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**EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL**

Twenty-third Meeting
Montreal, 12-14 November 1997

**REPORT OF THE EXECUTIVE COMMITTEE'S SUBGROUP
ON THE PRODUCTION SECTOR**

Introduction

1. The fourth meeting of the Executive Committee's Subgroup on the Production Sector was held on 18 September 1997 at the headquarters of the International Civil Aviation Organization (ICAO) at Montreal.
2. The meeting was attended by the representatives of the following members of the Subgroup, as re-established pursuant to Executive Committee decision 20/43: Australia, China, Costa Rica, India, United Kingdom of Great Britain and Northern Ireland, and United States of America.
3. The Subgroup had before it two documents prepared by the Secretariat: the first, a consolidated report on the Production Sector; the second, a draft guide on funding closures (including gradual closures) of ODS producing plants.

4. The meeting was opened by the Chief Officer of the Secretariat of the Multilateral Fund at 9 a.m. on Thursday, 18 September 1997. The representative of Australia served as Facilitator for the Subgroup.

AGENDA ITEM 1: ADOPTION OF THE DRAFT AGENDA

5. The Subgroup adopted the following agenda on the basis of the draft circulated by the Secretariat:

1. Adoption of agenda
2. Briefing by Chief Officer on the consolidated report prepared by the Secretariat
3. Status report on outstanding issues
4. Review of the consolidated report
5. Other matters
6. Closure of the meeting

AGENDA ITEM 2: BRIEFING BY CHIEF OFFICER ON THE CONSOLIDATED REPORT PREPARED BY THE SECRETARIAT

6. The Chief Officer said that the consolidated report had been prepared in response to a decision of the Executive Committee (Decision 22/65) and consisted of two parts: the first a chronological narrative of the progress made and decisions taken since the Twelfth Meeting of the Executive Committee; followed by a series of nine annexes, the first four of which were the subjects of decisions by the Executive Committee. The second document before the meeting had been prepared at the request of the Facilitator to assist the Subgroup in seeing precisely how the decisions taken to date fitted into the model of the methodology as proposed by the Expert Group and what remained to be done in terms of outstanding issues.

AGENDA ITEM 3: STATUS REPORT ON OUTSTANDING ISSUES

7. The Chief Officer noted that Annex VIII of the consolidated report outlined the results of the consultations conducted through correspondence and teleconferencing in August 1997 with the Expert Group on the Production of Substitutes for Ozone-Depleting Substances (ODS) on three issues where clarifications were specifically sought from the Expert Group by the Subgroup on the Production Sector, namely inflation, design capacity, and packaged forms/local conditions. On the issue of inflation, the Expert Group believed this to be 3 per cent per year, but the actual figures could be checked against U.S. CPI Output Index or U.S. Producer Index for Industrial Chemicals. On design capacity, the Expert Group had agreed with the definition included in the

report of the Executive Committee's Subgroup on the Production Sector (UNEP/OzL.Pro/ExCom/22/68) but agreed that the term "design capacity" could be removed. With regard to packaged forms/local conditions, the Expert Group had confirmed its earlier recommendation on packaged forms but was still studying a methodology presented by one of its members on how to calculate the premium on local conditions.

8. The Subgroup then proceeded to review the modelling of the methodology for calculating compensation for ODS plant closures in Article 5 countries presented in the appendix to the draft guide, concentrating on the key issues still to be resolved but recognizing that - in view of the short time available and their controversial nature - it would probably not be possible to resolve completely some of the outstanding issues. It might, however, be possible to identify issues which could be resolved on a case-by-case or country-by-country basis.

Baseline capacity and growth rate

9. One representative contended that, if one looked at a no-Montreal-Protocol scenario, there could be no doubt that in principle growth should be allowed, and that if that principle was accepted all that remained was to determine the parameters for assessing the level of such growth. On the other hand, one representative argued that, even before the Montreal Protocol, developed countries had in large measure already phased out, or had agreed to phase out, ODSs, not because of ozone-layer depletion but because they found it cost-effective to do so. There had been an absolute glut of capacity on the market, and there would have been no growth whether or not there had been the Protocol. He would be prepared to analyze the situation and prepare a paper for the information of the Subgroup. Responding, the first representative said that whether or not there was growth was really determined by both national and international forces interacting in the economic system. He could make a case that the use of CFCs, at least in his country, would still have grown.

10. The Subgroup agreed that it was not possible to take a decision at this time on whether or not there should be allowance for some growth. It accepted the offers of the representatives of the United States and India to prepare documents in support of their views, hopefully in time for the Subgroup's consideration at its next meeting. Other representatives who wished to present information to assist in the Subgroup's future consideration of this item were welcome to do so. In order to facilitate discussion, all papers should be circulated at least three weeks in advance of the next meeting.

11. The Subgroup accepted a suggestion that the reference to "baseline capacity" should be amended to read "baseline production".

12. It was agreed that, in any revision of the draft guide, reference should be included to the relationship between "capacity verification" and "baseline production".

Profit margins

13. The representative of one country suggested that the issue of profit margins would be controversial, and that it would probably not be possible to decide on a figure that applied to all countries, plants and circumstances. Instead, an attempt should be made to agree on the type of factors to be used in determining, on a case-by-case basis, what a reasonable profit margin might be. The representative of another country suggested the following three factors which he believed needed to be examined: (a) the justification for taking fixed costs in the model on a local basis; (b) the need for more work on local conditions; and (c) bearing in mind that with the no-Protocol scenario there would have been a glut, determination whether the profits would have been sustainable. Still another representative mentioned that a further issue that required attention was the suggestion made during the Subgroup's earlier discussions that the appropriate profit margin to be considered for compensation was net earnings. In response to a comment by a representative, the Secretariat noted that the Expert Group had agreed that international prices should be used in calculating both costs and sales, and that there should be a standard way of reflecting local conditions. One member of the Expert Group had been entrusted with the task of preparing a methodology on weighing local conditions, for clearance by the other members. The matter was still under discussion and no agreement on the methodology had yet been reached since some of the assumptions had been challenged.

14. The Subgroup agreed that it was not possible to take a decision at this time on the issue of profit margins. At the request of the Facilitator, the representative of the United States agreed to try to prepare for the Subgroup's consideration, hopefully by the next meeting, a document outlining the factors to be used in determining, on a case-by-case basis, what a reasonable profit margin might be. He could not, however, guarantee that the document could be distributed three weeks in advance of the next meeting. The Subgroup accepted an offer by the representative of India also to prepare a document for its consideration, dealing with the issues he had raised earlier. Again, any other representative wishing to do so was free to submit documentation, which the Facilitator emphasized should be as simple and straightforward as possible.

Discount rate

15. The Subgroup agreed that, in the light of information received from the World Bank in response to the Subgroup's request for information on what real discount rates it applied to chemical industry projects in the relevant Article 5 countries over the 8 to 17 year time period concerned, the square brackets in the text of Recommendation 9 of the Expert Group could now be removed (*UNEP/OzL.Pro/ExCom/22/68, Annex II*).

16. The representative of one country suggested that there was a need to define more clearly what was meant by discount rate, to bring it more closely into line with the definition commonly used in business practices. This issue was linked to profit margins. He volunteered to prepare a short paper for the Subgroup's consideration at its next meeting, explaining why local factors, if included in the margin, would still tend to justify use of the international discount rate. Another representative disagreed with the views just expressed, on the basis of advice received from economists.

17. The offer of the representative of India to prepare a document was accepted, and the Facilitator asked the representative of the United Kingdom also to prepare a document outlining the rationale for his stand.

Remaining useful life

18. The Subgroup held a brief exchange of views on this issue, but reached no conclusion.

AGENDA ITEM 5: OTHER MATTERS - DATE OF NEXT MEETING OF THE SUBGROUP ON THE PRODUCTION SECTOR

19. It was agreed that the date of the next meeting of the Subgroup of the Production Sector would be determined by the Facilitator and would be communicated shortly to members of the Subgroup.

AGENDA ITEM 6: CLOSURE OF THE MEETING

20. The meeting adjourned at 12:35 p.m.