

For discussion
on 3 January 2017

Legislative Council Panel on Financial Affairs

Asian Development Bank – Contribution of Hong Kong to the 11th Replenishment of the Asian Development Fund

PURPOSE

This paper briefs Members on our proposal for Hong Kong to contribute US\$17.47 million (about HK\$137.2 million) to the 11th replenishment of the Asian Development Fund (or “ADF XII”)¹ over a ten-year period from 2017-2018 to 2026-2027.

BACKGROUND

2. Asian Development Fund (“ADF”), established in 1973, has served as 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 range from infrastructure projects for road improvement, power distribution, water supply and sanitation, etc., to development programmes in education, health, agriculture and finance sectors, in the poorest countries in the region. Since inception, ADF has provided more than US\$50 billion for projects and programmes that helped poor families escape poverty. ADF is typically replenished once every four years. Hong Kong has been a donor of ADF since 1983, contributing a total of US\$115.25 million so far.

¹ It is the 12th round of contribution to ADF, and commonly known as the 11th replenishment exercise by ADB members after the first round.

² Established in 1966, the 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 countries in Europe and North America, are donors of ADF.

3. ADF assistance consisted of both grants and loans in the past. In 2015, the ADB Board of Governors approved the transfer of ADF loan operations and its related assets to the ADB's ordinary capital resources ("OCR") balance sheet, with effect from 1 January 2017. The OCR is the major lending window of the ADB, which offers loans at near market terms to developing countries. The OCR balance sheet is financed by ADB capital, borrowing from capital market, and cumulative earnings. The purpose of the transfer of ADF loan operations to OCR balance sheet is to allow the ADB to leverage on ADF's resources to borrow from the capital market, thus achieving more efficient use of capital.³ With the transfer from 1 January 2017, concessional loans will be provided to eligible members and financed from the OCR balance sheet without the need of donors' support. Meanwhile, ADF will become a grant-only facility.⁴ As a result, the replenishment size of ADF XII and beyond is substantially reduced.

4. After three rounds of negotiations on ADF XII, donors reached consensus in May 2016 on a total replenishment size of US\$3.76 billion⁵, for the period from 2017 to 2020. Funding for ADF XII will come from donor contributions (a target size of US\$3.07 billion, which is 47.3% lower than that of ADF XI), ADF's investment income, and net income transfer from OCR. 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 a donor member's per capita Gross National Product adjusted for its shareholding in the ADB. Hong Kong has maintained its burden share at 0.57% of the target donor contributions in the last five replenishments since 1997. This translates into a contribution of US\$17.47 million for ADF XII, which is 47.3% lower than our last contribution of US\$33.14 million for ADF XI. As

³ Under the ADF Regulations, ADF cannot borrow money. Its operations are mainly funded by donors' contributions and transfers from the ADB.

⁴ It is expected that 13 developing member countries will have access to ADF grants during the ADF XII period. Afghanistan, Nepal and Tajikistan are the top recipients of ADF grants, accounting for 67% of the total ADF grant approvals during 2005-2014. Details of the ADF recipient jurisdictions are at [Annex C](#).

⁵ Including US\$461 million allocated for replenishing the Technical Assistance Special Fund ("TASF"). The TASF is a special fund established by the ADB with the purpose of providing financing for the technical assistance and related operational activities of the ADB. The TASF is indispensable for the preparation of ADB's investment projects.

noted in paragraph 3 above, the decrease is due to the combination of ADF and OCR resources, which has reduced the total size of replenishment of ADF XII.

HONG KONG'S CONTRIBUTION TO ADF XII

5. We consider that Hong Kong should continue to contribute to ADF in its 11th replenishment for the following reasons –

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

Despite considerable economic progress in the Asia and Pacific region over the past decades, poverty continues to affect the lives of millions in the less developed countries of the region. The ADB, mainly through ADF, has played a key role in helping its poorest members in the region tackle poverty by providing them with loans, grants and technical assistance for a broad range of development activities.⁶ 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

The ADB is one of the few multilateral financial institutions of which Hong Kong is a member. As a responsible member, Hong Kong has a strong moral obligation to support the activities of

⁶ During 2011- 2014, the ADB, through the ADF operations in the Asia and Pacific region, has –

- built or upgraded educational facilities for the benefit of over 17 million students, and trained over one million teachers with quality or competency standards;
- installed 230 megawatts of new generating capacity, and built or upgraded 11 300 km of transmission and distribution lines;
- reduced greenhouse gas emissions by 600 000 tons of carbon dioxide equivalent per year by promoting more efficient and cleaner energy operations;
- facilitated over 16 million tons of annual cross-border cargo and 790 gigawatt-hours of cross-border transmission of electricity per year;
- built or upgraded 25 000 km of roads which saw over ten million vehicle-km of daily use on average in the first full year of operation; and
- provided more than one million households with access to clean water by installing or rehabilitating 15 000 km of water supply pipes, and upgraded sanitation in 293 000 households.

the 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 the ADB to finance various infrastructure projects.⁷ All loans were repaid in full by 1987. Given that Hong Kong’s per capita Gross National Income (“GNI”), at US\$41,000 in 2015, 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 assistance⁸ – to contribute to ADB’s poverty reduction efforts.

6. Since Hong Kong is no longer eligible for ADF assistance, we will not derive any direct economic benefits from our contribution to ADF XII. However, there could be indirect benefits to the extent that firms in Hong Kong are able to bid for ADB projects. According to the ADB, as of end 2015, Hong Kong firms have been awarded ADB-financed projects such as procurement contracts and consultancy services worth US\$961.97 million in total.

Other Donors’ Positions

7. A majority of regional donors (including Australia, China, India, Japan, Korea, Malaysia, Singapore, Thailand and Taipei,China) have agreed to either increase or maintain their burden share at the same level as in the previous replenishment (i.e. “ADF XI”). In particular, China has pledged to substantially increase its burden share from 0.77% to 3.26%. Meanwhile, Indonesia re-joined as a donor. While New Zealand has reduced its burden share, it would consider a supplementary contribution

⁷ 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).

⁸ Graduation from ADB assistance will be triggered when the GNI per capita of a member exceeds the threshold (US\$7,115 in 2012). Hong Kong “graduated” from regular ADB assistance in 1999.

to ADF XII.

8. Some European non-regional donors have decided to contribute less than the amount required to maintain their burden share in ADF XI, citing such reasons as fiscal constraints, or expectation for regional donors to take up a greater role in financing ADF. This leaves a funding gap of about US\$0.54 billion, or 17.62% of the target total donor contributions.⁹ It is expected that part of the funding gap will be narrowed by the contributions to be made by a few donors who have yet to pledge their commitment, as well as possible additional contributions to be made by some existing or new donors. Details on individual donor contributions are at **Annex A**.

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

Payment Schedule

10. We intend to adopt a ten-year standard encashment schedule for Hong Kong's contribution to ADF XII, as set out at **Annex B**. Sufficient provision will be included in the draft Estimates of the relevant financial years.

PAST CONTRIBUTION

11. Hong Kong has contributed to eight past replenishments of ADF. Unlike the initial token donations in the earlier replenishments (ADF IV

⁹ Funding gap represents the difference between target total donor contributions and the total actual contributions pledged by donors. Funding gaps existed in the past five rounds of ADF replenishment and were subsequently partly filled by additional donor contributions. Hong Kong maintained its burden share at 0.57% of the target total donor contribution in all these cases.

through ADF VI), the amount contributed by Hong Kong in the past five replenishments (ADF VII through ADF XI) 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 –

<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
2013	ADF XI	33.14

ADVICE SOUGHT

12. Members' views are sought on the above proposal.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
22 December 2016

Overview of Donors' Contributions and Burden Sharing of ADF XII

Donor	ADF XII contribution ¹ (US\$ mn)	ADF XII burden share ¹ (%)	ADF XI burden share (%)	Difference in burden share (% point)
Non-regional (19)				
Austria	22.79	0.74	0.74	-
Belgium	18.39	0.60	0.60	-
Canada	101.96	3.33	3.33	-
Denmark	13.05	0.43	0.43	-
Finland	12.73	0.42	0.50	-0.08
France	56.92	1.86	2.22	-0.36
Germany	86.55	2.82	3.34	-0.52
Ireland	14.71	0.48	0.46	+0.02
Italy	48.41	1.58	1.58	-
Luxembourg	5.98	0.20	0.20	-
Netherlands	16.23	0.53	1.39	-0.86
Norway	26.49	0.86	0.86	-
Portugal	0.26	0.01	0.01	-
Spain ²	TBC	TBC	1.15	TBC
Sweden	24.06	0.78	1.37	-0.59
Switzerland	27.99	0.91	0.91	-
Turkey	2.31	0.08	0.10	-0.02
UK	166.03	5.42	5.41	+0.01
US	189.58	6.19	6.19	-
Sub-total	834.42	27.24	30.79	-3.55
Regional (14)				
Australia	337.16	11.00	11.00	-
Brunei Darussalam	0.50	0.02	0.11	-0.09
China, People's Republic of	100.00	3.26	0.77	+2.49
Hong Kong, China	TBC	TBC	0.57	TBC
India	41.74	1.36	0.52	+0.84
Indonesia	14.00	0.46	0.00	+0.46
Japan	1,072.78	35.00	35.00	-
Kazakhstan ²	TBC	TBC	0.09	TBC
Korea, Republic of	88.53	2.89	2.89	-
Malaysia	5.05	0.16	0.16	-
New Zealand ²	8.05	0.26	0.56	-0.30
Singapore	4.60	0.15	0.15	-
Taipei, China	12.14	0.40	0.40	-
Thailand	2.56	0.08	0.08	-
Sub-total	1,687.12	55.04	52.31	+2.73
Total actual contribution (A)	2521.54	82.28	83.10	
Supplemental contribution (B)	3.11	0.10	0.00	
Target size (basis for burden sharing) (C)	3,065.09	100.00	100.00	
Funding gap =(C)-(B)-(A)	540.44	17.62	16.90	

¹ Source: Asian Development Bank. Position as of 6 December 2016.

² Kazakhstan and New Zealand advised that their ability to commit more than indicated is subject to Government and/or parliamentary action and budgetary process, but such circumstance should not be construed as a changed or diminished endorsement of ADF or its desire to continue to engage and collaborate with the ADB regarding ADF. Spain will not be able to pledge until a new government is formed and all necessary approvals are obtained.

* Figures on the table may not add up due to rounding.

ADF XII Encashment Schedule

Payment Date	Encashment Drawdown Rate ¹ (%)	Estimated Encashment ² (US\$)	Subtotal Estimates (in Each Financial Year)		
			(US\$)	(HK\$ equivalent) ³	(rounded up to nearest thousand HK\$)
FY 2017/2018					
Jul-17	9.70	1,687,000			
Feb-18	6.25	1,091,500	2,778,500	21,813,406.12	21,814,000
FY 2018/2019					
Jul-18	6.25	1,091,500			
Feb-19	7.85	1,375,500	2,467,000	19,367,886.60	19,368,000
FY 2019/2020					
Jul-19	7.85	1,375,500			
Feb-20	9.50	1,656,500	3,032,000	23,803,580.12	23,804,000
FY 2020/2021					
Jul-20	9.50	1,656,500			
Feb-21	5.75	1,000,500	2,657,000	20,859,535.75	20,860,000
FY 2021/2022					
Jul-21	5.75	1,000,500			
Feb-22	5.05	884,500	1,885,000	14,798,729.73	14,799,000
FY 2022/2023					
Jul-22	5.05	884,500			
Feb-23	3.95	694,000	1,578,500	12,392,464.12	12,393,000
FY 2023/2024					
Jul-23	3.95	694,000			
Feb-24	2.65	466,000	1,160,000	9,106,910.60	9,107,000
FY 2024/2025					
Jul-24	2.65	466,000			
Feb-25	2.35	412,500	878,500	6,896,914.62	6,897,000
FY 2025/2026					
Jul-25	2.35	412,500			
Feb-26	1.80	311,010	723,510	5,680,121.46	5,681,000
FY 2026/2027					
Jul-26	1.80	311,010	311,010	2,441,672.64	2,442,000
Total	100.00	17,471,020	17,471,020	137,161,221.75	137,165,000

¹ Source: ADF XII Donors' Report

² Source: ADB estimates

³ 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 Jurisdictions¹**1) ADF Grant Recipients, 2005-14**

	US\$ mn
Afghanistan	2,483.2
Bangladesh	10.0
Bhutan	180.6
Cambodia	255.7
Kiribati	3.0
Kyrgyz Republic	448.6
Lao People's Democratic Republic	438.2
Maldives	42.5
Mongolia	172.2
Nauru	6.0
Nepal	823.8
Pakistan	5.0
Papua New Guinea	15.0
Samoa	60.7
Solomon Islands	81.4
Sri Lanka	52.2
Tajikistan	808.8
Timor-Leste	85.0
Tonga	48.1
Tuvalu	5.6
Viet Nam	45.6

2) ADF Loan Recipients, 2005-14 ²

	US\$ mn
Afghanistan	235.0
Armenia	438.6
Azerbaijan	13.0
Bangladesh	4,316.5
Bhutan	231.9
Cambodia	958.0
Cook Islands	9.7
Federated States of Micronesia	4.4
Georgia	764.8
Indonesia	430.4
Kiribati	19.6
Kyrgyz Republic	388.7
Lao People's Democratic Republic	324.0
Maldives	62.7
Mongolia	381.1
Myanmar	715.5
Nepal	1,268.0
Pakistan	3,385.8
Palau	5.3
Papua New Guinea	468.0
Republic of the Marshall Islands	14.5
Samoa	64.3
Solomon Islands	23.1
Sri Lanka	1,091.8
Tajikistan	128.2
Timor-Leste	19.2
Uzbekistan	838.6
Vanuatu	15.8
Viet Nam	3,904.3

¹ Source: Asian Development Bank

² Starting from 1 January 2017, ADF will become a grant-only facility, while ADF loans and other assets will be transferred to the ADB's ordinary capital resources balance sheet.