UNITED
NATIONS

EP

United Nations Environment Programme

Distr.
LIMITED

UNEP/OzL.Pro/ExCom/20/59
23 September 1996

ORIGINAL: ENGLISH

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

Twentieth Meeting
Montreal, 16-18 October 1996

CONCESSIONAL LENDING FOR ODS PHASE-OUT

(A joint document submitted by the World Bank and the Fund Secretariat)

Submission Note

This document consists of two parts: Part I: Models and Issues which is prepared by the World Bank presents a number of hypothetical projects applying the two concepts for concessional lending proposed by the World Bank to the 18th Meeting of the Executive Committee and also a number of management issues under each concept.

Part II: Policy Implications of Implementing the Two Concepts which is prepared by the Fund Secretariat provides an analysis of implications on the current policy structure of the Multilateral Fund of implementing the two concepts proposed by the World Bank. Part II also provides a brief assessment of the issues raised by the World Bank in Part I.

PART I

CONCESSIONAL LENDING FOR ODS PHASEOUT:

MODELS AND ISSUES

(Submitted by the World Bank)

Concessional Lending for ODS Phase-Out: Implications and Models

Introduction

At the Eighteenth Meeting of the Executive Committee (ExCom), the World Bank presented the paper, "Concessional Lending for ODS Phaseout" (UNEP/OzL.Pro/ExCom/18/74) which discussed the possibility of using concessional lending mechanisms to leverage the resources available through the Multilateral Fund for the Implementation of the Montreal Protocol (MFMP). This paper was prepared in response to the ExCom's request at the 16th meeting and reflects the interest which has been expressed on concessional lending going back to the third meeting of the ExCom in 1991.

The paper highlighted the following characteristics which would be necessary for a concessional lending mechanism to be successful in the context of the MFMP:

- Given the scarcity of Multilateral Fund resources, a concessional lending mechanism should leverage available resources.
- Given the processing efficiencies gained over the last three years, the concessional lending mechanism should utilize existing funds processing/allocation procedures and require minimum amendments to agency-ExCom agreements or other aspects of legal framework now covering the flow of funds from the Multilateral Fund to participating enterprises.
- The spirit of the Montreal Protocol and the Multilateral Fund (i.e., to cover eligible incremental costs) should be maintained through any type of concessional lending arrangements.

Having examined these factors, the paper concluded that two different mechanisms for concessional lending would be feasible within the context of the MFMP:

(1) "providing interest buy-down grants to enterprises (in addition to incremental-cost grants) on non-Multilateral Fund sourced loans for the project cost component not covered by the grant;" and
(2) "providing sectoral incremental-cost grants to Article 5 countries for concessional on-lending to enterprises."

Upon consideration of the paper presented at the 18th meeting, the ExCom decided, "to request the Secretariat, together with the World Bank, and in consultation with other entities with expertise in the filed, such as regional development banks, to prepare for the Twentieth Meeting of the Executive Committee a more detailed document on this issue, exploring the operational implications of applying the concepts set out in the report. This paper should include an examination of hypothetical projects, to be prepared by the World Bank, which would practically demonstrate the implications of the application of these concepts." (UNEP/OzL.Pro/ExCom/18/75, para. 58(b), Decision 18/26).

Given this mandate, this paper will examine the two "feasible" mechanisms identified in the October 1995 paper more closely and illustrate through sample cases the practical implications of applying these concepts. In parallel to the World Bank's efforts, the US Environmental Protection Agency is working with the InterAmerican Development Bank to develop a model operational mechanism to illustrate how a particular concessional lending concept might be implemented.

Goals of Concessional Lending

Before discussing the concepts and models for concessional lending, it is important to first outline what the goals are for establishing any kind of concessional lending mechanism. The goals for concessional lending, as indicated above, should also be in line with those of the MFMP as a whole. The overriding goal of the MFMP is of course to achieve fast, cost-effective ODP phaseout. In addition to achieving phaseout, the program should provide the correct incentives to enterprises to take part in the phaseout activities. Both of these goals should be echoed in whatever concessional lending mechanisms are developed.

In order to reach these goals, the ExCom has developed, in its grant-specific phaseout work, a variety of eligibility criteria which are designed to help achieve timely, cost-effective phaseout. These include enterprise-specific criteria such as, the percentage of non-Article 5 ownership and the percentage of exports to non-Article 5 countries, as well as project-specific criteria, such as eligible incremental costs, equipment cost templates, and cost-effectiveness thresholds for each sector. Through use of the eligibility criteria, the ExCom sought to separate enterprises with sufficient savings to phase out ODP on their own, from those which need grants in order to move forward with conversion.

Unfortunately, "ineligible" companies could not always move forward with conversion. Two main reasons were behind this lack of movement:

1. Despite likely savings in the future, companies did not have sufficient capital to move forward with the conversion, and
2. Despite receiving a small grant amount, companies did not have sufficient incentive to move forward with conversion.

These issues have resulted in the MFMP missing out on some large, cost-effective ODP phaseout. Is the answer, therefore, to remove eligibility criteria? Obviously not. However, the answer may very well lie in the concessional lending options outlined above.

Concessional lending in the form of interest buy-down grants to enterprises and sectoral incremental-cost grants for on-lending to enterprises can leverage other resources to provide additional capital and create the right incentives to get the cost-effective phaseout underway. In addition, the incremental-cost grants to Article 5 countries would enable countries to "recycle" funds as enterprises complete phaseout and begin paying back on loans. To see how these options might play out in actual practice, the next section of the paper will examine each model as applied to three different types of projects:

- Aerosol filling
- Halon portable fire extinguisher conversion, and
- Replacement of existing chillers

Case Studies

As mentioned above, the following two types of concessional lending mechanisms have been identified as feasible within the present operational framework of the Multilateral Fund:

In Model A, **"interest buy-down grant,"** it is assumed that the companies will have access to loans from commercial banks and financial institutions. It is also assumed that the cost of such loans will be high in many countries. The aim is to cover the cost difference between normal international market interest and the actual loan cost offered by the national financial agency by giving the company an up-front grant to cover the cost difference of the loan.

In Model B, **"national grant for on-lending facility,"** a one-time grant covering one or more sectors will be given to the countries. The country would then set up a mechanism to distribute the grant to companies, which could be a combination of either grant and loan or 100 percent loan. The one-time grant is assumed to cover all eligible national phaseout costs within the sectors covered by the activity. The one time grant would be based on negotiation between the country and the ExCom.

Aerosol sector

Examples for the aerosol sector are based on the fact that the conversion of aerosol filling from CFC to HAP is commercially beneficial and the savings normally offset a high portion of the incremental capital cost required for the conversion.

In Example 1.1 (Model A), two scenarios are examined: First, (A1) the present baseline with a 100 percent commercial loan and an additional grant within the eligible project cost and second, (A2) with the eligible grant and 100 percent concessional loan component. In (A2), the grant equals the eligible incremental capital cost *plus* additional buy-down grant.

Example 1.1: Aerosol Plant, Model A		
Loan Condition		
	Local Commercial Loan	Concessional Loan
Duration	8 years	8 Years
Interest	20%	7%
Model A	**Present Baseline (A1)**	**Case A2**
Eligible incremental capital cost	1,500,000	1,500,000
Operating savings	750,000	750,000
Initial MFMP grant	750,000	750,000
Concessional loan	0	750,000
Private loan	750,000	0%
MFMP Buy-down Grant (NPV)	0	399,427*
Total MFMP grant	**750,000**	**1,149,427**
MFMP grant as % of capital cost	**50%**	**77%**
Enterprise Annual Cost	**195,457**	**125,057**
* The buy-down grant reflects the NPV of the difference between the commercial interest rate and the concessional rate, i.e., 13%.		

In Example 1.2 (Model B), the total incremental cost for the sector phaseout is assumed to be agreed upon. Two cases are examined: Case **B1** is a 100 percent concessional loan to the companies. Case B2 is combination of 50 percent concessional loan and 50 percent loan based on local market terms.

Example 1.2: Aerosol Sector, Model B		
Loan Condition		
	Local Commercial Loan	Concessional Loan
Duration	8 years	8 years
Interest	20%	7%
Model B	**Case B1**	**Case B2**
Eligible incremental capital cost	1,500,000	1,500,000
Operating savings	750,000	750,000
National sector grant from MFMP	750,000	750,000
Concessional loan	1,500,000*	750,000
Private loan	0	750,000
MFMP grant	0	0
Total MFMP grant	**750,000**	**750,000**
MFMP grant as % of capital cost	**50%**	**50%**
Enterprise annual cost	**251,200**	**321,057**
* The $750,000 available from the MFMP will be used as revolving loan covering the demand for $1,500,000 capital cost.		

Case **B1** anticipates a revolving fund in order to cover the entire sector. With the interest used in the calculation and duration of loans, the last project could be financed five years after the first group of projects have started. The annual loan cost to the companies is given in the last row of the table. The annual cost to the companies should be compared to the annual operating savings.

Halon 1211 Portable Fire Extinguisher Sub Sector

In Example 2.1 (Model A), Case A1, the present baseline, is based on a 100 percent commercial loan and grant. Case A2 illustrates a 75 percent concessional loan and a 25 percent grant component.

Example 2.1: Halon Sector Model A		
Loan condition:		
	Local Commercial Loan	Concessional Loan
Duration:	8 years	8 years
Interest	20%	7%
Model A:	**Present Baseline (A1)**	**Case A2**
Eligible incremental capital cost:	1,500,000	1,500,000
Operating savings	1,125,000	1,125,000
Initial MFMP grant:	375,000	375,000
Concessional loan share:	0	1,125,000
Private loan share:	1,125,000	0
MFMP Buy-down Grant (NPV):	0	599,140*
Total MFMP grant:	**375,000**	**974,140**
MFMP grant as % of capital cost:	**25%**	**65%**
Annual Enterprise Cost:	**293,185**	**188,401**

* The buy-down grant reflects the NPV of the difference between the commercial interest rate and the concessional rate, i.e., 13%.

In Example 2.2 (Model B), a total grant of $375,000 is assumed to be agreed upon and provided by the MFMP. As in the aerosol sector, two different combinations of private and concessional loan are examined. The following example reflects operating savings of 75 percent.

Example 2.2: Halon sector, Model B		
Loan condition:		
	Local Commercial Loan	Concessional Loan
Duration:	8 years	8 years
Interest	20%	7%
Model B	Case B1	Case B2
Eligible incremental capital cost:	1,500,000	1,500,000
Operating savings	1,125,000	1,125,000
National sector grant from MFMP	375,000	375,000
Concessional loan share:	1,500,000*	375,000
Private loan share	0	1,125,000
Total MFMP grant	**375,000**	**375,000**
MFMP grant as % of capital cost	**25%**	**25%**
Annual enterprise cost:	**251,200**	**355,985**

* The $375,000 available from the MFMP would be used as a revolving loan covering the demand for $1,500,000 capital cost.

In Example 3.1 (Model A), Case A1, reflects the present baseline with a commercial loan of $375,000. Case A2 reflects a concessional loan of $375,000. (Example 3.1 reflects operating savings of 25%.)

Example 3.1: Halon Sector Model A		
Loan condition:		
	Local Commercial Loan	Concessional Loan
Duration:	8 years	8 years
Interest	20%	7%

Model A:	Present Baseline (A1)	Case A2
Eligible incremental capital cost:	1,500,000	1,500,000
Operating savings	375,000	375,000
Initial MFMP grant:	1,125,000	1,125,000
Concessional loan share:	0	375,000
Private loan share:	375,000	0
MFMP Buy-down Grant (NPV):	0	199,713*
Total MFMP grant:	**1,125,000**	**1,324713**
MFMP grant as % of capital cost:	**75%**	**88%**
Annual Enterprise Cost:	**97,728**	**62,800**

* The buy-down grant reflects the NPV of the difference between the commercial interest rate and the concessional rate, i.e., 13%.

In Example 3.2 (Model B), a total grant of $1,125,000 is assumed to be agreed upon and provided by the MFMP fund. As for the aerosol sector, two different combinations of private and concessional loans are examined. (Example 3.2 reflects operating savings of 25%.)

Example 3.2: Halon Sector, Model B		
Loan condition:		
	Local Commercial Loan	Concessional Loan
Duration:	8 years	8 years
Interest	20%	7%
Model B	**Case B1**	**Case B2**
Eligible incremental capital cost:	1,500,000	1,500,000
Operating savings	375,000	375,000
National sector grant from MFMP	1,125,000	1,125,000
Concessional loan share:	1,500,000*	1,125,000
Private loan share	0	375,000
Total MFMP grant	**375,000**	**375,000**
MFMP grant as % of capital cost	**25%**	**25%**
Annual enterprise cost:	**251,200**	**286,129**

* The $1,125000 available from the MFMP would be used as a revolving loan covering the demand for $1.500,000 capital cost.

Chiller Conversion Project

Example 4.1 (Model A), reflects the conversion of chillers based on a request from a company to provide a loan to cover the conversion cost with total cost equaling $1,500,000. The example assumes that a concessional loan is provided to the company and the interest gap is covered by the MFMP. Example 4.1 reflects 100% savings/ineligible costs

Example 4.1: Chiller Retrofitting Model A		
Loan condition:		
	Local Commercial Loan	Concessional Loan
Duration:	8 years	8 years
Interest	20%	7%
Model A:	**Present Baseline (A1)**	**Case A2**
Eligible incremental capital cost:	1,500,000	1,500,000
Operating savings	1,500,000	1,500,000
Initial MFMP grant:	0	0
Concessional loan share:	0	1,500,000
Private loan share:	1,500,000	0
MFMP Buy-down Grant (NPV):	0	312,580*
Total MFMP grant:	**0**	**312,580**
MFMP grant as % of capital cost:	**0%**	**21%**
Annual Enterprise Cost:	**390,914**	**251,201**
* The buy-down grant reflects the NPV of the difference between the commercial interest rate and the concessional rate, i.e., 13%.		

There is no example to reflect Model B as it has no relevance in this case where no grant would be provided.

Model Summary

Each of the Model A examples, "the interest buy-down grant," shows an increased cost to the MFMP resulting from adding the buy-down grant to the grant for eligible incremental costs. This additional cost to the MFMP should be considered as the necessary incentive for a given enterprise to move forward with the conversion. The examples attempt to illustrate the different rates of incremental costs and savings for each sector and, hence, the incentive which might be needed in each sector. In considering projects which arise under Model A, the Executive Committee may want to compare the additional incremental cost the incentive places on the MFMP with the additional ODP phaseout gained because the incentive is in place. In addition, the ExCom may want to consider the funds leveraged through adding private lending to the funding mix.

As they reflect a one-time grant covering one or more sectors in a given country, each of the Model B examples, " the national grant for on-lending facility," show a set cost to the MFMP. In considering this model, the Executive Committee may want to consider the additional funding leveraged through a revolving fund and/or private lending. In addition, the ExCom may want to consider the potential for more cost-effective phaseout when utilizing this sectoral approach.

Comments

The type, terms and conditions of loans will have a determining factor on the actual loan cost. The following issues will determine the loan cost:

- Type of loan
- Length of loan (grace period)
- Interest gap
- Mechanism and cost to set up an on-lending facility.
- Minimum size of loans or a lending facility

Eight-year loans have been used in the case studies carried out in the paper. Five-year loans would circulate the money more quickly, but would also result in higher costs to the companies, which could create problems.

Interest rates on concessional loans have been anticipated at seven percent. Lower rates could be applied which would increase the financial support from the MFMP. To illustrate the importance of the interest gap, the table below shows MFMP buy-down interest costs for various interest gaps and loan sizes:

	Interest gap and buy down grant (in 1,000$)			
Loan size	5%	10%	15%	20%
0.5 million	64	115	154	186
1.0 million	129	229	308	372
2.0 million	258	459	617	745

The total cost to the MFMP is important. The cost to the MFMP will depend on the actual interest in the countries where the loan is to be used. The interest gap might vary from five percent up to several hundred percent with a likely average of 15 - 20 percent. If Model A, the buy-down grant, was to be applied to the aerosol, halon and chiller retrofitting case studies and the total incremental cost to be financed amounted to $20 million, the buy down grant would amount to between $ 4.5 million and 7.5 million or an additional cost to the MFMP of 20 percent to 35 percent depending on the interest gap and duration of loans.

In Model B, in which a grant is given to the country and a loan mechanism is set up, a clear benefit would be that the grant functions as a revolving fund where the money is used several times. One problem, however, is that the repayment of loans might be too slow compared to the demand for money. In both the aerosol and halon case studies, money to finance the remaining part of the sector would only be available two to three years after the first projects had been started.

The willingness of companies to utilize a loan option instead of a grant will depend on the overall cost, the ability to obtain private loans and other incentives to use loans instead of doing nothing unless the grant is available. CFC and halon conversion projects are, by definition, normally not commercially focused and are uneconomical as they neither increase the production capacity nor upgrade the production. The incentives for companies to take loans might, therefore, have to be generated through a strong national policy, which makes CFCs and halons either too expensive or unavailable in the near future. Such policies would make changes necessary from a "business survival" perspective. Policies available for such purpose could be: (a) "control-command" policies; (b) "market-based incentives" policies: or (c) a "negotiation" approach. Without any such policies in place, the motivation for any commercial operating company to take a loan to phase out the use of CFCs and halons due to environmental reason. is unfortunately, likely to be very limited.

Possible areas where the loan option will be of interest appear to be:

- Loans to larger and financially stronger enterprises
- Joint ventures and enterprises with international ownership
- Areas of high interest rates (i.e., high inflation areas)
- Areas where access to loans might otherwise be impossible
- Low-consuming enterprises

For larger and financially stronger enterprises, it might be attractive to get access to low-cost loans instead of using their own capital. At the other end of the spectrum, for low ODS-consuming enterprises, where the projects are expensive and far exceed cost-effectiveness values, concessional loans could provide a vehicle through which the MFMP could assist such companies.

To set up loans or a lending mechanism within a country depends greatly on the practice within a given country and no general guidance can be given. The cost to set up the loans will add additional cost to a loan approach. This indicates that a minimum size of loans should be considered to keep the loan cost down. To set up a lending mechanism solely for Montreal Protocol projects in general or for a given sector as outlined in Model B, would require a minimum volume of probably more than $20 million to make it attractive to any financial institution to handle it and to limit the overhead cost. Given this concern, such an option would probably not be available for low-consuming countries. To work successfully for these countries, the loan may have to be combined with other environmental or industrial restructuring lending facilities.

Taxation rules and other legal aspects might affect the viability of the loan option compared to a grant. As taxation rules differ between countries, the loan option should be examined for country-specific tax issues before establishing in a given country.

The shortage of available funds at a given time is presently delaying the implementation of viable and cost-efficient projects. A loan mechanism might be an option, which could allow the companies to move ahead without waiting for the grant. With access to loans, the companies could apply for loans based on the present project format, obtain the loan and start project implementation. When (and if) a grant is made available to the company covering all eligible incremental cost in accordance with the guidelines, the grant will be used to repay the loan in full or in part depending on the actual loan and the grant obtained from the MFMP. The MFMP could assist the countries in setting up such loan facilities.

Issues

While the case studies presented above give a general idea of how the two concessional loan models might play out in practice, there are a number of issues which may need to be considered before embarking on either one.

Interest buy-down -- As discussed earlier in the paper, the interest buy-down model (Model A above) could have the advantage of promoting cost-effective phaseout and of leveraging additional funds, however, the following issues should be taken into account when considering this model:

Additional cost to MFMP	Projects which have received a small grant may need a loan to further finance the project. Providing funds for an interest buy-down for these projects would create additional costs for the MFMP.
Equal access to loans	Access to loans might be an issue in some countries. Larger and financially stronger companies would likely have easier access to loans than smaller enterprises.
Loan guarantee	With every loan there is a risk of non-payment, who would bear the cost if the company fails to meet its obligations? Would any loan guarantee be provided? If so, by what agency or bank?
Project-by-project approach	Utilizing the interest buy-down model would mean a continued focus on the "project-by-project approach" and potentially mean less flexibility for countries to develop a sector strategy approach.
Presentation of request	How would requests for interest buy-down be developed and processed? Would they need to be calculated and presented at the time of the project presentation? How would this impact on the reliability of the calculation?
Monitoring interest buy-down	What kind of mechanism would be in place to handle monitoring the actual interest rate paid by the company? If the buy-down is presented in advance, what action will be taken if there are "savings" from the original estimate? What duration of lending/interest payment would be allowed?

On-lending facility -- The on-lending approach (Model B above), has similar advantages to that of the interest buy-down model, i.e., it should promote cost-effective phaseout and leverage additional funds. In addition, this model is in-line with sector approach as it allows countries the flexibility to develop a strategy for sectoral phaseout and set priorities for which companies would be targeted for on-lending. However, the following issues should be taken into account when considering this model:

Agreement on up-front costs	How would program needs and concomitant costs be estimated up-front? How would agreement be reached on what these costs are? What criteria would be used?
Grant or loan to country?	Would the country receive a grant from the MFMP to establish an on-lending facility or would it be in the form of a loan to the country? Who would administer such a country loan?
National monitoring	With the country in charge of allocation of funds, who would be responsible for monitoring this allocation? Would the MFMP ExCom expect to review enterprise requests for loans? Would this be appropriate in a lending model?
Application of eligibility criteria	There are currently a number of eligibility criteria and constraints placed on enterprises, such as those barring technical upgrades and modernization and the restriction of funds based on partial ownership by a non-Article 5 country and export to non-Article 5 countries. Would such strict eligibility criteria be required under the on-lending model?
Cost & timing of establishing loan mechanism	How would the cost of establishing loan mechanisms be handled? Would it be appropriate to set up such a mechanism in a low-volume consuming country? How would the MFMP create a balance between concessional lending and grants in each country? When would such a mechanism be established -- prior to initiating loans, in parallel with new lending activities?

Conclusion: Options for Implementation

Interest buy-down

Even taking into account the above issues, the interest buy-down approach could probably be implemented quickly under the current operational framework of the MFMP. As long as criteria for the presentation of requests were established with the MFMP Secretariat, implementing agencies would be able to present projects with interest buy-down components with very little additional work. Requests for interest would be made "up-front" to enable companies to pay for as much of the eligible incremental capital costs as possible, allowing them to finance a smaller portion of the capital costs through commercial loans.

On-lending facility

Some modification would likely be necessary before implementation of this approach could take place. However, the potential for establishing and utilizing on-lending facilities will likely improve as the MFMP continues to develop new sector-wide approaches to phaseout.

PART II

CONCESSIONAL LENDING FOR ODS PHASEOUT:

POLICY IMPLICATIONS

(Submitted by the Fund Secretariat)

Part II: Policy Implications

Introduction

1. The purpose of this part is to examine the compatibility of the two concepts for concessional lending with the current policy framework of the Multilateral Fund.

2. In the conclusion of its paper, the World Bank suggests that the interest buy-down approach (Model A in the Bank paper) could "probably be implemented quickly under the current operational framework of the MFMP", and that "implementing agencies would be able to present projects with interest buy-down components with very little addditional work". For the on-lending facility (Model B in the Bank's paper), the World Bank suggested that some modification of additional policies might be necessary, but "the potential for establishing and utilizing on-lending facilities will likely improve as the MFMP continues to develop new sector-wide approaches to phaseout." However, as both options are likely to have policy implications for the MFMP, the Secretariat has provided the following policy compatibility analysis to assist the Executive Committee in its analysis of these models.

Policy Compatibility Analysis

3. It is understood that the objective of setting up a concessional lending mechanism is to provide additional incentive to projects which, because of the deductions resulting from the application of the policies of the Multilateral Fund, do not have enough incentive to move ahead with their phase-out. It is also understood from the paper of the World Bank that the spirit of the Montreal Protocol and the Multilateral Fund (i.e. to cover eligible incremental costs) should be maintained through any type of concessional lending arrangement.

4. Under this overall rationale, the paper raises the following issues which may have implications on the current policies of the Multilateral Fund:

(a) Funding those components which were unfunded (ineligible) because of operating savings

By definition, incremental costs equals the sum of incremental capital costs and incremental operating costs. If, in the case of some projects, savings exceed operating costs and the eligible incremental cost is reduced by the amount of the net savings, then the deductions are not incremental costs by definition. Therefore, funding that part of the project costs is considered as funding costs other than eligible incremental costs. Although this is a conceptual issue, it may have implications on the basis of the policy-making of the Multilateral Fund.

(b) Funding the deductions resulting from non-Article 5 country ownership

In order to simplify the hypothetical projects in the present paper, the World Bank did not include any cases of funding the deductions from eligible incremental costs because of non-Article 5 country ownership. However, the World Bank's earlier paper submitted to the 18th Meeting did consider funding these deductions under the concessional lending mechanism. The current policy of the Multilateral Fund, which precludes funding the multinational ownership, is based on the rationale that resources of the Multilateral Fund should not finance multinational corporations based in Article 2 countries. Therefore, any future policy consideration to cover the loan operation of the Multilateral Fund should be developed with the awareness of the current policy.

(c) Funding the deductions resulting from export to non-Article 5 countries

Once again, in order to simplify the hypothetical projects in the present paper, the Bank did not include any cases of funding the deductions from export to non-Article 5 countries. However, the World Bank's earlier paper submitted to the 18th Meeting did consider funding these deductions under the concessional lending mechanism. The current policy of the Multilateral Fund, which precludes funding shares of export to non-Article 5 countries is to minimize the impact of potential unfair trading. Therefore, any future policy consideration to cover the loan operation of the Multilateral Fund should be developed with the awareness of the current policy.

(d) The number of years for the calculation of interest buy-down grants

Currently, the calculation of the incremental operating cost is based on a policy of up to four years. Considering that the interest buy-down grant could increase the eligible incremental cost grant by as much as 20-35 per cent, it could happen that the interest buy-down grant calculated at an eight-year duration could more than offset the deductions because of incremental operating savings. This could be the case, especially in projects where the operating savings are not that significant, and this is also shown in one of the hypothetical projects in the World Bank's paper, where the total grant is 88 per cent of the eligible incremental capital costs (halon portable fire extinguishers, Model A, Example 3.1).

(e) Ceiling for the total grant amount

Also related to the number of years used to calculate interest buy-down grants is the maximum percentage of the grant a project might have, which includes the eligible incremental cost grant and the interest buy-down grant. If the total grant amount could increase without ceiling, this could also have an impact on the earlier decision of the Executive Committee on partial funding. In addition to this, the hypothetical projects in the World Bank's paper illustrate quite different percentages across the various projects. Such unevenness in practice could create inequity among projects across countries.

5. In conclusion, these are issues which have to be reflected upon by the Executive Committee in considering the hypothetical projects proposed by the World Bank and the issue of concessional lending, in general.

A brief assessment of the issues raised in Part I (submitted by the World Bank)

6. In the conclusion of its paper, the World Bank raised a number of issues with regard to implementation of the two conceptual models - "Interest buy-down grant" and the "On-lending Facility". To facilitate the review of the Executive Committee, the Secretariat provides a brief assessment on the issues raised by the World Bank in Part I:

Interest buy-down:

World Bank Statement	Fund Secretariat Comments
Additional cost to MFMP: Projects receiving a small grant may need a loan to further finance the project. Providing funds for an interest buy-down for these projects would create additional costs for the MFMP.	 Need to look at the number of years for the calculation of interest buy-down grants and to establish a ceiling for the total grant amount as a percentage of the total incremental capital cost.
Equal access to loans: Access to loans might be an issue in some countries. Larger and financially stronger companies would likely have easier access to loans than smaller enterprises.	 No one can change the situation drastically, however, an interest buy-down grant should at least make it easier for the smaller enterprises to have access to a loan.
Loan guarantee: With every loan there is a risk of non-payment, who would bear the cost if the company fails to meet its obligations? Would any loan guarantee be provided? If so, by what agency or bank?	 The enterprises applying for an interest buy-down grant should follow the traditional channels for loan guarantee. Again, an interest buy-down grant should increase their chance for a loan from the local bank.

World Bank Statement	Fund Secretariat Comments
Project-by-project approach: Utilizing the interest buy-down model would mean a continued focus on the "project-by-project approach" and potentially mean less flexibility for countries to develop a sector strategy approach.	 While the concept of interest buy-down is presented on the project-by-project approach, there is nothing, however, which prevents an agency from setting up a country/sector facility such as the arrangement the World Bank had in Chile, but this time for a loan programme.
Presentation of request: How would requests for interest buy-down be developed and processed? Would they need to be calculated and presented at the time of the project presentation? How would this impact on the reliability of the calculation?	 The World Bank's earlier paper states "after negotiating a loan (but before finalizing it), the enterprise could present a proposal for an interest buy-down grant to the Multilateral Fund". The financial intermediary should exercise its responsibility as the local agent to check the reliability of the loan/interest calculation.
Monitoring interest buy-down: What kind of mechanism would be in place to handle monitoring the actual interest rate paid by the company? If the buy-down is presented in advance, what action will be taken if there are "savings" from the original estimate? What duration of lending/interest payment would be allowed?	 The financial intermediary could be used as the local agent of an agency to monitor the actual interest rate paid. The Bank said in its earlier paper "on approval, the grant would be channeled through the national financial intermediary, and disbursed in synchronization with the loan repayment."

On-lending facility:

7. The issues raised by the World Bank under this concept could best be dealt within the context of the sectoral phase-out programme which the World Bank is presently experimenting in co-operation with the Government of China. The experience of the World Bank in managing an on-lending facility in Turkey could also benefit this exercise.

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