EP

United Nations
Environment
Programme

Distr.
GENERAL

UNEP/OzL.Pro/ExCom/13/3
1 July 1994

ORIGINAL: ENGLISH

Executive Committee of
the Multilateral Fund for the
Implementation of the Montreal Protocol

Thirteenth Meeting
Montreal, 25-27 July 1994

OVERVIEW OF ISSUES IDENTIFIED DURING PROJECT REVIEW

1. As recommended in the Executive Committee's decision on streamlining the project review process, this document addresses, in a brief format, some of the major issues that may be addressed during the Thirteenth Meeting.

2. In the process of reviewing the documentation submitted to this meeting, the Secretariat identified several issues which, in its view, might not only have an impact on the Committee's decision on the several projects being considered for this meeting, but might also have policy implications beyond the current meeting of the Committee. To facilitate the work of the Committee and put the issues in the right context where they arise, the issues are presented as conveniently as possible in the order of the Agenda items. Since most of the issues are project related, especially Agenda items 6 (b) and 8, it is believed that as in the 12th Meeting of the Executive Committee, this paper will also be used by the Sub-Committee on Project Review.

Agenda item 4 (a) Contributions and Fund disbursements

Shortfall in funds for requested amount of funding

3. The resources of the Fund, as at 31 May 1994, stood at US $42.7 million, including US $14 million in promissory notes. The Committee has, before its present session, requests for approval of approximately US $62.7 million, which represents the total of project proposals and amended work programmes. If all requests for funds are approved, a shortfall in cash holdings amounting to approximately US $20 million would arise.

FUNDS REQUESTED BY IMPLEMENTING AGENCIES
AT THE THIRTEENTH MEETING

	UNDP US $	UNEP US $	UNIDO US $	World Bank US $	Total US $	%
Work programme activities	768,900	918,015	15,000	629,500	2,331,415	3.7
Projects costing below US $500,000	5,596,500			2,270,562	7,867,062	12.5
Project proposals						
Aerosols				1,744,000	1,744,000	2.8
Foams	3,702,000		1,182,701	1,311,000	6,195,701	9.9
Halons		685,000		2,500,182	3,185,182	5.1
Refrigeration	9,712,964		12,877,081	12,524,315	35,114,090	56.0
Solvent			799,154	790,000	1,589,154	2.5
Sub-Total	19,780,364	1,603,015	14,873,936	21,769,559	58,026,933	92.5
Agency support costs	2,571,447	208,392	1,933,611		4,713,450	7.5
TOTAL	22,351,811	1,811,407	16,807,547	21,769,559	62,740,324	100

4. The promissory notes should be encashed in its entirety on demand.

5. The Secretariat is however recommending approval of US $47.75 million. Additional funds requested for projects with remaining unresolved issues might be approved during the meeting.

6. It thus transpires that a shortfall of a maximum of US $20 million and minimum of US $5.05 million might arise.

7. Thus, the Committee would be restrained in its approval process by the terms of reference under which it cannot approve amounts in excess of its cash holdings (UNEP/OzL.Pro/2/3, Annex IV, Chapter D, paragraph 19).

8. Given the certainty of a shortfall in resources, the Executive Committee may wish to approve funding on projects that meet the Committee's guidelines for setting priorities as adopted at the Third Meeting of the Executive Committee. These priorities are:

(a) Projects with potential for the most cost-effective and efficient reduction in the emission of controlled substances.

(b) Projects involving broad geographic balance.

(c) Projects with ease of replication and technology transfer to other Parties operating under Article 5, paragraph 1.

(d) Projects with the highest potential reduction of controlled substances in the shortest period of time in terms of global impact.

Agenda item 6 (a) **Implementing agency progress reports**

General Issues

Late submissions of reports and responses to Secretariat queries

9. Implementing agencies are increasingly submitting progress report updates after the documentation deadline and not providing responses expeditiously or as requested, to clarifications sought by the Secretariat. With an increasing number of projects to monitor after each Committee Meeting, implementing agencies should provide completed progress reports no later than the deadline for documentation.

Information on activities of ozone protection units

10. Little information is provided about the activities of the ozone protection units created with institutional strengthening resources from the Fund. Information on their activities should be provided in each progress report.

Separating previously reported progress from progress during reporting period

11. In order to facilitate the review of projects during the reporting period, progress report summary tables should include a section for activities reported as completed previously.

Coordination in developing a reporting format for project supervision

12. Project supervision and project execution are currently underway and UNDP, UNIDO, and the World Bank have indicated that they are preparing computerized project supervision management systems. Since the Committee will want to be informed about project execution and project supervision activities, the computerized systems under development should be coordinated in order to provide comparable supervision reporting from all agencies.

Low level of disbursement by implementing agencies

13. Disbursements are still at a low level, although UNDP's progress has been improving recently. According to the World Bank's progress report, its budget for projects committed representing signed grant agreements is 43.6 per cent of the total project related budget but in fact the actual project related disbursement is only 6.2 per cent of the total budget.

14. The implementing agencies should make an earnest effort to accelerate implementation and disbursement.

Status of Disbursement as at 31 May 1994

(Unit = US $)

Agency	Funds Allocated	Project Related Budget	Project Related Disbursement
UNDP	43,802,316	38,299,277	12,562,023 (32.8%)
UNEP	11,512,687	10,182,366	3,509,820[1] (34.5%)
UNIDO	7,040,867	6,300,00	1,000,000 (16.85)
World Bank	90,096,124	81,191,000	5,060,000[2] (6.2%)

[1] As of end of 1993
[2] Projects committed representing amounts in Grant Agreements signed: US $35,430,000

UNDP Progress Report

Policy towards balance of funds from completed projects

15. UNDP has reported several activities that have been completed with a budget surplus. The balance from completed projects financed by the Fund should return to the general pool of

the Fund for further programming. Requests for using the balance from completed projects should follow the same procedure for work programme amendments.

World Bank Progress Report

Internal approvals under the Mexico Line of Grant

16. The Executive Committee approved a Line of Grant for the World Bank at its Fifth Meeting with the provision that project documents for the projects internally approved by the Bank should be subsequently presented to the Executive Committee. Although the World Bank has internally approved US $1.4 million of the US $4 million Line of Grant in Mexico, documentation of the projects has not been received. This also makes it difficult to coordinate the World Bank activities with activities being undertaken in Mexico on bilateral basis.

Umbrella, grant, and letter agreements for review and the archives

17. The World Bank's progress report presents information about umbrella, grant, and letter agreements which are legal commitments made on behalf of the Multilateral Fund by the World Bank. Currently, signatures of grant agreements occur 15 months after Executive Committee approval. Project "effectiveness" dates do not necessarily correspond to the signature dates of these agreements because all conditions in the agreements must be met before funds can begin disbursing. As part of its monitoring function, the Executive Committee should require that all umbrella, grant, and letter agreements that are classified as effective should be submitted to the Executive Committee as part of the progress report.

Agenda item 6 (b) Work programme amendments

UNDP work programme amendments

Relation between "ODS-free Cleaning Equipment Manufacturing Centre" and each solvent cleaning investment project in China (Tianjin Picture Tube project and Baoshi Electronics project)

18. China submitted two solvent cleaning projects for the consideration of the Executive Committee at the 13th Meeting. However, at its 12th Meeting, the Executive Committee decided "further project proposals requesting cleaning equipment in the solvent sector in China would be considered within the context of the project (ODS-free Cleaning Equipment Manufacturing Centre)".

19. Therefore, the proposals should not be approved as submitted, but the decision should not always mean that all solvent cleaning investment projects cannot be approved.

20. A guideline is required to explain which conditions are to be met in order to approve a project.

World Bank work programme amendments

Use of Fund resources for conversion of companies engaged in exports to non-Article 5 countries (Embraco Refrigerator Project, Brazil)

21. The Embraco project in Brazil targets 30 per cent of its production to developed countries. The manufacturer of HFC-134a compressors does not phase-out ozone depleting substances directly. It happens only when non-CFC compressors are installed in the refrigerator at the refrigerator manufacturing facility and the refrigerator system is filled with non-CFC refrigerant. When HFC-134a compressors produced in Article 5 countries are exported to non-Article 5 countries, it does not affect ODS phase out in Article 5 countries. The Executive Committee may wish to consider whether incremental costs apportioned for export to developed countries are eligible for funding.

Agenda item 7 Country programmes

Base year consumption date of controlled substances.

22. In view of the concern expressed by the Parties on difficulties experienced by Article 5 Parties in reporting data and the need to use the process of country programme preparation to collect the initial data for reporting, implementing agencies should be requested to expand the scope of data collection during the country programme preparation to cover the base years for respective ODS.

Data reporting

23. Implementing agencies should advise Article 5 countries to report their data to the Ozone Secretariat as required following completion of the country programmes.

Projects in country programmes

24. Projects that are developed as part of the process of country programme preparation and included in the country programmes for approval by the Executive Committee should first be discussed with the designated implementing agency and where necessary a technical review obtained from the agency and attached to the project before submission. This will obviate the problem of the agency subjecting such approved projects to further review and/or revision of costs before implementation, thus adding to delays.

Halon recycling and banking

25. The request for banking of small stocks of halon from low consuming countries and requests for recycling machines for small quantities of fire protection equipment for essential uses are issues that would need to be resolved as countries with airline fleets, small or large, begin to consider recycling as the solution to halon requirements for essential uses.

Retrofitting of Refrigeration Equipment

26. Several low-consuming countries, intending to phase-out ODS as early as possible have made retrofitting or replacement of domestic and other refrigeration equipment a key element for a faster phase-out. The cost for even very low consumers with ODS consumption of 15-50 tonnes ODP run into several million dollars for retrofitting and premature replacement of refrigerator equipment. Implementing agencies should encourage or advise the countries they assist of other possibly more viable alternatives, such as extended use of CFC for servicing of refrigerators and freezers during the phase-out period. For some countries abrupt curtailment of use of existing domestic refrigerators may not be technically feasible or economically viable, even without taking account of the costs and technical implications of concomitant ODS destruction activities.

Policy towards funding projects to maintain strategic stocks of ODS

27. An increasing number of country programmes are including requests for funding to maintain strategic stocks of ozone depleting substances before these substances are phased out. Implementing agencies should discourage this inclusion in country programmes as an ineligible activity under the Fund.

Agenda item 8 Project proposals

General Issues

Lack of use of the approved format for technical reviews

28. At its last meeting, the Executive Committee decided that implementing agencies should use the standard format for technical reviews attached to the meeting report. The technical review format has not been used and the World Bank has indicated that the format will not be implemented until a training workshop is held in October 1994.

Lack of implementation of decisions on contingency costs

29. At its last meeting, the Executive Committee decided that contingency charges should not be applied against known costs for project components and contingency costs should be

minimized. None of the work programme amendments or project proposals have included lower contingency costs than normal, nor have any provisions been made for excluding contingencies on known costs.

Fee for financial intermediaries in countries with several Fund projects (World Bank)

30. A standard fee for financial intermediaries is three per cent of the cost of the project. In cases where there are only a few projects requiring a financial intermediary in a country, this fee may be appropriate due to start-up expenses, training, etc. However, in countries where several projects require a financial intermediary, a standard fee may result in large accumulated profits due to the economies of scale. Implementing agencies should be discouraged from using a standard percentage of project cost in these cases in favour of accounting for the volume of business handled by the financial intermediary.

Incremental Operating Costs

- Two projects in commercial refrigeration, Malaysia (submitted under UNEP Work Programme Amendments)
- Eight domestic refrigeration projects for Cameroon, Egypt, Jordan and Syria (submitted by UNIDO)
- Three commercial refrigeration projects for Malaysia, Philippines and Thailand (submitted by UNDP)

Compensation of actual versus estimated incremental operating costs:

31. The issue of compensation of actual versus estimated incremental operating costs exists when dealing with positive incremental operating costs (not savings). Incremental operating costs are calculated on the basis of current prices and included in the total requested allocations. Incremental operating costs will be incurred at the time when the project is commissioned completely and the plant is fully operational. The duration of project implementation depends on the complexity of work to be done and may vary from six months to four years, as the case may be. In most sectors, the factors determining incremental operating costs have a downward trend. If the allocations for incremental operating costs are disbursed to implementing agencies just after the approval of the project, they will be held by the implementing agency until the time when the costs are incurred. The actual incremental operating cost might be lower due to market prices prevailing at the time when actual costs are incurred. The Executive Committee may wish to consider approval of the incremental operating costs in principle pending the reassessment of these costs by the implementing agency and reporting back to the Executive Committee. The implementing agency overhead costs should be adjusted accordingly. This approach is not applicable to incremental operating savings, since they are deducted from the project costs when calculating the MLF grant amount.

Operational cost duration in the domestic and commercial refrigeration sector

32. Several projects with different operational cost durations have been submitted to the Executive Committee in the domestic refrigeration sector. Eight projects with six months and one project for four companies with two years of operational cost duration are submitted for consideration by the Executive Committee at its Thirteenth Meeting. The Secretariat prepared a discussion paper on this subject in accordance with the request of the Executive Committee (UNEP/OzL.Pro/ExCom/13/40). The paper is submitted under Agenda item 10.

33. Five projects on commercial refrigeration conversion with two years operational costs have been submitted. Incremental operating costs for conversion projects in the commercial refrigeration sector have a similar nature and can be considered just as domestic refrigerators conversion projects.

34. The Executive Committee may wish to take into consideration issues raised in the Fund Secretariat's discussion paper when making the decision on the incremental operational cost duration for projects in the domestic and commercial refrigeration sectors.

Small ODS-consuming companies' projects (Uruguay Flexible PU project, Malaysia Allied PU Foam project under UNDP Work Programme Amendments and Uruguay Rigid PU project)

35. Small ODS-consuming companies (foam, halon extinguisher, commercial refrigerator) are requesting almost the same capital equipment as large ODS consumers. Guidelines are needed to deal with these types of projects.

36. If savings are projected, small consumers would receive almost all capital costs of the project due to the tiny amount of ODS used; however, large consumers will not receive adequate financing to convert their plants. (Reference: "Projects that Might Realize Net Incremental Savings", UNEP/OzL.Pro/ExCom/13/42).

Lost profits as operational costs (China Benxi project under World Bank Work Programme Amendments and China Zhuzhou project and India Real Value Project)

37. Benxi, Zhuzhou and Real Value are three producers of halon extinguishers who are submitting projects to convert their filling lines to use the cheaper ABC dry powder as a fire extinguishant. The conversion will result in substantial operating savings. In order to eliminate the negative impact of the savings on the capital costs, the World Bank calculated the incremental operating costs as the lost profit for four years.

38. Incremental operational cost is intended to make up the difference between the operational costs under the business-as-usual situation and that under the converted production mode. In this calculation, the issue of profit does not enter the discussion, because the calculation of incremental operating cost implies that this is not a complete incremental

cost/benefit analysis. Otherwise the incremental benefit should also be examined by looking at the future sales:

- therefore using the lost profit as agreed operational cost has gone beyond the basic concept of the Multilateral Fund; i.e., the consensus on financing agreed incremental cost of conversion from CFC to non-CFC technologies.

- on a practical level, it may also give rise to difficulties in project the sale price and sale volume of the new products which are the basic components in estimating the profits.

<u>Funding conversion projects for fire extinguisher manufacturers (China Benxi project under World Bank Work Programme Amendments and China Zhuzhou project and India Real Value Project)</u>

39. Fire extinguisher manufacturing projects have already been approved by the Executive Committee in large-consuming Article 5 countries. Projects already funded should serve demonstration purposes. Since the costs of halon alternatives is substantially lower than halon, projects of this nature would result in net incremental savings which might reduce the amount of grant eligible for funding to a level insufficient to effect conversion. To preclude costly project preparation efforts for these types of projects, implementing agencies may require policy guidance from the Committee on this issue.

Agenda item 8 (c) Project proposals (China)

<u>Calculation of incremental costs for plant closure (Tongxiang project)</u>

40. Since this is the first plant closure project without replacement in the production sector being submitted to the Executive Committee, in that sense it is a precedent setting case. Therefore, it might be prudent to consider:

(a) Such closures should be encouraged.

(b) Such closures should be verified to ensure the actual elimination of promised production capacity. This is especially true in the sense that a new producer may step in to fill in the eliminated capacity. Government intervention may be essential.

(c) While such cost items as demolition and dismantling, foregone profits and lost employment are eligible for incremental financing, close examination should be given to the authenticity of such details as:

- sale price used for calculation of sales
- salary and benefits scales
- size of workforce.

(d) Benchmarks could be sought from developed countries for similar closures which are taking place.

(e) In considering the incrementality of costs of such closures, should it also be considered in the wider context of the country, especially in the context of setting up new replacement capacities to produce substitutes such as, for instance, the new production of 3,000 tonnes of ABC powder in Beijing? There is a possibility of double-counting within the country without an equal compensation of new production for closed production. It requires a country perspective rather than a project perspective to decide first of all the eligibility of such closures.

(f) If it is to go by project level, and it is determined that such closures are eligible as incremental, it is important to determine:

- the duration of compensation for lost employment
- the duration for calculation of lost profits. Is it to go by the actual remaining life of the plant, or is it to make it uniform: no more than transitional period to be determined?

<u>China Aerosol Industry Southern Filling Center (Zhongshan Fine Chemical Industrial Limited Aerosol CFC-12 Substitution and Conversion Engineering Project)</u>

41. Two projects on CFC conversion to LPG for China (Tianjin and Shanghai) were approved at the Seventh Meeting of the Executive Committee. Conversion to LPG generates operating savings. The project documents indicated that "a portion of this cost savings will be passed on to small manufacturers to encourage conversion to hydrocarbon aerosol propellants and to offset transportation costs to filling stations". The incremental cost savings of these two projects are still to be calculated by the World Bank. In addition, China has submitted a third aerosol project: Zhongshan Fine Chemical to this meeting. Two-thirds of incremental savings generated from the filling services for small enterprises have been deducted from the total cost savings of the project. The rationale for such deductions should be established by the implementing agencies. The guidelines from the Executive Committee are requested to deal with this issue in the future.

Agenda item 8 (d) Project proposal (Colombia)

<u>Elimination of CFC in the Manufacture of Domestic Refrigerators in Colombia at Household Refrigerator Companies</u>

42. The conversion of four domestic refrigerator and one compressor manufacturing facilities to non-CFC technology is covered by the project proposal. Although compressor manufacturing company incurs both incremental capital and operating costs in the course of conversion, only capital costs are considered to be eligible for funding to avoid double-counting. Incremental

operating costs of the compressor manufacturer will be passed on to refrigerator manufacturers and will be funded as part of their eligible incremental operating costs. The Executive Committee is requested to adopt this approach to deal with distributional issues within and across the country(ies).

Agenda item 8 (f) Project proposals (India)

Hindustan Syringe's sterilization and siliconization project

43. The project consists of 2 sub-projects. The cost-effectiveness of silicon application nozzle sub-project (100 per cent silicon use) is poor (US $88 per kg. ODP saved) and the technical reviewer stated that "hydrocarbon based solvent blends are in advanced development stages which may offer an appropriate long-term alternative to the CFC-113". Taking this into consideration, the Committee may wish to decide on the most appropriate timing for approval of these projects. Should 20 per cent export to developed countries be taken into consideration in determining the grant amount?

Indian Halon Management and Banking system (UNEP)

44. The project proposes to develop a plan for managing existing stocks of halons in India. The Executive Committee will also consider a project, submitted through another implementing agency, to develop a sectoral strategy for the phase out of halons in the country. The strategy will be ready by end-1997. The Executive Committee might consider the appropriateness of reviewing and approving this project when a phase-out strategy is being developed.

Agenda item 8 (m) Project proposals (Venezuela)

AAISA - HFC-134a conversion

45. Conversion of the mobile air-conditioning industry from CFC-12 to HFC-134a requires modifications of some basic systems. The necessity of modification of certain systems like compressor, condenser, and hose assembly might be generated by the introduction of the new refrigerant. The modification of other systems, like the evaporator, is a normal business to satisfy the needs of customers based on new technological developments and to be competitive on the market. Projects on conversion of MAC system and component manufacturing facilities should clearly distinguish between the two categories of costs involved in the conversion.

Agenda item 10 Impact on the Fund of various operational cost durations in the domestic refrigerator sector

46. In response to the request of the Executive Committee at its 12th Meeting for an overview paper showing the impact on the Fund of various operational cost durations in the

domestic refrigeration sector, this discussion paper by the Fund Secretariat addresses this concern by taking stock of the phase-out requirements of this sub-sector and putting the magnitude of operating costs into the right perspective. The paper also tries to assess the impact of the operating cost on the Fund under the current three-year period, in particular.

47. Related issues are also identified: benefits accruing to Article 5 countries, duration of incremental operating costs, double-counting, export component and the two different implementation approaches.

48. The Committee may wish to consider the matters included in this paper in the context of establishing standard treatment in the domestic refrigeration sector.

Agenda item 11 Cost-effectiveness of ODS phase-out projects

49. In response to the request of the Executive Committee at its 12th Meeting, the Fund Secretariat has prepared the draft paper on cost-effectiveness of ODS phase-out projects which would help the Committee to consider the possible future use of reasonable cost-effectiveness ranges on a sub-sector by sub-sector basis. The draft has incorporated comments by implementing agencies.

50. Due to the lack of standardization of projects, cost of equipment and materials vary from country to country and sometimes within the same country. This makes it extremely difficult to fix a value for cost-effectiveness.

51. Economy of scale is a critical factor in determining whether a project is cost-effective. Projects which will result in the elimination of the maximum amount of ODS should be given priority. However, due regard should be given to smaller ODS consumers so that they are not discriminated against. By following this approach, the level of chlorine loading in the upper stratosphere will decrease, and new capacities in large enterprises in Article 5 countries will be created that could provide assistance to smaller enterprises within the country in the context of a sectoral strategy. The implementing agencies should be encouraged to develop strategies for formulating more cost-effective projects for small consuming enterprises.

Agenda item 12 Projects that might realize net incremental savings

Mechanisms and modalities for funding projects with net incremental savings

52. At the request of the Executive Committee, this paper is a revision of the paper presented to the last meeting of the Committee. The paper states that only incremental costs should be financed with grants, and projects with net savings may be funded through concessional loans. The paper recommends the consideration of such projects within the context of a country's sectoral strategy where remedial action can be recommended as part of a plan that might include both grant and loan components. It is recommended that lending institutions including the implementing agencies should be encouraged to provide loans for projects with net

incremental savings that lead to ODS phase-out, but may not be eligible for grants from the Multilateral Fund. Feasibility studies and project proposals prepared by implementing agencies or bilateral donors should be made available to such lending institutions.

Agenda item 13 Data collection and data reporting

53. In response to a request of the Executive Committee, the Fund Secretariat has prepared a paper dealing with the scope of activities under institutional strengthening projects and country programme preparation and how they are related to data collection. The paper also provides links between data collection and other activities under the auspices of the Montreal Protocol.

54. As a result of the survey, it has been concluded that given the opportunities of data collection provided through the Regional Networks, other regional and national training workshops, the process of country programme preparation and institutional strengthening activities, there should not be a need for regional workshops specifically on data collection and reporting.