

USE OF SPECIAL FUND RESOURCES TO
FINANCE FOREIGN EXCHANGE COMPONENT OF
LOCAL CURRENCY EXPENDITURES

A suggestion has been made by a Member of the Board of Directors that an aspect of operations with Special Funds resources which may assume importance in the near future be brought to the attention of the Board of Directors for consideration. The aspect referred to concerns the utilisation of Special Funds resources to pay for the import component of goods and services procured for the project concerned locally, as a part of local currency expenditure. Referring to "the utilisation of Special Funds resources to pay for the foreign cost component of the local cost portion" of a project, the Director has pointed out:

"There are two separate issues involved. The first question relates to the desirability of utilising scarce Special Funds resources and possibly set-aside resources to finance local costs. The second issue relates to whether, and under what circumstances, Special Fund contributors

would be willing to have their contributions utilised for financing local costs. This is a matter to be determined by the contributors.

However, I regard the first issue as a matter of policy and feel it should be discussed by the Board since both the question of using scarce resources for this purpose and the question of whether set-aside resources should be used for this purpose are at issue."

2. The total cost of a project in a developing member country, which, on appropriate criteria, may qualify for Special Fund operations, would consist of two elements:

(a) the cost of goods and services directly imported for the project, i. e. a clearly identifiable foreign exchange cost, to be met out of the proceeds of the Bank's loan on the basis of appropriate documentary evidence of import for the purpose of the project;

(b) the cost of goods and services domestically procured and identified in terms of local currency cost.

The latter element may, however, have an import component, which is not specifically identifiable and which, hence, cannot be included in the directly identifiable foreign exchange cost mentioned at (a) above. For example, petroleum products may be needed for the project and may with economy and efficiency be locally procured from production at local refineries; these refineries, however, may be operating with imported crude oil; the petroleum products locally procured would thus have a foreign exchange (i.e. import) component. Other elements of goods procured locally may have similar import components. As the procurement thus effected for a specific Bank-financed project may be only a fraction of the total domestic production of such goods, it may be impracticable to seek specific evidence of import as the basis for disbursement of the proceeds of the loan. In such circumstances, the question would arise whether such foreign exchange component of items procured for the project with local currency could or could not be financed with such foreign exchange as may be available to the Bank.

3. Before examining the question in the context of special operations, it is useful to recall that in some of the operations so far undertaken by the Bank from its ordinary capital resources, provision has been made within specified limits for meeting, from the proceeds of the loan, the import component of local procurement. For example, in the Penang State Water Supply Project (No. 4 MAL) a percentage of the cost of goods purchased through local importers or fabricated locally from imported components and raw materials^{1/} was made eligible for financing from the proceeds of the Bank's loan.

4. In special operations, Section 4.04 of the Special Funds Rules and Regulations provides that

"In its special operations, the Bank may provide financing in the following ways:

(a) by furnishing the recipient with currencies other than the currency of the

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See Annex A for excerpts from the relevant loan documents.

member in whose territory the project or programme concerned is to be carried out, which are necessary to meet the foreign exchange costs of such project or programme; or

(b) by providing financing to meet local expenditures on the project concerned where it can do so in accordance with the terms of any relevant contribution agreement or the relevant resolution of the Board of Governors under Article 19, paragraph (i) of the Articles."

As far as the use of Special Funds contributions is concerned, certain Contribution Agreements contemplate that the Bank may, in special cases, seek the concurrence of the contributor to the use of its contributed resources to finance a portion of the local currency expenditures. To the extent that such provisions are made use of, it is possible to reimburse to the borrowing entity, inter alia, some part of the foreign exchange expended in respect of the import component of locally procured equipment and materials.

5. In considering the use of set-aside resources for a similar purpose, it will be recalled that Resolution No. 26

of the Board of Governors, whereby action was taken to set aside ten per cent of the capital paid in under Article 6.2 (a) for use as part of the Consolidated Special Funds of the Bank, laid down (in paragraph 5) that

"The provision of currencies for loans made from the resources set aside shall be governed by the relevant provisions of Article 13." ^{2/}

The provisions of Article 13 of the Bank's Articles of Agreement therefore apply to the use of set-aside resources to the same extent as they do to ordinary capital resources.

6. The use of set-aside resources for financing the import content of local procurement is authorised under Article 13. Where the foreign exchange component of local currency costs of a project is significant, the fact that this component is not readily identifiable or easily established by

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See Annex B for the text of the Resolution, and of the Directors' Report recommending it.

specific documentation does not in itself seem a sufficient reason for excluding it from being financed from the proceeds of a loan made by the Bank. To the extent that a project is deemed suitable for concessional financing, on the ground for instance that the country concerned faces a heavy strain in its balance of payments position and/or that the project itself, while economically sound, may not be capable of translating economic benefits into financial and foreign exchange returns compatible with financing from ordinary operations, the case for financing the import component of domestic procurement would seem to be equally as strong as the case for financing direct and readily identifiable imports. Moreover, the recognition that set-aside resources may be used in the financing of such import content appears to be in conformity with the aim, approved by the Board of Governors

in the Resolution referred to, of using such resources flexibly so as to secure optimum benefits to recipients.

7. It may also be noted that the Resolution, by reference to paragraph 4 of the Report of the Directors recommending the resolution, sanctions the application of the Bank's Guidelines for Procurement to the use of set-aside resources. In the Guidelines, one of the principal purposes and objectives is set forth (in Section 1.1(c)) as follows:

"The Bank is required by Article 14(xi) of the Charter to ensure that the proceeds of any loan are used with due attention to considerations of economy and efficiency. Accordingly, the Bank requires its borrowers to obtain goods and services on an international competitive basis, unless in special circumstances another procedure more appropriate to the circumstances has been agreed between the Bank and the borrower."
(underlining supplied)

The procurement from local suppliers of certain types of materials and equipment may, in certain cases, be the most appropriate procedure for procurement if due attention is paid

to considerations of economy and efficiency. The result may be that the import component is not readily identifiable or easily traced through documentation, but this should not prevent the use of an appropriate amount of the loan proceeds to help finance this component.

8. It would be understood that whether, and to what extent, the Bank's Special Fund operations should include the import content of domestic procurement would have to be decided most carefully on a case-by-case basis on the merits of each investment proposal. Subject to this understanding, it is recommended that the Board agree that, in principle, the use of Special Funds resources should not necessarily preclude the financing of the import component of local procurement.

ANNEX A

LOAN NO. 4 MAL : PENANG STATE
WATER SUPPLY PROJECT

Loan Agreement, Section 2.04:

The State, acting as the agent of the Borrower pursuant to Section 8.01 of this Loan Agreement, shall be entitled to withdraw from the Loan Account:

(a) the equivalent of a percentage or percentages to be established from time to time by agreement between the State acting as such agent and the Bank of such amounts as shall have been paid for the reasonable cost of goods to be financed under the Loan Agreement; and

(b) such amounts as shall have been paid for the reasonable foreign currency cost of goods to be financed under the Loan Agreement; and if the Bank shall so agree, such amounts as shall be required to meet payments to be made for the reasonable foreign currency cost of such goods.

Side Letter No. 1, paragraph 4:

During discussions regarding this Loan, we pointed out that some of the goods to be used in the Project may be purchased through local importers or may be fabricated locally from imported components and raw materials. It has been agreed that in such cases, where evidence of the actual foreign exchange cost is not available, 70% of the total cost of such goods purchased locally, or such other percentage as shall be agreed between the Bank and the State from time to time, will be eligible for reimbursement under

withdrawals from the Loan Account under Category II of the attached allocation, the balance of **their** cost being a reasonable estimate of the average local currency portion of such cost. In support of applications for withdrawals in respect of the foreign currency cost of such goods, we shall supply a copy of the **local** supplier's invoice, indicating, where possible, the origin of the imported goods, and evidence that payment has been made to the local supplier.

Category II of the allocation of proceeds provides for:

Category II	Plant and Equipment	\$1,730,000
	Weir gates, Pumping plants, Treatment plant, Miscellaneous equipment.	

ANNEX B

ACTION TO SET ASIDE CAPITAL FOR SPECIAL FUNDS

REPORT OF THE BOARD OF DIRECTORS

1. The Board of Directors has considered the desirability of the Board of Governors taking action, under Article 19, paragraph 1(i) of the Articles of Agreement of the Asian Development Bank, to set aside a portion of the unimpaired paid-in capital subscriptions to the Bank for the purpose of making loans of the nature specified in Article 19, paragraph 2 and submits the following Report to the Board of Governors.

2. The Board of Directors is of the view that such action now is desirable for the following reasons:

(a) The Governors for Canada, Denmark, Japan and the Netherlands gave firm indications at the First Annual Meeting of the Governors as to the contributions their respective Governments were prepared to make, under Article 19, paragraph 1(ii), for the provision of Special Funds resources for the Bank's operations. On 10 December 1968 the Bank accepted a contribution by Japan to the Agricultural Special Fund. A contribution by Canada to the Multi-Purpose Special Fund was accepted on 23 December 1968. It is hoped that additional contributions will be forthcoming from other countries in the near future. The Bank has also accepted a number of contributions to the Technical Assistance Special Fund. At this time, the willingness of the Board of Governors to take action under Article 19, paragraph 1(i) will be demonstrable evidence of the importance that is attached to increasing the availability of Special Funds resources.

(b) In the initial stages and pending receipt by the Bank of contributed resources from a considerable number

of contributors, the availability of modest amounts of Special Funds resources from a set-aside action will permit needed flexibility in the Bank's special operations so as to secure optimum benefits to recipients.

3. The Board of Directors, taking into account the complexities arising out of the provisions of the Articles relating to the use of subscriptions under Article 6, paragraph 2(b) and taking into account the need to have set-aside resources in an amount significant enough to yield the results indicated in paragraph 2 above, is agreed, and advises the Board of Governors, that at the present stage the appropriate action would be to exercise the provisions of Article 19, paragraph 1(i) to the extent of 10% of the unimpaired paid-in capital subscriptions already paid to the Bank under Article 6, paragraph 2(a) with the actual transfer of these resources to take place as and when required for financing special operations.

4. If this advice commends itself to the Board of Governors, the Board of Directors would recommend that:

(a) the set-aside resources so made available be allocated to the Multi-Purpose Special Fund contemplated in the Special Funds Rules and Regulations adopted by the Board of Directors on September 17, 1968; within the limit proposed the set-aside resources be transferred to the Multi-Purpose Special Fund as and when required in the course of special operations;

(b) the use of set-aside resources be directed as far as possible to achieving the advantages indicated in paragraph 2(b) above;

(c) the relevant provisions of Article 13 on the provision of currencies be applied to operations with set-aside resources;

(d) where, in special circumstances, a project is to be financed entirely from set-aside resources, care be taken to ensure that a disproportionate amount of such resources is not made available to any one country;

(e) the provision of technical assistance from set-aside resources be made available only in special circumstances and only on a reimbursable basis;

(f) policy relating to the terms of repayment and interest be determined by the Board of Directors taking into account the terms applicable to the various contributed resources, so that the optimum use of contributed resources is facilitated;

(g) where set-aside resources are used to finance a project care be taken to ensure that the Bank's Guidelines for Procurement shall apply to loans made from the set-aside resources.

5. The Board of Directors, in light of the foregoing, submits the attached draft Resolution for consideration by the Board of Governors.

RESOLUTION NC. 26

ACTION TO SET ASIDE CAPITAL FOR SPECIAL FUNDS

The Board of Governors of the Asian Development Bank,

Having considered the Report of the Board of Directors (Doc. BG2-7 of 11 February 1969) on action currently desirable to implement the provisions of Article 19, paragraph 1(i) of the Articles of Agreement Establishing the Asian Development Bank (hereinafter called the Articles) and

Being in agreement with the views of the Board of Directors as incorporated in that Report,

HEREBY RESOLVES THAT

1. Pursuant to the provisions of Article 19, paragraph (i) of the Articles, ten percent of the unimpaired paid-in capital paid by members pursuant to Article 6, paragraph 2(a) as of the date hereof shall be set aside to be used as part of the Consolidated Special Funds of the Bank.

2. The Special Funds resources so set aside shall be allocated to the Multi-Purpose Special Fund and transferred to such Fund as and when required to finance special operations of the Bank as hereinafter provided.

3. The Special Funds Rules and Regulations dated 17 September 1968 as amended from time to time shall apply to the resources set aside as from the respective dates of transfer and to accrued resources derived therefrom.

4. Pursuant to Article 19, paragraph 2 of the Articles, the resources so set aside shall be used primarily to finance loans of high development priority in accordance with Article 19, paragraph 2 but may also be used in special circumstances to finance technical assistance on a reimbursable basis in accordance with the Rules.

5. The provision of currencies for loans made from the resources set aside shall be governed by the relevant provisions of Article 13.

6. In the use of the resources set aside, the Board of Directors shall bear in mind the contents of paragraph 4 of the Report.

7. The Board of Directors is hereby authorized to take all further action necessary to implement this Resolution.

3. The Special Funds Rules and Regulations dated 17 September 1968 as amended from time to time shall apply to the resources set aside as from the respective dates of transfer and to accrued resources derived therefrom.

4. Pursuant to Article 19, paragraph 2 of the Articles, the resources so set aside shall be used primarily to finance loans of high development priority in accordance with Article 19, paragraph 2 but may also be used in special circumstances to finance technical assistance on a reimbursable basis in accordance with the Rules.

5. The provision of currencies for loans made from the resources set aside shall be governed by the relevant provisions of Article 13.

6. In the use of the resources set aside, the Board of Directors shall bear in mind the contents of paragraph 4 of the Report.

7. The Board of Directors is hereby authorized to take all further action necessary to implement this Resolution.