

For discussion
on 7 January 2013

Legislative Council Panel on Financial Affairs

Asian Development Bank – Hong Kong’s Contribution to the 10th Replenishment of the Asian Development Fund

PURPOSE

This paper briefs Members on our funding proposal to seek approval of the Finance Committee for Hong Kong to contribute US\$33.14 million (about HK\$260.18 million) to the 10th replenishment of the Asian Development Fund (or “ADF XI”)¹ over a nine-year period from 2013-14 to 2021-22.

BACKGROUND

2. Asian Development Fund (“ADF”), established in 1973, is a concessional financing window of the Asian Development Bank (“ADB”)² available to the most needy members in the Asia and Pacific region to support poverty reduction and improve the quality of life. ADF operations include various infrastructure projects for road improvement, power distribution, water supply and sanitation, etc., as well as development programmes in education, health, agriculture and finance sectors, in the poorest countries in the region. The total ADF assistance for these countries amounted to US\$46.93 billion since its

¹ It is the 11th round of contribution to ADF, and commonly known as the 10th replenishment exercise by Asian Development Bank (“ADB”) members after the first round.

² Established in 1966, ADB is a multilateral development finance institution with the aim of reducing poverty in the Asia and Pacific region. It currently has 67 members, including 48 regional members and 19 non-regional members. Regional members comprise (a) the more developed economies including Hong Kong and (b) the developing economies that are eligible for ADB’s various forms of assistance. All non-regional members, comprising developed economies in Europe and North America, are donors of ADF.

inception to the end of 2011³. ADF is typically replenished once every four years. Hong Kong has been a donor of ADF since 1983, contributing a total of US\$82.11 million so far (see paragraph 10 below).

3. After three rounds of negotiations on ADF XI, donors reached a consensus in April 2012 on a total replenishment size of US\$12.40 billion, for the period from 2013 to 2016. Part of the funding will come from donor contributions (a target size of US\$5.81 billion), and the remainder from ADB's internal pool of resources. Although contributions to ADF are voluntary, donors have generally referred to a burden sharing framework in determining their levels of contribution. The formula is based on donor member's per capita Gross National Product adjusted for its shareholding in ADB. Hong Kong has maintained its burden share at 0.57% of the target donor contributions in the last four replenishments since 1997. This translates into US\$33.14 million for ADF XI, 26.25% higher than our last contribution of US\$26.25 million for ADF X beginning in 2009. The increase in Hong Kong's contribution relative to that of the last replenishment is a result of the burden sharing of the enlarged size of ADF operations due to increased demand for assistance and inflation⁴.

HONG KONG'S CONTRIBUTION TO ADF XI

4. We consider that Hong Kong should continue to contribute to ADF in its 10th replenishment for the following reasons –

³ Members' eligibility for ADF is based on two criteria, namely, per capita Gross National Income ("GNI") and creditworthiness. ADF offers loans at very low interest rates (typically 1% - 1.5% per annum with a loan maturity of up to 32 years) as well as grants to help reduce poverty in ADB's poorest member countries. There are currently 28 developing member countries of ADB that have access to ADF resources. Bangladesh, Vietnam, Pakistan and Afghanistan are the largest beneficiaries, accounting for 57.47% of the total ADF resources for the period from 2001 to 2010. Details of ADF recipient jurisdictions are at [Annex C](#).

⁴ The increase in the replenishment size and hence overall donor contributions to ADF XI is attributable to the following factors –

- increase in demand for ADF assistance – ADB estimated the demand for ADF resources during the ADF XI period to be US\$12.9 billion, which represents a 17.27% increase over the US\$11.0 billion operational programme of the last replenishment at the time of negotiations; and
- inflation – the nominal inflation rate of Special Drawing Rights ("SDR"), in which ADF is denominated, is estimated to have been 7.35% from 2007 to 2010. The SDR is an international reserve asset whose value is based on a basket comprising US dollar, Euro, Japanese yen and British pound.

(a) Demonstration of Hong Kong's commitment to support poverty reduction in the region

Despite the considerable economic progress in the Asia and Pacific region over the past three decades, poverty continues to affect the lives of millions in the less developed countries in the region. ADB, mainly through ADF, has played a key role in helping its poorest members in the region tackle poverty by providing them loans, grants and technical assistance for a broad range of development activities⁵. Hong Kong's continuing funding support for ADF will be a clear demonstration of our contribution towards regional poverty reduction efforts;

(b) Hong Kong's commitment to ADB

ADB is one of the few multilateral financial institutions in which Hong Kong is a member. As a responsible member, Hong Kong has a strong moral obligation to support the activities of ADB, along with other members, as fully as possible; and

(c) Expectation of Hong Kong's commitment

Hong Kong has benefited from ADB's lending programmes. In the period from 1972 to 1980, Hong Kong obtained five loans totalling US\$101.5 million from ADB to finance various infrastructure projects⁶. All loans were repaid in full by 1987. Given that Hong Kong's per capita Gross National Income

⁵ Over the past six years, ADB, through the ADF operations in the Asia and Pacific region, has –

- expanded the access of more than 19 million students to quality education by building or upgrading more than 60,000 classrooms and training 720,000 teachers;
- helped more than 252 million people gain better access to wider economic opportunities and social services by building or upgrading more than 56,000 km of roads;
- provided more than 2.1 million households with access to clean water by installing or rehabilitating about 14,000 km of water supply pipes;
- connected more than 1.8 million households to electricity by building or upgrading more than 35,000 km of power transmission and distribution lines; and
- reduced greenhouse gas emissions by 2 million tons of carbon dioxide equivalent per year by promoting more efficient and cleaner energy operations.

⁶ The loans from ADB were used to finance construction of public housing projects (Shatin Urban Development (Housing) Project (Wo Che Estate and Sha Kok Estate) and the second Shatin Urban Development Project (part of the development of Shatin New Town and the construction of Mei Lam Estate)), sewage (Shatin Sewage Treatment Plant Stage 1), polyclinic (Shatin Hospital Polyclinic Project) and other infrastructure projects (Lok On Pai Sea Water Desalting Plant).

(“GNI”), at US\$35,160 in 2011, is now one of the highest in the region, there is general expectation for Hong Kong – together with other regional members which have “graduated” from ADF or regular ADB assistance⁷ – to contribute to ADB’s poverty reduction efforts.

5. Since Hong Kong is no longer eligible for ADF assistance, we will not derive any direct economic benefits from our contribution to ADF XI. However, there could be indirect benefits to the extent that firms in Hong Kong are able to bid for ADB projects. According to ADB, as of end 2011, Hong Kong firms have been awarded procurement contracts for goods, works and consultancy services on ADB-sponsored projects worth US\$878.39 million in total.

Other Donors’ Positions

6. A majority of regional donors (including Japan, Australia, China, Malaysia, Singapore and Thailand) have agreed to either increase or maintain their burden share at the same level as the previous replenishment (i.e. “ADF X”). Kazakhstan, which is an ADF graduate, joined as a new donor. Even though Korea is unable to fully maintain its burden share, it has agreed to increase its contribution by 32% in terms of won. Brunei Darussalam, New Zealand and Chinese Taipei have pledged the same amount of contribution as ADF X.

7. That said, most of the non-regional donors, in particular the United States and some European countries, have decided to contribute less than the amount required to maintain their burden share in ADF X, citing such reasons as fiscal constraints, or expectation for regional donors to take up a greater role in financing ADF. This leaves a considerable funding gap of about US\$1.17 billion, or 20.09% of the target total donor contributions⁸. As a result, all those donors who choose to maintain their burden share at the same level as the last

⁷ Graduation from ADB assistance will be triggered when the GNI per capita of a member exceeds the threshold (US\$6,725 in 2008). Hong Kong “graduated” from regular ADB assistance in 1999.

⁸ Funding gap represents the difference between target total donor contributions and the total actual contributions pledged by donors. Funding gaps existed in the past four rounds of ADF replenishment but to a lesser extent. These gaps were subsequently partly filled by additional donor contributions. Hong Kong maintained its burden share at 0.57% of the target total donor contributions in all these cases.

replenishment will see their “effective” burden share increase⁹. It is expected that part of the funding gap will be closed by additional contributions to be made by some existing or new donors. Details on individual donor contributions are at **Annex A**.

8. In this light, there is a general expectation that Hong Kong will at least maintain its burden share in ADF XI like many of its regional peers. Any diminution from the burden-shared contribution is likely to be met with adverse reactions within ADB and among the international community, as it will be misinterpreted as a sign of Hong Kong backtracking on its commitment to support poverty reduction in the region and not shouldering the moral obligation that comes with its membership at ADB, thus damaging Hong Kong’s image as well as our reputation as an international financial centre.

Payment Schedule

9. Subject to the approval of the Finance Committee, we propose to adopt a nine-year standard encashment schedule for Hong Kong’s contribution to ADF XI, as set out at **Annex B**.

Past Contributions

10. Hong Kong has contributed to seven past replenishments of ADF. Unlike the initial token donations in the earlier replenishments (ADF IV through ADF VI), the amount contributed by Hong Kong in the past four replenishments (ADF VII through ADF X) was determined according to the consensus burden sharing formula agreed by donors during the ADF VII replenishment negotiations. Hong Kong’s past contributions to ADF are as follows -

⁹ If Hong Kong maintains its burden share of 0.57% of the target total donor contributions in ADF XI, the “effective” burden share based on the actual total donor contributions would amount to 0.71%.

<u>Year</u>	<u>Replenishment</u>	<u>Hong Kong's Contributions</u> <u>(in USD million)</u>
1983	ADF IV	1.00
1987	ADF V	1.00
1992	ADF VI	3.00
1997	ADF VII	15.39
2001	ADF VIII	16.28
2005	ADF IX	19.19
2009	ADF X	26.25

WAY FORWARD

11. Subject to the views of Members, the Administration aims to submit this funding proposal to the Finance Committee at its meeting of 8 February 2013 for approval.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
27 December 2012

Overview of Donor Contributions and Burden Sharing of ADF XI

Donor	ADF XI contribution ¹ (US\$ mn)	ADF XI burden share ¹ (%)	ADF X burden share (%)	Difference in burden share (% point)
Non-regional (19)				
Austria	43.2	0.74	0.91	-0.17
Belgium	34.8	0.60	0.72	-0.12
Canada	193.4	3.33	4.50	-1.17
Denmark	24.9	0.43	0.43	0.00
Finland	29.2	0.50	0.73	-0.23
France	128.8	2.22	3.48	-1.26
Germany	194.2	3.34	4.82	-1.48
Ireland	27.0	0.46	0.90	-0.44
Italy	91.8	1.58	3.00	-1.42
Luxembourg	11.3	0.20	0.10	+0.10
Netherlands	81.0	1.39	2.34	-0.95
Norway	44.9	0.77	0.97	-0.20
Portugal	0.5	0.01	0.60	-0.59
Spain	66.9	1.15	2.80	-1.65
Sweden	79.7	1.37	1.37	0.00
Switzerland	53.1	0.91	1.04	-0.13
Turkey	5.8	0.10	0.14	-0.04
UK	314.6	5.41	5.07	+0.34
US	359.6	6.19	10.01	-3.82
Sub-total	1,784.8	30.70	43.92	-13.22
Regional (12)				
Australia	523.3	9.00 ²	6.49	+2.51
Brunei Darussalam	6.3	0.11	0.12	-0.01
China, People's Republic of	45.0	0.77	0.76	+0.01
Hong Kong, China	-³	-³	0.57	-
Japan	2,034.9	35.00	35.00	0.00
Kazakhstan	5.2	0.09	N/A	+0.09
Korea, Republic of	167.9	2.89	3.35	-0.46
Malaysia	9.6	0.16	0.13	+0.03
New Zealand	32.6	0.56	0.70	-0.14
Singapore	8.7	0.15	0.12	+0.03
Chinese Taipei	23.0	0.40	0.47	-0.07
Thailand	4.9	0.08	0.08	0.00
Sub-total	2,861.4	49.22	47.79	+1.99
Total actual contribution (A)	4,646.1	79.91	91.71	
Target size (basis for burden sharing) (B)	5,813.9	100.00	100.00	
Funding gap (C)=(B)-(A)	1,167.8	20.09	8.29	

¹ Source: ADF XI Donors' Report

² Australia has indicated that it intends to confirm an additional contribution of 2% burden share by 30 June 2013. The supplemental payment will count towards Australia's final burden share in ADF XI.

³ Hong Kong has indicated its intention to contribute to the replenishment subject to seeking approval of the domestic legislature, with the amount to be confirmed.

ADF XI Encashment Schedule

Payment Date	Encashment Drawdown Rate (%)	Estimated Encashment ¹ (US\$)	Subtotal Estimates (in Each Financial Year)		
			(US\$)	(HK\$ equivalent) ²	(rounded up to nearest thousand HK\$)
FY 2013/2014					
Jul-13	5.10	1,690,000			
Feb-14	4.50	1,491,500	3,181,500	24,977,272.48	24,978,000
FY 2014/2015					
Jul-14	4.50	1,491,500			
Feb-15	6.30	2,088,000	3,579,500	28,101,884.91	28,102,000
FY 2015/2016					
Jul-15	6.30	2,088,000			
Feb-16	8.30	2,750,500	4,838,500	37,986,023.22	37,987,000
FY 2016/2017					
Jul-16	8.30	2,750,500			
Feb-17	7.55	2,502,000	5,252,500	41,236,248.21	41,237,000
FY 2017/2018					
Jul-17	7.55	2,502,000			
Feb-18	7.35	2,435,500	4,937,500	38,763,250.94	38,764,000
FY 2018/2019					
Jul-18	7.35	2,435,500			
Feb-19	6.50	2,154,000	4,589,500	36,031,177.76	36,032,000
FY 2019/2020					
Jul-19	6.50	2,154,000			
Feb-20	4.45	1,474,500	3,628,500	28,486,573.37	28,487,000
FY 2020/2021					
Jul-20	4.45	1,474,500			
Feb-21	2.50	828,690	2,303,190	18,081,849.50	18,082,000
FY 2021/2022					
Jul-21	2.50	828,690	828,690	6,505,867.02	6,506,000
Total	100.00	33,139,380	33,139,380	260,170,147.41	260,175,000

¹ Source: ADB estimates

² Converted into Hong Kong dollars using the exchange rate of US\$1 = HK\$7.85, being the upper bound of the Convertibility Zone (between 7.75 and 7.85) under the Linked Exchange Rate system, plus 0.01% contingency.

ADF Recipient Jurisdictions

	Per Capita GNI (US\$; 2010)	ADF Loan and Grant Approvals (US\$ million; 2001-10)
1. Afghanistan	410	2,037.3
2. Armenia #	3,200	223.9
3. Bangladesh #	700	3,241.1
4. Bhutan	1,870	215.6
5. Cambodia	750	930.2
6. Georgia #	2,680	423.8
7. Kiribati	2,010	12.0
8. Kyrgyz Republic	840	555.6
9. Lao PDR	1,010	592.7
10. Maldives	6,150	85.6
11. Marshall Islands #	3,640	24.5
12. Federated States of Micronesia #	2,730	27.2
13. Mongolia #	1,870	463.0
14. Nauru	-	-
15. Nepal	490	1,376.2
16. Pakistan #	1,050	3,019.4
17. Palau #	6,560	3.4
18. Papua New Guinea #	1,300	328.0
19. Samoa	3,020	91.0
20. Solomon Islands	1,030	51.3
21. Sri Lanka #	2,260	1,105.3
22. Tajikistan	810	538.1
23. Timor Leste #	2,730	62.0
24. Tonga	3,340	31.3
25. Tuvalu	4,600	7.1
26. Uzbekistan #	1,300	482.6
27. Vanuatu	2,630	-
28. Vietnam #	1,160	3,180.0

Data source: World Bank and Asian Development Bank

Remarks:

- (1) “#” denotes recipients which have access to both ADF and ADB’s ordinary capital resources. Other ADF recipients have access to ADF only.
- (2) Some jurisdictions have no access to ADF but are eligible for ADB’s ordinary capital resources loans. These are Azerbaijan, Cook Islands, People’s Republic of China, Fiji, India, Indonesia, Kazakhstan, Malaysia, Philippines, Thailand, and Turkmenistan. Several of these jurisdictions are donors of ADF.
- (3) Some jurisdictions have outstanding ADF loans, although currently they are not eligible or otherwise have no access to ADF. These are Azerbaijan, Cook Islands, Indonesia, Kazakhstan, Myanmar, and the Philippines. ADB is currently considering granting ADF access to Myanmar.
- (4) ADF eligibility is based on both per capita GNI and creditworthiness. The per capita GNI cutoff for ADF eligibility was US\$1,175 in 2010. Creditworthiness measures the member’s debt repayment capacity and is assessed by ADB’s internal credit rating system.