Global Environment Facility

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Agenda Item 13

COFINANCING

Recommended Council Decision

The Council, having reviewed the paper *Cofinancing* (document GEF/C.20/6/Rev.1), approves the proposed policy and procedures subject to comments made at the meeting. The Council requests the Secretariat, in consultation with the Implementing Agencies and the Executing Agencies acting under expanded opportunities (i) to implement the policy when preparing future Work Programs submitted for Council approval and when proposing any projects eligible for CEO approval under expedited procedures; and (ii) to report to Council in each GEF Business Plan the overall progress in implementing the policy.

Table of Contents

1. In May 2001, Council requested a note on cofinancing of GEF projects. In the *Policy Recommendations agreed as part of the Third Replenishment of the GEF Trust Fund* [1] in August 2002, the Participants in the Third GEF Replenishment also recommended that a cofinancing policy be prepared by the Secretariat, in consultation with the Implementing and Executing Agencies, for consideration by the Council at its meeting in October 2002. A paper was prepared in response to those requests, and submitted to the Council for review at that meeting meeting. After review, Council requested the Secretariat to revise the paper taking into account the comments made and to submit the revised paper to Council for its review and approval in May 2003. Council also specifically requested that the Secretariat, in consultation with the Implementing and Executing Agencies, establish a database on cofinancing that would allow a better analysis of GEF experience and monitoring of cofinancing throughout project development and implementation.

2. Council has affirmed that cofinancing is a key principle underlying GEF's success in its efforts to have significant positive impact on the global environment. Cofinance for GEF projects is important because:

(a) With limited financial resources, increased capacity, and a growing demand for assistance, it is essential for the GEF to mobilize additional resources for the global environment. Cofinancing expands the *resources* available to finance environmental objectives;

(b) Cofinancing is an important indicator of the strength of the *commitment* of the counterparts, beneficiaries, and Implementing and Executing Agencies to those projects; and

(c) Cofinancing helps ensure the *success* and local acceptance of those projects by linking them to sustainable development, and thereby maximizes and sustains their *impacts*.

I. CURRENT PRACTICE

3. Cofinancing data are recorded for each project at the time the project is submitted for approval and is described in the *Operational Report on GEF Programs*. The cumulative cofinancing commitment is reported to Council in the Secretariat's cover notes to each Work Program.[2] However, there are a number of issues concerning the consistency of the definition and reporting of, and policy concerning, cofinancing. There have been some instances where cofinancing, and sometimes even GEF financing, has been amended after Council approval. The Secretariat was requested in May 2001 to prepare a note on cofinancing, reviewing among other things the cofinancing policies already in place and highlighting the issues that need to be clarified or addressed. The Second Overall Performance Study of the GEF (OPS2) also reviewed

[1] See GEF/R.3/37.

[2] The actual cumulative cofinancing differs from this cumulative commitment to the extent that the realized cofinancing differs from that expected at the time of Work Program approval. The actual cofinancing is not currently monitored.

cofinancing and recommended more rigorous criteria for cofinancing and for monitoring both cofinancing and the resources leveraged through replication.

4. Currently, data are reported on a variety of financial contributions. These include:

(a) The GEF allocation for which Council approval is sought, including any PDF funds previously authorized. The allocation is the amount directly supporting in-country GEF activities. The PDF amount has been committed earlier for preparation, either by the agency (PDF-A up to $25,000), by the CEO under expedited authority (PDF-B up to $350,000 for a single country project and $700,000 for a regional project, and PDF-C up to $1 million for detailed design), or by the Council;

(b) Resources from the agency itself. Note that although loans and credits from IBRD or the Regional Development Banks are recorded as cofinancing from the agency, the government typically assumes responsibility for debt;

(c) Resources from other non-GEF sources that will be managed jointly or in parallel with the GEF allocation as part of the financing package for the GEF project and without which the project could not be implemented. The agencies report contributions mobilized for the project from other multilateral agencies, bilateral development cooperation agencies, NGOs, the private sector, and beneficiaries;

(d) Government counterpart resources.[3] The definition of these does not include loans or credits which are recorded under the relevant agency;

(e) Finance for other baseline or foundational activities upon which the project would build or without which the project could not be implemented. An example of this would be the current institutional budget for a targeted protected area site which is an essential pre-condition for effective conservation of biodiversity;

(f) Finance for activities other than the GEF activities that are processed for transactional convenience in the same loan or technical assistance package of the GEF Agency. For example, a GEF-funded component may be included in an infrastructure loan, most of whose components are unrelated to the GEF objectives; and

(g) Funds that are expected to be mobilized in future for follow-on or replication activities, even though implementation of the project would proceed before mobilization is confirmed. For example, it may be assumed in a “barrier-removal” project that additional private sector finance will start to flow in parallel. Funds may sometimes be mobilized that were not envisaged because opportunities and new linkages emerged later.

[3] Taxes and duties are not economic costs of the project, and so taxes and duties that are waived by the Government are not included as cofinancing.

5. Cofinancing can also take many different forms, which have different values and raise different issues for reporting and monitoring. The GEF allocations and some cofinance (typically for technical assistance) is in the form of grants. World Bank and RDB cofinance may often be in the form of loans or credits. Implementing Agencies also report resources contributed "in-kind."

II. ISSUES

6. There are several issues concerning current practice.

Consistency in reporting

7. As described above, there are many types of financing and it is important to have clearer definitions to permit consistent reporting across agencies. The Second Overall Performance Study of the GEF noted that the database for reporting on cofinancing is surprisingly weak. Their analysis encountered serious problems in interpretation of data in the absence of clearly articulated and well-accepted definition of the term "cofinancing." [4]

Monitoring of cofinancing

8. Cofinancing commitments are not currently monitored on a systematic basis, but would need to be to ensure that the commitments were both adequate and stable.

Adequacy of cofinancing levels

9. OPS2 describes the cofinance as "surprisingly modest, particularly since only a few projects account for most of the total cofinancing generated under the completed projects. and recommends stronger project design criteria."[5]

Stability of commitment

10. OPS2 reports on the difference between planned and actual cofinance. Total planned ratio of cofinancing to GEF resources in the cohort of projects examined had been 4.0 but dropped to 3.5, and the Implementing Agency contribution itself dropped from a planned 72 per cent to 44 per cent. Cofinancing commitments have sometimes dropped sharply between Council approval and CEO endorsement, and occasionally the source of cofinancing at Work Program inclusion has been misidentified.

III. PROPOSED POLICY AND PROCEDURES

11. Participants in the Third GEF Replenishment recommended that the GEF establish a cofinancing policy, with consistent criteria and reporting requirements as well as cofinancing

[4] *The Second Overall Performance Study of the GEF* (OPS2), page 63.
[5] OPS2, page 66.

targets. Such targets should provide flexibility to take into account specific project situations. Cofinancing policy with the following six actions is proposed:

Adopt consistent criteria for reporting cofinance

12. To ensure consistency of reporting, the following definitions will be used and the resulting data will be recorded in the GEF database for reporting and monitoring purposes. Precise reporting will highlight and thereby help to underpin the efforts of the agencies to attract cofinancing.

13. ***GEF funds***. These are the allocation approved by Council and any PDF resources. The agency fee is not included.

14. ***Cofinancing*****.** These are project resources that are committed by the GEF agency itself or by other non-GEF sources and which are essential for meeting the GEF project objectives. Typically, such resources are committed as part of the initial financing package, but in some cases part of the cofinancing may actually be mobilized subsequently. In particular, note that:

(a) Finance for baseline activities is included in the definition only when such activities are essential for achieving the GEF objectives, as shown in the project logical framework within the project document;

(b) Finance for activities that are not essential for achieving the GEF objectives, but which are processed for transactional convenience in the same loan or technical assistance package of the GEF Agency, are excluded from the definition of "cofinance"; and

(c) Resources that are not committed as part of the essential financing package at the outset but which are mobilized subsequently are not included as "cofinance." Such leveraged resources are nevertheless important and will be also be tracked (see below).

15. Cofinancing will be reported and monitored by source, by type, and by the stage of the Project Cycle. Sources include

(a) The agency's own cofinancing;

(b) Government cofinance (counterpart commitments) e.g., for baseline or foundational activities upon which the project would build or without which the project could not be implemented; and

(c) Contributions mobilized for the project from other multilateral agencies, bilateral development cooperation agencies, NGOs, the private sector, and beneficiaries.

16. Types of cofinance include:

(a) Grants;
(b) Loans, concessional or market-rate;
(c) Credits;
(d) Equity investments;
(e) Committed in-kind support; and
(f) Other (specified) types.

17. Cofinancing does not include either "associated financing" or "leveraged resources."

(a) ***Associated financing.*** This is finance for other activities that are related to the project or to similar commitments but which is not essential for the project's successful implementation. Associated financing may be reported for information but commitments are not required and the financing is not monitored.

(b) ***Leveraged resources.*** Leveraged resources are the additional resources -- beyond those committed to the project itself -- that are mobilized later as a direct result of the project, e.g. for further replication or through programmatic influence. As such, leveraged resources do not form part of the committed financing plan at the outset and so they are not defined as "cofinance." Leverage is nevertheless a very important indicator of GEF's catalytic effect.

18. To implement this:

(a) ***Project formats***. The Secretariat will revise the standard format[6] for project summaries at the stage of Work Program Inclusion so that it can record cofinancing data disaggregated by type and source as above. The Secretariat will also prepare appropriate *formats* to record such data for other stages of the GEF Project Cycle (Concept Agreement/Pipeline Entry, CEO Endorsement, and Project Completion & Evaluation), and for other evaluations such as those needed for tranche releases and subsequent phases;

(b) ***Common definitions.*** Implementing and Executing Agencies will use the common *definitions* above for type and source[7] of cofinancing, and submit their data in the formats; and

(c) ***Database***. The Secretariat will record the cofinancing data in the overall GEF *database*, which will permit analyses to be made of cofinancing levels and trends.

[6] See *Format for the Executive Summaries of* GEF *Project Proposals*, GEF/C.20/Inf.4. This format, which currently includes a summary financing plan on the first page, will be used for the first time for the May 2003 Work Program.
[7] To assist this, the Secretariat will also issue a standard list of acronyms for commonly accessed sources of cofinance.

Monitor and evaluate the GEF experience in cofinancing

19. Participants in the Third GEF Replenishment specifically requested that the amount of realized cofinancing in a project or program be monitored and compared to the amount of cofinancing anticipated at the time of Council approval, and this indicator should be reported to the Council on a regular basis. OPS2 had also recommended that cofinancing commitments and achievements be "systematically assessed and monitored, for instance, in all project completion, termination, and project reports, as well as in the annual interagency Project Implementation Review (PIR) process." [8]

20. ***Monitoring***. The M&E Unit will systematically monitor cofinancing experience [9] throughout the project cycle, using the Secretariat's database. Cofinancing commitments -- including those for in-kind resources -- that had been part of the initial financing plan for the project will be specifically monitored, and included in project reports.

(a) Cofinancing will be tracked by project for each stage in the Project Cycle – in particular, realized cofinancing will be reported in the project completion review;

(b) Cofinancing will be reviewed as part of the mid-term review and in completion reports;

(c) Cofinancing will be reviewed each time an evaluation is submitted as a condition of tranche release or submission of a subsequent project phase. The M&E Unit will review the consistency of actual with planned cofinancing, among other issues.

(d) The cofinancing realized by each agency would be systematically assessed and reported to Council annually (e.g., in the Business Plan); and

(e) The *Secretariat Managed Project Review* (SMPR) will also include a review the cofinancing realized.

21. ***Evaluation of a selective sample***. The M&E Unit, in consultation with the Implementing Agencies and Executing Agencies, will evaluate the impact of cofinancing policy on a selective sample of projects already in the GEF portfolio with a view to assessing the impact that specific cofinancing targets would have had. This will build up a set of "reference" cases.

Apply lessons, manage in-kind commitments, and increase cofinancing levels

22. ***Apply lessons.*** Reference cases (as described above) where the cofinancing was a factor in project success or failure will be particularly important comparators. The Secretariat will therefore amend the Project Review Criteria to include the use of such reference cases as broad

[8] OPS2, page 67.
[9] Additional resources that had been leveraged for the GEF objectives after project implementation began would also be recorded.

indicators of the adequacy of proposed cofinancing. The Secretariat views of the adequacy of cofinancing will be reported in the cover note to each Work Program submitted for Council approval.

23. ***Manage in-kind commitments.*** Implementing Agencies and Executing Agencies may include "in kind" resources as part of project cofinancing. In such cases though, those resources must be accounted for with the same diligence as financial resources. The Secretariat will include in the Project Review Criteria for Work Program inclusion a requirement that the agency provide assurances that the identified in-kind resources be:

(a) Dedicated uniquely to the GEF project;

(b) Valued as the lesser of the cost and the market value of the required inputs they provide for the project; and

(c) Monitored, with documentation available for any evaluation or project audit.

24. ***Increase cofinancing levels.*** Participants in the Third GEF Replenishment noted that increased cofinancing is a key issue in GEF efforts to have a significant positive impact on the global environment. Participants requested recipient countries, the Implementing Agencies and Executing Agencies, and other donors to generate additional resources to leverage GEF funding and recommended that cofinancing levels be a key consideration in considering Work Program inclusion. The Implementing Agency for a project (or the Executing Agency, if acting under expanded opportunities) will therefore use best efforts to maximize the cofinancing for any given project.[10]

25. Some countries have less opportunity than others to raise cofinancing, because their economic development, absorptive capacity, and familiarity with GEF and global environmental issues makes this difficult. Likewise, not all agencies have the same ability to commit or mobilize cofinancing. This reflects the fact that agencies tend to specialize in the type of projects in which they have a comparative advantage. For example, the World Bank and the Regional Development Banks implement the larger investment projects and these typically have higher cofinancing.

Confirm commitments and review substantive changes

26. The Secretariat will also amend the Project Review Criteria for full-size projects to strengthen the confirmation of cofinancing commitments and to distinguish between cofinancing that is regarded as an essential part of the initial financing package from cofinancing that can be mobilized during implementation.

[10] The emphasis on increasing the levels of cofinancing is expected to affect the selection, design, scale, and scope of projects. However, the GEF financing will not exceed the estimated incremental cost even when the cofinancing ratio is large.

(a) At Pipeline Entry, the agreed concept will distinguish between the “initial” cofinancing critical to project success -- which would need to be committed prior to endorsement -- from the “subsequent” cofinancing that would be mobilized during implementation. Implementing Agency cofinancing, Government counterpart commitments, and finance for all major critical activities would need to be secured initially, i.e., prior to endorsement. Cofinancing mobilized subsequently would typically include that from sources which are individually small, such as when a number of private sector firms or community organizations are expected to join a program already under implementation. Where not all the cofinancing can be committed initially, the financing strategy must justify the likelihood that the remaining resources would actually be mobilized during implementation. Where known, and in accordance with current practice, the financing strategy would continue to indicate potential sources of cofinancing and identify the financing instrument that would be proposed;

(b) At Work Program inclusion, the agency will identify specific sources covering all the initial cofinancing needs, and document the corresponding expressions of interest from those sources. The agency would also estimate the cofinancing by source that would be mobilized subsequently. The plan for disbursing GEF resources should ensure that disbursements be commensurate with the cofinancing actually mobilized; and

(c) By CEO endorsement, the agency will provide to the Secretariat documentation from the cofinanciers confirming their commitments in relation to the initial cofinancing, and update the financing plan with respect to the status of any cofinancing that would be mobilized during implementation.

27. For CEO endorsement of Medium Size Projects, the agency would be required to prepare a financing plan and provide to the Secretariat documentation from cofinanciers on the status of their commitments.

28. The Implementing Agency, or Executing Agency where appropriate, will inform the Secretariat whenever there is a potentially substantive cofinancing change (i.e., one affecting the project objectives, the underlying concept, scale, scope, strategic priority, conformity with GEF criteria, likelihood of project success, or outcome of the project). Such changes may occur during appraisal (that is, after Council approval but before CEO endorsement) or during implementation. The Secretariat will re-review the concept as thereby modified first to determine whether the modification is indeed substantive and second to recommend whether continuation or termination is appropriate in the circumstances. In the case of full-size projects with substantive changes, the CEO will submit the revised project document, the explanations of the accountable agency, and the CEO’s recommendation to Council members for their own

review using procedures adopted for projects submitted for intersessional approval.[11] In the case of MSPs, the CEO will make a determination and the revised project documents for continued projects will be reposted on the web using the procedures adopted for expedited processing of MSPs.

[11] Project implementation arrangements may change for other reasons as well, and Council has been informed on an ad hoc basis because the current GEF Project Cycle does not codify these procedures. Such procedures will be proposed in the next amendment to the Project Cycle that is proposed for Council consideration.