THE MONTREAL PROTOCOL MULTILATERAL FUND: A MODEL FOR THE FRAMEWORK CONVENTION ON CLIMATE CHANGE

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At the just concluded seventh session of the Intergovernmental Negotiating Committee for a Framework Convention on Climate Change, delegates for the first time took up the details of the financial mechanism called for in article 11 of the convention.

While little progress was made in elaborating these details, certain preferences were clear: Developed countries want the Global Environment Facility (GEF) to be the "operating entity" of the financial mechanism, while developing countries and non-governmental organizations (NGOs) prefer a mechanism structured along the lines of the Montreal Protocol Multilateral Fund (MPMF).

The two international financial mechanisms, the MPMF and the GEF, were created in 1990 to assist developing countries in their efforts to address a number of global environmental concerns. The MPMF was established to finance the incremental costs to developing countries of meeting their obligations under the Montreal Protocol on Substances that Deplete the Ozone Layer. The GEF was established as a stand-alone financial mechanism to help developing countries address four global environmental problems: global warming, ozone depletion, loss of biodiversity, and pollution of international waters.

While the GEF originally had no formal links to any other environmental agreements, it was contemplated that it might assume responsibilities for managing funds established by future international environmental agreements, notably the climate and biodiversity conventions.

In fact, both of these conventions have since designated the GEF as the interim operational entity for their financial mechanisms. The question, however, of what type of financial mechanisms should be adopted by the conventions on a long-term basis has yet to be settled.

The Climate Convention provides that "its operation shall be entrusted to one or more existing international entities." While some Parties to the Convention clearly envision that the GEF will fill this role, the language seems flexible enough to permit other possibilities.

One alternative is suggested by the MPMF. Though far from perfect, as a convention financial mechanism, the MPMF is significantly better than the GEF in a number of respects.

In Parts I and II this paper examines the structures of the two mechanisms. Part III compares key features and notes some important differences. Part IV discusses the advantages of the MPMF model over the GEF for the Climate Convention financial mechanism.

I. The Montreal Protocol Interim Multilateral Fund

The US$240 million MPMF was established on an interim basis in June 1990 [1] to provide financial and technical assistance, including the transfer of relevant technologies, to eligible developing countries to enable them to comply with the control measures set out in the Montreal Protocol. Although the MPMF has links to the GEF, it operates as an independent entity with its own administrative structure, terms of reference, work programs, guidelines, and funding arrangements.

Organizational Structure

The MPMF is administered by an Executive Committee made up of seven developed and seven developing country parties. The chair rotates annually between the developed and developing country members.

The committee's duties include: developing a three-year plan and budget and allocating resources among the implementing agencies; supervising and administering the fund; developing project eligibility criteria and guidelines; monitoring and evaluating operation of the fund; assessing bilateral arrangements to determine compliance with eligibility criteria; reporting annually and making recommendations to the parties; nominating the chief officer of the fund Secretariat; and performing all other functions assigned by the parties.

The Executive Committee reviews all country programs and projects and approves projects with agreed incremental costs in excess of $500,000. It also reviews any disagreements concerning funding requests under $500,000.

The MPMF is staffed by an independent Secretariat, which assists in discharging the day-to-day operations of the Executive Committee. Its responsibilities include: acting as a liaison with the parties, implementing agencies, and other institutions; helping the Executive Committee to develop the three-year plan and budget; monitoring and evaluating fund expenditures; and assessing country programs and work programs developed by the implementing agencies and making recommendations to the Executive Committee.

It also completes reports for the Executive Committee on projects over $500,000; prepares implementation performance reports for review by the Executive Committee; serves as liaison between governments, implementing agencies, and the Executive Committee; and monitors the activities of the implementing agencies.

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[1] At their recent meeting in Copenhagen, the Parties to the Protocol approved the permanent establishment of the Multilateral Fund as of January 1, 1993, with a proposed replenishment of $340-500 million in 1994-96.

The Executive Committee is assisted in its work by the fund's three implementing agencies: the United Nations Environment Programme (UNEP), the United Nations Development Programme (UNDP), and the World Bank.

UNEP is the fund's designated administrator, trustee, and treasurer. It receives and administers all contributions and disburses funds to the Secretariat and implementing agencies. UNEP also assists in the political promotion of the objectives of the protocol, as well as in research, data gathering, and clearinghouse functions.

UNDP provides technical assistance, including conducting feasibility and pre-investment studies, and cooperates on country studies and demonstration projects.

The World Bank assists the Executive Committee in administering and managing the program to finance agreed-upon incremental costs and approves projects under $500,000.

Financial Structure

Contributions to the MPMF are based on the U.N. scale of assessments, but countries can be credited up to 20 percent of their assessment for bilateral assistance. MPMF resources are to be independent of other World Bank funds allocated for ozone layer protection.

Assistance for investment projects is generally provided as a grant but may take the form of a highly concessional loan if the payback period is short and if the Executive Committee agrees. All technical assistance and pre-investment activities must be provided in the form of grants.

In some cases, countries are permitted to make their contributions in kind. At the request of the recipient country, in-kind support can be provided in the form of expert personnel, technology, technology documentation, and training.

Project Development

Before they can obtain assistance from the fund, countries must prepare a country study to determine their production and consumption of ozone-depleting substances (ODS), and a country program describing their ODS regulatory framework, activities undertaken in response to protocol requirements, a strategy statement, action plan, timetable, and budget for eliminating ODS. They may receive help from the implementing agencies in preparing their country study and program.

The Executive Committee reviews country programs and individually reviews all projects costing more than US$500,000. Upon approval, the agencies proceed with full preparation, appraisal, and implementation. The agencies also prepare annual work programs which include technical assistance and training. These programs also require Executive Committee approval.

Although countries have yet to do so, they may prepare their own projects and apply directly to the fund without the participation of the implementing agencies.

II. The Global Environment Facility

The GEF was established in November 1990 as a three-year pilot program to provide grants and concessional financing to developing countries to help them implement environmental programs in four problem areas: ozone depletion; global warming; loss of biodiversity; and pollution of international waters. The GEF is operated jointly by the World Bank, UNDP, and UNEP.

Organizational Structure

The World Bank is the GEF administrator and is responsible for all investment projects. UNDP is responsible for pre-investment studies, technical assistance projects, and a small grants program. UNEP provides environmental expertise and ensures project consistency with existing environmental treaties.

The GEF chairman, who comes from the World Bank staff, is responsible for the operation of the facility and promotes cooperation between the implementing agencies. The chairman is assisted by the GEF administrator, also from the bank, who manages the day-to-day operation of the facility and coordinates the work programs.

Delegates from contributor countries—the "Participants"—meet twice a year to oversee the GEF's activities and review and approve work programs. The Participants set terms and conditions for use of GEF funds and assess work programs developed by the implementing agencies.

An Implementation Committee composed of GEF operational and managerial staff from all three implementing agencies meets regularly to review policy, program, and project issues. It screens project proposals to determine eligibility for GEF assistance and identifies and reviews policy issues for the work programs.

A Scientific and Technical Advisory Panel (STAP) advises the three implementing agencies on technical issues including available technology options, technical criteria for project approval, and evaluation of performance reports.

Financial Structure

The GEF began with an initial funding commitment of 1 billion Standard Drawing Rights (about US$1.3 billion). Funding is on a grant or concessional basis and is additional to existing aid flows.

The GEF is actually made up of three separate funding arrangements: the Core Fund; bilateral funding arrangements known as "co-financing" and "parallel financing"; and the Ozone Projects Trust Fund (OTF).

Roughly speaking, 40-50 percent of Core Fund and bilateral funds are for global warming, 30-40 percent to conserve biodiversity, and 20 percent to protect international waters. All the money from the OTF goes to protect the ozone layer.

Project Development

Projects may be proposed by governments, the implementing agencies, non-governmental organizations, the private sector, and others. Project proposals must be endorsed by the recipient government, which submits the proposal directly to the appropriate implementing agency. Normally proposals are initiated outside the GEF, but the implementing agencies may also solicit proposals for projects they are interested in funding.

Projects can be "freestanding" or linked to regular World Bank loans. Eighty percent of investment projects (projects administered by the bank) are linked.

All technical assistance projects (projects administered by UNDP) are freestanding. Freestanding projects are limited to $10 million, while linked projects may receive up to $30 million. These amounts may be increased through co-financing or parallel financing.

Each of the three implementing agencies develops its own work programs containing new projects it is administering. After individual project review by the STAP for technical and scientific merit and by the Implementation Committee to ensure they meet established criteria, work programs are submitted to the Participants for their approval.

Upon approval by the Participants, projects undergo further development. Final approval of investment projects is by World Bank management and the appropriate regional

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vice president. Linked investment projects must also be approved by the bank's executive directors.

UNDP project development takes place in the recipient country and may involve outside participation from NGOs and local people.

GEF Restructuring and Replenishment

The GEF pilot phase is over at the end of 1993, and the GEF is currently seeking to have its funds replenished and its mandate extended.

At the U.N. Conference on Environment and Development (the Rio Earth Summit), several countries indicated they would be willing to support a continuance of the GEF but only if it is significantly restructured to take into account concerns regarding, among other things, governance, management, participation, and access to information.

Reflecting similar concerns, the Climate Convention calls for restructuring the GEF to provide for "universal" membership (Article 21.3).

It also requires that the financial mechanism have an "equitable and balanced representation of all parties within a transparent system of governance" (Article 11.2). NGOs generally oppose replenishment until a thorough, open, and independent review has demonstrated that the GEF is performing as intended and all significant problems have been identified and corrected.

III. Comparing The MPMF With The GEF

While there are certain similarities between the MPMF and the GEF, there are also important differences. For example:

▸ *Representation.* All Parties to the Montreal Protocol on Substances that Deplete the Ozone Layer are eligible to participate in the MPMF, whereas to participate in the GEF, countries must contribute a minimum of SDR 4 million (about US$5.7 million). The GEF has proposed dropping this requirement but would still require Participants to contribute to administrative costs of the facility.

▸ *Voting.* The MPMF Executive Committee votes by consensus, when possible; otherwise, it votes by two-thirds majority plus simple majorities of both developed and developing country blocs. In the GEF, however, the Participants vote by consensus only. This provision is also under review in the GEF.

While a number of new voting formulas are being considered, most would retain some degree of "weighting" in favor of large contributors.

▸ *Segregation of Funds.* The MPMF is designated only for ozone depletion projects. The Core Fund—which the GEF proposes to utilize for the climate and biodiversity conventions—is designated for projects in three areas: global warming, biodiversity protection, and protection of international waters.

▸ *Contributions.* MPMF contributions are based on the U.N. scale of assessments, while contributions to the GEF are discretionary—GEF Participants are only required to meet the SDR 4 million minimum. Furthermore, GEF Participants have the option of providing all funds bilaterally, while Montreal Protocol parties are only permitted to provide 20 percent of their assessment bilaterally.

▸ *NGO Participation.* NGOs are permitted to attend MPMF Executive Committee meetings as observers, but are barred from GEF Participants' meetings. The GEF has instituted an NGO consultation immediately before each Participant meeting, to which Participants have been invited. Few have accepted, however, and those who do attend have been reluctant to participate in discussions.

▸ *Project Approval.* The MPMF Executive Committee approves projects on a project-by-project basis and has final say on all projects over $500,000. In contrast, GEF Participants approve work programs, not individual projects, and review programs early in the project cycle, after which they have no role in project development or approval.

▸ *Role of the World Bank.* The World Bank plays a considerably more prominent role in the GEF than in the MPMF. The bank staff administers the GEF and gives final approval to all GEF investment projects. Currently, 80 percent of GEF investment projects are linked to regular World Bank loans. The role of the bank in the MPMF is limited primarily to assisting countries in the preparation of their programs, preparing and supervising investment projects, and approving projects costing less than US$500,000.

IV. MPMF Is The Better Model For The Climate Convention

Policy Considerations

This partial list of differences suggests a number of ways in which, from a policy standpoint, the MPMF provides a better model than the GEF for a Climate Convention financial mechanism. The MPMF is, for example, more consistent with Climate Convention requirements that the financial mechanism have an "equitable and balanced representation of all parties." The MPMF assures developed and developing countries equal representation, while the GEF does not.

Membership in the MPMF is also more "universal." All Parties to the Montreal Protocol are eligible to be on the Executive Committee, whereas participation in the GEF requires a contribution of SDR 4 million, not an insignificant sum for many developing countries. The GEF has indicated this "membership fee" requirement might be dropped, but Participants will still be expected to pay their share of administrative expenses "taking into consideration countries' ability to pay."

The MPMF is also more "transparent" than the GEF, which, like the World Bank, as been criticized for failing to disclose important information about its operations. Participants have complained that they receive insufficient information about projects they are asked to approve and little or no information about regular World Bank projects to which GEF investment projects are appended.

As more has been learned about some of these bank projects, they have been criticized as environmentally unsound and inappropriate for GEF funding.

The MPMF and the GEF also differ in their public participation policy. NGOs may participate as observers in MPMF Executive Committee meetings but are excluded from GEF Participants meetings.

Voting procedures in the MPMF are designed to facilitate decision-making and promote equal participation by developed and developing countries; indeed, they ensure that developed and developing countries have an equal voice in all decisions.

The Executive Committee strives for consensus, but if consensus cannot be reached, decisions are made by two-thirds majority plus simple majorities of developed and developing countries.

Voting in the GEF, in contrast, is strictly by consensus, giving individual countries the opportunity to block projects they oppose. GEF voting procedures will probably change, but the options presently under consideration would still retain some "weighting" of votes in favor of large contributors.

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The GEF's "unitary fund" approach also raises concerns. Because project funding is not segregated, Parties to the Climate Convention might not be able to earmark their contributions strictly for global warming.

The unitary fund approach would give oversight responsibility for global warming projects to Participants that are not party to the convention, which presents a problem of expertise, since it requires Participants to assess projects in a number of different areas.

The MPMF approach, by comparison, would ensure that all money contributed by parties to the convention is managed by the parties and earmarked strictly for global warming projects.

The MPMF model is also more consistent with the convention requirement that funding be provided in a "predictable and identifiable manner." Whereas MPMF contributions are based on the U.N. scale of assessments, any contributions to the GEF beyond SDR 4 million are entirely discretionary.

It is also significant that GEF Participants have the option of providing all funds bilaterally, while Montreal Protocol Parties are only permitted to provide 20 percent of their assessment bilaterally.

Perhaps most important are the differences between the roles of the Executive Committee in the MPMF and the Participants in the GEF, and the consequent differences in the functions of the implementing agencies, notably the World Bank.

The Executive Committee has considerably more say in the operation of the MPMF than do the Participants in the operation of the GEF. This is evident in the project approval process.

Whereas the Executive Committee has final approval of all MPMF projects over $500,000, the GEF Participants do not approve projects at all. Rather, they approve work programs; GEF project selection and approval is done by the implementing agencies.

It is also noteworthy that the MPMF gives countries the option of applying directly to the Executive Committee for funding of their projects without any participation or mediation by the implementing agencies.

Legal Considerations

A financial mechanism with a structure modeled after the MPMF must meet all the legal requirements of the Climate Convention. To understand those requirements, it is important to distinguish between the financial mechanism and its "operating entity." The language of the convention suggests—and most negotiators seem to agree—that they are not one and the same.

While the operating entity or entities of the mechanism must be "existing international entities," this limitation does not apply to the financial mechanism itself. Thus, as long as the everyday operation of the mechanism is undertaken by such existing international entities as UNEP, UNDP, or the World Bank, establishing an Executive Committee, subsidiary to the Conference of the Parties, to oversee the operation of the financial mechanism should not conflict with the language of the convention.

Indeed, the convention stipulates that the "financial mechanism" (*not* the operating entity) "shall have an equitable and balanced representation of all Parties, within a transparent system of governance," which suggests that a governance body separate from the operating entity was contemplated by the convention's drafters.

A further question is whether a Climate Convention Executive Committee could perform the same tasks as the MPMF Executive Committee. In particular, could it review and approve or disapprove funding of individual projects.

The Conference of the Parties, as the "supreme body of the convention," has a mandate to make "the decisions necessary to promote the effective implementation of the convention," and may exercise all such functions as "are required for the achievement of the objective of the convention." Unless the convention stipulates otherwise, it would seem clear that the Conference of the Parties may determine where the locus of decision-making should be.

The convention provides that the Conference of the Parties shall decide on the "policies, program priorities, and eligibility criteria" of the financial mechanism, but this list of powers is not exhaustive. Indeed, with respect to the financial mechanism, the Conference of the Parties has other explicit functions, including the right to require reconsideration of a funding decision and the right to receive reports from the operating entity or entities. This provision, therefore, does not limit the powers of the Conference of the Parties with respect to the financial mechanism.

It has been suggested that the right of the Conference of the Parties to require reconsideration of a funding decision implies that it is not to be the decision-making body. One answer to this argument is that the right to require reconsideration refers to any funding decisions left to the operating entity (e.g. decisions on projects below $500,000). It does not imply that *all* funding decisions are beyond the authority of the Conference of the Parties.

The Conference of the Parties may "[e]stablish such subsidiary bodies as are deemed necessary for the implementation of the convention." Presumably, any powers possessed by the Conference of the Parties may be delegated to such a subsidiary body. Thus, there would seem to be no legal impediments to creating an Executive Committee with project-by-project decision-making authority.

V. Conclusion

Within a year after the convention enters into force, the Conference of the Parties—the governing body of the convention—will hold its first session, at which it must decide on the structure of the financial mechanism.

While the requirement that the mechanism's operation "be entrusted to one or more existing international entities" limits the field of candidates, it does not lock in the GEF as the operating entity.

The MPMF approach presents a viable alternative; like the MPMF, day-to-day operation of the financial mechanism could be handled by the World Bank, UNEP, and UNDP—perhaps even within a restructured GEF—while governance could be delegated by the Conference of the Parties to a subsidiary body such as the Executive Committee.

Many problems have been identified with the GEF as presently structured. For example, it gives too much responsibility to the World Bank and not enough to the Participants or the other implementing agencies.

As a result, many of the bank's long-criticized policies, including information disclosure and decision-making, are reflected in the operations of the GEF. These policies are at cross purposes with the financing of environmental projects and should not be perpetuated in the Climate Convention financial mechanism.

In the final analysis, it seems foolhardy to give the bank management and executive directors power over convention-related projects. From an environmental standpoint, the bank has a long history of financing bad projects. To relinquish to the bank power that properly belongs to the convention parties is asking for trouble.

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The MPMF approach would ensure that decisions to approve projects are made by the parties, on a project-by-project basis. It would guarantee full disclosure of all pertinent information to parties and NGOs and would ensure that the parties have acceptable rules of membership, voting, financial contributions, segregation of funds, and public participation.

While it is possible that in the process of restructuring the GEF the problems that would impair its ability to function as the financial mechanism's operational entity could be addressed and remedied, the Conference of the Parties should look elsewhere for models for the mechanism's governance and administration.

A restructured GEF could still play an important, though circumscribed, role in managing and disbursing funds for climate projects.

No role should be contemplated for the GEF, however, until it has undergone a thorough, open, and independent review.

While the MPMF has had its own start-up difficulties, it has resolved many of these problems and shown itself to be a workable model for financing convention-related projects.

The Conference of the Parties could take advantage of and build on this experience by giving the MPMF model careful consideration, and perhaps reproducing it, in the design of the Climate Convention's financial mechanism.

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