

LEGISLATIVE COUNCIL BRIEF

ASIAN DEVELOPMENT BANK - HONG KONG'S CONTRIBUTION TO THE 9TH REPLENISHMENT OF THE ASIAN DEVELOPMENT FUND

INTRODUCTION

At the meeting of the Executive Council on 9 December 2008, 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\$26.25 million to the 9th replenishment of the Asian Development Fund (or ADF X) of the Asian Development Bank (ADB) over a 9-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. These include various infrastructure projects for road improvement, power distribution, water supply and sanitation, etc. in the poorest countries of the region, and the total ADF assistance amounted to US\$34.6 billion since its inception to the end of 2007. At present, 29 ADB developing member countries are eligible for ADF resources (see Annex A). Among them, Bangladesh, Pakistan, Vietnam, Sri Lanka and Nepal are by far the largest beneficiaries of the ADF¹.

3. The ADF's cause for poverty reduction has met with strong international support. A total of 29 economies² have pledged their contributions to

¹ These 5 countries have an average per capita Gross National Income (GNI) of about US\$700 in 2006. (Source: ADF X Donors' Report)

² Not including Hong Kong. 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. There are at present 30 donors including Hong Kong.

ADF X (see Annex B) which, as agreed among ADF donors in May 2008³, will have a replenishment size of US\$11.3 billion, of which US\$4.61 billion would be provided by donor contributions and the remaining from the ADB's internal pool of resources. A consensus has also emerged that the burden sharing formula for ADF X should follow that of the ADF IX⁴.

4. Contributions to the ADF by ADB members are on a voluntary basis and the ADF is replenished once every 4 to 5 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 ADF since 1983⁵ and maintained its burden share according to the consensus burden sharing formula in the past 3 replenishments. According to the formula, Hong Kong's burden sharing ratio is 0.57% of the target donors' contribution size, which translates into US\$26.25 million for Hong Kong's contributions to ADF X. The increase of Hong Kong's contribution relative to that of ADF IX is a result of the burden sharing of the enlarged size of ADF lending operations due to increased demand for assistance and the appreciation of the Special Drawing Right⁶ versus the US dollar.

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\$26.25 million, same burden share as in the past 3 replenishment exercises, to ADF X for the reasons explained in the ensuing paragraphs.

Expectation of Hong Kong's commitment

7. Hong Kong joined the ADB in 1969 and has benefited from ADB's operations in the region. In the period from 1972 to 1980, Hong Kong obtained 5 loans totaling US\$101.5 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

³ The target size of contributions by donors represents an increase of 36.8% from that of donors' contribution in ADF IX.

⁴ Although contribution to the ADF is on a voluntary basis, donors have generally made reference to a burden sharing formula in setting their levels of contribution, which is based on the donor's shareholding in the ADB adjusted for its per capita Gross National Product (GNP).

⁵ Hong Kong contributed to 6 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), US\$16.28 million in 2001 (ADF VIII) and US\$19.19 million in 2005 (ADF IX). Unlike the token donations in ADF IV to VI, the amount contributed by Hong Kong to ADF VII to ADF IX matched that derived from the consensus burden sharing formula agreed amongst the donors.

⁶ SDR is a currency basket (comprising US dollar, Euro, Japanese yen and British pound) in which the ADF is denominated.

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. Hong Kong also derives indirect economic benefits from the contribution to the extent that firms in Hong Kong (as ADF donor) might gain additional scores when they bid for ADB sponsored projects. According to the ADB, as of end 2007, Hong Kong firms have been awarded ADB loan and technical assistance projects such as consultancy worth US\$847.29 million in total.

9. Given that Hong Kong's per capita Gross Domestic Product, at US\$29,104⁷ in 2007, is one of the highest in the region, there is general expectation for Hong Kong, together with the other Newly Industrialised Economies which have "graduated" from the ADB assistance programme, to contribute to poverty reduction efforts in the region⁸.

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 the 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. We note that there is still a large population living in extreme poverty with US\$1 per day⁹, and about two-thirds of these people live in South Asia¹⁰. These people are deprived of even the most basic amenities, social services and education. The ADB, mainly through the ADF and other concessional lending, has played a key role in supporting efforts to reduce poverty in the Asia-Pacific region. Hong Kong's continued participation in the ADF will be a clear demonstration of our contribution towards poverty reduction efforts in the region.

11. The major regional donors including Japan, Korea, Singapore, Australia and New Zealand have agreed to maintain the same contribution share as in ADF IX, leaving the total share of regional donors largely the same¹¹. Even

⁷ Source: Census and Statistics Department, HKSARG, Chained (2005) dollars.

⁸ Graduation from ADB assistance will be triggered when a country reaches a Gross National Income per capita benchmark (\$6,275 in 2006 US dollar). ADB will then analyze the country's readiness for graduation focusing on (i) availability of commercial capital flows on reasonable terms; and (ii) levels of development of key economic and social institutions.

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.

¹¹ Japan is the largest donor which accounted for 35% of the donor's contribution.

though China is still receiving ADB assistance, it has, for the second time, agreed to contribute US\$35 million to ADF X which is higher than its contribution of US\$30 million in ADF IX.

12. Being a regional donor, there is a general expectation that Hong Kong will maintain its burden share like its regional peers. Any diminution from the burden-shared contribution 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, thus damaging Hong Kong's image as well as reputation and status as an international financial centre;
- (b) there can be misunderstanding that the fiscal position of Hong Kong is going to deteriorate to an unsustainable level. While the amount of fiscal deficit for this financial year is expected to increase as a result of global financial crisis, the reduction of Hong Kong's level of contribution at this time can cast strong doubt on our fiscal sustainability in the long term. The potential damage to the financial stability of Hong Kong can be significant in the light of the current volatile global economic and market conditions.

13. It is recommended that Hong Kong opts for the standard 9-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 13 February 2009. A spokesman will be available to handle media enquiries.

ENQUIRIES

17. Enquiries on this brief may be directed to Miss Natalie Li, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2529 0121, and Ms Carmen Chu, Head (External), Hong Kong Monetary Authority at 2878 1946.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
December 2008

Annex A

Overview of Eligible ADF X borrowers

ADF Loans, 1973 - 2007

<u>Borrowers</u>	<u>Per Capita GNP (2006 \$)</u> <u>(US\$)</u>	<u>Loans</u> <u>(US\$ mn)</u>
Bangladesh	480	6,699.3
Pakistan	770	6,627.4
Viet Nam	690	3,861.0
Sri Lanka	1,300	3,137.4
Nepal	290	1,886.6
Lao PDR	500	1,163.1
Cambodia	480	987.8
Afghanistan	218 ^a	800.8
Mongolia	880	684.9
Kyrgyz Republic	500	640.4
Papua New Guinea	770	390.4
Tajikistan	390	383.9
Bhutan	1,420	172.2
Uzbekistan	600	139.2
Samoa	2,270	131.6
Maldives	2,670	93.5
Micronesia, Fed. States of	2,380	71.2
Armenia	1,930	68.8
Marshall Islands	3,060	62.4
Azerbaijan	1,850	59.3
Solomon Islands	680	57.2
Vanuatu	1,710	50.8
Tonga	2,170	46.6
Kiribati	1,230	14.0
Tuvalu	2,516 ^a	8.3
Timor leste	840	-
Georgia	1,560	-
Nauru	2,640	-
Palau	7,990	-
Regional	-	1.6
Total		<u><u>28,239.9</u></u>

Note:

(1) India is also eligible for ADF but had not received any ADF loans during the specified period.

(2) Cook Islands, Indonesia, Kazakhstan, Myanmar, Philippines and Thailand are no longer eligible for new ADF assistance but they still have outstanding ADF loans with ADB. As at end-2007, outstanding ADF loans totalled to US\$24.02 billion.

^a Per capita GNI in 2005

Sources: ADB Annual Financial Statements 2007, Key Indicators 2007 and ADF X Donors' Report

Overview of the Financing and Burden Sharing of ADF X

	ADF X Contribution (USD mn)	ADF X Burden share (%)	ADF IX Burden share (%)	Difference (%)
Non-regional members				
Austria	42.1	0.91	0.87	0.04
Belgium	33.2	0.72	0.72	0.00
Canada	207.2	4.50	4.66	-0.16
Denmark	19.8	0.43	0.89	-0.46
Finland	33.2	0.72	0.50	0.22
France	160.2	3.48	4.41	-0.93
Germany	222.1	4.82 ¹	5.78	-0.96
Ireland	41.2	0.90	0.83	0.07
Italy	138.2	3.00	3.90	-0.90
Luxembourg	4.6	0.10	0.10	0.00
Netherlands	107.7	2.34	2.90	-0.56
Norway	44.6	0.97	1.11	-0.14
Portugal	27.6	0.60	0.60	0.00
Spain	128.9	2.80	2.00	0.80
Sweden	63.1	1.37	1.37	0.00
Switzerland	47.9	1.04	1.23	-0.19
Turkey	6.4	0.14	0.16	-0.02
United Kingdom	221.1 ²	4.80	6.00	-1.20
United States	461.0	10.01	13.70	-3.69
Sub-total	2,010.0	43.65	51.73	-8.08
Regional members				
Australia	298.9	6.49	6.49	0.00
Brunei Darussalam	5.6	0.12	0.28	-0.16
China, People's Republic of	35.0	0.76	0.89	-0.13
Hong Kong, China	26.25 ³	0.57	0.57	0.00
Japan	1,611.8	35.00	35.00	0.00
Korea, Rep. Of	154.3	3.35	3.35	0.00
Malaysia	6.0	0.13	0.15	-0.02
New Zealand	32.2	0.70	0.70	0.00
Singapore	5.5	0.12	0.12	0.00
Taipei, China	21.7	0.47	0.54	-0.07
Thailand	3.6	0.08	0.09	-0.01
Sub-total	2,200.9	47.79	48.18	-0.39
Total Actual Contribution	4,210.9	91.44	99.91	-8.47 ⁴
Target size (basis for burden sharing)	4,605.3	100.00		

¹ Germany may increase its burden share subject to parliamentary approval.

² UK indicated its willingness to make a supplementary contribution afterwards based on benchmarks to be agreed with ADB management.

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 Part of the remaining gap is to be filled by additional contributions and/or internal resources .

⁵ Figure may not add up due to rounding.

ADF X Encashment Schedule

Fiscal Year	Drawdown Rate %	Note Encashment		
		US\$	US\$ Total	HK\$ equivalent*
FY 2009/2010				
Jul-09	3.30	866,000		
Feb-10	3.50	919,000	1,785,000	14,013,651
FY 2010/2011				
Jul-10	3.50	919,000		
Feb-11	5.50	1,444,000	2,363,000	18,551,405
FY 2011/2012				
Jul-11	5.50	1,444,000		
Feb-12	7.60	1,995,000	3,439,000	26,998,850
FY 2012/2013				
Jul-12	7.60	1,995,000		
Feb-13	7.95	2,087,000	4,082,000	32,046,904
FY 2013/2014				
Jul-13	7.95	2,087,000		
Feb-14	7.70	2,021,000	4,108,000	32,251,025
FY 2014/2015				
Jul-14	7.70	2,021,000		
Feb-15	6.85	1,798,000	3,819,000	29,982,148
FY 2015/2016				
Jul-15	6.85	1,798,000		
Feb-16	5.45	1,431,000	3,229,000	25,350,185
FY 2016/2017				
Jul-16	5.45	1,431,000		
Feb-17	3.80	997,000	2,428,000	19,061,706
FY 2017/2018				
Jul-17	3.80	996,974	996,974	7,827,029
Total	100	26,249,974	26,249,974	206,082,902 say 206,083,000

* US dollar amounts are converted into HK dollars using the exchange rate of US\$1 = HK\$7.85, being the upper bound of the convertibility zone of 7.75-7.85 under the Linked Exchange Rate system, plus 0.01% contingency.

Economic implications

Since Hong Kong is not eligible for ADF assistance, we will not derive any direct economic benefits from the contribution. Nonetheless, there could be indirect benefits to the extent that firms in Hong Kong (as ADF donor) might gain additional scores when they bid for ADB sponsored projects. According to the ADB, as of end 2007, Hong Kong firms have been awarded ADB loan and technical assistance projects such as consultancy worth US\$847.29 million in total.

Financial implications

2. Subject to the approval of the Finance Committee of the Legislative Council, Hong Kong will contribute US\$26.25 million to ADF X. The ADB can draw down Hong Kong's contribution in 9 years according to the standard encashment schedule, or within a shorter period, if Hong Kong chooses to participate in the Accelerated Note Encashment (ANE) programme, which offers a one-off, 2-year, 4-year or 6-year encashment schedule. The ANE programme gives credit (i.e. discount) to the donor for making early payments.

3. Hong Kong has been following the practice of majority of the ADF donors in choosing the encashment schedule. In ADF IX, Hong Kong chose the standard encashment schedule (10-year), as in the case of many donors. For ADF X, we recommend Hong Kong to continue to opt for the standard encashment schedule (9-year) in ADF X, following the practice of the majority of donors.

4. The estimated cashflow requirements for a 9-year encashment schedule, as estimated by the ADB, are as follows –

<u>Fiscal Year</u>	<u>Cashflow requirement (in millions)</u>
2009-10	US\$1.785 (around HK\$14.01)
2010-11	US\$2.363 (around HK\$18.55)
2011-12	US\$3.439 (around HK\$27.00)
2012-13	US\$4.082 (around HK\$32.05)
2013-14	US\$4.108 (around HK\$32.25)
2014-15	US\$3.819 (around HK\$29.98)
2015-16	US\$3.229 (around HK\$25.35)
2016-17	US\$2.428 (around HK\$19.06)
2017-18	US\$0.997 (around HK\$7.83)
Total	US\$26.25 (around HK\$206.08)

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