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Agenda Item 6

REPORT OF THE MONITORING AND EVALUATION UNIT:

PROJECT PERFORMANCE REPORT 2003, AND

REVIEW OF GEF ENGAGEMENT WITH THE PRIVATE SECTOR

(Prepared by the Monitoring and Evaluation Unit)

The Council, having reviewed document GEF/C.23/3, *Report of the Monitoring and Evaluation Unit*, takes note of the conclusions and recommendations of the Project Performance Report 2003 and the Review of GEF's Engagements with the Private Sector (Final Report).

Concerning the Project Performance Report 2003 the Council requests the Monitoring and Evaluation Unit to follow up on the report's recommendations with the GEF Secretariat and the Implementing Agencies and report the outcome to the November 2004 Council meeting.

The GEF Secretariat is requested to take the conclusions and recommendations of the Review of GEF's Engagement with the Private Sector into consideration in elaborating on the principles for engaging the private sector approved by the Council.

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INTRODUCTION

1. This report from the Monitoring and Evaluation unit contains summaries of two reports, which are also presented in full as information documents to this Council meeting. These are:

- Project Performance Report 2003 (GEF/C.23/Inf.5)

- Review of GEF's Engagement with the Private Sector (Final Report) (GEF/C.23/Inf.4), and

A. PROJECT PERFORMANCE REPORT 2003

2. In preparing the 2003 Project Performance Review (PPR) the M&E unit has drawn on the findings of 336 individual Project Implementation Reviews (PIR), 8 Specially Managed Project Reviews (SMPRs) and 18 Terminal Evaluations (TEs). The M&E unit coordinates the annual PIR process which involved the Implementing Agencies (IAs), the GEF Secretariat, and STAP. The PPR is essentially a tool for monitoring project implementation and not the key tool for in-depth analysis of GEF project outcomes and impacts, which are addressed by the program studies that the M&E Unit is conducting in the Biodiversity, Climate Change and International Waters focal areas. These will be completed in July 2004.

3. The 2003 PPR report presents a portfolio overview including distribution of funds, disbursements, elapsed time of projects between GEF allocation and effectiveness, an assessment of progress towards achievement of project outcomes, as well as the main challenges in the focal areas of Biodiversity, Climate Change, International Waters, Ozone Depletion and Integrated Ecosystem Management. In addition, the PPR focuses on three key M&E review criteria, sustainability, replication and monitoring and evaluation. Finally, this year's PPR explores the issues of project complexity and overly ambitious objectives as factors negatively affecting project performance. The major findings and recommendations of the 2003 PPR are as follows:

(a) Size and Distribution of the Portfolio

4. From the beginning until June 30, 2003, a total of 722 full and medium-sized projects had been allocated funding in approved GEF work programs, compared to 621 projects by June 30, 2002, which is an increase of about 14 percent.

(b) Time from Allocation to Implementation

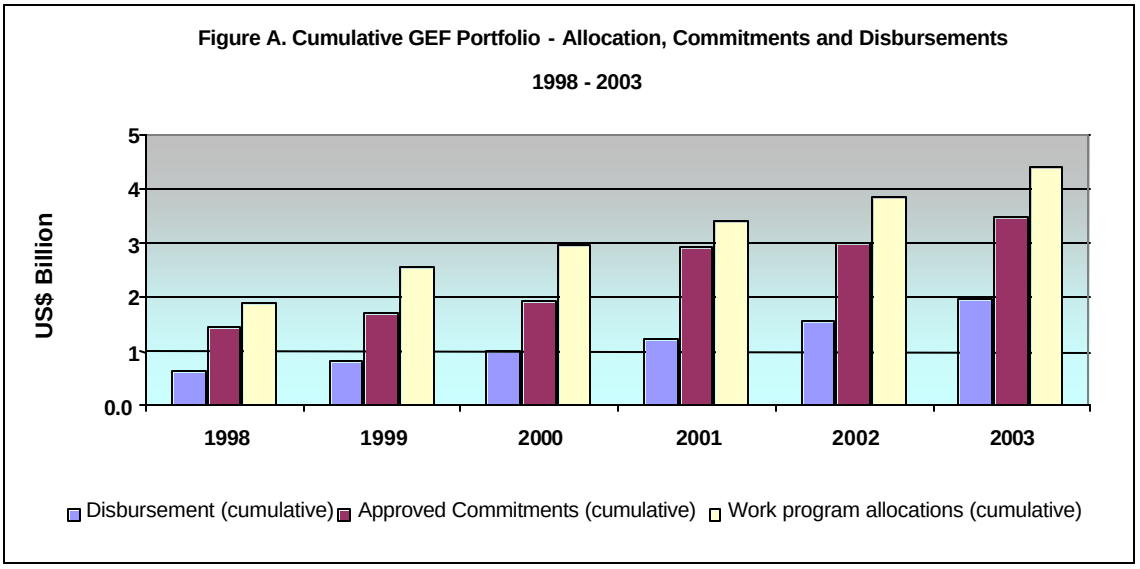
5. UNDP and the World Bank report that over the last few years they have been looking for ways to reduce the elapsed time from allocation of GEF funds to implementation. Nevertheless, the elapsed time increased for all three IAs in 2003 to the following number of days: World Bank 795, UNDP 370, and UNEP 391 days.

6. **Recommendation**: The GEF M&E Unit will conduct a special review with the participation of the IAs of the factors that lie behind the long time required for project preparation and initiation.

(c) Gaps Between Approved Commitments and IA Project Disbursements

7. Figure A shows GEF allocations, commitments, and disbursements as of June 30, 2003. The cumulative work program allocation from the start of the GEF was US$ 4.205 billion. During FY03, 67 full size projects (FSP), 39 medium size projects (MSP) and 121 Enabling Activities were approved totaling US$555.63 million. Cumulative disbursement for the entire GEF portfolio, increased during FY03 to US$1.987 billion, up from US$1.54 billion in FY02.

8. The gap between the approved commitments and the actual disbursements was 57 percent in 2001 but has been decreasing since then and was 43 percent in 2003. Figure A shows that the level of disbursements in 2003 is approximately the same as the level of approved commitments in 2000.



9. **Recommendation**: The GEF M&E Unit will conduct further analysis of the trends in approved commitments and project disbursements together with the analysis of "elapsed time" between project allocation and start of implementation.

(d) PIR Project Ratings

10. The PIR is a monitoring tool that relies on each IA to rate project performance. The IAs rated their projects according to two criteria: implementation progress (IP) and likelihood of attaining development/global environment objectives (DO).

11. This year, 46 projects (14 percent) were rated Highly Satisfactory in IP, 213 projects (65 percent) were rated Satisfactory, 31 Partially Satisfactory (9 percent), and 16 (5 percent) unsatisfactory. 24 projects (7 percent) did not provide ratings for IP in their PIRs. The ratings on attainment of global environmental objectives were very similar to the implementation progress ratings.

12. The PPR found that there is a need for more consistent ratings, especially to avoid over-rating. The definitions of "highly satisfactory" or "satisfactory" are not consistently applied across the three IAs. For example, some projects rated "highly satisfactory" did not provide much, if any, evidence that project achievements were beyond those that would have merited only a "satisfactory" rating. In addition, there are inherent problems in reconciling the rating practice to the differences in project circumstances and the context in which the project is implemented. In other words, when the external circumstances (context) to project implementation becomes very difficult, the agencies tend to accept a less ambitious outcome than the one originally proposed as satisfactory.

13. Most IAs have acknowledged the problem of "over-rating" projects and have already put in place internal review processes to remedy this issue. When requested to reconsider project ratings, moreover, two agencies downgraded their ratings for 5 projects in International Waters.

14. **Recommendation:** The M&E unit will form a working group, which will include representatives of the IAs and the GEF Secretariat, to develop and adopt clearer guidelines and to identify best practices in rating project results.

(e) Sustainability

15. Sustainability refers to the likelihood that project benefits (outcomes and impacts) will continue, within or outside the project domain after GEF assistance has come to an end.

16. There are several dimensions of sustainability, which vary from one project to another. This year's TEs, SMPRs and PIRs continue to affirm previous PPR findings that sustainability of projects continues to be a challenge. In the International Waters focal area, GEF has supported Transboundary Diagnostic Analysis (TDAs) and Strategic Action Programs (SAPs) on reduction of stress in water bodies. However, there is uncertainty about whether investments are taking place after the planning exercise.

17. Financial sustainability, while a critical factor, is not sufficient for the continuation of project benefits. In biodiversity, the PPR found that financial and institutional sustainability are a major problem at the time the GEF projects are closed.

18. For the climate change portfolio, which frequently addresses market transformation and the introduction of new technologies, four factors were found to be essential for sustainability of benefits: strong market supply and demand, supportive government policies, capable institutions, and adequate financing. Some projects failed to address all four factors, which reduced the sustainability of the outcomes. Projects also need to address other non-financial dimensions of sustainability, such as policies, awareness, capacity and consumer behaviors, depending on local circumstances.

19. **Recommendation:** In consultation with the GEF Secretariat and the IAs, the M&E Unit will develop a methodology and framework for a better assessment of sustainability.

(f) Replication

20. Replication in the context of GEF projects is defined as using the lessons and experiences of a project in the design and implementation of other projects. Replication proper takes place in a different geographic area, whereas "scaling up" of a particular lesson or experience occurs within the same geographic area but with other sources of funding. Replication of GEF projects is seen as a tool to increase impacts and cost effectiveness of GEF interventions.

21. There are projects in all focal areas for which replicability is highly relevant, such as energy efficient product market transformations. However, the PPR found that the concept of replication is still unclear and that generally the development of replication strategies is often overlooked during project design and implementation and that including replication strategies in project design, where relevant, increases the replication potential.

22. **Recommendation:** The GEF Secretariat should develop specific guidelines for replication strategies in each focal area.

(g) Monitoring and Evaluation

23. An important criterion for reviewing projects is the quality of monitoring and evaluation (M&E) systems. Projects are required to design and implement plans for monitoring and evaluation with adequate funding and appropriate staff and to report on project M&E systems, data sources and methods for data collection.

24. Reports by the IAs as well as the M&E Unit's evaluation reports show that there has been some progress in the establishment of M&E systems, although there are still several gaps and weaknesses in parts of the portfolio. The World Bank undertook a review of M&E in project design and supervision based on 45 project appraisal

documents (PAD) and 24 project supervision reports. The review found that most project designs did not adequately address M&E arrangements. Only one-third of projects were making good use of M&E during supervision, whereas two-thirds exhibited at least one of the common M&E problems found. These included absence of M&E plans with adequate financial and human resources; inadequate systems for data collection, including baseline data; inappropriate indicators to assess project impact; continued focus on inputs and outputs rather than outcomes and impacts; and inconsistent linkage of indicators to higher level objectives. The World Bank developed a plan to address the weaknesses it has identified in M&E systems.

25. The newer projects represent an improvement over older ones, and project staff are increasingly aware of the deficiencies and the need to remedy them. The emphasis on program and outcome indicators by the M&E unit in 2003 is requiring the IAs to focus more on outcomes and the quality of information generated by projects. UNDP reports that several projects with poor or no indicators have initiated plans to rectify the situation. UNDP has also developed a plan of action to assist in retrofitting impact indicators for priority projects.

26. In addition, as part of their M&E systems, IAs reported that they are making progress to develop their projects-at-risk systems. These systems seek to establish an early warning system to identify potential problem projects before problems mature. The primary purpose of this classification is to bring added managerial attention to such projects to help prevent unsatisfactory outcomes.

27. During the last few years, the World Bank has developed a projects-at-risk system to overcome the possibility of over-optimism in the rating by task managers. UNDP and UNEP are following suit and expect to have their systems in place by FY 2005.

28. **Recommendation:** UNDP and UNEP should also carry out an assessment of the M&E systems in their GEF projects similar to the one carried out by the World Bank and devise a plan to address the weaknesses identified in each project.

(h) Complexity and Overly Ambitious Objectives

29. PPR review meetings have highlighted project complexity and over-ambitious objectives as factors that reduce the likelihood of achieving project objectives and substantial environmental benefits. The same two issues were identified in two SMPRs, 9 of the 18 project final evaluations submitted by the IAs in 2003, and IA overview reports. IAs report that GEF projects tend to include too many separate activities, resulting in lack of clarity of what the project objective actually is. The issues of project complexity and over-ambitious objectives have also been raised in previous PPRs.

30. Although the factors leading to project complexity are not entirely clear, one cause may be the unrealistic expectations about the need for projects to be all-inclusive and deal with too many aspects of the problem. Those projects in which complexity was not reported as an issue had concise objectives, and the activities supported under the

project were clearly and directly linked to those objectives. The scale of these projects, their technical complexity and their implementation schedules were consistent with the capacities of local executing agencies.

31. Closely related to the problem of complex projects are over-ambitious objectives in relation to the available resources and the time frames for implementation. Objectives may be unrealistic in terms of the capacities of local partners, assumptions about initial conditions or the resources and time required to achieve the desired results. Another problem is unrealistic assumptions about either project problems or solutions. For example, the World Bank biodiversity focal area report notes that a whole generation of projects has been designed on the often flawed assumption that poverty and lack of alternative livelihoods is the primary, if not the only, driving factor behind biodiversity loss and threats to protected areas. It has turned out that frequently national policies and decisions at the country level or outside the country have posed greater threats. These include allocation of logging concessions, new transport infrastructure or dams, etc. Similarly, one International Waters midterm review indicated that the project wrongly assumed that participating governments would quickly adopt economic instruments and that countries would be fully engaged in the preparation of national action plans and pre-investment studies early on in the project, while these processes have taken several years in other projects.

32. It is likely that pursuance of overly complex projects is related to the incentive structure in the IAs. It would be desirable that the Third Study of GEF's Overall Performance (OPS3) reviews the incentive structures to ensure that they encourage the IAs, project managers and recipient countries to present projects with clear and realistic objectives, as well as manageable levels of complexity.

33. **Good Practice.** The PPR general review meeting proposed a set of good practices for project preparation and project review for the IAs and the GEF Secretariat, respectively:

- Analyze and break down complex causes of environmental problems to arrive at actions that address key aspects of the problem.
- Adopt, when appropriate, a "phased" or "benchmark" approach. For example, in the initial phase the emphasis can be on capacity building and other preparatory activities including a few minor investments to reduce risks and test assumptions, with follow-on investments in a second phase as the project context is more ready to assimilate these.
- Conduct thorough country capacity assessments early in project preparation, to ensure that key organizations to be involved in project implementation are either already fully capable or can be strengthened to reach the required level of capacity to effectively implement the project.
- Clearly define partner responsibilities and establish legally binding contracts when appropriate.

B. REVIEW OF GEF'S ENGAGEMENT WITH THE PRIVATE SECTOR

34. At its May meeting in 2002 the GEF council requested the GEF Secretariat to prepare a Private Sector Strategy. As a contribution towards this strategy, the current review by the M&E Unit was initiated at the end of 2002.

Private Sector Policy

35. The GEF private sector portfolio has evolved from the early days of the pilot phase. Two GEF Council papers of 1996 and 1999 laid down some essential objectives and principles. The centerpiece of these Council documents was that there would be two different approaches to GEF's engagement with the private sector: in the narrower and more rigorous sense the GEF provides incentives to private sector entrepreneurs to invest in ventures designed to create global environmental benefit. Under the broader approach, the GEF supports activities to help make policy and regulatory frameworks conducive to more environmentally sound private sector investments. The two papers are rather rudimentary and do not fully resolve a number of fundamental issues, such as: (a) the objectives of engaging the private sector within the context of GEF's overall and focal area strategies; (b) the use of appropriate modalities of support; (c) GEF policy on risk-sharing, co-funding and leveraged funding; and (d) tools to monitor the progress of sub-projects (which are more common in the private than the public sector approach).

Extent of Engagement, Co-funding and Leveraged Funding

36. Of the 621 regular and medium-sized GEF projects under implementation on June 30, 2002, 60 involve cooperation with the private sector beyond procurement of goods and services. GEF allocation to these projects is almost US$ 585 million and the total co-funding committed at project design is US$ 2.138 million. About 87 per cent of the co-funding comes from donor organizations, the recipient governments and other public sector sources. All the recorded private sector co-funding has been made in only about 20 projects. The total recorded amount is US$ 391 million.

37. While co-funding is mostly decided at the stage of GEF allocation, the contribution by the private sector, especially in IFC projects, is sometimes decided at later stages. Such private sector contributions, whether in the form of investments related to the GEF project objectives by financial intermediaries, equity investments or similar, is considered as "leveraged funding." This term has not been closely defined in the context of private sector investments and the reporting on leveraging has not been systematic[1]. It is therefore not yet possible to draw a firm conclusion about the degree to which GEF projects have been successful in leveraging private sector financial risk-taking. However, in some important projects the leveraged funding is smaller than had been expected at the time of GEF allocation.

[1] The Council paper on "Cofinancing"(GEF/C.20/6/Rev1) does not define "leveraged resources" closely and does not specify monitoring procedures for such funds.

38. **Recommendation:** GEF should develop a more rigorous definition of leveraged funding and make better arrangements for the collection of accurate data on the leveraged funding achieved.

Modalities of Support

39. As proposed in the GEF 1996 and 1999 Council papers, GEF has utilized both grant and non-grant assistance. However, two other project modalities proposed—bankable feasibility studies and progressive partnerships—are not satisfactorily described in the Council papers; the former is used in only one project and the latter is not used at all.

40. Grants have been used to stimulate markets through awareness raising, standard-setting and certification, for technical assistance, to cover market development costs or to provide a degree of subsidy to the investments. Non-grant modalities have included contingent grants, loans, partial risk guarantees, investment funds and reserve funds. Non-grant modalities have been most appropriate where projects were potentially economic, but where there might be a lack of local expertise, environmental uncertainties or other obstacles.

41. The appropriateness of particular financing mechanisms in the climate change focal area is highly dependent on the state of the market. Grants may be most appropriate for markets in early stages of development of energy efficient equipment, whereas more sophisticated mechanisms may be better suited for markets whose development is farther along. Energy Service Companies (ESCOs) can play a significant role in developing energy efficiency projects. However, in many countries, it is difficult to set up ESCOs successfully, because of the lack of the necessary equity basis for obtaining loans from local banks. Financing mechanisms used in the biodiversity focal area have included loans through financial intermediaries, and grant financing for direct payments to landowners and for technical assistance. Four projects involving equity funds in climate change and biodiversity have faced great problems to raise the required private sector capital. For the portfolio as a whole, the soundness of business plans of investors and the quality of project management and supervision have been found to be more important than the choice of financial instruments, even if the right mix of financial and non-financial instruments can be very critical to individual projects.

Implementation Progress

42. An overriding problem with both public and private sector engagement is the slow maturing of GEF projects. During this review it was found that considerable delays have occurred at all stages in the project cycle from identification and preparation through approval and implementation. This is due to a number of reasons, including poor and unrealistic project designs, lack of adaptive approaches to changing realities on the ground and weaknesses in project management and supervision. The delays have often reduced the likelihood of attaining the desired impacts as well as of replication.

43. **Recommendation:** The elapsed time between the initial proposal and final approval of projects that engage the private sector should be made more predictable and transparent. GEF Secretariat and Implementing Agencies should adopt clearer business

norms for providing information to project proponents and other stakeholders on the status of project proposals, the anticipated time required for various steps toward approval, and the reasons for any delays. For this purpose, an online project tracking system should be developed.

Host Country Support

44. As required by GEF procedures, GEF projects have been duly approved by host country governments. However, some governments have raised questions about the approval procedures for sub-projects linked to regional or global projects. In those cases ownership by the governments was apparently weak.

45. Supportive government laws, policies and regulations are generally necessary also for private sector project success. When the host country government has pursued policies that reflect less than enthusiastic support for the project objectives, there have been obstacles to meeting the objectives, especially if the projects did not enjoy very strong support by private sector champions either.

GEF Competence

46. The World Bank and the IFC has a comparative advantage in planning and implementing macro-economic and private sector strategies. Otherwise, competence on business finance matters in the context of global environmental issues is scarce in the GEF. Nevertheless, the attention to this area has increased in UNDP and UNEP during recent years.

47. **Recommendation:** GEF should not attempt to enforce a strict agreement on role and comparative advantages on each of the three Implementing Agencies in this respect. The GEF Secretariat should strengthen its own expertise and work with each of the IAs as well as Executing Agencies to define the types of projects that are most appropriate to the capabilities and comparative advantages of each agency. UNEP and UNDP need to strengthen their institutional capacity on contingent financing, if they are to continue to implement projects involving such mechanisms.

Selection of Financial Partners

48. The selection of the right financial partners for planning and implementing projects, and provision of appropriate incentives for achieving GEF objectives, are important factors for successful project outcomes. Selection of partners on a clear, transparent and fully competitive basis through bidding or open negotiation would be advantageous to the GEF, not only for ensuring the best-informed choice of partners, but also for negotiating costs, benefits and risk sharing. However, most financial partners in World Bank and IFC energy efficiency projects have been selected on a sole-source basis, or based solely on their qualifications early in the project cycle, before the project was fully designed. Compensation and incentives to financial intermediaries in some projects have lacked objective, transparent criteria. The 1999 GEF Council decision that contingent loans and grants must be carefully structured to include risk-sharing

arrangements has not been adequately implemented. The GEF does not have the information and legal tools it needs to implement the policy, with the result that GEF is too often liable for first loss and is unable to handle re-flows (financial reimbursement) to which it would otherwise be entitled.

49. **Recommendation:** GEF should seek a higher degree of risk sharing among project participants, based on the respective roles of partners (e.g., IAs, guarantors, lenders, ESCOs, equipment suppliers, end-users) to create better incentives for project success and to avoid conflicting interests and "moral hazards." For this purpose, individual contracts under GEF supported projects should be accessible to the GEF Secretariat and the M&E unit upon request. In particular cases the GEF Secretariat should negotiate legal agreements with the agency implementing or executing the project to ensure adequate and realistic cost-sharing. Compensation and incentives to financial intermediaries must be based on objective and transparent criteria.

Monitoring and Evaluation

50. Monitoring and Evaluation frameworks for most of the reviewed projects do not explicitly aim at measuring environmental impacts. Baseline studies are rare in biodiversity-related projects, and some climate-related projects lack methods for measuring GHG emissions reductions under the project. Some of the projects have financial and environmental performance criteria as triggers for disbursement, but lack the capacity to monitor progress towards these criteria.

51. **Recommendation:** GEF needs more detailed guidelines on Monitoring and Evaluation systems for both public and private sector projects and sub-projects. In cooperation with other GEF entities, the GEF Secretariat needs to distil and compile joint experiences and lessons learned on such issues as financial tools, risk mitigation, credit systems, working with intermediaries and economic viability of various technology applications and approaches.

Climate Change

52. GEF projects aimed at influencing public policy/regulatory frameworks appear to create conditions for market transformation in energy efficient equipment. Promising results have been achieved through projects related to certification, labeling and standard-setting. With the support of public sector agencies, some manufacturers and private investors have demonstrated highly cost-effective options for reduction of CO2 emissions through promotion of markets for energy-efficient refrigerators, fluorescent lighting equipment, building insulation and air conditioning.

53. The results of projects aimed at developing a market for off-grid energy from photovoltaic technologies, which represent the vast majority of GEF projects in renewable energy, have not been so encouraging. These projects face a number of obstacles, including relatively high cost to consumers and lower than expected demand, service problems for dispersed rural populations, competition with the grid-based energy and especially the absence of risk-sharing by PV manufacturers and other private sector

actors. During the design phase of PV-related projects, the assessment of market issues and of the strengths and weaknesses of the private sector actors whose participation are essential for success, was often inadequate.

54. **Recommendation:** GEF should review its renewable energy policy and not approve new PV projects without very convincing evidence that the past obstacles to success are likely to be absent or can be overcome.

Biodiversity

55. The biodiversity projects reviewed include efforts to create markets for agro-forestry commodities, ecotourism, environmental services and conservation on private lands.

56. In areas where very little of the original forest cover remains, coffee and cacao cultivation can provide significant biodiversity benefits, depending on the type of shade system employed. The goal of GEF projects is to encourage biodiversity-friendly production of cocoa and coffee by supporting certification systems which includes criteria for biodiversity richness. However, the projects have faced the problem of an absence of adequate certification systems and markets which distinguishes satisfactorily on biodiversity richness. Although coffee and cacao are marketed under various specialty coffee labels related to fair trade and organic production, the current certification systems do not provide satisfactory incentives for maintaining or achieving acceptable biodiversity-related standards.

57. An innovative approach to the creation of incentives for conservation of biodiversity on private lands is the concept of Payment for Environmental Services (PES), which has been pioneered in Costa Rica. Some of the project areas have only involved relatively short term easements (agreements on conservation), which may run the risk of logging after a few years. The application of the PES approach has also to some extent involved logging and monoculture plantations, which raises complex conservation policy issues.

58. Eco-tourism can benefit biodiversity conservation by providing additional financial support for protected area management while minimizing impacts on the ecosystem. The main challenges in the few projects reviewed have been to minimize the risk of failure associated with choice of location and to be assured that government biodiversity policies and enforcement practices provide a minimum level of protection.

59. Private lands conservation is an important adjunct to public protected areas in Latin America, where so much of the remaining forested land is privately owned. Some limited progress has been made to reform legal and policy frameworks to support private protected areas.

Recommendations

60. GEF should not finance new projects aimed at certification of coffee or cacao or other commodities unless the certification system meets acceptable minimum biodiversity criteria, or GEF can decisively influence the establishment of and the adherence to such criteria. GEF should continue to study carefully the evolution of the markets in order to determine its possible additional roles vis-à-vis the various actors.

61. Prior to approval of a private sector eco-tourism project, a critical minimum level of government efforts for protection should be agreed.

62. GEF should prioritize projects whose emphasis is on longer term easements or more permanent forms of conservation.