



MEKONG BRIEF

NUMBER 1

December 2000

**The Asian Development Fund (ADF)
& Asian Development Bank (ADB) in the Mekong Region**

- ❖ **The ADF represents 28% of the ADB's total lending**
- ❖ **Australia is the ADF's 3rd largest donor - the largest on a per-capita basis**
- ❖ **Australia's contribution to the ADF constitutes 15% of the national aid budget**
- ❖ **Replenishment of the Fund takes place every three to four years**
- ❖ **AusAID staff represent Australia in ADF negotiations**
- ❖ **Recipient countries are not represented at replenishment meetings**
- ❖ **The allocation of ADF loans demonstrates the ADB's continued emphasis on economic growth as the key to poverty alleviation**

What is the Asian Development Fund?

Established in 1973, the ADF is the largest 'special fund' of the Asian Development Bank. Through the ADF, loans are made on concessional terms ('soft' loans) to countries with low per capita GNP and limited capacity to repay debts.

At the end of 1998 the ADF represented 28% of the Bank's lending. It is the only multilateral source of concessional assistance dedicated exclusively to the Asia Pacific Region.

The ADF is replenished every 3 to 4 years. Negotiations for the replenishment of ADF VIII (the 8th round of the Fund) were completed in September 2000. ADF VIII will operate from early 2001 with a pool of US\$5.6 billion.

What is Australia's role in the ADF?

Australia is an influential player in the ADB in terms of both policy and financial contribution¹. Australia is currently the third largest donor to the ADF (following Japan and USA) with a contribution to ADF VIII of US\$185 million.

Australia's contribution to the ADF constitutes 15% of its total overseas aid expenditure. Australian NGOs are expressing concern that unless the ADB undergoes substantial reform, these funds would be more effective if directed through bilateral or direct aid programs².

AusAID – the Australian government agency responsible for overseas aid - represents Australia at ADF replenishment meetings. AusAID, responding to growing criticism of the allocation of a significant portion of the aid budget to a Fund which lacks transparency is now:

- working more effectively through the Executive Director's office,
- pushing the poverty reduction strategy and improved development effectiveness,

- assessing the effectiveness of the ADF, through a new Development Effectiveness Committee
- co-financing arrangements³.

What are the aims of the ADF?

According to the ADB, ADF financed operations serve many of the "economic, strategic, and humanitarian interests of contributing members" in a cost-effective manner⁴.

The objectives of ADF projects are categorized as 'growth', 'social', 'environmental' and 'growth plus social or environmental'. The definitions of these categories are:

- Growth projects aim to promote economic growth through investments which increase economic production capacity or enhance economic efficiency.
- Social projects aim to reduce poverty, support human development (including population planning), or to improve the status of women.
- Environmental projects aim to promote sound management of natural resources.

The Bank aims for at least 50% in number, and 40% in value, of ADF projects to be directly targeted at social and environmental objectives. A review of the projects funded by ADF VII (see www.adb.org/Finance/ADF/loans.asp) reveals that although this minimum requirement was met by ADF VII classifications, the majority of loans were actually directed at infrastructure projects

ADF loans in the Mekong Region

Cambodia, Lao PDR, Myanmar and Vietnam are all current recipients of ADF loans. However Vietnam also receives limited OCR (Ordinary Capital Resources) funding - loans made on non-concessional terms. Thailand, due to its higher GNP, only qualifies for OCR funding. Of the Mekong countries Vietnam is by far the largest

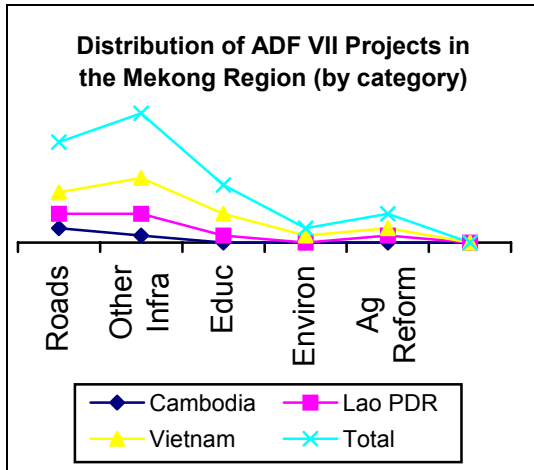
¹ Australian Council for Overseas Aid (ACFOA) Briefing Paper 2000

² Finance Australia 30/8/00

³ Ross Muir presentation to Workshop, Canberra 15/11/00

⁴ www.adb.org

recipient of ADF loans followed by Laos and Cambodia.



Source: www.adb.org/Finance/ADF/loans.asp

This graph demonstrates the continued emphasis of the ADB on roads and 'other infrastructure' (water supply and sanitation, power distribution and financial reform).

The three projects funded in Cambodia by the ADF VII were the Phnom-Penh Ho Chi Minh Superhighway, a primary roads program and 'provincial towns improvement'. According to the ADB's classification system nearly half of the funding allocated to these projects was for 'growth plus social and environmental' benefits. The ADB is increasingly under criticism for its assumed link between economic growth and social benefits, primarily that of poverty reduction.

In most cases any social or environmental objective is secondary that of 'growth' which is described by the ADB as "the most powerful weapon in the fight against poverty"⁵.

The ADB claims that projects and programs considered for ADF finance reflect the "legitimate prioritized needs" of recipient countries as agreed between the Bank and the recipient government with the participation of 'civil society'⁶. However

⁵ ADB President Chino addressing the Australian Press Club, 28/8/00

⁶ for a debate on the understanding of this term and its relevance to ADB's work in the Mekong

recipient countries do not attend replenishment negotiations. Decisions are made according to a project classification system which safeguards the Bank's commitment to shareholders.

How does the replenishment process operate?

The Fund operates on the basis of 'fair burden sharing'. Donors are expected to contribute according to their relative position in the region or the world. In preparation for the replenishment of the Fund, donors meet to negotiate burden-sharing arrangements.

The aim is for ADF to achieve a 50:50 ratio between non-regional and regional donors. Australia and other regional donors will bear an increased burden until the Fund becomes self-funding. This is expected to occur within the next twelve years or by ADF XI.

The ADF is being redesigned as a revolving fund. An Expanded Advanced Commitment Authority Scheme (EACA) has been established to manage the financial resources. Repayments from previous loans are used to commit future funding agreements. Thus the ADF VIII total of US\$5.6 billion is made up of US\$2.91 billion contribution from donors and US\$2.69 billion repayments from earlier loans.

With the new structure in place, donor replenishments will only be triggered when borrowing needs exceed the Bank's capacity to generate required resources. One way in which resources are generated is through private sector investment in infrastructure projects.

What are the parameters of ADF loans?

Concessional loans are made at nominal interest rates. From January 1999 the service charge was redesignated as an interest charge of 1% per annum during the grace period of 8 years and 1.5% per annum thereafter. Project loans

see Watershed, vol. 5 No. 2 November 1999-February 2000

have a maturity of 32 years whereas Program loans have a maturity of 24 years⁷.

The Bank claims that concessional loans are an effective way of giving poor countries access to capital without significantly adding to their debt-repayment burden. Community Aid Abroad counters that in reality 'soft' loans can have detrimental impacts as the notion of 'easy money' can contribute to institutional corruption and dependence.

Furthermore in the case of 'soft' loans the Bank is likely to maintain much greater control, via loan conditions, on the economic policy of debtor countries. This greater 'conditionality' has serious implications for the political and economic sovereignty of poor countries⁸.

How does the ADB evaluate the success of ADF loans?

The ADB has been criticised for giving inadequate attention to evaluation of the Fund, or its impact on poverty⁹. Although one of the objectives is to apportion a percentage of funding to social and environmental objectives, the achievement of this goal is not assessed.

In response to these criticisms a Development Effectiveness Committee is being established to evaluate ADF VIII expenditure.

Key Issues

- The ADF is considered a useful tool by the ADB but is criticized by the NGOs primarily due to its concessional nature.
- One of the questions at the centre of the debate is – whether the ADB is increasing dependency of poor nations through the ADF?

- Donors, including AusAID, have expressed concern over the allocation of funds and are demanding a greater emphasis on poverty reduction.
- Some Australian NGOs are questioning the value of this means of support compared with bilateral aid programs funded by Overseas Development Assistance (ODA) through AusAID.
- The AMRC is working with Community Aid Abroad, ACFOA, AidWatch and other NGOs which are actively campaigning to increase the accountability of the ADB. Concern over the mechanism of the ADF should be viewed within this broader context.

Further information:

www.usyd.edu.au/su/geography/mekong
www.adb.org www.caa.org.au
www.ausaid.gov.au www.imf.org

AMRC's Mekong Brief Series

This Brief is the first in a series of information sheets to be produced by the Australian Mekong Resource Centre (AMRC), University of Sydney, for students, teachers and others with an interest in the Mekong Region.

The AMRC was established in 1997 to promote research, discussion and debate on development and environmental issues in the Mekong Region. The AMRC is a focal point for information, dialogue and activities in support of an equitable and sustainable development path for the Mekong Region.

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⁷ see www.adb.org for details

⁸ The Asian Development Fund
www.caa.org.au/campaigns/adb/fact_sheets/adf.html

⁹ see www.caa.org.au & ACFOA Briefing Paper 2000