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MANAGEMENT RESPONSE TO THE REVIEW OF GEF'S ENGAGEMENT WITH THE PRIVATE SECTOR

(Prepared by the GEF Secretariat and Implementing Agencies)

Recommended Council Decision

The Council takes note of document GEF/ME/C.24/6, *Management Response to the Review of GEF's Engagement with the Private Sector*, and requests the Secretariat to better articulate a private sector strategy, with the collaboration of the Implementing/Executing Agencies, and in consultation with private sector stakeholders, with specific attention to the following topics:

- (a) A clearer understanding of the expectations of various partners in a project/program context, to ensure that appropriate risk-sharing arrangements are established amongst the various partners;
- (b) Roles of the Implementing and Executing Agencies to define the types of projects that are most appropriate to the capabilities and comparative advantages of each agency;
- (c) Identification of staffing needs at the Secretariat and the Agencies in the context of implementing the strategy;
- (d) Norms for identification and selection of private sector partners on a competitive and transparent basis, and criteria for rewarding performance.

Executive Summary

This report is a GEF management response to a review (GEF/C.23/Inf.4) conducted by the GEF M&E unit of GEF's Engagement with the Private Sector. The findings and recommendations in the review cover three broad areas: (i) biodiversity conservation; (ii) climate change; and (iii) cross-cutting issues. The GEF Secretariat, in consultation with the Implementing Agencies, has prepared this management response.

The management agrees with the report's wider recommendation that there is a need for better definition and clarity regarding GEF's terms of engagement with the private sector, with specific attention paid to the following items: (i) establish appropriate risk-sharing arrangements among various partners; (ii) align roles of Implementing/Executing Agencies with their comparative advantages; (iii) identify staffing needs at the Secretariat and at the Agencies; and (iv) institute norms for identification and selection of private sector partners on a competitive and transparent basis.

There are other recommendations that are related to leveraging, country ownership, measurement of global benefits, project processing times, M&E systems, etc that are being followed up in the context of various other activities of the Secretariat and the Agencies.

In the Biodiversity focal area, management is concerned about the recommendations being based on a very narrow sub-set of projects. There are considerable opportunities for engaging the private sector through GEF's strategic priority on *Mainstreaming Biodiversity in Production Landscapes and Sectors*. Given that this is a new and emerging area, more in-depth analyses are desirable to better understand the conditions under which global environmental benefits can be generated in a cost-effective manner.

In the Climate Change focal area, while the review itself has failed to clearly articulate the major barriers to and opportunities for bringing the dynamism of the private sector to bear on GEF programming issues, some of the findings with respect to the market transformation interventions, ESCO projects, and to a lesser extent, the use of financial instruments have been beneficial. Unfortunately, the major recommendation in the Climate Change focal area – discontinuing work on solar photovoltaic projects – does not follow from the analysis, is too general, and far-sweeping to be meaningfully applied. Management will continue to screen photovoltaic projects carefully to ensure that they are market-driven -- focusing broadly on remote renewable electrification, emphasizing productive opportunities wherever possible – and that they set realistic goals and priorities.

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Introduction

1. This report is a management response prepared by the GEF Secretariat, in consultation with the Implementing Agencies, to respond to the recommendations of the Review of GEF's Engagement with the Private Sector (GEF/C,23./Inf.4). 5
2. For the purpose of the review, GEF projects with a substantial private sector engagement component were considered for examination. "Private sector enterprises" were broadly defined as having commercial viability as their goal. The review focused by and large on projects in the biodiversity and climate change focal areas, as projects involving the private sector are more concentrated in those two focal areas.
3. The findings and recommendations in the review cover three broad areas: (i) biodiversity conservation; (ii) climate change; and (iii) cross-cutting issues. The management response as presented covers the cross-cutting areas first, followed by the biodiversity and climate change focal areas.

Cross-cutting Issues: Findings

4. Findings in the cross-cutting areas pertain to issues that are common to all the focal areas of the GEF, and in several instances relate to underlying policies and procedures associated with the GEF project cycle.

Slow Maturing of GEF Projects

5. The review found slow maturing of GEF projects an overriding problem, and that delays have often reduced the likelihood of attaining the desired impacts and the likelihood of replication. We agree that there is scope for improvement in the project cycle, but do not necessarily agree that there is a negative impact on project success and replication. The Second Overall Performance Study (OPS2) concludes - in a more balanced analysis - that the processing steps were generally justified for project quality and due diligence, but that there was scope for streamlining various steps to reduce transaction costs and elapsed time.

Country Ownership

6. The review found that governments have raised questions in a few cases about the approval procedures for subprojects linked to regional or global projects. In those cases country ownership was apparently weak. More often projects lacked strong proponents and champions, whether in the public sector or in host governments.
7. Host-country ownership is a key criterion that must be met to secure GEF funding and this is expressed in many ways during project implementation, but it starts with the official Government endorsement by the GEF operational focal point. It may be true that some projects enjoy greater Government support than others and that subprojects linked to global or regional projects may not be as strongly supported as single-country interventions. We agree that ensuring country ownership for all projects that take place within a country is essential and that GEF projects should be complementary to existing national policies, laws, and regulation and

that the national policy frameworks should be supportive of the project objectives. Current project review criteria include all of these factors and thus project designs must address these issues.

Measuring Global Environmental Impacts

8. Monitoring and evaluation frameworks included in most private sector projects, the review found, are weak in aiming to measure global environmental benefits; baseline information is rare in most projects.

9. Measuring global environmental impacts is specific to focal areas and to projects within focal areas. Aggregating project level impacts to the portfolio level is also challenging particularly when project interventions are as diverse as they are in the biodiversity focal area, for example. We agree that establishing baselines against which progress can be measured is a first required step in any type of M&E framework to measure impact.

Leveraging the Private Sector

10. Since systematic data are not available on leveraging, the review could not arrive at a firm conclusion regarding the degree to which GEF projects have been successful in leveraging private sector financial risk sharing. The review also found that the 1999 GEF Council decision that contingent loans and grants be carefully structured to include risk-sharing arrangements has not been adequately implemented.

11. We agree that mechanisms to collect data on leveraging private sector financial risk sharing and cofinancing are important and essential to allow for accurate reporting and to monitor progress in these areas. The Implementing/Executing Agencies, who work closely with the client countries and partners, assure us that the choice of instruments is made within the context of market conditions. However, we do note the point about appropriate risk-sharing, and the need to develop arrangements with the GEF Trustee to handle project cash reflows.

Selection of Financial Partners

12. The review has emphasized the necessity of identifying and engaging the financial partners in a transparent and competitive process; compensation and incentives to financial intermediaries, in a few cases, have lacked objective, transparent criteria and indicators.

13. We agree with the above finding, and will emphasize these issues with the Implementing/Executing Agencies in project preparation and implementation.

Learning Frameworks

14. The review identified the lack of any joint learning process with regard to experiences with different approaches and instruments across the portfolio. While we agree with the need to further strengthen the learning framework at the GEF, we would like to point out that successful approaches such as financial risk mitigation to encourage participation of local financial institutions employed in the Hungary Energy Efficiency Co-financing Program have been

transferred across the focal areas through the recently approved Environment Business Facilitation Program.

Cross-cutting Issues: Recommendations

15. The review recommends that the GEF prepare a comprehensive strategy for engaging with the private sector covering the various findings emerging from the review: (i) objectives of private sector engagement within the context of GEF's overall and sector strategies; (ii) the use of appropriate modalities of support; (iii) GEF policy on risk sharing, co-funding and leveraged funding; (iv) the establishment of a transparent tracking tool to monitor project progress; and (v) further guidelines for the measurement of global environmental impact. In addition, there are several specific recommendations:

- (a) Seek a higher share of risk sharing amongst project partners to create better incentives for project success and to avoid moral hazards;
- (b) Make further efforts to ensure real country ownership of projects and subprojects;
- (c) Develop clear guidelines on the identification and measurement of global environmental benefits in each focal area, also in conjunction with private sector
- (d) Develop a more rigorous definition of leveraged funding and arrange for the collection of accurate data on the levels of cofunding and leveraged funding achieved
- (e) 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.
- (f) Develop staff capacity in the Secretariat and the Agencies on global environmental issues, business finance, and public sector policies to influence relevant markets.
- (g) Work with each of the Implementing Agencies as well as executing agencies to define the types of projects that are most appropriate to the capabilities and comparative advantages of each agency.
- (h) Select financial intermediaries, fund managers, and similar partners competitively and on the basis of transparent criteria. The criteria for decisions on how each financial intermediary is rewarded for project success should also be clear and transparent; and
- (i) Develop more detailed guidelines on M&E systems for various types of private sector engagement. Subprojects of umbrella projects should submit annual reports on progress towards achieving objectives, including progress on establishing M&E systems.

- (j) 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.

Cross-cutting Issues: Management Response

16. The framework and policies for GEF's private sector engagement were laid down in two GEF Council Papers dating from 1996 and 1999.¹ We agree that a better definition and clarity regarding terms of engagement with the private sector would provide a better thrust to the GEF's objective of beginning to influence wider actors in national and international economies. Towards this objective, a decision document, *Principles for Engaging the Private Sector*, GEF/C.23/11, was submitted for discussion at the May 2004 Council meeting. Given the heavy agenda of the Council at that meeting, the document was not discussed. The document lays out three broad areas of engagement with the private sector: (i) indirect engagement by helping create market conditions in recipient countries; (ii) direct engagement with the private sector through projects aimed at dealing with incremental risk; and (iii) providing firms with procurement opportunities in GEF projects. The strategy will be better articulated in FY05 and FY06 with the collaboration of the Implementing/Executing Agencies and in consultation with private sector stakeholders. Specific attention will be paid to addressing the following topics:

- (a) A clearer understanding of the expectations of various partners in a project/program context, to ensure that appropriate risk-sharing arrangements are established amongst the various partners;
- (b) Roles of the Implementing and Executing Agencies to define the types of projects that are most appropriate to the capabilities and comparative advantages of each agency;
- (c) Identification of staffing needs at the Secretariat and the Agencies in the context of implementing the strategy;
- (d) Norms for identification and selection of private sector partners on a competitive and transparent basis, and criteria for rewarding performance.²

17. Leveraging. GEF has developed definitions on cofunding and leveraged funding and this can be found at http://www.gefweb.org/Documents/Council_Documents/GEF_C22/annexes.html, Annex C.

18. Country Ownership. The current project cycle provides ample opportunity for expression of country ownership of projects and involvement of key Government and non-government stakeholders. In fact, stakeholder participation is one area where the GEF has consistently scored high marks in external reviews. In order to ensure that national subprojects that are

¹ GEF, 1996, *GEF Strategy for Engaging the Private Sector*, GEF/C.7/12, March 7; GEF, 1999, *Engaging the Private Sector in GEF Activities*, GEF/C.13/Inf.5, April 22.

² Procurement would continue to remain the sole responsibility of the Implementing/Executing Agencies.

linked to global and regional projects are truly country-owned, the GEF will more carefully assess country involvement in these projects during project review and implementation.

19. Measurement of Global Environmental Benefits. Global environmental benefits are measured at the project level and the tools required to measure them are encompassed within any project design, regardless of focal area. The development of the strategic priorities for GEF-3 identified areas of focus within each focal area including measurable indicators of success that gauge progress in achieving and contributing to global environmental benefits as identified within each strategy. As experience is gained in applying the tools developed to track progress against these indicators they will be adjusted to best measure GEF impact at the portfolio level including but not limited to measuring global environmental impact.

20. Project Processing Times. The Office of M&E and the Inter-agency Operations Task Force will coordinate activities to address the issue of elapsed time between project allocation and project implementation. Please see the management response to the PPR 2003 (GEF/ME/C.24/2).

21. Monitoring and Evaluation Systems. Mechanisms for monitoring and evaluating progress in achieving objectives is an important part of any project management structure, regardless of the stakeholders involved. Given the GEF structure, monitoring and evaluation at the project level is a responsibility of the Implementing Agency. Current M&E practices normally include reporting on all subprojects within umbrella projects and this should be reinforced. We support the recommendation that developing guidelines on M&E systems for various types of private sector projects would be useful. The Secretariat will discuss this with the Office of M&E.

22. Learning. The Secretariat, the Office of M&E, and the Implementing Agencies are in the process of embarking on establishing a knowledge management framework for the GEF, building upon the last ten years of GEF operational experience.

Biodiversity Conservation: Findings, Recommendations and Management Response

23. The long-term conservation of the earth's biodiversity requires conserving biodiversity both within and outside protected areas. Given that it is unlikely that more than 10-15% of the earth's surface will ever be protected within formally protected areas, it is crucial for biodiversity to be conserved within ecosystems that are used as production landscapes, and in which private actors play the leading role. Indeed, and according to the Sustainable Use Specialist Group of the World Conservation Union (IUCN), the likelihood that no more than 15% of the Earth's surface will ever be effectively conserved in protected areas means that "*the Survival of Biodiversity largely depends on land use practices outside formal protected areas*" (IUCN, 2004).

24. In recognition of this fundamental fact, and in order to generate higher impacts outside protected areas, the GEF has engaged the private sector in financing conservation in landscapes outside protected area. Before GEF-3 (in which these approaches were formalized within Strategic Priority #2 and are outside the scope of the subject review), three principal methods were tested in pilot projects that aimed to produce biodiversity gains in agro-forestry and silvo-pastoral production systems, the tourism sector, and through payments for environmental services (PES). These three approaches were analysed in the subject review.

Certification of Agro-forestry Commodities

25. The report concludes that “Coffee and cacao cultivation can provide significant biodiversity benefits in areas where very little of the original forest cover remains, depending on the type of shade system employed. However, projects utilizing certification systems to provide an incentive for biodiversity-friendly coffee cultivation have been unable to overcome the absence of a market for coffee cultivated in a biodiversity-friendly manner. Although coffee and cacao are marketed under various specialty coffee labels related to fair trade and the environment that provide premium prices, certification does not provide any incentive for maintaining or achieve minimum biodiversity-related standards.”

26. The rationale for GEF agro-forestry interventions has been that by supporting land-use systems in which the maintenance of forest habitats is integrated with the production of agro-commodities, biodiversity conservation will be enhanced. Coffee and cocoa plantations are largely situated in tropical biodiversity hot spots of Africa, South East Asia, and Central and South America. Coffee and cocoa are traditionally cultivated under the shade of native canopy trees within agro-forestry systems that contribute to the maintenance of these forests. GEF-sponsored operations have supported a series of approaches to explore ways in which these systems can be maintained, including certification of agro-commodities, in such cases where opportunities for both biodiversity conservation and commercial prospects to improve branding and market recognition exist.

27. The report recommends that “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.” This management response is in full agreement with this finding and indeed, in all certification examples, GEF funds were used explicitly to incorporate measurable biodiversity considerations within these certification systems. Certification procedures, however, are instruments and not objectives in themselves. The objective of this type of project is to support on-farm biodiversity conservation and the report correctly emphasizes that these projects succeeded in maintaining on-farm biodiversity. This is a major finding that needs to be highlighted. Certification of agro-commodities within GEF projects has been based on sound ecological agro-production principles, thereby allowing in most cases for certified coffee to be of higher quality and to command a premium price compared to non-certified coffee. A recent Financial Times article³ reports the following: “Overall, specialty coffee, where buyers – usually small and independent companies – pay more than the market price for the best beans, accounts for about 20 per cent of the US market but 50 percent of the profits for the growers concerned. The specialty market is growing at about 15 per cent a year. Another growth area is Fair Trade which guarantees \$1.21 a pound plus 5 cents for social projects. It has just 0.4 per cent of the worldwide market but is doubling in size every two years.” Purchases of organic, fair trade, and shade grown conservation coffees commanding premium prices have grown steadily and dramatically in recent years, and now account for five percent of coffee sourced by Starbucks, the world's largest specialty coffee roaster. In addition to Starbucks ambitious commitments to increase its buying and selling of coffees endorsed by third-party certification and labeling programs, Starbucks has set a five-year target of having 60

³ Financial Times, September 25-26, 2004

percent of its entire coffee purchases independently verified to meet environmental, social and quality guidelines under the company's preferred supplier program known as "CAFE Practices."

28. The findings reveal that great strides in understanding the factors responsible for transforming agro-forestry markets with proven biodiversity benefits have been made. It is now time to move to a broader, more global scale of market transformation approaches and the Council is encouraged not to limit the GEF's ability to move in this direction, as the report recommends.

Payments for Environmental Services (PES)

29. The report concludes that: "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."

30. The GEF supports projects that use Payments for Environmental Services (PES) to explore the potential roles that ecosystem service payments can play in conserving biodiversity outside protected areas. Amongst others, payments for Environmental Services are used in GEF operations as a mechanism to encourage the adoption of silvo-pastoral and other practices (including conservation in private lands) leading to biodiversity conservation, to reverse deforestation processes, and to curtail illegal logging. The GEF-supported Regional Integrated Silvo-pastoral Ecosystem Management Project, for example, is currently testing the use of the PES mechanism to protect silvo-pastoral ecosystems in Colombia, Costa Rica and Nicaragua that support species that depend on the continuation of these farming systems.

31. The GEF supports the report's following recommendation and has implemented it: "GEF should continue to look for additional opportunities to support systems of payments to landowners for biodiversity conservation as an approach to biodiversity conservation in countries where forests with high biodiversity values is privately owned." This management response is in full agreement and the GEF is enthusiastic about exploring further possibilities.

32. However, in order to scale up impacts of PES on global biodiversity, future GEF supported operations should focus on: assessing the demand for PES and disseminating best practices; viable size of PES operations; incentives and counter-effects such as over-harvesting; minimizing transaction costs; identifying, leveraging and securing sources of financing for environmental services (e.g. sustainable income flows through fiscal revenues).

Ecotourism

33. GEF-supported ecotourism projects foster the conservation of global biodiversity by enhancing the enabling environments for ecotourism operations with positive biodiversity impacts, and where their demonstration effects and replicability are significant. GEF interventions have been supporting strategies that provide relative stability to the ecotourism market, such as widening the market so as not to focus only on international tourists but also on local ones, and facilitating the inducement of conservation policy reforms through successes of the private sector lodges (in generating jobs for example).

34. Whilst an attractive location and sound government biodiversity policies are ingredients that contribute to success in the overall tourism sector (not only ecotourism) success can vary due to external events such as political circumstances and natural disasters. A recent IFC study on ecotourism highlights that the main ingredient to success is the presence of high-valued wildlife rather than destination (which is considered the most important factor in the success of eco-lodges in the report).

35. The report recommends “Prior to approval of a private sector ecotourism project, a critical minimum level of government efforts for protection should be agreed on.” The report’s conclusion is: “The main challenge to GEF in supporting investment in ecotourism is to minimize the risk of failure associated with location and to be assured of government biodiversity policies and enforcement practices that provided a minimum level of protection for protected areas.” This management response is in agreement with the recommendation that a proper enabling environment is key to the success of ecotourism operations. Whilst the GEF operations in ecotourism can be influenced by a variety of exogenous factors outside their sphere of influence, they can conserve biodiversity and promote strategies providing more stability and support for policy reforms. The key element is to ensure that ecotourism operations are both financially viable and generate biodiversity benefits – government practices may or may not be crucial, depending on the circumstances. This management response is therefore in disagreement with adopting such a narrow and prescriptive conclusion.

Concluding Remarks

36. Interventions outside protected areas were formalized under GEF-3 through the establishment of new Strategic Priorities to guide investments in the biodiversity focal area. Strategic Priority #2 aims at *Mainstreaming Biodiversity in Production Landscapes and Sectors* including the agriculture, forestry, tourism, and other sectors.

37. GEF supports programs in the agro-forestry and tourism sectors that create value for ecosystems and enhance biodiversity conservation outside protected areas. Since the undertaking of the review, the GEF, in supporting Strategic Priority #2 through the Implementing Agencies, has made considerable progress in engaging the private sector and very encouraging results are emerging throughout the world (Please see Report on Meeting the Biodiversity Performance Measures by Fall 2004.)

38. Given most of the projects considered in the study were conceptualized long before the development of Strategic Priority #2 (which has greatly enhanced the opportunities for private sector engagement), the recommendations of the report concentrate on general matters and do not represent a full analysis of the GEF’s engagement with the private sector in biodiversity conservation in a comprehensive way.

39. Given the considerable opportunities for engaging the private sector through GEF’s Second Strategic Priority in Biodiversity, we emphasize the danger of adopting recommendations based on a very narrow sub-set of earlier projects. We believe that given that this is a new and emerging area, more in-depth analyses are desirable to better understand the conditions under which global environmental benefits can be generated in cost-effective

manners. The recent STAP workshop on mainstreaming held in South Africa is an important step in this direction.

Climate Change: Findings, Recommendations and Management Response

40. The “stabilization of GHG concentrations in the Earth’s atmosphere” will require enormous efforts from all nations of the world. Governments, businesses and civil society will all need to cooperate if humanity is to avert the unprecedented levels of global warming predicted in many of the simulations carried out by the Intergovernmental Panel on Climate Change (IPCC). For developing countries, the challenge of pursuing a low-carbon future that does not compromise growth, development, and poverty alleviation is immense. In the climate change focal area, the GEF’s charge is to assist developing countries and countries with economies in transition to improve the efficiency of energy use; increase the use of renewable energy; improve urban mobility while emitting fewer GHG’s; and test and adopting new, low GHG-emitting energy technologies. Given the enormity of the task, GEF efforts have always taken into account the fact that no real progress will be possible without a widespread engagement of the private sector. All private sector agents use energy and emit GHG gases in one way or the other. In addition, the private sector is the primary purveyor of the technologies that will need to be developed and deployed to bring about a low carbon future. For these reasons, private sector engagement has always been a central focus of the GEF’s work in the climate change focal area. Many climate change projects directly support private sector industries to improve the efficiency of their energy use or to enhance their use or manufacturing of renewable energy technologies. It is therefore not surprising that of the sixty projects included in the private sector review, over forty of them are climate change projects.

41. This review of GEF’s engagement with the private sector has been a welcome, but ambitious, attempt to understand the interactions of the GEF with the private sector. The GEF’s engagement of the private sector has been constructed around attracting the dynamic forces of the private sector—particularly the efficiency, know-how, and ability to mobilize resources—to address the climate change challenge. At the same time, GEF interventions attempt to minimize distortion or perverse incentives that might undermine those very qualities that make the private sector attractive partners in the first place. All of the projects included in the review have attempted to balance these issues in different ways. Unfortunately, the range of experience and lessons is somewhat unevenly represented in the review which has not been able to evaluate a sufficiently large sample of the portfolio to draw robust conclusions. General trends and conclusions are derived from aspects of specific projects that are often a one-of-a-kind experiments.

42. The projects included in the private sector review were evenly split between energy efficiency projects (OP5) and renewable energy projects (OP6), causing the review team to focus its efforts accordingly. Within each of these areas, a number of clusters of project approaches was identified. The reviewers conclusions draw somewhat unevenly on the analysis in each of these areas. While the economics of energy efficiency and renewable energies dictate that the energy efficiency field offers many more immediately cost-effective opportunities for GHG reduction as the technologies are developed and need only be deployed, renewable energy sources still require larger up-front capital investments resulting in their being economically less attractive and therefore leading to less cost-effective interventions. The GEF’s mandate is to be

catalytic, working with Governments and the private sector to deliver GHG benefits in both a near-term, immediate and a longer-term, catalytic basis.

Energy Efficiency: Market Transformation, ESCO's, and Financial Intermediaries

43. The first category of energy efficiency intervention evaluated was the focus on market transformation of energy efficient products and processes as demonstrated by the efficient lighting initiative, the China refrigerator project, and the China efficient lighting project. While the evaluation team makes several interesting observations with respect to these projects, their overall conclusion is that “These projects have demonstrated highly cost-effective options for reduction of CO₂ emission through promotion of markets for highly efficient refrigerators, fluorescent lighting equipment, building insulation, and air conditioning. This Management Response confirms this conclusion and management is redoubling its efforts to support country-driven and owned initiatives for these projects. In fact, this approach was formalized as the Climate Change Strategic Priority 1, as proposed by the Business Plan submitted to Council in November 2003.

44. The second category of projects evaluated were those attempting to promote new market mechanisms for third party financing for energy efficient investments. Most of these projects have attempted to create energy service companies or ESCO's. While the review notes that the term “ESCO” may differ from one context to another and that the challenge of ESCO creation is more difficult than has been assumed in many GEF project designs, the review team notes that the positive experiences in both China and Hungary can be used to inform future project activities in other countries. The Management Response confirms this supportive conclusion.

45. The third category of projects—that employing innovative financial instruments to engage financial intermediaries to undertake energy efficiency investments—is one where GEF's thrust is to overcome reluctance on the part of financial entities to invest in energy efficiency. Several projects deploy GEF resources in innovative financial instruments and the HEECP project has “helped banks in developing an internal knowledge of appraising energy efficiency projects.” Unfortunately, the “short time available for field review of the project did not permit an authoritative assessment of its contribution to market transformation.” This Management Response affirms that the approach of working with financial intermediaries through technical assistance and non-grant mechanisms is considered very promising for overcoming barriers to sustainable local investments in energy efficiency, as embodied in the climate change Strategic Priority #2. While the Review Team could have spent more time and effort in understanding these initiatives, Management appreciates that further, and more complete, evaluation work is being undertaken as part of the Climate Change Program Study. The GEF has been learning from these earlier projects and constantly refining these approaches in order to better transform markets in its program countries for investments in energy efficiency. More informed input from the review team would have proven beneficial in this regard, in particular with regard to the underlying cost and benefit structures of the respective projects and investments.

Renewable Energy: Equity Funds, Support to SME's, and Multi-country Facilities

46. In the renewable energy field, the review examined the equity funds that were established to place investments in renewable energy and energy efficiency and solar photovoltaics,

respectively. Both funds faced difficult challenges in implementation and have either been reformulated or cancelled. Despite several encouraging findings with respect to the funds, the review team considers each of them to have been “overambitious in their expectations of markets, rates of return, timeframes, and potential investors”. In the case of the multi-country, multi-instrument facilities, the reviewers note that with respect to the PVMTI—the only project of this type—“it is difficult to make a definitive judgment because of the very slow pace of implementation....” However, they conclude that “no significant market transformation can be demonstrated....”

47. As a result of the limited time of the study team and the limited number of case studies available, the review team focused much of its attention on the second category of renewable energy projects reviewed, that of Direct Support to Local SME’s. The sample of projects reviewed primarily included projects to remove barriers to rural electrification using renewable energy, largely making use of photovoltaic technology, especially solar home systems. In general, the review team states that “The results of projects aimed at developing a market for off-grid energy from photovoltaic technologies ... have not been so encouraging.” Although a number of innovative financial mechanisms have been tested and some interesting results have been documented, the PV projects are not viewed as being successful by the review team because of the high cost of the technology contrasting with the limited purchasing power of the rural populace, the weak market assessments undertaken during project design, and the limited commitment of PV manufacturers and purveyors to become engaged in any delivery model that does not involve immediate sale of PV systems. This led the review team to their sole recommendation in the climate change focal area. “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.”

48. It is the opinion of this Management Response that this conclusion seems not only to overreach the bounds of the analysis, but more importantly, to ignore the evolution of thought and practice that has already taken place in the climate change focal area. It is based upon a limited sample of the PV portfolio which did not include the significant success stories where thousands of rural households now obtain electricity from PV systems. The conclusion also fails to account for the many lessons that have been learned through both successful and unsuccessful GEF-supported endeavors in this field and the evolution of theory and practice in the formulation of PV projects. For example, relatively newer projects in Bangladesh, Mozambique, Uganda, Botswana, and Lesotho have addressed many of the issues associated with earlier PV projects. Their PV components are linked to broader rural electrification or rural development efforts.

49. If, in fact, the purpose of this review has been to assess interactions with a single stakeholder (ie., the private sector), it seems unusual that this review of engagement with the private sector should make a recommendation on a specific type of technology without reference to that specific stakeholder. The Review of the GEF Solar PV Portfolio, published in 2000, raised questions about the various business models used to supply PV systems and questioned “whether purely private delivery models, by themselves, are able to achieve the widespread market penetration in poorer countries that will satisfy both global environmental and development objectives”. This earlier review, which analyzed all GEF’s interventions with a focus on solar PV technology, served as an input to the Second GEF Overall Performance Study. The conclusions of the GEF Solar PV review were far more balanced, as they were based upon a

comprehensive review of the portfolio at the time, even if the portfolio was slightly less mature at the historical moment in which the study was undertaken.

50. This is not to deny that the GEF PV portfolio faces challenges: it does. These challenges have been recognized by the Secretariat and Implementing Agencies for a considerable amount of time and have been integrated into the strategies and policies of the GEF as expressed by Council documents. The development of the Strategic Priorities led to the shifts in programming as first published in the Business Plan submitted to Council in November 2003, and continued in the Business Plan submitted to this Council meeting. Among the strategic priorities, Strategic Priority 4, “Supporting the Productive Uses of Renewable Energy” was formulated specifically to respond to the weaknesses in the PV portfolio. This strategic priority focuses renewable rural electrification activities that go beyond just the provision of electricity for lighting through PV systems, and provide electricity and other energy services first and foremost for income generating opportunities to generate employment and income-generating opportunities for rural inhabitants in GEF program countries. In order to avoid a single focus on one technology – which is considered one of the weaknesses of many PV projects – the strategic priority seeks to adopt a broader framework for intervention that is technology-neutral, focusing on multiple technologies instead of just one..

51. In summary, although this conclusion reached in the Private Sector Review was made without taking account of the latest thinking in the GEF programming area, the Management Response will be to keep in mind the challenges identified in the past PV projects, ensuring that future renewable energy projects undertake more sound market analyses and focus more on productive uses of all sources of renewable energy rather than merely on household uses of photovoltaics.

Concluding Remarks

52. As stated earlier, Management has been pleased to be involved in this review of engagement with the private sector as it has forced the GEF Secretariat and Implementing Agencies to clarify our thinking with respect to the goals, means, and ends of our collective engagement with the private sector. While the review itself has failed to clearly articulate the major barriers to and opportunities for bringing the dynamism of the private sector to bear on GEF programming issues, our collective efforts have benefited from some of the findings with respect to the market transformation interventions, the ESCO projects, and to a lesser extent, the use of innovative financial instruments. Unfortunately, the major recommendation in the climate change focal area—that of discontinuing work on photovoltaic projects—does not follow from the analysis, is too general and far-sweeping to be meaningfully applied, and seems unnecessary after the recent evolution of the strategic priorities currently used for programming. Management will continue to screen photovoltaic projects carefully to ensure both that they are market-driven--focusing broadly on remote renewable electrification emphasizing productive opportunities wherever possible—and that they set realistic goals and priorities.