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Arrangement on Officially Supported Export Credits

EX ANTE GUIDANCE FOR TIED AID

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This text of the *Ex Ante* Guidance for Tied Aid was agreed by the Participants to the Arrangement at their 94th Meeting held in April 2005.

FOREWORD

Ex Ante Guidance

This *Ex Ante* Guidance is the result of over 13 years of implementing the so-called "Helsinki" tied aid rules of the Arrangement on Officially Supported Export Credits. The *Ex Ante* Guidance is derived from the evaluation (at monthly meetings of the Participants held since February 1992 through 1996 and less frequently since) of over 131 individual project notifications for such aid. It is also the product of discussions among the technical experts who designed the underlying "methodology" and project evaluation procedures.

Tied Aid: The Rules

The Arrangement covers tied or partially untied aid financing: that is, credits or grants that are either tied exclusively to purchases from the donor, or are tied to purchases from the donor and one or more developing countries. A number of governments combine such development aid with export credits to create "mixed credits" or concessional loan facilities. According to the Arrangement, the concessionality level of tied aid for individual transactions must be at least 35%.

In December 1991, the Participants to the Arrangement agreed the Helsinki rules on tied aid credits aimed at limiting the use of concessional financing for projects that should be able to support commercial financing (*i.e.* those which are "commercially viable"). The rules went into effect on 15 February 1992.

These rules also redirect tied aid away from richer developing countries (*i.e.* those whose per capita GNP makes them ineligible for 17- and 20-year loans from the World Bank), which should be able to attract commercial credits, towards developing countries which are less well off.

In implementing these rules, the Participants also agreed to exempt the poorest Least Developed Countries (LLDCs as defined by the United Nations) which may have difficulty in gaining access to commercial financing no matter how attractive a project may be. Furthermore, the use of tied aid in these countries requires at least a 50% concessionality level.

In agreeing the Helsinki tied aid rules, the Participants expected a body of experience to develop over time that would more precisely define, for both export credit and aid agencies, *Ex Ante* guidance as to the line between projects that should be financed with tied aid or on commercial terms.

Arrangement on Guidelines for Officially Supported Export Credits

The Arrangement on Guidelines for Officially Supported Export Credits came into being in April 1978 and was developed in the framework of the OECD. It is a gentlemen's agreement, not an OECD legal Act; its Participants are most OECD Member countries.

The main purpose of the Arrangement is to provide the institutional framework for an orderly export credit market and thus to prevent an export credit race in which exporting countries compete on the basis of who grants the most favourable financing terms rather than on the basis of the price and quality of the product.

Export Credits

In addition to setting out rules for tied aid, the Arrangement provides a framework for official export credits. It sets limits on the terms and conditions for export credits involving credit terms of two years or more - that is, that are insured, guaranteed, extended, refinanced or subsidised by or through export credit agencies.

Such terms and conditions include a minimum cash payment of at least 15% of the contract by delivery, a maximum repayment term of eight and a half years (this may be extended to ten years for relatively poor countries, and up to 12 years for power plants) and minimum interest rates where official financing support is involved, *i.e.* "Commercial Interest Reference Rates" (CIRRs), which are subject to monthly adjustments to reflect market rates.

EX ANTE GUIDANCE FOR TIED AID

INTRODUCTION

1. In February 1992 the erstwhile Secretary-General of the OECD, Mr. Jean-Claude Paye, announced the new rules on tied aid credits, the so-called "Helsinki Package", aimed at limiting trade and aid distortions, and which would target much-needed external resources to projects and to countries with little or no access to market financing. The press release noted that:

> "The new rules will limit the use of tied aid for projects that should be financed commercially. They provide a level playing field where tied aid credits are used to fund projects that are developmentally sound but not commercially viable. .... Many had complained in the past that they are disadvantaged by tied aid credits used by their competitors for projects that could be financed commercially. These new rules should reduce or even phase out this disadvantage. .... I urge commercial lenders and export credit insurance agencies to accept this challenge by expanding credits and coverage for commercially attractive projects in developing countries so that total flows of resources to these countries will expand."

PURPOSE

2. The purpose of the *Ex Ante* Guidance below is to help project planners anticipate, at an early stage, whether (or not) a project is likely to pass the two Helsinki Package key tests[1] on commercial viability as caught within the Arrangement on Export Credits[2].

3. The *Ex Ante* Guidance has been derived from the body of experience developed over the past four years by the Participants to the Arrangement in their review of tied and partially untied aid for individual projects, and from the understandings reached on methodological issues.

4. The *Ex Ante* Guidance seeks to identify key technical and economic characteristics of past-evaluated projects that have impacted significantly on the Participants' decisions as to whether a project was considered eligible or ineligible for tied aid financing under the Helsinki Package. The *Ex Ante* Guidance can provide useful information on the probability of the commercial viability of a project; and therefore is not intended to pre-judge or pre-empt the evaluation of individual projects; rather, the

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[1] These key tests are:

- Whether the project is financially non-viable, *i.e.* does the project lack capacity with appropriate pricing determined on market principles, to generate cash flow sufficient to cover the project's operating costs and to service the capital employed, or
- Whether it is reasonable to conclude, based on communication with other participants, that it is unlikely that the project can be financed on market or Arrangement terms.

[2] The Arrangement on Guidelines for Officially Supported Export Credits [OECD/GD(92)95].

Participants recognise that all projects must be considered on a case-by-case basis in relation to their particular circumstances, contributing in future to a growing body of experience.

EX ANTE GUIDANCE

5. According to the Arrangement, financially non-viable projects with "appropriate pricing determined on market principles" are not expected to generate sufficient cash flow to cover the project's operating costs and service the capital employed under standard export credit terms, *i.e.* 12 years for power generation projects and ten years for all other projects.

6. The general characteristics of financially non-viable projects include projects whose principal output is a public good, capital-intensive projects with high per unit production costs and slow capacity uptake, and/or where the beneficiary group (normally household consumers) is deemed unable to afford the output at the appropriate market-determined price.

7. At the same time, it is recognised that each project should be considered on a case-by-case basis in relation to its particular circumstances.

8. Accordingly, the *Ex Ante* Guidance, by project concentration area, is as follows:

a) Power Projects (Electricity)

- If a project cannot be reasonably "isolated", both technically and financially, from the integrated power grid, it should be evaluated on a grid-wide, time-slice (*i.e.* project analysis undertaken at a special time interval) basis. Appropriate pricing of inputs and outputs would tend to favour a conclusion of financial viability, unless the grid at large is projected to be unable to cover its operating costs and debt service because the beneficiaries as a whole are unable to pay such prices.

- If a project can reasonably be "isolated" from the integrated power grid, marginal (or incremental) analysis should be used. High initial investment costs and relatively slow capacity uptake (normally associated with low-income, sparsely populated, environment) would tend to favour a conclusion of financial non-viability.

Transmission Lines, Substations and Final Distribution

- In order to determine the financial non-viability of transmission line and substation projects, projects should be capable of being "isolated" from the integrated power grid. Such projects would normally involve low voltage with clearly identifiable beneficiaries, such as finger extensions of the integrated power grid to outlying low population density areas, or projects entailing investment in low voltage final distribution to households. High capital costs and slow capacity uptake would also tend to contribute to a conclusion of financial non-viability.

Power Generation

- The ability to "isolate" power generation projects from the integrated power grid is related to whether or not the generator represents "base-load" capacity. Base-load power generation should, therefore, be evaluated using marginal (or incremental) analysis.

- Generators with "peaking power" characteristics are, by definition, part of the integrated power grid. Peaking power carries a price premium that implies a willingness-to-pay that would exceed the grid's LRMC.

Hydro-Power Projects

- Past experience has shown that hydro-power generation projects have been analysed in the context of whether or not they display peaking power or base-load characteristics.

- Hydro-power projects should take into account all financial benefits that are directly attributable to the project. Where such projects are part of larger multi-purpose projects, they should account accurately for the proportion of investment costs allocated to power production when assessing financial viability.

SCADA Systems (Supervisory Control and Data Acquisition Systems)

- As SCADA systems (and other grid-related computer/telecommunications projects) are specifically designed to enhance the efficiency of the integrated power grid, such systems would tend to favour a conclusion of financial viability.

b) Power Projects (Gas)

- Gas power projects exhibit many of the characteristics of their electricity counterparts. However, a major distinction is that isolation of a gas reticulation system from a larger grid is relatively common. Thus, as a general principle, rural greenfield gas projects would tend to favour financial non-viability, whereas urban projects may not, due to the high initial investment cost in infrastructure and the relatively slow take-up of demand.

c) Coal Gasification Projects

- Projects related to the supply of coal gasification equipment that benefit low-income residential users would tend to favour a conclusion of financial non-viability, especially if such projects are associated with substantial investment in pipeline and distribution infrastructure and slow capacity uptake.

d) Non-Hydro Renewable Energy Projects

- Projects relating to renewable energy (*e.g.* wind power) would tend to favour the conclusion of financial non-viability.

e) Telecommunications Projects

- Telecommunications projects with relatively high installation costs per line, low rates of growth of capacity utilisation and predominantly poor, rural household customer bases, often in geographically inhospitable environments (*i.e.* high operating and maintenance costs), would tend to favour a conclusion of financial non-viability. Low revenue-generating local calls and low growth prospects for high value long distance calls would also tend to contribute to a conclusion of financial non-viability.

- However, if "new" projects can be connected into national networks, a similar argument to the integrated power grid approach to project definition arises.

f) Transportation Projects

- Transportation projects associated with large capital investments and slow capacity uptake could tend to be financially non-viable; such projects would include:
  - greenfield airport infrastructure projects;
  - rail infrastructure projects (stations, bridges, tunnels, tracks, rolling stock for passenger transportation);
  - metro infrastructure systems; and
  - roads and bridges.
- Financially viable transportation projects would tend to be those projects where capital investments are relatively small, where marginal benefits can be isolated and where beneficiaries have the ability to pay, *e.g.* expansion of payload capacity, air navigation equipment, and possibly certain upgrades and replacements.

g) Manufacturing Projects

- Projects involving the creation or expansion of the output of a commodity that is priced on market-based principles would tend to be financially viable unless it can be demonstrated that the beneficiaries cannot afford to pay for the product.

FEASIBILITY STUDIES

9. The Checklist at Annex I (including Appendices I-IV) should assist in the preparation of Feasibility Studies for the evaluation of individual projects subject to the Helsinki process.

ANNEX I

CHECKLIST FOR INFORMATION IN FEASIBILITY STUDIES

1. PROJECT DESCRIPTION

The description of the project should be made on the basis of the definition in Appendix I.

1.1 Project Justification and Objectives

As a justification for project implementation, describe the overall objective to which the project is expected to contribute in the long run and describe the direct effects of a successful completion of the project, *e.g.* increase in production, increase in transport volumes.

1.2 Description of the Economic Environment

1.2.1 The economic system in which the project will operate

This would be a description of the level of development of the economy of the country, province, region or city as appropriate.

1.2.2 Financial status of the implementing organisation(s)

Information on the financial capacity of the implementing organisation(s), their status (public/private), their profitability, their relations with the borrower and the impact the project will have on them.

1.2.3 Financial status of the consumers

Description of the consumers of the products of the project: their status (industrial, households, government, etc.), GNP per capita and all available indications of price elasticity of demand.

1.3 Description of the Technical Environment

1.3.1 Technical Description of the Export Contract and the related Marginal Investment

Description of the aims/purpose (single/multi) of the investment and the technical means to achieve them (*i.e.* specify the technology and its appropriateness).

1.3.2 Technical Status of the Implementing Organisation(s)

Information on the technical capacity of the implementing organisation(s), the impact the project will have on them and their technical relations with the foreign contractor(s).

1.3.3 Description of Inputs and Outputs

Give a general description of goods and services to be supplied as inputs to the project with a break down on sourcing, *i.e.* domestic or imported.

Description of goods and/or services exported and domestic, their value, description of project's technical relations with larger system and explanation of project definition.

2. FINANCIAL APPRAISAL

2.1 Cash Flow Calculations

Give a description of the proposed financing of the project with a breakdown on equity, domestic financing, proposed tied aid credit and other financing.

Cumulative cash flow should be calculated over the Arrangement credit period from the starting point. Cumulative cash flow calculations should exclude depreciation but include all other relevant marginal costs and benefits, including on-lending and financing costs as well as borrowings to cover deficit years, and should include the costs associated with FEED, A&E and PRTA which are defined at Appendix I hereof. The treatment of taxes and duties as costs should be clearly specified and explained. Costs and benefits should be treated consistently, *i.e.* using the same project definition, currency, inflation assumptions, exchange rates, etc. Assumptions regarding prices, discount rate, exchange rate, etc., should be explained clearly.

To facilitate further transparency, the notifying country should endeavour to present cumulative cash flows in a format consistent with Appendix II, showing sensitivity analyses and scenarios.

If the product of the project is currently imported, describe normal import prices. If an alternative is produced domestically, describe the project's competitive position and any cross elasticities involved (*e.g.* public versus private transportation).

2.2 Sensitivity Analysis

2.2.1 Risk

If the project entails important risks that may have a large effect on cumulative cash flow, these should be specified and their effect on the cumulative cash flow should be quantified.

2.2.2 Alternative assumptions

Please provide cumulative cash flows based on:

a) extended terms in line with the economic life of the project's assets or, alternatively, include a suitable residual value where the economic life extends beyond market/Arrangement terms; and

b) the anticipated tied aid credits.

Where the agreed methodological approach has not been followed, the rationale for not using this approach may be explained; at the same time, cumulative cash flows based on the agreed approach may be provided. In this way, the effect of following an alternative approach would be clarified.

If you contend that the consumers are unable to pay, you should present a calculation of the break-even price for the project. If regulated local prices are used, calculations based on World Market/World Bank prices should be provided.

If the definition of the project is open to different interpretations, you should present calculations using those interpretations.

If taxes and duties impact considerably on the result of the cumulative cash flow, please make calculations with and without taxes and duties.

2.3 Conclusion on Financial Viability

This section pulls together the arguments of the previous ones. It allows you to justify your position based on the facts/data outlined in the above sections.

3. DEVELOPMENT AID ASPECTS

- In the event that an AQuA is provided, or specifically requested, the following information is relevant :

GUIDANCE IN PREPARING AID QUALITY ASSESSMENTS
(The following text was prepared by the Development Assistance Committee.)

The purpose of the following "expanded checklist" is to highlight, for each of the topics addressed, what the aid quality assessment (AQuA) should demonstrate/achieve. In preparing AQuAs, responses should therefore clearly demonstrate (and not merely state) the compatibility of the project with each of the themes addressed.

General: All appraisals are based on certain approaches and assumptions. These should be spelled out in appropriate detail; key assumptions underlying evaluations (*e.g.* pricing, technical requirements, administrative capacity, maintenance requirements, etc.) should be explicitly stated.

3.1 Project Selection (consistency of the project with the recipient country's overall investment priorities)

This section concerns the overall context in which the development project is being undertaken. Information provided under this heading should demonstrate the "fit" of the project into the recipient's economic and development plans, that the project is of priority for the recipient and that it is an appropriate use of scarce donor resources.

This section of the AQuAs should also state whether the project in question is in a sector for which there is a sectoral adjustment programme agreed between the recipient and donors and, if so, the compatibility of the project with that reform programme. Where there is no such adjustment programme for the sector in question, the donor should give its views on the adequacy of the recipient's sector plan, how the project in question is related to or compatible with that plan, and the extent of donor co-ordination, to ensure a coherent approach to supporting projects in the sector in question.

3.2 Project Preparation and Appraisal

The overall objective of this section is to demonstrate clearly that a project has been prepared, designed and appraised against a set of standards and criteria broadly consistent with the DAC Principles for Project Appraisal. The nature of the project will determine the depth of appraisal required and the nature of the information which should be included in the AQuA. Specific aspects for which donors should consider appraising the project against the DAC principles may include some or all of the following:

- ***Economic aspects***: Economic analysis is concerned with the larger impact of the project on the sector and the national economy, including production, factor incomes, consumption, public finances and the balance of payments. Where projects have quantifiable economic benefits and costs, a quantitative cost/benefit analysis should be undertaken and the findings reflected in the AQuA. Where it is not possible to calculate a meaningful rate of economic return, all relevant factors on the cost and benefit side should be taken into account through a systematic analysis, even if benefits cannot be expressed in monetary terms. [Many donors see value in including economic internal rates of return (EIRR) in AQuAs; not only do these quantify the economic/development benefits of the project, they also permit assessment of whether the substantive arguments presented in support of projects match the estimated benefits.]

- ***Technical aspects:*** Technical appraisal should show that the project can meet its objectives using technology and standards appropriate to the circumstances of the recipient country. The technical appraisal could, for example, demonstrate the appropriateness of the technology used. When the level of technology is felt to be unwarranted it may suggest that it is export driven rather than needed by the recipient as a priority.

- ***Financial aspects:*** Careful financial analysis and planning are required to ensure the financial soundness and sustainability of the project. This will not only address the financial viability of the project itself and the entity operating it but must also take into account the repercussions of the project on overall public sector finances. [The importance of a proper and appropriate definition of the project is an essential prerequisite for the financial analysis. Due attention must be given to the cost as well as the benefit side of the financial analysis.]

- ***Institutional assessment:*** AQuAs should include an assessment of the implementing or operating agency's capacity to execute the project effectively as well as of the institutional environment in which the project will operate. This should include an examination of the financial management capabilities of the organisation and the nature/duration of technical assistance which may be required to ensure continued successful operation of the project.

- ***Social and distributional analysis:*** It is important that intended target groups of a project be clearly identified and an assessment made as to whether the impact of the project is truly relevant to the capacities and needs of the intended beneficiaries and participants. Socio-cultural conditions, structures and traditions should not only be analysed for impact but should also lead to a strategy for enhancing the commitment and sustained participation of the people directly involved. Attention should also be given to gender composition at all stages of the project, particularly when considering such key elements as division of labour, access to and utilisation of resources, decision-making processes, distribution of income and benefits, etc. The impact of these factors may well affect the success of the project.

- ***Environmental assessment:*** The environmental assessment should make a clear statement of the significant beneficial and adverse environmental effects of the project. Attention must be paid to upstream and downstream effects and suggestions should be made as to mitigating measures or alternative designs for limiting negative environmental impacts. All of these should be quantified in monetary terms and incorporated into the economic analysis.

3.3 Procurement Procedures

The DAC has agreed to a number of principles which should guide the procurement conducted within aid projects. These are listed in the Good Procurement Practices for ODA. The objectives of these principles are to ensure transparency of process and ensure value for money. In particular, the nature and degree of competition in procurement should be identified and information provided to demonstrate that the procurement procedure achieves the maximum possible competition among potential/eligible suppliers. The AQuAs should clearly indicate the procurement modality (*e.g.* international competitive bidding, limited international bidding, national competitive bidding, direct negotiation) and demonstrate that it has been conducted in a manner compatible with Good Procurement Practices. Any requirements/guarantees/ assurances of the procurement agency or from the supplier concerning value for money could usefully be included.

APPENDIX I

PROJECT DEFINITION

1. For purposes of assessing financial viability, a project is defined in terms of a mix of inputs and value-added activities that produce a specific, marketable output. Specifically, a project may be defined as:

> the smallest complete productive entity, physically and technically integrated, that fully utilises the proposed investment and captures all financial benefits that can be attributed to the investment.

2. A project should include all marginal costs or inputs (including the proposed investment) technically required to produce a discrete marketable output. More specifically, for the purpose of cash flow calculations, it should include implementation-related investments such as:

- front-end engineering and design (FEED);
- architect engineering (A&E);
- procurement-related technical assistance (PRTA);

i.e. activities associated with (i) preparation of (a) detailed engineering, designs and specifications for the implementation of projects and (b) contract and bidding documents, (ii) pre-qualification of contractors, suppliers or manufacturers, and (iii) evaluation of (a) the eligibility of bidders, (b) bids and/or (c) recommendations regarding award of contracts, which would be provided after the decision to finance the related capital goods and services investment has been taken, but exclude:

- pre-investment decision technical assistance (TA);
- pre-investment decision technical cooperation (TC);

i.e. activities which would be used to evaluate the general feasibility of a project or otherwise used to determine whether a certain project is economic and should be undertaken. It is understood that specific technical assistance activities that would normally fall under the former category may be ignored from the scope of the definition of a project hereof only if they are within a value of USD one million or 3% of the total contract value, whichever is lower. The project entity for purposes of the financial viability evaluation is defined in terms of a specific marketable output and does not necessarily correspond to the legal or accounting unit.

3. The inputs and outputs of such a project should be technologically and physically related to avoid dissimilar activities being aggregated for application of the financial viability test. Investments in technically discrete activities or outputs should not be combined in defining a project. Investment in separate inputs each related to different discrete outputs should be, as far as possible, disaggregated into sub-investments with a clear connection inputs-outputs. Investments in similar activities in disparate geographic areas generally should not be aggregated for defining a project.

4. The project should count all benefits from the proposed investment. Therefore, the scope of the project should be defined so as to allow the full potential direct benefits of the investment to be counted across all users who derive benefits from the investment.

5. The project should fully utilise the proposed investment. The scope of project should be defined so that the investment financed by the offer is fully utilised in producing the intended output.

6. The evaluation of the financial viability is conducted with exclusive reference to the project as previously defined and normally leaves out analysis and evaluation of the financial statements of the implementing company, unless sufficient cash flow information is not available.

7. The Participants recognise that some add-on investments to projects with external environmental effects require special attention under the adopted definition, and that inflexible application of the polluter pays principle may create difficulties and may consequently lead to the rejection of projects. Whilst recognising that the aim of the Helsinki Disciplines is to avoid trade distortion in the provision of tied aid, the Participants agree to maintain a positive case-by-case approach when considering the arguments presented to the Group in support of the eligibility of such projects. In cases where the cash flow of the project, including the add-on investment is marginally positive, notifiers may reinforce the claim for special attention of their project by providing full and transparent information on the external environmental effects of the add-on investment. In addition to the elements necessary to establish the financial viability, Appendix IV of the Checklist contains some additional elements which may, amongst others, be considered by the Group when assessing those investments.

APPENDIX II

CUMULATIVE CASH FLOW TABLE
(currency in millions; constant prices)

YEAR	CAPITAL COSTS	OPERATING & MAINTENANCE COSTS	FOREIGN LOANS	DOMESTIC LOANS	INTEREST FOREIGN LOANS	INTEREST DOMESTIC FINANCE *	REPAY FOREIGN LOANS	REPAY DOMESTIC LOANS	INTEREST ON CUMULATIVE DEFICIT OR SURPLUS	TOTAL COSTS	TOTAL REVENUE	ANNUAL NET CASH FLOW	PROJECT'S CUMULATIVE NET CASH FLOW
**													
0													
1													
2													
3													
4													
5													
6													
7													
8													
9													
10***													
****													

*** includes interest on domestic loans and costs associated with project's domestic equity, *i.e.* returns to shareholders**

**** precommissioning/construction period**

***** Arrangement terms; this could be 12 years for power plants**

****** as appropriate according to the economic life of project's assets (*i.e.* for sensitivity analyses)**

Key Assumptions:

i) Input price(s): local or market? source?

ii) Output price(s): local or market? source?

iii) Interest rate(s): real or nominal?

iv) Inflation rate, if applied.

v) Treatment of taxes and duties.

All other assumptions should be detailed in the feasibility study.

APPENDIX III

APPROPRIATE PRICING

INTRODUCTION

1. The Arrangement provides that the financial non-viability of individual projects is tested against the capacity of each project

> "with appropriate pricing determined on market principles, to generate cash flow sufficient to cover operating costs and to service the capital employed."

2. Therefore, in principle, "appropriate pricing" should be based on local economic conditions without excessive government intervention and free of excessive market distortions; and inputs and outputs in cash flow analyses should reflect such a "global" approach with provision for individual projects to be considered on their own merits, *i.e.* case-by-case.

3. The following guidance elaborates on the above approach to appropriate pricing and on how such pricing should be treated in feasibility studies, appraisal reports and aid quality assessments for projects that are proposed for tied and partially untied aid credit support. Such treatment should lead to improved transparency which should, in turn, increase the clarity and predictability of opinions expressed by the Participants.

GUIDANCE

4. In the preparation of studies (*e.g.* feasibility studies, appraisal reports/aid quality assessments), it is desirable that Notifying Participants provide an appropriate number of cumulative cash flow analyses [format as detailed in Appendix II of the Checklist] in accordance with the base case approaches detailed below.

5. The approaches offer the Notifying Participant the opportunity to provide the maximum transparency needed in order for the Participants to evaluate the pricing employed in the study and whether particular local circumstances exist that suggest an approach other than the immediate removal of existing market distortions.

BASE CASES

6. The base case approaches are:

Local Prices

- If the Notifying Participant considers that local prices are appropriate, the project's study should use the prevailing (*i.e.* unadjusted) local market input and output prices from the beginning and throughout the entire analysis period.

- Therefore, the study should argue that local prices are appropriate for the purposes of the cash flow analysis. Accordingly, the study should explain the specific local market characteristics that support the argument that local prices are appropriate.

- The sources of local pricing and market information should be explained; possible sources might include exporters, consultants, commercial banks and local embassies/consultants.

Adjusted Prices

- If the Notifying Participant considers that local prices are not appropriate, the project's study should "adjust" the pricing in an attempt to estimate prices that would be expected to prevail in the market of the recipient country under competitive, non-distorted market conditions. Input and output prices should be adjusted at the beginning of the analysis period and maintained throughout.

- Estimates of appropriate prices may be derived from a variety of sources, including: price projections by multilateral development institutions (*i.e.* World Bank), prices of the good(s) in other markets adjusted for transportation costs, non-distorted prices of the good(s) in markets with similar economic characteristics, non-distorted prices of close substitutes in the domestic market, the long-run marginal cost (LRMC) of production for power projects, etc.

- The study should argue that local markets are not competitive and that prices are not set freely, *i.e.* in such a market, government intervention is precluding prices that are determined on market principles. The study should explain the specific local market characteristics that make it distorted and the local market characteristics in which prices are not freely set.

Phased Prices

- If the Notifying Participant considers that adjusted prices should be "phased-in" over time, a description of local market characteristics supporting such an approach should be provided (*e.g.* the targeted beneficiaries' inability to pay for the final product of the project could support this approach).

- Adjusted prices could be phased-in over a reasonable time period: the study should explain the specific local market characteristics that warrant such phasing-in. As well, the rationale behind the time period over which prices are to be adjusted should be explained.

APPENDIX IV

PROJECT DEFINITION "ADDITIONAL ELEMENTS"

Amongst others, the following additional elements may be considered by the Consultations Group when assessing, under the Helsinki disciplines, add-on investments with external environmental effects for projects where the cash flow is marginally positive:

- the seriousness of the environmental problem;
- the adequacy of the technical solution;
- the local and regional environmental legislation and enforcement;
- the capability and/or ability to pay for the add-on component of a project; and
- the revenue or output consequences of the add-on component to the overall project.