

LEGISLATIVE COUNCIL BRIEF

ASIAN DEVELOPMENT BANK - HONG KONG'S CONTRIBUTION TO THE 8TH REPLENISHMENT OF THE ASIAN DEVELOPMENT FUND

INTRODUCTION

At the meeting of the Executive Council on 2 November 2004, the Council **ADVISED** and the Chief Executive **ORDERED** that, subject to the funding approval of the Finance Committee of the Legislative Council, Hong Kong should contribute US\$19.19 million to the 8th replenishment of the Asian Development Fund (or ADF IX) of the Asian Development Bank (ADB) over a 10-year period.

BACKGROUND

The Asian Development Fund (ADF)

2. The ADF, established in 1973, is a concessional lending window of the ADB available to the most needy members in the Asia and Pacific region to support poverty reduction and improve the quality of life. The ADF aims to help its most needy members to eradicate key barriers to human development – poverty, hunger, disease, infant mortality, illiteracy, environmental degradation as well as discrimination against women. The ADF resources are used to improve the conditions of the poor by helping them gain better access to basic amenities and social services. At present, 29 ADB developing member countries are eligible for ADF resources (see Annex A). By far, the largest beneficiaries of ADF loans are Bangladesh, Pakistan, Sri Lanka, Vietnam and Nepal¹.

¹ These countries have an average per capita GNP of only US\$454 in 2002. (Source: Asian Development Outlook 2004)

3. The ADF's cause for poverty reduction has met with strong international support. A total of 27 economies² from all over the world have pledged their contributions to ADF IX (see Annex B) which, as agreed among ADF donors in May 2004³, will have a replenishment size of US\$7.17 billion, of which at least US\$3.37 billion would be provided by donor contributions and the remaining from the ADB's internal pool. A consensus has also emerged that the burden sharing formula⁴ for ADF IX should follow that of the ADF VIII. The great majority of the donors have agreed to adhere to the burden sharing formula.

4. Contributions to the ADF by ADB members are on a voluntary basis and the ADF is replenished once every three to five years. ADF loans repayment would be pooled to form the ADB's internal resources for future ADF replenishments.

5. Hong Kong has been a donor of the ADF since 1983⁵, and has made contributions according to the consensus burden sharing formula since ADF VII in 1997. According to this formula, Hong Kong's burden sharing ratio is 0.57%, which translates into US\$19.19 million for Hong Kong's contributions to ADF IX. The increase of Hong Kong's contribution relative to that of ADF VIII is a result of the burden sharing of the enlarged size of ADF lending operations due to increased demand for assistance, appreciation of the Special Drawing Right⁶ versus the US dollar, and the introduction of grants.

² Not including Hong Kong. There are at present 28 donors.

³ The agreement comprised two parts. First, donors agreed to a total replenishment size of US\$7.17 billion, of which at least US\$3.37 billion will be provided by donor contributions on a burden-shared basis. The target size of contributions by donors represents an increase of 17.8% from that of donors' contribution in ADF VIII. Secondly, there will be provision of grants set at a level of 21% of the total ADF IX operation.

⁴ The ADF burden sharing formula is based on a donor member's per capita GNP (which reflects the member's financial strength) and adjusted for its shareholding in the ADB. The same burden sharing formula has been adopted since ADF VII. The formula provides very useful guiding principles for donor members to determine their contributions to the ADF.

⁵ Hong Kong contributed to five previous replenishments – US\$1 million each in 1983 (ADF IV) and 1987 (ADF V), US\$3 million in 1992 (ADF VI), US\$15.39 million in 1997 (ADF VII) and US\$16.28 million in 2001 (ADF VIII). Unlike the token donations in ADF IV to VI, the amount contributed by Hong Kong to ADF VII and ADF VIII matched that derived from the consensus burden sharing formula agreed amongst the donors.

⁶ The Special Drawing Right is a currency basket (comprising USD, Euro, Japanese Yen and British pound) in which the ADF is denominated.

JUSTIFICATIONS FOR HONG KONG'S CONTRIBUTIONS

6. It is recommended that, subject to the approval of the Finance Committee of the Legislative Council, Hong Kong should contribute US\$19.19 million, according to the consensus burden sharing formula, to ADF IX for the reasons explained in the ensuing paragraphs.

Recognition of the ADB's contribution to Hong Kong

7. Hong Kong joined the ADB in 1969 and has benefited from ADB operations in the region. In the period from 1972 to 1980, Hong Kong obtained five loans totalling US\$94.5 million from the ADB. These loans 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 project (Lok On Pai Sea Water Desalting Plant). All loans were repaid in full by 1987.

8. The ADB has contributed to the development of the bond market in Hong Kong by being an active bond issuer for both foreign currency and Hong Kong dollar bonds. The principal amount of Hong Kong dollar bonds issued by ADB totaled HK\$6.1 billion. In particular, the ADB was the first international financial institution which had issued bonds straddling 1997. In 1992, the ADB issued a HK\$500 million 7-year bond maturing in 1999, which demonstrated the ADB's confidence in Hong Kong for a smooth transition and conveyed the "business as usual" message in the run up to 1997.

9. Hong Kong derives indirect economic benefits from the contribution, as firms in Hong Kong are able to bid for ADB projects. According to the ADB, on a cumulative basis up to end-2003, Hong Kong firms have been awarded a total of US\$589 million worth of goods and civil works procurement contracts and US\$46 million worth of consulting services and technical assistance contracts in relation to all ADB sponsored projects.

Hong Kong's commitment to the ADB

10. The ADB is one of the few multilateral financial institutions in which Hong Kong is a full member. As a responsible member, Hong Kong has the obligation, along with other economies from within and outside the region, to support ADB activities as fully as possible. Hong Kong's continued contribution to the ADF is an important practical demonstration of Hong Kong's support to the ADB.

11. Given that Hong Kong's per capita GNP, at US\$26,503⁷ in 2003, is one of the highest in the region, there is general expectation for Hong Kong, together with the other newly industrialised economies (NIEs)⁸ which have "graduated" from the ADB assistance programme, to assist in poverty reduction efforts in the region. We note that there are still a large population living in extreme poverty with US\$1 per day⁹ in Asia. Asia and the Pacific region is still home to about two-thirds of the world's poor, and over 60% of the poor people in Asia are in South Asia¹⁰. These people are deprived of even the most basic amenities, social services and education. Hong Kong's continued participation in the ADF will be a clear demonstration of our commitment towards poverty reduction efforts.

12. For all previous ADF replenishments, the non-regional members contributed more than 50% of the total donors' contribution. Japan was the major donor in the region which accounted for over 30% of the donors' contribution. The non-regional donors are pressing the regional donors, especially the NIEs, to contribute more to the ADF. Any diminution from the burden-shared contribution from Hong Kong is likely to be met with adverse reactions within the ADB and amongst the international community -

- (a) it can be misinterpreted as a sign of Hong Kong backtracking its commitment to poverty reduction efforts in the region and not shouldering the obligation that comes with its membership at the ADB; and

⁷ Source: Census and Statistics Department, HKSARG, Constant (2000) market price.

⁸ The NIEs are South Korea, Singapore, Taiwan and Hong Kong.

⁹ The World Bank uses "living on US\$1 per person per day" as the international benchmark for defining the poverty line.

¹⁰ South Asia includes Bangladesh, India, Nepal, Pakistan and Sri Lanka.

- (b) there can be misunderstanding that Hong Kong is experiencing very serious fiscal difficulties. It should be noted that we were able to contribute our full burden share in 2001 at a time when Hong Kong was still suffering from the aftermath of the Asian financial crisis. It would be difficult to justify a decrease in our burden-shared contribution when Hong Kong is now experiencing a robust economic growth of 7.5% in 2004.

13. It is recommended that Hong Kong opt for the standard 10-year encashment schedule, which is also adopted by the majority of donors, as shown in Annex C.

IMPLICATIONS OF THE PROPOSAL

14. The proposal has economic and financial implications as set out at Annex D. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no civil service, productivity, environmental or sustainability implications.

PUBLIC CONSULTATION

15. The Panel on Financial Affairs of the Legislative Council will be consulted.

PUBLICITY

16. A press release will be issued following approval (if given) by the Finance Committee of the funding request scheduled to be made on 14 January 2005. A spokesman will be available to handle media enquiries.

ENQUIRIES

17. Enquiries on this brief may be directed to Mrs Millie Ng, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2529 0121, and Mr Francis Lau, Head (External), Hong Kong Monetary Authority at 2878 8173.

Financial Services and the Treasury Bureau

November 2004

Annex A

Overview of Eligible ADF borrowers

ADF Loans, 1973 - 2003

<u>Eligible / Existing Borrowers*</u>	<u>2002 Per Capita GNP (US\$)</u>	<u>Loans (US\$ mn)</u>
Bangladesh	360	6,643.4
Pakistan	410	6,625.3
Sri Lanka	840	2,906.5
Vietnam	430	2,501.0
Nepal	230	2,020.7
Indonesia	710	1,327.9 ^e
Philippines ^a	1,020	1,105.2
Lao PDR	310	1,038.2
Cambodia	280	718.0
Mongolia	440	568.7
Myanmar	164 ^b	524.3
Kyrgyz Republic	290	512.7
Afghanistan	191 ^c	407.1
Papua New Guinea	530	378.0
Tajikistan	180	180.9
Samoa	1,420	116.6
Bhutan	590	111.2
Maldives	2,090	83.7
Solomon Islands	570	79.3
Rep. of Marshall Islands	2,350	74.1
Thailand ^a	1,980	72.1
Kazakstan ^a	1,510	60.0
Tonga	1,410	57.8
Fed. States of Micronesia	1,980	56.1
Vanuatu	1,080	51.3
Cook Islands	6,321 ^{c, d}	26.7
Azerbaijan	710	22.0
Uzbekistan ^a	450	20.0
Kiribati	810	15.1
Tuvalu	1,431 ^c	5.8
Regional loans to a group of borrowers	-	282.0
Total		<u>28,591.7</u>

Data Source: Asian Development Outlook (2004)

* People's Republic of China, India and Nauru are also eligible for ADF but had not received any ADF loans during the specified period.

^a

These borrowers are no longer classified as "eligible" borrowers for new ADF resources. The loan amounts shown for these economies are loans approved in past ADF programmes.

^b

Only per capita GDP at current market prices are available.
Data source: IMF, World Economic Outlook Database, September 2004

^c

Only per capita GDP at current market prices are available.
Data source: Asian Development Bank - Key Indicators 2004

^d

While the per capita GDP of Cook Islands is well above the threshold for ADF loans, its debt repayment capacity is weak. It is difficult for the country to access to commercial capital, a key factor that supports the ADB's view that Cook Islands is still eligible for ADF.

^e On watchlist for graduation from ADF.

Overview of the Financing and Burden Sharing of ADF IX

	ADF IX US Dollar (mn)	Contribution as a % of total	ADF VIII Burden sharing % as per formula	Difference
Non-regional members				
Austria	29.28	0.87	0.87	0.00
Belgium	24.24	0.72	0.72	0.00
Canada	156.86	4.66	4.66	0.00
Denmark	29.96	0.89	0.89	0.00
Finland	16.83	0.50	0.50	0.00
France	148.44	4.41	4.41	0.00
Germany	194.55	5.78	5.78	0.00
Italy	131.27	3.90	3.90	0.00
Luxembourg	3.57 ¹	0.10	n.a.	0.10
Netherlands	97.61	2.90	2.90	0.00
Norway	37.36	1.11	0.95	0.16
Portugal	20.20	0.60	0.60	0.00
Spain	67.32	2.00	1.00	1.00
Sweden	46.11	1.37	1.37	0.00
Switzerland	41.40	1.23	1.23	0.00
Turkey	5.50	0.16	0.18	-0.02
United Kingdom	201.96	6.00	4.80	1.20
United States	461.00	13.70	14.42	-0.72
Sub-total	1,713.47	50.90	49.18	1.72
Regional members				
Australia	218.45	6.49	6.49	0.00
China, People's Republic of	30.00	0.89	n.a.	0.89
Japan	1,178.10	35.00 ²	35.13 ²	-0.13
New Zealand	23.56	0.70	0.70	0.00
Hong Kong, China	19.19 ³	0.57	0.57	0.00
Korea, Rep. Of	112.76	3.35	2.85	0.50
Malaysia	5.00	0.15	n.a.	0.15
Singapore	3.80	0.12	0.14	-0.02
Taipei, China	18.18	0.54	0.54	0.00
Thailand	3.03	0.09	0.09	0.00
Sub-total	1,612.07	47.90	46.51	1.39
Total	<u>3,325.54</u>	<u>98.80</u> ⁴	<u>95.69</u>	<u>3.11</u>

¹ Includes a supplementary contribution of \$200,000 which Luxembourg agreed to provide on the condition that such supplementary contribution will not be taken into account in calculating relative percentage share for the purpose of negotiating future ADF replenishments.

² Japan considers its burden share to be remained at the first assigned level of 33.69% despite its historically higher contribution share.

³ Hong Kong has indicated the intention to contribute to the Replenishment subject to the approval of the Executive Council and the Legislative Council, and with the amount to be confirmed.

⁴ The remaining gap is to be filled by additional contributions and/or internal resources.

10-Year Encashment Schedule for ADF IX

Year/Month	Drawdown Rates as a Percent of Total Contributions (%)	Note Encashment	
		Amount (USD)	Fiscal Year Total (USD)
2005			
July	3.6	691,000 *	
2006	5.8		
February		716,000 *	1,407,000 FY2005-06
July		397,000	
2007	9.8		
February		1,100,000 *	1,497,000 FY2006-07
July		781,000	
2008	14.0		
February		1,502,800 *	2,283,800 FY2007-08
July		1,183,000	
2009	14.6		
February		1,401,000	2,584,000 FY2008-09
July		1,401,000	
2010	15.9		
February		1,525,000	2,926,000 FY2009-10
July		1,525,000	
2011	15.0		
February		1,439,000	2,964,000 FY2010-11
July		1,439,000	
2012	11.0		
February		1,055,000	2,494,000 FY2011-12
July		1,055,000	
2013	6.9		
February		662,000	1,717,000 FY2012-13
July		662,000	
2014	3.4		
February		326,000	988,000 FY2013-14
July		325,400	325,400 FY2014-15
Total	100.0	19,186,200	19,186,200

* Includes transfer to Technical Assistance which will be encashed in four years' time.

Economic implications

Hong Kong derives no direct economic benefits from the contribution, since we are not eligible for ADF assistance. However, there can be indirect benefits as firms in Hong Kong are able to bid for ADB projects. According to the ADB, on a cumulative basis up to end-2003, Hong Kong firms have been awarded US\$589 million worth of goods and civil works procurement contracts and US\$46 million worth of consulting services and technical assistance contracts in relation to all ADB sponsored projects.

Financial implications

2. Subject to the approval of the Finance Committee of the Legislative Council, Hong Kong will contribute US\$19.19 million to ADF IX. The ADB can draw down Hong Kong's contribution in 10 years according to the standard encashment schedule. In this regard, Members may wish to note that Hong Kong has been following the practice of majority of the ADF donors in choosing the encashment schedule. In ADF VIII, Hong Kong opted for a 7-year encashment schedule under the Accelerated Note Encashment programme, as in the case of many donors. In ADF IX, we recommend to opt for the standard 10-year schedule, which is the choice of the majority of ADF IX donors.

3. The estimated cashflow requirements for the 10-year encashment schedule, as estimated by the ADB, are as follows -

Fiscal Year	Cashflow requirement (in millions)
2005-06	US\$1.407 (around HK\$10.975)
2006-07	US\$1.497 (around HK\$11.677)
2007-08	US\$2.2838 (around HK\$17.814)
2008-09	US\$2.584 (around HK\$20.155)
2009-10	US\$2.926 (around HK\$22.823)
2010-11	US\$2.964 (around HK\$23.119)
2011-12	US\$2.494 (around HK\$19.453)
2012-13	US\$1.717 (around HK\$13.393)
2013-14	US\$0.988 (around HK\$7.706)
2014-15	US\$0.3254 (around HK\$2.538)

Total: US\$19.1862 (around HK\$149.653)

4. There will be very moderate additional administrative costs¹ involved in Hong Kong's contribution to ADF IX, and they will be absorbed by the operating departments.

¹ Administration costs refer to the staff cost involved in the process.