

**ESTABLISHMENT OF A NEW FACILITY  
IN THE EXISTING  
JAPAN SPECIAL FUND  
TO ASSIST  
CURRENCY CRISIS-AFFECTED MEMBER COUNTRIES**

**Strategy and Policy Office  
March 1999**

**ABBREVIATIONS**

ADF	–	Asian Development Fund
CAMC	–	Crisis Affected Member Country
DMC	–	Developing Member Country
JSF	–	Japan Special Fund
OCR	–	Ordinary Capital Resource
TA	–	Technical Assistance

## CONTENTS

		<b>Page</b>
I.	INTRODUCTION	1
II.	PROPOSED ASIAN CURRENCY CRISIS SUPPORT FACILITY	1
	A. Objectives	1
	B. Proposed Modalities	1
	C. Financial Resources	3
	D. Treatment of Residual Funds	4
	E. Administration and Consultation	4
III.	THE EXISTING JAPAN SPECIAL FUND	4
	A. Objectives	4
	B. Modalities	5
	C. Financial Resources	5
	D. Processing and Administration	5
	E. Accounting, Investment, and Audit	5
	F. Consultation	6
IV.	ARRANGEMENTS TO INCORPORATE THE NEW FACILITY IN THE JSF	6
V.	RECOMMENDATION	6
	APPENDIX	7

## I. INTRODUCTION

1. The Government of Japan has launched a plan to assist affected countries of Asia in the alleviation of and recovery from the financial crisis that was precipitated by the currency turmoil in mid-1997; this plan is commonly referred to as the New Miyazawa Initiative. As part of that overall plan, the Government of Japan is proposing the establishment of a Special Fund, described as an Asian currency crisis support facility (the Facility) to be administered by the Asian Development Bank. This will complement the Bank's assistance to crisis affected member countries (CAMCs) by helping to mobilize cofinancing/private financial resources for projects and programs in the CAMCs.

2. To date, financial cooperation between the Government of Japan and the Bank has been arranged and managed through the Japan Special Fund (JSF), a special fund established by the Board in 1988 designed to channel financial resources contributed by the Government of Japan toward the accelerated economic development of the Bank's developing member countries (DMCs). Since the general framework and administrative procedures of the JSF could be interpreted to substantively include the more specific purposes of the newly proposed Facility, it is proposed that the Facility be covered by the existing arrangements and arrangements set forth in this paper and in the attached letter from the Government of Japan to the President of the Bank (Appendix) as a special-purpose component of the JSF.

3. This paper describes in further detail the Facility as proposed by the Government of Japan; outlines the agreed framework, objectives, scope, modalities, and management procedures of the existing JSF; and makes recommendations on the arrangements necessary to enable the JSF to include the Facility as a special-purpose component.

## II. PROPOSED ASIAN CURRENCY CRISIS SUPPORT FACILITY

4. For the purposes of this paper, the key aspects of the Facility being proposed are its objectives, scope, and time frame; assistance modalities; financial resources; and management and administration requirements.

### A. Objectives

5. The Facility will assist in the economic recovery of the CAMCs by (i) helping to mobilize private financial resources; and (ii) adding to and enhancing the financial support extended by the Bank. Presently, the beneficiary countries will include, but not be limited to, Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand.

### B. Proposed Modalities

6. The following modalities are proposed to implement the objectives of the Facility: (i) interest payment assistance and technical assistance (TA) grants, and (ii) guarantees.

## **1. Interest Payment Assistance and Technical Assistance Grants**

7. Following the currency crisis in the region, many of the CAMCs are faced with severe adverse social impacts. A vast segment of the population is experiencing considerable loss of purchasing power and is consequently not able to maintain the basic intake of food (a condition leading to malnutrition and disease), afford proper medication, or pay the costs of keeping children in school. Considerable expenditures are required to alleviate these impacts through social maintenance programs. Such maintenance expenditures, unlike revenue-earning capital expenditures, are not likely to produce immediate returns to service the cost. Expenditures on environmental protection and improvement are faced with the same problem. In addition, there is a general worsening of the debt service capacity of the CAMCs. They are faced with greatly diminished access to international capital markets, and a higher cost of accessing foreign funds. To alleviate these adverse financial conditions and effectively reduce the interest cost for funding, in principle for social and environment purposes, the proposed Facility will assist with loan-related and bond-related interest payments on a grant basis, provided the borrower fulfills principal and interest repayments in compliance with the respective contractual agreements.

8. Specifically, grants from the Facility will be applied to part of the related interest payments for Bank ordinary capital resource (OCR) loans that (i) are, in principle, for social and environment purposes, and (ii) are approved during the three-year period after establishing this Facility or during extended periods as the Government of Japan and the Bank may agree if the CAMCs are not fully out of the crisis. While the period of interest payment assistance from the Facility will be determined on a loan-by-loan basis, it will normally not extend beyond 31 December 2002 unless otherwise agreed by the Government of Japan and the Bank. Any such proposal(s) for extension will be presented to the Board for approval. The amount of interest payment assistance will also be determined on a loan-by-loan basis with the provision that the effective interest cost for Bank OCR loans will not be allowed to fall below the Bank's Asian Development Fund (ADF) interest charge.

9. For official cofinancing of Bank-assisted projects that are, in principle, for social and environment purposes, the interest payment assistance should not make the effective interest cost lower than the interest rate charged by the relevant bilateral agencies for concessional loans. Interest payment assistance grants are proposed on commercial cofinancing for Bank-assisted projects in all sectors; the lowered effective interest cost to the CAMCs should not be lower than the market rates of the one-year period preceding 1 July 1997. For sovereign bond issues of the CAMCs and bond issues by public sector entities in the CAMCs made in support of the objectives of Bank assistance under the Facility, the interest payment assistance should not lower the coupon rates to a level less than the coupon rates for sovereign bonds in the country concerned, which are representative of the one-year period preceding 1 July 1997. This will serve to assist the CAMCs in facing the abnormally high cost of commercial funding following the crisis, and to mobilize official and private funds.

10. The grant TA modality for the CAMCs under the proposed Facility will be targeted at activities to support policy dialogue, human resource development, institutional strengthening, and other relevant efforts focusing on bank restructuring and corporate debt restructuring; creation or development of sound financial monitoring, supervision, and regulation; enhancement of public sector and corporate governance;

development of social safety nets; and protection of the environment. Such grants will be approved during the three-year period after establishing this Facility or during extended periods as the Government of Japan and the Bank may agree if the CAMCs are not fully out of the crisis, and will cover preventive as well as corrective crisis-related measures. Any such proposal for extension will be presented to the Board for approval. The TA grants under the Facility will be generally governed by the rules and procedures applied to TA grants under the existing JSF. Also, TA grants under the Facility will be on an untied basis and the selection and engagement of consultants will be done in accordance with the Bank's *Guidelines on the Use of Consultants*.

## **2. Guarantees**

11. It is proposed that the Facility also be used to provide guarantees, with appropriate fees, to support the raising of resources in conjunction with Bank loans for projects and programs in the CAMCs. These resources will include government loans, bonds, and commercial loans with government counterguarantees, and be denominated in either Japanese yen or other major currencies. Priority will be given to projects and programs aimed at the implementation of structural adjustments in the financial and key real sectors, establishment of social safety nets, and other measures to address social impacts of the crisis. The face value of outstanding guarantees will not exceed the value of the Government of Japan contribution (as stipulated in para. 13). Exchange rate risks involved in guaranteeing non-Japanese yen-denominated instruments will be taken into account through appropriate adjustment of the ceiling on the total amount of outstanding guarantees.

12. Such guarantees as part of the Facility will be part of the Bank's Special Funds operations and not a part of its ordinary operations (as are its existing guarantee operations). Such Special Funds guarantees will be limited in recourse to the assets of the portion of the JSF contributed to the Funds for such purposes by the Government of Japan. Such guarantees, not being a part of the Bank's ordinary operations, will not reduce the Bank's lending and guarantee headroom for its ordinary operations under Article 12 of the Agreement Establishing the Asian Development Bank. Such Special Fund guarantees would be approved by the Bank during the three-year period after establishing this Facility or during extended periods as the Government of Japan and the Bank may agree if the CAMCs are not fully out of the crisis. Any such proposal for extension will be presented to the Board for approval. The terms and conditions of such Special Funds guarantees will be approved on a case-by-case basis as part of the Board approval of each guarantee transaction under the Facility and of the related Bank loan or investment to which such a guarantee relates. Subject to the above conditions, such Special Funds guarantees will be implemented generally in accordance with the Bank's Guarantee Policy. Guarantee proposals under the Facility will be presented for Board consideration after completion of the ongoing review of the Bank's guarantee operations which will take into account all pertinent aspects relating to guarantees under the Facility, including the preferred creditor status of such guarantees and impact, if any, on the Bank's credit rating.

## **C. Financial Resources**

13. The Government of Japan will contribute ¥7.5 billion in cash for interest payments and TA grants. To support the guarantees, the Government of Japan will contribute ¥360 billion in noninterest-bearing, nonnegotiable Government of Japan

notes, encashable by the Bank at any time to meet a call on any of the Bank's Special Funds guarantees. Any additional future contributions by the Government of Japan for the same purposes will be included as part of the Facility arrangements.

#### **D. Treatment of Residual Funds**

14. If and when the purpose of the Facility is considered to have been fulfilled, the remaining nonencashed balance of the Government of Japan notes will be canceled by the Government of Japan, and the use of the residual funds available in cash at the time of liquidation of the Facility will be decided by consultation between the Government of Japan and the Bank.

#### **E. Administration and Consultation**

15. The Facility will be treated as a new component of the existing JSF. Accordingly, the processing of eligible applications of the Facility will be done in consultation with the Government of Japan and generally in line with procedures outlined in this paper and Bank procedures. The reimbursement of Facility-related administrative costs to the Bank, as well the use of surplus funds, will be treated in the same manner as with the JSF. These and other arrangements for administering the Facility are set forth in this paper and in the attached letter from the Government of Japan to the President of the Bank (see Appendix).

### **III. THE EXISTING JAPAN SPECIAL FUND**

16. On 10 March 1988, the Board approved the acceptance and administration by the Bank of the JSF. The JSF is an untied grant to the Bank and facilitates the economic restructuring of the DMCs with resources additional to OCR, ADF, and technical assistance special fund resources. The JSF is not a substitute for, but a complement to, the ADF and the technical assistance special fund. Article 19, para. 1(ii), of the Bank's Articles of Agreement provides that the Bank may "accept the administration of Special Funds which are designed to serve the purpose and come within the functions of the Bank." Article 19, para. 3, of the Articles authorizes the Bank to use such Special Funds "in any manner and on terms and conditions not inconsistent with the purpose of the Bank and with the agreement relating to such Funds." The framework for the JSF covers a fairly general area of applicability in terms of objectives and scope, administration and management, and guidelines and procedures.

#### **A. Objectives**

17. The objective of the JSF is to help the DMCs restructure their economies in light of the changing global environment and broaden the scope of opportunities for new investment, thereby assisting in the recycling of funds to the DMCs. Within this general objective, the JSF supports the efforts of the DMCs toward industrialization, natural resource development, human resource development, and technology transfer.

18. Initially funded for the Government of Japan's fiscal years 1987-1990, subsequent funding has enabled the JSF to continue operations to this date.

**B. Modalities**

19. The JSF can be used to finance or cofinance the following:
- (i) on a grant basis, TA projects in the public or private sectors, including project preparatory TA, advisory TA, and regional TA;
  - (ii) private sector development projects through equity investments; and
  - (iii) in special cases and on a grant basis, TA components of public sector development projects financed by loans from the Bank.
20. The JSF is used and administered by the Bank generally in accordance with its normal policies for financing projects and programs supported by the Bank.

**C. Financial Resources**

21. Established with an initial grant of ¥2.5 billion from the Government of Japan in its fiscal year 1987, regular contributions from the Government of Japan have since amounted to the equivalent of \$696.4 million through 1998.

**D. Processing and Administration**

22. As the bank identifies specific projects for financing under the JSF, it provides to the Government of Japan for approval, at agreed intervals, a list of such projects, their outlines, the amounts of proposed assistance, and the items of expenditure to be financed. The Bank is responsible for appraisal and negotiations, and concludes the agreements with recipients. Each financing proposal is subject to the Bank's processing procedures as applied to the JSF. Furthermore, JSF-financed projects that do not fall within the President's delegated authority to approve and need to go to the Board for approval, are submitted to the Board on a no-objection basis.

23. The Bank is solely responsible for administration and evaluation of JSF-financed projects in accordance with its normal practices, procedures, and standards. JSF funds are used to finance foreign exchange or local expenditures for goods, services, and consultants from member countries following the applicable guidelines and procedures of the Bank. The Bank makes available to the Government of Japan at six-month intervals a summary of progress on all projects financed through the JSF.

**E. Accounting, Investment, and Audit**

24. The Bank maintains separate records and accounts for the JSF; these are audited annually by the Bank's external auditors. The proceeds of the JSF are transferred to an account in the name of the Bank at the Bank of Japan in advance, in the agreed installments. The bank is entitled to invest the proceeds of the JSF pending disbursement, and may use income from any such investment to defray the direct and identifiable costs it incurs in the investment and administration of the JSF.

**F. Consultation**

25. At the request of each party, the Government of Japan and the Bank from time to time consult with each other on matters arising out of the cooperation arrangement. The Bank promptly informs the Government of Japan of any major development affecting the operations financed through the JSF.

**IV. ARRANGEMENTS TO INCORPORATE THE NEW FACILITY IN THE JSF**

26. The objectives; scope; time frame; financial resources; and proposed processing, administration, and management procedures of the proposed Facility can be covered within the general framework of the JSF as it now stands. TA grants (para. 10) fall within the modalities of the existing JSF. For provision of interest payment assistance and provision of guarantees (paras. 8-9 and 11-12, respectively), new administrative arrangements (para. 27) are proposed to be added to the existing JSF arrangements.

27. The administrative arrangements for the Facility broadly envisage the screening, selection, consultation, and reporting process with the Government of Japan for existing JSF operations (paras. 22-23) to also apply to the provision of TA grants, interest payment assistance, and guarantees under the Facility. The approval process for TA grants will generally follow that applied to TA grants under the existing JSF, i.e., approval by management for grants up to \$1 million (with the President's approval to be reported to the Board) and approval by the Board on a no objection basis for grants above \$1 million. For interest payment assistance, Board approval will normally be obtained at the time and as part of the approval of the relevant Bank loan. If this is not possible, separate Board approval will be obtained on a no objection basis. For guarantees, the approval process will be the same as that applicable to OCR guarantees with the approval authority vested in the Board. The costs of administering the Facility will be financed through income from investments made under the existing JSF, income from investments made under the Facility, and guarantee fees to be earned on guarantees provided under the Facility.

**V. RECOMMENDATION**

28. It is recommended that the Board approve (i) the acceptance by the Bank of the proposed Facility, to be called the Asian Currency Crisis Support Facility, as a new and separate component of the existing JSF with separate accounts, and (ii) the administration of the Facility in accordance with the provisions set forth in this paper and in the letter from the Government of Japan to the President of the Bank appended hereto.

\_\_\_\_\_ March 1999

Mr. Tadao Chino  
President  
Asian Development Bank

Dear Mr. President,

The Government of Japan (hereinafter referred to as the "Government") and the Asian Development Bank (hereinafter referred to as the "Bank") made certain arrangements by a letter dated 10 March 1988 for administration by the Bank of the Japan Special Fund (JSF), the objective of which is to help developing member countries of the Bank (DMCs) restructure their economies in the light of the changing global environment and broaden the scope of opportunities for new investment, thereby assisting the recycling of funds to such DMCs, and which is to be utilized (a) to finance or co-finance, on a grant basis, technical assistance projects in the public or private sector for the formulation and preparation of development projects and programs, advisory services and regional activities; (b) to finance or co-finance private sector development projects or programs through equity investments to private entities; and (c) to finance or co-finance, in special cases and on a grant basis, technical assistance components of public sector development projects or programs financed under loans from the Bank.

In this connection, I have the honour to inform you that the Government has recently launched a plan to assist affected countries in Asia in alleviation of and recovery from the financial crisis that was precipitated by the currency turmoil in mid 1997; this plan is commonly referred to as the New Miyazawa Initiative. As part of that overall plan, the Government wishes to add a separate special-purpose component to the JSF, to complement the Bank's assistance to crisis affected member countries (CAMCs) by helping in mobilizing cofinancing/private financial resources for projects and programs in the CAMCs. For this purpose, the Government tends to make available to the Bank funds in an aggregate amount of three hundred sixty seven billion and five hundred million Yen (¥367,500,000,000.-); seven billion five hundred million Yen (¥7,500,000,000) in cash and three hundred sixty billion Yen (¥360,000,000,000) in noninterest-bearing, nonnegotiable Government notes encashable on demand. Additional amounts may be made available to the Bank for the same purpose in the future, subject to the budgetary approvals by the Diet of Japan. Concerning the provision of the funds, I have the honor to propose the following arrangements:

1. The separate special-purpose component to be included under the JSF that will provide support for the crisis shall be referred to as the "Asian Currency Crisis Support Facility" ("ACCSF").

2. The objective of the ACCSF shall be to assist the economic recovery of the CAMCs, through: (i) helping to mobilize private financial resources for these countries; and (ii) adding to and enhancing the financial support extended by the Bank to these countries. (Presently, the beneficiary countries shall include but not be limited to Indonesia, Korea, Malaysia, the Philippines, and Thailand).

3. The Bank shall administer the ACCSF in accordance with the arrangements included in the 10 March 1988 letter (JSF Letter) and this letter. However, the funds provided under this letter for ACCSF shall be segregated from the rest of the funds provided under the JSF Letter (original JSF funds) and shall be used, committed, invested and accounted for entirely separately from the original JSF funds, except that administration cost of the ACCSF as part of the overall JSF shall be borne by the income from investment of the original JSF funds as well as income from investments under the ACCSF and guarantee fees to be earned on guarantees provided under the ACCSF. Furthermore, even within the ACCSF, separate sub-accounts shall be maintained for (i) the interest payment assistance and technical assistance grants; and (ii) guarantees, provided respectively, under the ACCSF.

4. A portion of the ACCSF, in the amount of seven billion five hundred million yen (¥7,500,000,000.-), shall be used to assist CAMCs by financing, on a grant basis:

- (a) part of interest payment in respect of loans and bonds as noted below for which principal and interest payment obligations are discharged in accordance with their contractual agreements:
  - (i) the Bank's OCR loans to CAMCs that are, in principle, for social and environment purposes in order to lower the effective interest cost to a level not lower than that of the Bank's ADF interest charge;
  - (ii) loans from official bilateral agencies for the Bank's co-financed projects that are, in principle, for social and environment purposes in order to lower the effective interest cost to a level not lower than the rates charged by the relevant bilateral agencies for concessional loans;
  - (iii) loans from commercial banks and other institutions for the Bank's co-financed projects in all sectors in order to lower the effective interest cost to a level not lower than the market rates representative of the one-year period preceding 1 July 1997;
  - (iv) sovereign bonds of CAMCs and bonds by public sector entities in CAMCs issued in support of the objectives of the Bank's assistance under the ACCSF in order to lower their coupon rates to a level not lower than the coupon rates for sovereign bonds representative of the one-year period preceding 1 July 1997.
- (b) technical assistance activities in the CAMCs that support the alleviation of, and recovery from, the Asian currency crisis in such areas as policy dialogue, human resource development, institutional strengthening, and other assistance focusing on bank restructuring and corporate debt

restructuring; creation or development of sound financial monitoring, supervision, and regulation; enhancement of public sector and corporate governance; development of social safety nets; and protection of the environment.

5. A portion of the ACCSF in the amount of three hundred sixty billion yen (¥360,000,000,000.-) shall be used to finance provision of guarantees, with appropriate fees, for raising of resources, which shall include government loans, bonds and private loans with government counter-guarantees denominated in either Japanese yen or other major currencies, to finance projects and programs in the CAMCs.

6. Interest payment assistance, technical assistance and guarantees under the ACCSF shall be approved within an initial three-year period after establishment of the ACCSF or such other period as the Government and the Bank may agree. While the period of interest payment assistance from the Facility shall be determined on a loan-by-loan basis, such period shall normally not extend beyond 31 December 2002 unless otherwise agreed between the Government and the Bank. The quantum of interest payment assistance shall also be determined on a case-by-case basis with the provision that the effective interest cost shall not be allowed to fall below the levels specified in paragraph 4, (a), (i) to (iv) of this letter.

7. The use of any residual funds including investment income of such funds available in cash under the ACCSF, if and when the purpose of the ACCSF is considered to have been fulfilled, shall be decided by consultation between the Government and the Bank and the remaining uncashed balance of the Government notes shall be canceled by the Government.

8. The proposed arrangements shall constitute a supplementary arrangement to the arrangements contained in the JSF Letter and shall enter into force on the date of your confirmation.

Sincerely yours,

---

Naoyuki Shinohara  
Director for Japan