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Asian Development Bank (Additional Subscription) Bill 2009

Scott Kompo-Harms
Economics Section

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Asian Development Bank (Additional Subscription) Bill 2009

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House: House of Representatives

Portfolio: Treasury

Commencement: Royal Assent

Links: The relevant links to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

To enable Australia to take up its allocated subscription (409 480 shares) as part of the fifth general capital increase (GCI V) at the Asian Development Bank (ADB).

Background

Brief Chronology of the Asian Development Bank

The Asian Development Bank (ADB), which is headquartered in Manila, Philippines, was established in 1966 to provide assistance to Asian countries, which were at that time, predominantly based on agriculture. Its initial efforts were directed towards rural development and providing technical assistance aimed at increasing food production. Throughout the 1970s, the focus of the ADB shifted into education, health, infrastructure and industry. Concessional lending and co-financing also commenced in the 1970s. In the 1980s, the ADB focussed on improving private sector participation in development projects. Since then, the ADB has expanded into areas such as regional cooperation, poverty reduction and enhancing the effectiveness of development activities.[1]

The ADB currently has 67 member countries of which 48 are from the Asia Pacific region. Australia is a founding member.

Governance

The highest level of decision-making at the ADB is the Board of Governors. One Governor and one Alternate Governor are appointed by each member country. In

1. For more information on the ADB, see: http://www.adb.org/about/serving-asia.asp, viewed 18 August 2009.

Australia's case, the Governor is currently the Treasurer, Wayne Swan MP, while the Alternate Governor is Bob McMullan MP. The Board of Governors meets formally at an annual meeting held in a member country. The day-to-day running of the ADB is delegated from the Board of Governors to a full-time Board of Directors. The Board of Governors also appoints a President for a term of five years.[2] The ADB President, under the direction of the Board of Directors, is responsible for carrying out the business of the ADB. Under the President are four Vice Presidents, the Managing Director General and the Dean of the ADB Institute. In addition, the Independent Evaluation Department and the Office of the Compliance Review Panel report directly to the Board of Directors.

Shareholding and voting share

When the ADB was established in 1966, the authorised capital stock of the ADB was USD1 billion (in terms of the value of US dollars as at 31 January 1966).[3] This was divided into 100 000 shares, at a par value of USD10 000 each. Half of the shares were 'paid-in' shares, while the other half were 'callable' shares.[4] Australia's initial subscription was USD85 million, or 8.5 per cent of the total shares available. The issue of valuation of shares since the formal collapse of the Bretton Woods system of fixed exchange rates in 1978 has still not been satisfactorily resolved, although now ADB shares are nominally valued at SDR10 000.

The ADB reviews its capital needs on a five-yearly basis and can replenish its capital through either general capital increases (GCIs) or special capital increases (SCIs). GCIs

2. The president is able to be reappointed for more than one term.

3. The Agreement establishing the ADB refers to '*United States dollars of the weight and fineness in effect on 31 January 1966*'. This reference was made when the Bretton Woods system of managed fixed exchange rates was in place, and the US dollar was pegged to the price of gold. Since 1 April 1978, currencies no longer have par values in terms of gold. This is why a nominal valuation of SDR10 000 is currently used. SDR refers to Special Drawing Rights, or the IMF unit of account, which is comprised of a basket of four currencies, the Euro, US Dollar, UK Pound and Japanese Yen, in set proportions, which are reviewed every five years. The valuation is based on market exchange rates.
See: *Agreement establishing the Asian Development Bank*, Asian Development Bank, Manila, Philippines, 1966, viewed 19 August 2009, http://www.adb.org/Documents/Reports/Charter/default.asp
See also: *Annual Report 2008 Volume 2*, Asian Development Bank, Manila, Philippines, 2008, pp.48-49, viewed 19 August 2009, http://www.adb.org/Documents/Reports/Annual_Report/2008/Annual-Report-2008-Vol02.pdf

4. The financial obligations of ADB members for both of these classes of shares is discussed in the 'Key Issues' section of this Digest. Paid-in shares form the equity base for the Bank's Ordinary Capital Resources (OCRs) and these shares are fully paid by all members. Callable shares on the other hand, do not form part of the OCRs, but are merely for the protection of the ADB's creditors, in the event of wide-scale defaults by ADB borrowers.

are capital increases where all members are given the opportunity to subscribe to the shares on offer, in the same proportion as their existing holdings, thus (if fully subscribed) leaving voting shares unchanged. Each member is under no obligation to subscribe to each increase. SCIs occur when members want to change their proportion of shareholdings in the ADB and are conducted through an entirely separate process. GCIs have been undertaken on four occasions in the past, and the Board of Governors passed a resolution in favour of the current proposed GCI, known as GCI V, on 29 April 2009. The last GCI, GCI IV, was undertaken in 1994.

At present Australia holds 204 740 shares, or 5.77 per cent of the total and is the fifth largest shareholder. The overall Australian capital subscription is USD3.17 billion (as at 31 December 2008), with paid-in capital of USD 221.93 million.[5] The Bill proposes to triple Australia's shareholding, an increase of 409 840 shares, to a total of 614 220 shares.

Voting shares are partly related to shareholdings. The aggregate sum of both 'basic' and 'proportional' votes comprises the total number of votes. Twenty per cent of the total stock of votes is set aside as basic votes, while the remaining 80 per cent of votes (proportional votes) is equivalent to the total number of shares held. The basic votes are distributed equally to all ADB members. Australia has 217 972 votes, or 4.92 per cent of the total. The total capitalisation of the ADB is summarised below in table 1:

Table 1: ADB Capitalisation, 2002-2008[6]

USD MILLION (as at 31 December)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Subscribed Capital	47 234	51 997	54 162	50 163	53 169	55 978	54 890
Callable Capital	43 912	48 340	50 352	46 635	49 429	52 041	51 029
Paid-in Capital	3 322	3 657	3 809	3 528	3 740	3 937	3 861

Basis of policy commitment

At the Group of Twenty (G20) summit, held in London on 2 April 2009, national leaders (including Prime Minister Rudd) committed to supporting an increase in lending of at least USD100 billion by the multilateral development banks, of which the ADB is one. The explicit commitment made by national leaders of the G20 at the London summit communiqué, in relation to funding multilateral development banks is as follows:

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5. *Asian Development Bank & Australia*, 'ADB Fact Sheet', Asian Development Bank, Manila, Philippines, 2009, viewed 19 August 2009, http://www.adb.org/Documents/Fact_Sheets/AUS.pdf

6. 'Credit Fundamentals, Capital Structure', Asian Development Bank, , ADB website, viewed 19 August 2009, http://www.adb.org/Bond-Investors/cf-capital-structure.asp

> We have…agreed today to make available an additional $850 billion of resources through the global financial institutions to support growth in emerging market and developing countries by helping to finance counter-cyclical spending, bank recapitalisation, infrastructure, trade finance, balance of payments support, debt rollover, and social support. To this end:
>
> - we have agreed to increase the resources available to the IMF through immediate financing from members of $250 billion, subsequently incorporated into an expanded and more flexible New Arrangements to Borrow, increased by up to $500 billion, and to consider market borrowing if necessary; and
> - we support a substantial increase in lending of at least $100 billion by the Multilateral Development Banks (MDBs), including to low income countries, and ensure that all MDBs have the appropriate capital.[7]

The specific Australian commitment was made by the Australian Government in the 2009-10 Budget. The Government has committed USD197.6 million (AUD241.0 million) over 10 years as additional paid-in capital towards the ADB's USD110 billion increase. Australia has also committed to increase its uncalled capital subscription by USD5.6 billion (AUD6.8 billion).[8]

Committee consideration

As at the time of writing, the Bill has not been referred to a committee for inquiry. The Senate Standing Committee for the Scrutiny of Bills examined the Bill and did not raise any concerns with it. The committee noted that the standing appropriation is limited to a specific purpose and for a specific amount of funds.[9]

Financial implications

As such, the Bill will not have any impact on the underlying cash or fiscal balance. The increase in Australia's paid-in shareholding is included as a capital measure in the 2009-10 Budget. The increase in Australia's callable shareholding is shown in the 2009-10 Budget as a contingent liability. Passage of the Bill will mean that, as a result of GCI V, the uncalled capital subscription will total USD8 billion.

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7. Group of Twenty, *Final Communiqué*, London Summit, London, 2 April 2009, paragraph 17, viewed 18 August 2009, http://www.londonsummit.gov.uk/en/summit-aims/summit-communique

8. Australian Government, *Budget measures: budget paper no.2: 2009-10*, Commonwealth of Australia, Canberra, 2009, p. 417. Please note that conversions of US dollar figures into Australian dollars uses the (more up-to-date) exchange rates assumed in the Explanatory memorandum to this Bill, as opposed to those used in the 2009-10 Budget Papers.

9. Senate Standing Committee for the Scrutiny of Bills, *Alert Digest*, No. 10 of 2009, 19 August 2009, viewed on 24 August 2009, http://www.aph.gov.au/senate/committee/scrutiny/alerts/2009/d10.pdf

Standing appropriations

The Bill contains a standing appropriation from the Consolidated Revenue Fund which is limited to payments made under any agreement reached between the Treasurer and the ADB, including any payments to be made under a promissory note.

Key issues

Fifth General Capital Increase[10]

GCI V is the largest ever GCI in the history of the ADB. The Board of Governors of the ADB adopted Resolution No. 336, which served to increase the ADB's authorised capital stock by 7 092 622 shares and authorised the acceptance of increases in individual member countries subscriptions. If the increase is fully subscribed, the capitalisation of the ADB would be tripled and relative shareholdings (and therefore voting shares) would be unaltered. Only four per cent of GCI V takes the form of 'paid-in' shares, the rest being 'callable' shares. 'Callable' shares are merely an obligation for the member to pay, either partially or fully, an amount to the ADB in the event of default by borrowers. They entail a contingent liability, in other words, a potential liability that is contingent upon a certain event occurring, in this case, default by ADB borrowers.

The payment method for 'paid-in' shares is complex. The payments for are to be in five equal annual instalments. Of each instalment, 40 per cent is required to be paid in a freely convertible currency (the ADB considers the Australian dollar to be freely convertible), while the other 60 per cent can be paid in the member's own currency. The 60 per cent that can be paid for in the member's own currency is able to be paid as promissory notes, which the current Bill enables the Treasurer to do. The ADB has stated that any promissory notes are likely to be encashed in five equal annual instalments after the last cash instalment is paid. Thus the total amount for paid-in shares is likely to be paid over a ten year period.

The ADB has specified two payment options with different prices. The choice of which option to pay under is at the discretion of the individual member country. The first option is to pay (in current terms) USD12 063.50 per share, while the second option is to pay SDR10 000 per share. Using the daily average exchange rate for August 2009 (SDR1=USD1.560163), the USD price per share is around USD3 500 cheaper than the SDR price per share. Thus, unsurprisingly, the Australian Government has nominated to pay for the instalments using the USD option.

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10. For details of the subscription process see: 'Information on subscription for the Fifth General Capital Increase', Asian Development Bank, May 2009, viewed 24 August 2009, http://www.adb.org/Documents/Brochures/Fifth-General-Capital-Increase/general-capital-increase.pdf

The ADB has provided flexibility for each member country to nominate either option for future instalments and to fix the exchange rate (at a rate predetermined by the ADB) between the USD and a freely convertible currency up to one year prior to each instalment falling due. The utility in the Australian Government availing itself of these options will depend on movements in exchange rates over time. However, the Bill specifically mentions only the USD option, and whilst that option is more favourable to Australia at present, over a time horizon of 10 years (for payment of the paid-in shares), this situation could change. It may therefore be wise for the Australian Government to avail themselves of the full degree of flexibility afforded by the ADB.

Main provisions

Clause 3 inserts definitions of the terms used in the Bill. Reference is made to the 'Agreement' establishing the Asian Development Bank, which is set out in the Schedule to the *Asian Development Bank Act 1966*. 'Callable shares' and 'paid-in shares' are defined as per the abovementioned agreement.

Clause 4 authorises the Treasurer to make an agreement, or agreements with the ADB to purchase both the 16 379 additional paid-in shares and 393 101 additional callable shares, at a price per share that is equivalent to USD12 063.50. Therefore, the text of the Bill indicates that the Australian Government has chosen the USD payment option, rather than the SDR option for all of the instalments. In addition, under this clause, the Treasurer is authorised to negotiate terms and conditions of any agreement between the Australian Government and the ADB.

Clause 5 authorises the Treasurer to create and issue to the ADB, promissory notes that are non-negotiable, non-interest bearing and payable to the bank at par value upon demand. The promissory notes are specifically for issue to the ADB, for the purposes of subscription to GCI V. Proposed subsection 5(3) removes any possible ambiguities about process for the creation and issue of promissory notes for the purposes of GCI V, as opposed to other ADB capital raisings or calls on existing callable shares. Specifically it provides that section 5 of the *Asian Development Bank Act 1966*, which empowers the Governor-General to issue promissory notes to the ADB, does not apply to any agreement entered into under subsection 4(1) of the proposed new Act.

Clause 6 establishes the standing appropriation from Consolidated Revenue for payments to be made under any agreement struck between the Treasurer and the ADB (including those made under a promissory note).

Concluding comments

The ADB has specified two payment options with different prices as part of the conditions for subscription. The choice of which option to pay under is at the discretion of the individual member country. The first option is to pay (in current terms) USD12 063.50 per share, while the second option is to pay SDR10 000 per share. The Bill explicitly mentions the USD option, however, each country has the option of using either price for each of the five annual instalments (and on what terms to pay the out any promissory notes issued when they are encashed), as well as an option to fix the exchange rate between a freely convertible currency and the USD one year in advance of an instalment being paid.

It should be noted that the conditions for subscription established by the ADB give member countries considerable flexibility in determining whether they pay each instalment using the USD or SDR payment options and also whether to fix the exchange rate between the USD and the member's currency up to a year in advance of payment of each instalment. It may be wise for these provisions to be explicitly referred to in the Bill, so as to provide maximum flexibility over the life of the agreement.

The long time horizon for payment of the instalments for paid-in shares suggests that the ADB does not urgently require an expansion of equity finance, in the form of 'paid-in' shares, but rather, requires an increase in 'callable' shares as collateral to expand their operations.

Members, Senators and Parliamentary staff can obtain further information from the Parliamentary Library on (02) 6277 2455.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.