

OPERATIONS MANUAL BANK POLICIES (BP)

These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

FINANCING INDIRECT FOREIGN EXCHANGE COST OF PROJECTS

A. Introduction

1. Article 13(i) of the *Agreement Establishing the Asian Development Bank* (the Charter) stipulates that, in making direct loans or participating in them, the Asian Development Bank (ADB) may provide financing that is necessary to meet the foreign exchange costs of a project.

B. Definition

2. The term “indirect foreign exchange cost” means the cost of the imported components of goods, works, and services purchased locally.¹ This may occur even when a developing member country exports and imports the same or similar resource but is a net importer of the resource.

C. The Policy

3. ADB finances the indirect foreign exchange cost of items procured in local currency for ADB-financed projects with foreign exchange costs, including the indirect foreign exchange costs of subprojects financed under ADB loans to development finance institutions and financial intermediaries.²

D. Scope of the Policy

4. ADB finances the indirect foreign exchange costs incurred in the procurement of (i) imported goods from a domestic supplier, (ii) locally manufactured goods that contain imported components, and (iii) works that include components under (i) and (ii) above.

¹ Some examples are the cost of petroleum products used on a construction site and purchased locally, the cost of imported iron ore in locally manufactured and processed steel, and the depreciation cost of imported machinery in manufacturing cement produced locally.

² This OM section applies only to outstanding loans that were approved before 15 March 2006.

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Basis: This OM section is based on:

ADB. 1969. R55-69, *Use of Special Fund Resources to Finance Foreign Exchange Component of Local Currency Expenditures*, 17 September. Manila.

ADB. 2005. R193-05, *Cost Sharing and Eligibility of Expenditures for Asian Development Bank Financing: A New Approach*, 4 August. Manila.

ADB. 2006. *Procurement Guidelines*, April. Manila.

This OM section is to be read with OM Section H2/OP.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Director, Central Operations Service Division 1, Central Operations Services Office.

**OPERATIONS MANUAL
OPERATIONAL PROCEDURES (OP)**

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FINANCING INDIRECT FOREIGN EXCHANGE COST OF PROJECTS

A. Introduction

1. The Asian Development Bank (ADB) finances the indirect foreign exchange cost in the case of imported goods purchased from a local supplier, procurement of locally manufactured goods, and procurement of works, subject to applicable cost-sharing limits.

B. Application of the Policy

1. Procurement of Imported Goods

2. When imported goods are purchased from a local supplier, the indirect foreign exchange cost is the landed cost in the developing member country. In some cases, this cost is identifiable. In cases when the landed cost is unclear, the indirect foreign exchange cost is assessed as a percentage of the contract price agreed upon by the borrower and ADB, based on identifiable landed costs of similar items.

2. Procurement of Locally Manufactured Goods

3. When locally manufactured goods are procured through international competitive bidding or international shopping procedures in accordance with ADB's *Procurement Guidelines* (2006, as amended from time to time), ADB finances the ex-factory price. This price includes both direct and indirect foreign exchange costs, as well as any local currency costs that ADB has agreed to finance under local cost-financing and cost-sharing arrangements effective before 15 March 2006, but excluding sales, business, and other taxes.

4. When locally manufactured goods are procured through local competitive bidding procedures that have been approved by ADB, ADB finances the estimated direct and indirect foreign exchange cost component. This component of the cost is expressed as a percentage of the total price of the goods for the purpose of disbursements from the loan account.

3. Procurement of Works¹

5. Works contracts carried out by both foreign and local contractors usually include (i) the direct foreign exchange cost of the imported services, materials, and equipment from outside of the developing member country; (ii) local currency costs of materials and equipment that have a significant import content; and (iii) local currency costs of items without an import content. Direct and indirect foreign exchange costs associated with items (i) and (ii) are eligible for ADB

¹ The term "works" includes all types of works—civil, mechanical, electrical, or others—as well as the supply of construction materials and equipment, and the provision of related services (other than consulting services) as part of the contract for such works.

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financing. The depreciation of the imported equipment used on a project, included in item (ii), is considered an indirect foreign exchange cost eligible for ADB financing.

6. A contract for works that is awarded through international competitive bidding or international shopping procedures in accordance with ADB's *Procurement Guidelines* is financed by ADB to the extent indicated in para. 3 regardless of whether the contractor is classified as local or foreign.

7. When a works contract is awarded under local competitive bidding procedures that have been approved by ADB, ADB finances the estimated direct and indirect foreign exchange cost of the contract as well as local cost that ADB has agreed to finance under local cost financing and cost-sharing arrangements effective before 15 March 2006.

Basis: This OM section is based on OM Section H2/BP and the documents cited therein.

Compliance: This OM section is subject to compliance review.

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