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CHINA'S HALON SECTOR STRATEGY

"SECTOR-BASED FINANCING UNDER THE MULTILATERAL FUND LIST OF ISSUES REQUIRING CONSIDERATION BY THE EXECUTIVE COMMITTEE"

This document is submitted by the World Bank in accordance with Decision 20/51 (c) which states:

> "To request the World Bank to circulate a list of the specific issues requiring consideration by the newly constituted Executive Committee"

Sector-Based Financing Under the Multilateral Fund
List of Issues Requiring Consideration by the Executive Committee

January 6, 1997

1. The Multilateral Fund for the Implementation of the Montreal Protocol (MFMP) was set up to help developing countries operating under Article 5 of the Montreal Protocol (MP) to meet their MP obligations. There are now over 90 countries eligible for MFMP assistance. Countries receiving MFMP assistance range from small island nations whose use of ozone-depleting substances (ODS) may be limited to servicing of imported refrigeration equipment, to vast rapidly industrializing countries which both produce and consume large and growing quantities of ODS for applications from foam packaging and circuit board cleaning to fire protection. Recognizing this vast span of needs, the MFMP is developing approaches to financial assistance that are equally diverse in scope. For example, the MFMP has already acknowledged special groups such as low-volume consuming countries and small and medium enterprises as requiring different approaches from standard project assistance. The Executive Committee (EC) is now considering another special approach, the "sector approach", in this case designed to address the special circumstances of large, complex, rapidly growing ODS economies where the standard project-by-project approach would result in higher phaseout costs.

2. A "sector approach" to financing ODS phaseout would be based on a program submitted by a Beneficiary Party (a government eligible for MFMP support) to completely phase out all ODS use in a given sector (e.g., aerosol or halon). The program would include an ODS phaseout schedule and the policy measures to achieve phaseout. MFMP funds for the entire sector phaseout program would be agreed up-front. Annual funding tranches would then be approved each year based on actual ODS phaseout in the previous year. As long as the ODS phaseout schedule is met year-by-year, new funds would continue to be approved in amounts which had been agreed up-front.

3. Recognizing the limitations of the standard project-by-project approach to ODS phaseout assistance in countries like China where thousands of enterprises would require conversion, members of the EC met together with representatives of the Government of China and the World Bank in June 1995 to discuss possible alternatives. All parties endorsed the concept of a sector-based approach to financing. Then, at its 17th Meeting, the EC approved project preparation resources for "further development by the World Bank of the sectoral strategies." (Decision 17/35) The Bank had requested these funds on behalf of the Government of China to design a sector-based approach with two primary objectives: (a) to reduce the unit costs of phaseout both to China and to the Multilateral Fund; and (b) to allow the Executive Committee to manage the Fund's resources based on actual ODS phaseout performance.

4. At its 20th Meeting, after hearing a brief presentation by the World Bank, "Introduction To a Sector Approach for Efficient ODS Phaseout", the EC decided that sector approaches would require the Committee to "deal with the modalities and technical issues arising from the halon sector strategy". To facilitate the process of developing new modalities for sector approach funding approvals, the EC requested that the World Bank "circulate a list of specific issues requiring consideration by the newly constituted Executive Committee." (Decision 20/24). This note has been prepared to respond to that request.

Key Features of the Sector Approach

6. The proposed sector approach, where it is applicable, offers lower cost phaseout, requires national level ODS reductions (for particular sector) as a condition for future funding, and allows for strategic grant utilization:

- Lower phaseout costs: By encouraging Beneficiary Parties to pursue strategic planning for ODS phaseout activities and by giving governments flexibility to provide comprehensive policy support and create the proper incentive environment, the sector approach is expected to reduce ODS phaseout costs to the country and, in turn, to the Fund.

- Funding approval based on national level reductions in ODS consumption: The sector approach introduces performance-based management of Multilateral fund resources. New funds (advanced annually to the Beneficiary Party) would be allocated only if the previous year's phaseout targets (national level consumption reductions) had been achieved.

- Strategic grant utilization: The sector approach allows the Beneficiary Party flexibility in disbursing grant resources to compliment its phaseout strategy and policy. For example, the recipient government may decide to encourage enterprises to find lower cost phaseout options by introducing competition for grants, or by disbursing funds through a revolving loan mechanism. At the same time, the government could allocate more resources to technical assistance activities to familiarize enterprises with substitute options.

7. Some of the distinctions between the standard project-by-project funding approach and the proposed sector approach are summarized in the Table 1.

Table 1 - Comparison of Standard Project Approach and New Sector Approach

	Standard Project Approach	**New Sector Approach**
Objective	Phaseout ODS use at individual enterprise	Phaseout ODS consumption for entire sector (or country)
Funding Proposal Format	For ODS using enterprise: * enterprise baseline * substitute technology * project description * schedule * costs	For entire ODS sector: * sector baseline (all enterprises) * phaseout strategy * policies * least cost schedule * costs * reporting
Funding Eligibility	Based on incremental costs for individual enterprises (as defined by EC guidelines)	Based on average incremental costs for individual enterprises aggregated for the sector (as defined by EC guidelines)
Funding Approval	One step approval: 1. Approval of technical proposal for conversion away from ODS at individual enterprise	Two-step approval: 1. Approval of sector program for complete phaseout in sector 2. Approval of annual funds for program implementation based on past ODS reductions in sector (performance)
Grant Disbursement	Rigid. Paid to ODS using enterprise or to substitute suppliers for goods and services approved in technical proposal	Flexible. Strategic allocation of grants by Beneficiary Party to achieve ODS phaseout objectives
Reporting	Implementing agency reports on implementation of technical proposal including disbursement and ODS phaseout for individual enterprise	Implementing agency reports on national level reductions in ODS consumption for the sector

11. As can be surmised from Table 1, the new sector approach raises certain operational matters which the Executive Committee might wish to consider as it develops new modalities for funding sector approaches including the sector approach for halon phaseout in China.[1] These matters, further discussed below, may be broken down into five areas:

I Sector Approach Program - What should it contain?
- (a) Format and content.

II Up-front Agreement on Incremental Costs - How should incremental costs be determined for a complete sector?
- (a) Application of incremental cost guidelines to sector approaches.
- (b) Cost comparisons to standard project approach.

III Approval of Sector Phaseout Program and Funding Approvals - What will approval mean and what criteria will be applied?
- (a) Obligations created by sector approach program approval.
- (b) Annual funding approval.

IV Disbursement of Grant Funds By IA and Beneficiary Party - What will it mean to have flexibility in grant disbursement?
- (a) Beneficiary Parties determine grant allocation to achieve ODS phaseout objectives.
- (b) Documenting grant usage for ODS phaseout (US$/kg eliminated) not goods and services.

V ODS Phaseout Verification - How will ODS reductions be verified and who will do it?
- (a) New progress report format for sector approaches.
- (b) Parameters of the independent audit of national level ODS consumption reductions.

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1 In addition to broader modality questions, sector approaches may raise technical issues particular to them. For example, for China's halon sector phaseout program, there may be questions about the appropriate ratio of CO_2 to ABC powder which would be needed to substitute for halon 1211 as fire fighting agents in portable fire extinguishers. This paper deals only with sector approach modality issues and assumes that such technical issues would be dealt with in the review of specific sector approach programs.

I - SECTOR APPROACH PROGRAM - WHAT SHOULD IT CONTAIN?

1. For a sector approach, the EC would be asked to approve a program for complete phaseout in a sector including eligible incremental costs, policy incentives, and a monitorable schedule for ODS phaseout. The program would be longer than a technical proposal for an ODS phaseout project, but it would contain less technical detail, focusing instead on strategy, policies, and costs for various scenarios. The program would be a Beneficiary Government document. However, as the program would also be the basis for MFMP funding, its technology choices, cost estimates and interpretation of MFMP policies on eligible incremental costs would be subject to independent technical (for World Bank projects this would mean review by the Bank's Ozone Operations Resource Group) and Secretariat review. The format and content of sector approach programs is an area for which the EC may wish to provide further guidance.

(a) Format and content. Based on the Bank's experience in working with China on preparing the halon sector approach program, such programs should likely include:

Baseline information on ODS production, consumption, imports and exports for the sector. This information should provide sufficient data on enterprises (size, product mix, plant life, production capacity and actual production) for analysis of likely incremental costs of phaseout.

Assumptions about "representative" enterprises and enterprise groupings which would be used to model the ODS sector and estimate incremental conversion, closure or other eligible incremental costs.

Phaseout schedule.

Specific policies measures including enforcement provisions for achieving schedule targets and other program objectives (i.e., efficiency, equity, etc.).

Program costs, including cost comparisons which demonstrate the efficiency of selected approach and provide an estimate of eligible incremental costs which could be agreed as the basis for funding.

Reporting provisions for monitoring, evaluating and auditing program results which would serve as the basis for approval of annual funding advances.

The format used for China's Plan to Phase out Halon and the contents it addresses could be adopted as an interim guideline for such programs. This format could be modified over time as experience is gained with sector approaches.

II - UP-FRONT AGREEMENT ON INCREMENTAL COSTS - HOW SHOULD INCREMENTAL COSTS BE DETERMINED FOR A COMPLETE SECTOR?

1. One of the key provisions which defines a sector approach is up-front agreement on eligible incremental costs for the whole sector. As the EC has already developed detailed guidelines on eligible incremental costs for individual projects, it is the application of those guidelines to sector approaches which may require further guidance from the EC

2. In addition, the sector approach promises cost savings both to the country and to the MFMP. Thus, the program should compare the sector approach cost request to costs that would likely be required under project-by-project funding. Overtime, the EC may wish to consider guidelines on how comparisons to the standard project approach should be made.

(a) Application of incremental cost guidelines to sector approaches. The calculation of sector-wide phaseout costs may be approached based on methods developed for estimation of costs for individual projects since aggregate costs may be built up from eligible costs at the firm level. Estimates of incremental costs for the China halon sector approach were, in fact, based on estimates of average enterprise-level unit phaseout costs. Unit costs were aggregated using a computer-based model. The EC may wish to consider the use of the approach used to prepare sector-wide incremental cost estimates in the proposed China halon sector approach (aggregating estimates of average enterprise-level unit phaseout costs using representative enterprises) on an interim basis and ask the Secretariat to work with the implementing agencies to prepare guidelines to adopt an appropriate version of this approach as standard practice.

To assess incremental cost estimates in sector phaseout programs, the EC could adopt review procedures for technology choice , costs, and consistency with MFMP policies as are currently applied for individual project submissions; cost estimates and technology choices in sector approach programs could be subject to independent technical review prior to submission. As with individual project technical reviews, standard guidelines for these program reviews could be developed over time. Likewise, the parameters of sector approach computer-based cost models could also be standardized over time as experience is gained.

Future costs, especially distant future costs, are difficult to predict. The current project-by-project approach deals with risk and unforeseen costs by including a contingency allowance in funding requests, through close monitoring of project implementation, allowing for technology choice changes, and by permitting project proponents to request additional funds at a future date (though this has rarely been put into practice). For sector-wide phaseout programs, incremental costs would be agreed up front for activities up to 13 years in the future. This long range cost estimation introduces an increased level of risk and uncertainty compared to individual project cost estimates.

Risk and uncertainty will require case-by-case consideration in sector approach programs. If experts agree that cost reductions are likely to outweigh cost increases over time, then an appropriate "discount" rate could be agreed. If on the other hand, cost increases seemed more likely, then a contingency provision could be included. Regardless of the approach taken, it will be important to agree up-front on the level of incremental costs and accept some level of uncertainty about future costs. This uncertainty is expected to be outweighed by the benefits of focusing in the future on implementation of the program and actual ODS phaseout instead of negotiations over funding levels.

(b) Cost comparisons to the standard project approach. The sector approach would lead to cost savings over the standard project approach. Through strategic planning and policy measures, including regulation, market-based incentives, information campaigns, and possible competition for grants, the sector approach is expected to reduce national phaseout costs and, in turn, reduce incremental costs to the MFMP. At the same time, the sector approach addresses reductions in national level consumption, thereby eliminating higher costs which would accompany enterprise-level use reductions in sectors with growing national-level consumption. By providing estimates in sector approach programs of the expected savings as compared to the standard project approach, the EC might find it easier to accept the higher level of uncertainty associated with sector approach cost estimates, not withstanding the advantages of performance-based fund management which are also part of the sector approach.

While assisting China prepare its halon phaseout program to pilot the sector approach, World Bank staff attempted to quantify potential savings from policy incentives and enterprise competition for grants. The savings which are expected to result from enterprise level actions towards cost efficiency such as maximum use of existing facilities, desire to maintain or increase market share and/or to enter new markets entirely, or exit from the halon business proved difficult to quantify. Estimation of such savings is highly subjective as they depend on future enterprise decisions based on many variables known only to the enterprise itself.

Incremental cost savings for sector approaches are more easily quantified when compared to a situation in which national ODS consumption is rising as ODS phaseout projects at individual enterprises are being implemented. The risk of continuing investments in countries where there is little or no regulation of ODS is minimal where there is no growth in ODS sectors. However, in countries where ODS growth rates are high, the Fund may be reducing ODS use at particular enterprises even as national level consumption of ODS continues to rise. As one group of enterprises is converted, another group is established, or existing enterprises expand production of ODS products. Estimates done for the halon sector in China show that use reductions in absence of growth curbs ahead of the Montreal Protocol schedule would, in fact, increase halon phaseout costs.

Incremental phaseout costs for the China halon sector phaseout were, in fact, highly sensitive to changes in baseline assumptions of ODS consumption making these more easily quantified. To estimate cost savings compared to the project-by-project funding approach, the cost-model was manipulated to estimate the increased incremental costs which would be associated with reducing halon use (through halon extinguisher enterprise conversions and halon producer closures) while increases in halon production and consumption were allowed to continue. These estimates showed higher costs of 15-30 percent as compared to standard project approach. In other words, if use reductions at individual enterprises are financed while the sector consumption continues to grow, total phaseout costs for the sector would be higher than if such use reductions correlated to consumption level reductions sector-wide. <u>The EC may wish to consider adopting the approach to cost comparison used in the China halon sector approach on an interim basis and request that the Secretariat work with the implementing agencies to develop guidelines for making cost comparisons between sector and project approaches.</u>

It could be argued that cost savings which are being attributed to sector approaches, especially those which are quantified in the halon sector approach (the savings from avoiding consumption growth as projects for use reductions are implemented), could be achieved using the standard project approach. In fact, Beneficiary Parties are expected to take measures to allow compliance with the Montreal Protocol controls. It is not unreasonable that governments would control ODS supply, or forbid new entrants, prior to requesting investment project funds for a given sector. However, for various reasons, concurrent adoption of ODS phaseout policies has been the exception.[2]

The sector approach, by offering Beneficiary Parties flexibility in grant distribution to compliment policy actions and by linking future grant resources to national-level reductions in ODS, both provides incentives to adopt policies to curb growth in ODS consumption and would make such actions easier to put into practice. Thus, while some developing countries are and will continue to put in place policy frameworks which would increase the effectiveness of ODS conversion projects to achieve national level reductions, the sector approach would make the introduction of such policies easier and more attractive.

2 Policy development may be limited in part because MP controls for developing countries do not go into effect until 1999. Other factors, including capacity, government priorities, and awareness appear also to have limited policy development in developing countries.

III - Approval of Sector Phaseout Program and Funding Approvals - What Will Approval Mean and What Criteria Will Be Applied?

1. The China halon sector approach program envisions approval of sector approach programs in two steps. First, the EC would approve the overall program which would set out the phaseout schedule and associated incremental costs year-by-year. Then, each year of the program, the EC would, as a second step, approve the funds which had been agreed for that year based on previous achievements of scheduled national level reductions in ODS consumption.[3] This two step approach, which distinguishes between program approval -- locking in beneficiary commitment to a particular phaseout schedule and MFMP commitment to a specific level of incremental cost financing -- and annual approval of funding advances, is a departure from the current approach of one step project approval. Thus, the EC may wish to consider what obligations will be created by sector approach approval and how annual funding approval will work.

(a) Obligations created by sector approach approval. Approval of a sector approach program would be an endorsement by the EC of all technical and cost elements of a plan to completely phase out ODS consumption in a given sector. Such an agreement would imply an obligation by the EC to provide annually a specific amount of funds to carryout the phaseout program provided the beneficiary party continued to meet the phaseout obligations specified in the approved program. Approval of a sector approach program would be one step short of actual funding approval, and to that extent would be similar to the EC practice of "clearing" a project for approval.[4] However, since future funding approvals under a sector approach are contingent on ODS reductions according to the program's phaseout schedule, funding releases would not be automatic as they are for "cleared" projects.

It may be useful to consider approval of a sector phaseout program as agreement on the policy guidelines for future approval of funding to the Beneficiary Party for all future ODS phaseout activities in that sector. That is to say, the program itself would become a set of guidelines so specific that they would specify exact funding levels (rather than eligible expenses), precise annual phaseout amounts (as opposed to guidance for calculating baseline ODS consumption), and provisions for reporting national level reductions (rather than enterprise use level reductions). Because the Beneficiary Party would have flexibility in using grant resources under the sector approach, it would agree to more rigorous reporting and verification of national level reductions. In addition, the

3 It would also be possible for the EC to approve a sector approach program in one step, set aside the money which it approved, and then release those approved funds based on performance toward agreed phaseout targets. However, given past reluctance by the EC to tie up funds which could in the meantime be used for more immediate phaseout activities, a two-step approval process seems more consistent with the Fund's priorities.

4 At its 17th Meeting, the EC "cleared projects for approval" by deciding that they would go forward to the next meeting on a priority basis "without further review" (Decision 17/20).

Beneficiary Party would accept that new funding advances would be contingent on completion of the previous year's ODS phaseout targets.

(b) Annual funding approval. Once the sector approach program, including eligible incremental costs, has been approved, the implementing agency would, as a second step, request annual funding advances to implement the program. Approval of annual funding tranches by the EC would be based on actual performance toward national level reductions in ODS according to the approved sector program's phaseout schedule. (Funding amounts would have been approved as part of the sector program approval.) The procedure for subsequent funding approvals, would, need to allow for a reporting time lag (time to collect and verify national level consumption data) as well as the Beneficiary Party's need to maintain momentum. For the halon sector approach, the World Bank and China have estimated that the cycle of data collection, reporting, submission to EC, and EC approval of funds would require 10-12 months. Thus, the EC may wish to consider basing future annual funding approvals on the basis of the previous year's national level reductions in ODS. As such, funds for ODS phaseout in the second year would be based on satisfactory progress reports. Funding of the third year (and subsequent years) would be approved based on achievement of the first year (or previous years) ODS phaseout target and satisfactory progress reports.

IV - DISBURSEMENT OF GRANT FUNDS BY IA AND BENEFICIARY PARTY - WHAT WILL IT MEAN TO HAVE FLEXIBILITY IN GRANT DISBURSEMENT?

1. The sector approach distinguishes between the determination of eligible incremental costs, and disbursement of those grant funds by the Beneficiary Party. Instead of the rigid project approach requirement that grant funds be used only for specific ODS phaseout equipment items and other costs approved in technical proposals, the sector approach would permit flexibility in the use of approved resources. As strategic grant usage is a key feature of the proposed sector approach, the EC may want to consider approaches for allowing Beneficiary Parties to determine grant allocation to achieve ODS phaseout program objectives.

2. Once Beneficiary governments have flexibility in grant allocation, the question of accounting for funds takes on a new meaning. In awarding such flexibility, the EC would in effect be indicating that it is no longer interested in what grant funds were used for, *per se* (i.e., knowing that grants were used to buy a particular piece of equipment would no longer be relevant). Rather, such an approach would indicate that the Committee is more concerned that the grant monies were used to achieve ODS phaseout program objectives and would base future fund approvals on achievement of agreed ODS reductions.

3. By allowing flexibility in grant utilization, and focusing on ODS phaseout results, savings could also be expected from reduced transaction costs. To capture these potential savings and move away from labor intensive documentation of equipment procurement and disbursement procedures currently employed for investment projects, the EC may further wish to consider guidance on documenting grant funds usage for ODS phaseout (US$/kg eliminated) instead of for goods and services.

(a) Beneficiary Parties determine grant allocation to achieve ODS phaseout program objectives. To best achieve the targets of its ODS phaseout program, beneficiary parties will need more flexibility to strategically allocate grant resources. Sector approach phaseout programs are expected to rely on policy incentives to drive phaseout and minimize costs. Policy measures might include regulation, information campaigns, technical assistance programs, and market-based incentives. Beneficiary governments would benefit from flexibility in targeting grants in ways that would best support the policy objectives it has adopted to achieved phaseout. To give flexibility in grant usage, the EC may wish to consider approval language which gives full authority to the Beneficiary Party to allocate approved funds as it deems appropriate to achieve goals of the approved sector ODS phaseout program.

It is expected that sector approach programs would indicate plans for grant allocation and how the proposed allocation approach would help achieve the program objectives. As experience is gained, the grant allocation approach would then be modified as needed to best achieve ODS phaseout program goals.

(b) Documenting grant usage for ODS phaseout (US$/kg eliminated) not goods and services.

To ensure accountability of MFMP resources, reporting on fund usage would still be required. However, the EC may wish to allow disbursement information in progress and completion reports to be tailored to the specific design of a given sector approach. For example, Beneficiary Parties could indicate in sector approach program submissions how grant funds would be allocated to achieve ODS phaseout program objectives. Progress Reports could be designed to record fund allocations and disbursements consistent with the sector program design. As the grant allocation approach evolved, reports could be tailored to match.

In addition to establishment of reporting requirements which build in flexibility, Beneficiary Parties and Implementing Agencies will also look for guidance on how disbursements should be documented. To be consistent with the performance based management approach and to capture the savings such an approach would offer in terms of reduced transaction costs, The EC may wish to note the acceptability of disbursement by Beneficiary Parties against performance targets (instead of goods and services) under sector approaches.

This would mean that documentation for grant disbursement by Beneficiary Parties would be consistent with the basis on which funds are provided to ODS producers and consumers. For example, if funds are paid out on the basis dollars per kilogram of ODP eliminated, disbursement documentation would also be on that basis. In other words, the Beneficiary Government in accordance with its grant allocation plan might contract with beneficiary enterprises to eliminate ODS (production or consumption) for an agreed amount if terms of US$/kg of ODP eliminated. Following the terms of the contract, the agreed grant amount would be paid in full when the enterprises ODS production or use is stopped. However, to Beneficiary Government would not inquire about or seek to document how those funds are then used by the enterprise. Whether the firm shuts down, uses a substitute, or goes into another line of business would be its own decision and would be seen as unrelated to compensation for ODS phaseout.

V - ODS Phaseout Verification - How will ODS Reductions be Verified and Who Will Do It?

1. Another key feature of the sector approach is independent verification of national level reductions in ODS consumption as the basis for annual funding advances. Reporting and verification would be taking place on many levels (local, national, and international implementing agency), with each level reinforcing the others. The Beneficiary Party would take primary responsibility for putting in place a system to monitor and report on national level ODS reductions. The implementing agency which is assisting the government carryout its sector phaseout program would supervise monitoring and reporting activities and oversee independent verification of national level consumption reductions. Semi-annual progress reports and annual reports on national level reductions in consumption would be submitted to the EC and would be the basis for future funding approvals. The EC may therefore wish to consider requiring semi-annual progress reports tailored for specific sector approaches and may also wish to consider parameters of the independent audit of national level ODS consumption reductions.

(a) New progress report format for sector approaches. The proposed sector approach is designed to allow the EC to manage funds based on actual performance on national level phaseout targets. A new type of progress report may therefore be required to provide information on indicators most relevant to the objectives of the particular sector approach. For example, the EC may want additional information on disbursement allocation (e.g., amounts allocated to categories to achieve ODS phaseout program objectives), while information such as time to first disbursement may be less meaningful. The EC may wish to ask to consider that sector approach program submissions include proposed reporting formats that could be reviewed and approved along with the program.

(b) Parameters of the independent audit of national level ODS consumption reductions. During preparation of the proposed sector approach program for halon phaseout in China, two types of independent audit were discussed. Each year, the National Audit Bureau (an agency independent from the Government bodies involved in program implementation) would audit the program including national level consumption reductions to verify government reports. In addition, the World Bank, with assistance from independent technical consultants, expects to conduct independent technical audits to confirm national level ODS consumption reductions.

To ensure sufficient objectivity, the EC may wish to provide guidance on auditing parameters, including format for audit reports and acceptable auditors. For the production sector, the EC decided at its 19th Meeting (Decision 19/36) on terms of reference for technical audits of ODS production facilities and at the 21st Meeting, the EC will consider guidelines on production capacity verification. While these terms of reference and guidelines are intended to establish baseline ODS production capabilities, they may help form a basis for guidelines on sector approach consumption reduction verification.

Summary of Issues and Possible Actions for Discussion:

I Sector Approach Program - What should it contain?

(a) Format and content

The format used for China's Plan to Phase out Halon and the contents it addresses could be adopted as an interim guideline for such programs. This format could be modified over time as experience is gained with sector approaches.

II Up-front Agreement on Incremental Costs - How should incremental costs be determined for a complete sector?

(a) Application of incremental cost guidelines to sector approaches.

The EC may wish to consider the use of the approach used to prepare sector-wide incremental cost estimates in the proposed China halon sector approach (aggregating estimates of average enterprise-level unit phaseout costs using representative enterprises) on an interim basis and ask the Secretariat to work with the implementing agencies to prepare guidelines to adopt an appropriate version of this approach as standard practice.

The EC could adopt review procedures for technology choice , costs, and consistency with MFMP policies as are currently applied for individual project submissions.

(b) Cost comparisons to standard project approach.

The EC may wish to consider adopting the approach to cost comparison used in the China halon sector approach on an interim basis and request that the Secretariat work with the implementing agencies to develop guidelines for making cost comparisons between sector and project approaches.

III Approval of Sector Phaseout Program and Funding Approvals - What will approval mean and what criteria will be applied?

(a) Obligations created by sector approach program approval.

It may be useful to consider approval of a sector phaseout program as agreement on the policy guidelines for future approval of funding to the Beneficiary Party for all future ODS phaseout activities in that sector.

(b) Annual funding approval.

The EC may wish to consider basing future annual funding approvals on the basis of the previous year's national level reductions in ODS. As such, funds for ODS phaseout in the second year would be based on satisfactory progress reports. Funding of the third year would be approved based on achievement of the first year ODS phaseout target and satisfactory progress reports.

IV Disbursement of Grant Funds By IA and Beneficiary Party - What will it mean to have flexibility in grant disbursement?

(a) Beneficiary Parties determine grant allocation to achieve ODS phaseout objectives.

The EC may wish to allow disbursement information in progress and completion reports to be tailored to the specific design of a given sector approach.

(b) Documenting grant usage for ODS phaseout (US$/kg eliminated), not goods and services.

The EC may wish to note the acceptability of disbursement by Beneficiary Parties against performance targets (instead of goods and services) under sector approaches.

V ODS Phaseout Verification - How will ODS reductions be verified and who will do it?

(a) Modification of progress report for sector approaches.

The EC may wish to ask to consider that sector approach program submissions include proposed reporting formats that could be reviewed and approved along with the program.

(b) Parameters of the independent audit of national level ODS consumption reductions.

For the production sector, the EC decided at its 19th Meeting (Decision 19/36) on terms of reference for technical audits of ODS production facilities and at the 21st Meeting, the EC will consider guidelines on production capacity verification. While these terms of reference and guidelines are intended to establish baseline ODS production capabilities, they may help form a basis for guidelines on sector approach consumption reduction verification.

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