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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
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CONCESSIONAL LENDING UNDER THE MULTILATERAL FUND

A discussion paper from the Swedish Delegation

Executive Summary

1. Concessional lending must be applied in a manner which enhances and not hampers the Art.5 countries capability's to comply with the Montreal Protocol requirements.

2. The application must take into account that ODS use by many small scale users (SMEs) is now the main not yet targeted use in Art.5 countries. It is therefore inevitable to link the issue of concessional lending with considerations on SME strategies and sectorial or sub-sectorial strategies.

3. There is primarily a role for concessional lending in the form of grants to the country which the government can use for concessional lending, subsidized assistance, etc. to ODS users.

4. This should be taken into account when considering funding sector or subsector projects and SME strategies, but need not be subject to detailed standardized rules from the ExCom on lending rates, pay-back periods, etc. The ExCom should instead focus on evaluation of ODS consumption and achievable results, necessary preconditions for success, etc.

5. Concessional lending to *enterprises* which can afford conversion to non-ODS alternatives would have been a useful concept if applied from the beginning but will at this stage, when all large enterprises have received grants, create unfair competition and undermine the governments' chances to control SME users.

6. Concessional lending to rich *countries* (above a GWP level to be decided) would, however, be worth considering.

Montreal Protocol and Executive Committee Decisions on Concessional Lending

Article 10, para 3 (a), of the Montreal Protocol states that the Multilateral Fund (MF) shall "*meet, on a grant or concessional basis as appropriate, and according to criteria to be decided upon by the Parties, the agreed incremental costs."*

At its 3rd meeting (1991), the Executive Committee (ExCom) decided that *"assistance for investment projects shall generally be provided in the form of grants. However, where the investment project has a short payback period (e.g., one to two years), financing may take the form of highly concessional loans."* (ExCom/3/18/Rev.1).

At its 13th meeting (1994), the ExCom stated that projects with net savings *"may be good candidates for concessional loans from resources provided by the Fund or from other funding sources"* and therefore recommended that *"consideration of projects with net incremental savings might be provided through the consideration of sector strategies for each country; .... implementing agencies, regional development banks and other lending institutions should be encouraged to provided loans for those projects in Art. 5 countries that lead to the phase-out of ODS but may not be eligible for grants from the MF."* (ExCom/13/47, para 176).

The 7th Meeting of the Parties (1995) stressed the need for an ongoing study by the World Bank to be completed as soon as possible for further discussions in the ExCom, *"with a view of starting the use of concessional loans by the end of 1996, to the extent that the need and demand exist".* (UNEP/OzL.Pro.7/12, Annex V, Action 10).

Present situation

To date, although various studies on concessional lending have been done, the Fund has acted almost exclusively on the basis of grants. Projects with short pay-back periods due to reduced operational costs are considered ineligible for funding as not involving any incremental costs.

One exception is a project in Turkey, where the government used MF grants to establish a revolving fund. Investment costs in refrigerator plants were paid partly by grants and partly by zero-interest loans from the revolving fund. Repaid funds were redeployed locally for other ODS phaseout activities under MF review.

US bilateral projects have also applied on-lending in some mobile air-conditioning projects. Large service stations are allowed to borrow recycling equipment for a limited period of time. The enterprises are then able to buy the equipment for half its real cost after gaining experience that recycling is profitable for them. Money paid and equipment which is not purchased are used to provide recycling machines to other enterprises.

At present, the ExCom is waiting for a study from the World Bank, aimed at exploring "ways in which the private-sector finance could be mobilized to assist Art.5 countries to phase out ODS, particularly in sectors with a good return on investments", and "to provide a theoretical overview of ways in which concessional funding and other forms of innovative funding could augment and make most effective use of Multilateral Fund resources". The study will be presented at the 25th ExCom.

The World Bank has submitted a proposal for a pilot project in Thailand to provide practical experience of one type of a non-grant project. The project contains establishment of a revolving fund to finance chiller replacement in order to reduce the quantities used for service in the chiller sector and is summarized in the annex. This project will also be considered at the 25 ExCom.

Views by ExCom members

The 24th ExCom asked members to submit their thoughts in writing for further discussions at the 25th ExCom. Papers were delivered by four Non-Art.5 members (Belgium, Italy, Japan and US) and three Art.5 members (Burkina Faso, India and Jordan). The views are still random as there is no specific proposal to react to.

A point stressed by all Art.5 countries is that loans should only be used upon demand from the country in question. India stresses that further concessions from the Art.5 countries will lead to non-compliance and that phase-out of production facilities and conversions in SMEs enterprises is possible only with grants. It would create a win-win situation if loans could be used for costs which are deemed ineligible by ExCom policies. Jordan emphasizes that introducing concessional loans at this stage will complicate the country's fulfillment of its obligations under the Protocol as it will create unfair competition between enterprises receiving grants and those getting loans and will reduce industry's interest for MF projects.

Non-Art. 5 countries see the concessional loans as a means of achieving more ODS elimination for the same amount of money (it is assumed by all that the MF when replenished will remain approximately at current levels). It is generally assumed that the MF money should only be used to cover incremental costs, but there are more diverging views with regard to the need to stay within the ExCom's present policies. The US, supported by Japan, stresses strongly that the MF money should not be used for costs which are now considered non-eligible, either by virtue of incremental cost guidelines or under current cost-effectiveness threshold values. The US suggests that loans should be used for currently eligible costs instead of grants when the enterprise is considered capable of covering the costs without a grant but may need a short term loan and proposes that the Secretariat should develop guidelines for when this could be considered to be the case. The European countries see a possibility for more flexibility with regard to cost-effectiveness thresholds. Switzerland suggests that loans could be used above the threshold as long as agreed sectorial thresholds are maintained, to fund incremental investment costs that will be paid back by operational savings, for retrofitting in the refrigeration sector and to cover additional costs for using environmentally more sound alternatives. (It should be noted that the cost-effectiveness thresholds have no base in the Protocol itself and are, by the ExCom itself, established as guidelines for priorities only).

The Non-Art.5 members point, in various degrees, to the need for the MF to establish detailed rules for the use of MF money for loans on issues such as lending rate, pay-back period and procedures, management fees, ways of offsetting funds against future project approvals in the country, procedures in case of loan default, etc. Japan flags concerns that ExCom's control and standards may be compromised if governments can use unused portions of loans at their discretion and proposes that unused portions should therefore be returned to the MF and, if needed, used for new loans.

Considerations regarding a Swedish policy on concessional lending

General objectives

An important starting point for a Swedish policy on the use of MF money for concessional loans should be that such use of MF money should enhance the Art.5 countries' capability to comply with the Montreal Protocol phase-out requirements. It is not enough solely to create additional investment projects to phase-out some more tonnes of ODS. It is therefore necessary to consider where the problems in achieving compliance are and how concessional lending can help solving these problems. It is also important that concessional lending is not applied in a way which in reality hampers the Art.5 country governments' capability to comply.

The difference between loans to the country and grants to the government which the government can use for concessional loans should be kept in mind.

Grants to the country, used by the Government for concessional loans

Most major industrial ODS users are already tackled by ongoing or planned investment projects, funded by grants from the MF. The remaining consumption is the scattered use by many small scale users, consisting of small industrial type enterprises and service companies as well as individual consumers such as owners of air-conditioned cars and buildings. This consumption is still quite substantial and in some sectors also growing. In many cases, alternatives are available which in the longer term are beneficial for all parties but not applied because of lack of capital, knowledge, time, interest and/or the availability of cheap ODS.

This makes it inevitable to link the issue of concessional lending and the phase-out of ODS use by the small scale users (generally collectively but somewhat inadequately considered under the term SMEs). It points also to the links to sectorial approaches.

It seems obvious that Non-Art.5 countries will not agree to pay each one of these small users their costs for switching to non-ODS alternatives. None of the Non-Art.5 countries has considered doing so in its own country. Art.5 countries must also realize this even though it has never been spelled out explicitly.

However, it should help Art.5 country governments to control and phase out this scattered use if they had to their disposal resources which could be used for grants in combination with concessional loans, to subsidize equipment and technical assistance, and to launch demonstration projects, while at the same time introducing regulations controlling the use of ODS.

It seems likely that the governments' chances to control the SME users successfully by such a combination of sticks and carrots will require that the government has a high degree of flexibility to decide on the structure and conditions for economic incentives to the users, adapted to the situation in the country and the sector of application. Detailed standards and rules from the ExCom could hamper, rather than enhance, the possibilities of success.

What should be important for the ExCom and Non-Art.5 countries should be conditions related to the results, rather than to the detailed structure and procedure of loans programs. The ExCom should therefore focus on how to make money available to Art.5 country governments which they could use for concessional loans, including revolving funds. This implies focusing on the targeted ODS consumption, achievable results and total costs, the design and preconditions for the programme to be successful etc. but not on setting up standardized conditions on lending rates, pay-back periods, management fees, etc. It is likely that the issue of concessional lending will primarily be part of the greater issue of support to sectorial approaches.

Loans to the country

The US suggestion on loans instead of grants to *enterprises* which can afford to convert to non-ODS alternatives on their own would have been a good suggestion if implemented from the start on the MF operations. Such a principle would, however, be very difficult for the government to explain to the users at this stage, when all major companies have got grants - including companies which clearly could have afforded the conversion on their own - and the main remaining users are SMEs. Introducing the US proposal now would further reduce the possibilities to make SME users committed to phase out the ODS use.

However, a variation of this theme could be worth proposing. Some of the *countries* which are classified as Art.5 countries have a high GWP and should be as able to afford the phase-out as most of the Non-Art.5 countries. The reason why they are classified as "Art.5 countries" is historical. It was erroneously assumed, when the Montreal Protocol was signed, that there was a clear UN definition on which countries should be considered as "developing countries". The Parties found it impossible to discuss individual countries' status. Therefore, at the first Meeting of the Parties, all countries belonging to the Group of 77 and any other country which wanted to be considered as a "developing country" were approved as an "Art.5 country" provided that the consumption was below 0.3kg/capita. The latter provision prevented earlier some countries e.g. Saudi Arabia, Kuwait, South Korea and Singapore, from taking advantage of the MF. These countries are now below 0.3 cap but the Parties have urged them not to seek assistance from the Fund.

This historical background of the definition of "developing countries" could justify introducing a principle of concessional loans instead of grants to countries above a certain a GWP limit (to be decided).

Annex

Summary of the World Bank's Thai Chiller Project

This project is based on the findings that projects for replacing CFC chillers with new non-CFC chillers are expected to lead to savings, due to enhanced energy efficiency, and are therefore unlikely to be eligible for funding under current MF criteria. However, chiller owners' interest in replacing the chillers is low due to shortage of capital, low priority as compared to other competing investment opportunities, a long pay-back period to reach the break-even point and low cost of CFCs. An important element is uncertainties with regard to the potential energy savings under Thai climate condition and service and support standards.

The pilot project is intended to use about US$ 5 million from the MF to finance replacement of 25 CFC chillers. 90 % of the savings will go to a revolving fund to buy new chillers, while chiller owners will keep 10 % as an incentive. Initial results will be used to leverage additional resources of US$ 25 million from other sources. Ultimately, the whole program would replace about 630 chillers of the existing fleet of about 1500 CFC-based chillers, which is estimated to consume some 70 tonnes of virgin CFC per year. Recovered CFCs will be used to service remaining CFC chillers until the end of their useful life.

The success of the project will be evaluated after three years. If unsuccessful, the revolving fund will be used to repay the MF. The ExCom is invited to consider how the initial funding should be repaid after completion of the program.