Mark.Jaskowiak@do.treas.gov

10/06/2004 05:53 PM

Subject: RE: GEF Resource Allocation Framework - Canadian Comments after Paris

Colleagues,

Thanks very much to Roger for his contribution. Attached are our comments as well, which summarize our views as expressed in Paris and in previous meetings and communications with the Council and Secretariat on this subject. While a bit lengthy, perhaps, we thought it might be helpful to try to address the broad range of issues on the table.

See you in November,

Regards,

Mark Jaskowiak

-----Original Message-----
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Sent: Monday, October 04, 2004 1:21 PM
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Subject: Re: GEF Resource Allocation Framework - Canadian Comments after Paris

Colleagues

Below are comments from Canada on the question of the Resource Allocation Framework. These comments are additional to those that we sent prior to the Paris seminar and to those we made during the seminar itself.

To begin we would like to reiterate our conviction that of the options presented and discussed (that is, Options 1, 2, 3 and others - 4, 5 6 X., Y) only Options 1 and 2 respond to the agreement we reached in GEF-3 replenishment. In our view any allocation system must be ex-ante: we do not see how you can have a system that allocates resources after they have already been approved for projects. We would hope that we would be able to build a consensus around option 2 but we believe we need to amend it somewhat to build greater suppport for it. Our suggestions for Option 2 and on other issues are as follows:

1. We would prefer to see more than 15 or 16 countries in the individual allocations. If we reduced the minimal individual allocation to $5M this would mean there would be 39 individual allocations for biodiversity and 39 individual allocations for climate change. I think at a minimum you would need 25-35 individual allocations to get broad support from a number of countries for this option. You might thus consider a minimum allocation of $6 M or $7 M depending on what that gives you in terms of countries. Alternatively you could simply make $5 M the minimum for individual allocations.

2. We need more clarity on the floor level since this will also take a number of countries out of the country groups. We think the floor should be $500 thousand at least. (We would be willing to consider a somewhat higher floor if you make a case for it.) If you take the 25-35 individual allocations as well as those covered by the floor you will be left with less than the numbers you now have in groups 1 and 2 (that is, 111 for biodiversity and 126 for climate change). We concur with US and Japan that the Groups as they currently exist in your Option 2 are too large.

3. We would suggest that you consider having 3 groups rather than 2 since this would reduce the numbers in each group. For example if you used $5 M as mimimum individual allocation and $500 thousand as the floor your 3rd group could be $500 thousand to $2 M (I think that would be about 30 countries for biodiversity and 40 for climate change); your 2nd group could be $2 M to $3.5M (about 30 countries for bio and 20 for climate); the 1st group could then be $3.5M to $5M (about 22 countries for bio and 10 countries for climate change). You may want to play with the numbers somewhat, but I think this would be much more defendable than having groups as large as 89 or 113. (If you decide not to have more than two groups we would need a better rationale for your decision.)

4. As the US correctly stated it would be possible under your stated procedures to have a country in your Group II get more resources than a country in Group I , if the country in Group II got the maximum and the country in Group I got less than the minimum because many other countries in Group I got close to the maximum. I am not sure how to deal with this - perhaps you have to go back to the Group average plus or minus 25% or perhaps a somewhat higher percentage.

5. Like the US we think it would be interesting to see how variations in the weights between environmental benefits (now 0.8) and country performance (now 1.0) would affect the results. We would not favour increasing the environmental benefit side since benefits already appear to have significant impact on the results. Since most other IFIs use a performance factor of 2, it would be interesting to see what a factor of 1.0 (or 1.5) for benefits and a factor of 2.0 for performance would give you.

(Presumably this would lower some of the higher allocations and either reduce the impact of the ceiling or give somehat higher allocations to more countries.) We are not necessarily advocating such a weighting system, but some discussion on weights would be useful at some point. 6. While we find that the set asides may be considerably higher than in other institutions, we can understand some of the reasons for this. We would thus be prepared to support the allocations you propose.

7. In our view we do need some greater clarity on the human and financial resource implications of the options. Obviously the more the GEF does itself the higher the direct costs whereas, the more it can "borrow" from others the lower the cost. We believe that it would be difficult for the GEF to develop its own indicators (like IFAD has done for example) given the small size of the GEF secretariat and the manner in which it functions.

We continue to appreciate the significant amount of work the secretariat has already undertaken on this subject. and we are confident that the documents you prepare for the November Council will help move our discussions forward. Despite the differences of opinion that were evident in Paris, we still believe that we can reach a reasonable consenus on this question.

We look forward to seeing you in Washington in November.

Sincerely,
Roger Ehrhardt
Council Member for Canada

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10/7/2004

GEF Resource Allocation Framework
US Comments

Summary: Consistent with our comments at the Paris seminar and our previous statements and communications to the Council on this issue, in order to meet the substantive and procedural requirements of the replenishment agreement the paper prepared for the November Council should contain all the essential components of an operational performance-based allocation system (PBAS). To reiterate, we believe the paper should include, at a minimum:

- a clearly presented **ex ante allocation model** that provides for **individual allocations** for all countries;
- a clear statement that the allocation for each GEF recipient sets the resource envelope that each country could expect to receive if its performance stays the same and it is able to work with GEF and the IAs/EAs to design a pipeline of quality projects, but it is **not an entitlement**;
- the identification of specific indicators for country performance and environmental benefits that are **publicly available**, either drawn from existing sources or developed by the GEF Secretariat;
- a country performance rating that includes at a minimum: **a governance indicator, a macro economics indicator, an environmental policy indicator, and a portfolio performance indicator.** For those indicators developed by the Secretariat, there should be a list of questions and detailed definitions for each of the rating levels for each indicator;
- a formula for calculating the precise allocations that has a **substantial majority weighting on performance**, and within that, a substantial weighting of governance in performance;
- a table listing the exact **amount of resources that would be covered** under the PBAS and the specific proposed amounts that would be set aside, including any proposed floors, the sum of which should be kept at an acceptable minimum (say, at or about 15%, per IDA);
- specification of **other operational features** such as the list of eligible countries, carry-overs, ceilings, annual assessments and adjustments of allocations;
- a delineation of **the annual process** that would be used to make the assessments and apply the formula in a way that ensures consistency and objectivity in the ratings;
- a clear **one year timetable** beginning in December 2004 for performing assessments and calculating the first set of allocations for each GEF recipient for the following four fiscal years, beginning July 1, 2006.

To elaborate on some of these points:

1. Models: The GEF 3 replenishment text calls for allocation *"to global environmental priorities and to countries based on performance."* It also requires that the system ensure that *"all member countries can be informed as to how allocation decisions are made."* **Option 1** in the August 6 Paris seminar paper is the only model that is consistent with the replenishment agreement because it (1) allocates to environmental priorities <u>and</u> to all countries; (2) does so on the basis of both potential environmental benefits <u>and</u> performance; and (3) is <u>explicit</u> about how allocation decisions are made. Furthermore, it is the only option that is <u>consistent</u> because the formula and criteria would be applied in exactly the same way for all countries and there would be a clear relationship between performance and allocations. Finally, there is no evidence to support the Secretariat's assertion that this option would be "extremely difficult" to operationalize. In fact, the experience of other institutions demonstrates quite the opposite, most recently in the IFAD case, as presented and described in detail at the Paris seminar.

The hybrid model **(Option 2)** is not acceptable. It fails to meet the standards of GEF-3 replenishment agreement on several levels because it: (1) allocates to groups, rather than to countries; (2) is not transparent about how allocation decisions are made; and (3) is discriminatory and inconsistent in its treatment of countries. Only 15 countries in biodiversity and 16 countries in climate change would have individual allocations. The rest, which comprise the vast majority of our collective membership (111 in biodiversity and 126 in climate change), are treated differently since they would be placed into two groups in which they would compete for funds, with highly uncertain outcomes.

The $10 million threshold for receiving individual allocations is arbitrary, with no analysis or evidence to back up the assertion that allocations below that amount would introduce transaction costs and "excessive complexity" into GEF operations. The experience of IFAD and GEF is that amounts as small as $1-3 million can fund high-quality projects with significant impacts, and that amount may be even lower for the GEF since it funds only the incremental cost of projects.

Moreover, as we stated last May, allocation to groups will lead to perverse outcomes, in which countries in one group receive less than countries in the lower performing group unless there are tight caps and floors for each country. Such caps and floors would be extremely complex to incorporate into such a model, and would effectively make the system either unworkable or, if applied correctly, would make it a genuine performance-based allocations system (with allocations to each country) anyway. Secretariat's proposal on Group I and II ceilings ($10m. and $5m., respectively) reinforces our concern. Indeed, Secretariat's conclusion that these ceilings would ensure that countries in Group II will not receive more than those in Group I is incorrect. If enough countries in Group I receive $10 million ceiling, there will not be enough left for the remaining countries, whose allocations would then fall below the ceiling of Group II.

Option 3 also fails to meet the requirements of the replenishment agreement. It has the same shortcomings as the hybrid model, plus it does not allocate on the basis of performance at all. This model also raises the troubling issue of whether there is adequate due diligence on current GEF projects. As we have repeatedly urged since May 2003, when a variation of this screening proposal was proposed, due diligence in GEF projects needs to be addressed now, regardless of the decision on performance-based allocations.

Finally, any proposal that is not based on an ex ante allocation of resources would be fundamentally inconsistent with the replenishment agreement.

2. Indicators: The GEF-3 replenishment agreement calls for performance to be based on ***"transparent assessments"*** of those elements of country capacity, policies and practices most applicable to successful implementation of GEF projects. The US has consistently urged that the country performance indicator include indicators for macro, governance, environmental policy and portfolio performance, and stressed that while our preference would be to use existing public indicators, it may be necessary for the GEF Secretariat to undertake its own assessments.

All existing PBAS utilize reasonably reliable data that can provide the basis for defensible, effective and transparent allocation decisions, and be improved over time. All have developed their own indicators which reflect their special mandates. Policy performance indicators have been created through the use of questionnaires with responses compared to detailed criteria for each level of performance.

All PBASs place a heavy weight on governance, accounting for 68% in IDA, 53% in AsDB, 59% in AfDB and 34% in IFAD. Governance indicators assess the policies and practices of public institutions that lead to a strong enabling environment for projects to succeed. A key aspect of this is the country's efforts to combat corruption. The US has consistently emphasized the importance of governance in a GEF PBAS. In our view, the effective weight of governance in the country policy rating should be in the same range as other PBASs (combined weight of the governance indicator plus the governance components of the macro and environment policy indicators). For the broad governance indicator, our preference would be to use the governance indicators from the World Bank's CPIA, although if necessary, we could support a temporary use of KKZ indicators.

There is a **serious transparency problem** with the World Bank's CPIA indicator. The World Bank Board recently approved public release of the CPIA for IDA countries after the FY2005 exercise (sometime between November 2005 and February 2006). However, there was no decision to make the CPIA available for non-IDA countries. While the US supports full transparency of CPIA for all countries, this almost certainly will not happen in time for a GEF PBA. So the next question is whether GEF should use the CPIA at all, and if so whether it should use the CPIA without disclosing it. Our understanding is that the GEF Secretariat has not formally requested permission from the World Bank on this issue, so even if we agreed, CPIA could be unworkable. Even if World Bank permission was granted, we would be reluctant to have the GEF, as arguably the most transparent international institution in the world, agree to withhold such key information from the public. Moreover, **the replenishment agreement calls for the performance-based allocations system to be based on transparent assessments.**

Therefore, we have consistently proposed (since March 2003) that the Secretariat design and conduct country-by-country assessments of policies and practices relevant to environmental protection, with a heavy emphasis on governance. These should utilize the same type of objective questionnaires that have been used in other PBASs. To minimize cost, the GEF Secretariat should draw on the expertise and capacities of the IAs and, to the extent possible, use indicators developed by those institutions. For example, GEF might be able to use the detailed indicators that the World Bank Environment Department is creating for the revised environmental sub indicator for the CPIA.

To date, we have seen no progress on this, but are encouraged by the indications in Paris that the GEF Secretariat is beginning to work with the World Bank Environment Department to see if it could help construct environmental sector policy indicators – this effort needs to be accelerated immediately in order to provide an operational framework for November.

There is still the issue of the macro economic indicators for non-IDA countries. In IFAD, members agreed not to use macro performance indicators for non-IDA countries for a temporary period and to base non-IDA country scores on the remaining indicators until a proxy macro economic indicator is found. This might also be an appropriate short term solution for the GEF.

The **cost** of these assessments would not be prohibitive. All other institutions with PBASs have undertaken this without difficulty. World Bank staff recently estimated the annual cost of its 20 indicator CPIA exercise at roughly $1.5 million. A single environmental policy indicator for GEF would cost a fraction of this, although the startup cost would be higher than the annual amount. There should be adequate funds in the corporate budget for this, particularly if we make it a high priority. Surely, as the preeminent global environmental fund, the GEF should have a basic understanding of the environmental policies and practices that exist in recipient countries. Moreover, as the IFAD representative indicated in Paris, the transactions costs are small compared to the enormous benefits that the PBAS brings by increasing the impact of scarce resources and providing incentives for policy improvements.

On **potential environmental benefits**, the improvements made to both biodiversity and climate change indicators are appreciated. We do not see any serious problems with these indicators, although we have not yet received final input from our technical experts.

Another indicator issue raised by other Council members relates to **poverty** and a country's ability to finance global environmental activities itself. There was no mention of this in the paper, despite the Council request. We see merit in using these indicators in the formula to ensure that lower-income countries are not left out of our efforts, which the data on the distribution of resources suggest is happening now.

3. Formula: The US appreciates that performance is given slightly higher weight than potential benefits. However, this is substantially lower than in all other PBASs, including IFAD where the performance exponent is 2, the equivalent "needs" exponent is .75, and the per capita income exponent is -0.25. Since the replenishment calls for the allocations to be "based on performance," country performance should have a substantial majority of the weight in the formula, such that allocations would increase significantly as performance improves. Also, as indicated above, we believe there is merit in considering inclusion of a poverty factor. Therefore, we request a graph showing the distribution of resources for an environmental benefits exponent of .75, a performance exponent of 2.0, and a per capita income exponent of -0.25.

4. Exclusions: There may be legitimate areas for exclusions but they need to be kept to a minimum in order to maximize the amount of resources available for country allocations, and those excluded amounts need to be specified. Floors must be counted as exclusions, and may in fact be sufficient to include a large portion of the categories being proposed. IDA, for example, excludes only 15% of total resources, including floors. In addition, one third of each regional project is funded by the individual allocations of countries participating in the regional project.

5. Eligibility: The paper should provide a list of the eligible countries. In general, all countries eligible for receiving funds pursuant to the conventions are eligible for GEF resources.

However, there are some countries with high per capita incomes that have not received funds in many years, and that all members recognize do not need and should not receive GEF resources. Excluding these countries might be handled by a per capita income cap set high enough to ensure that those who have received support in the recent past would not be excluded.

6. Other Operational Issues:

The US supports an **assessment and allocations cycle** of one year, as is common in all other PBASs, including IFAD. That is, every year a new assessment process would be undertaken and the allocations for the following four fiscal years would be calculated. In our view, this is the best way to provide an incentive to improve performance and receive more funding.

The US does not see the issue of **unused allocations** as a serious problem. Our experience has been that countries will prepare quality projects and take up their allocations. As to the idea of carrying over unused allocations, the US requests data on the number of countries that have received project funding within a four-year cycle, and the number that have gone beyond that cycle. In IFAD, banking was introduced because many countries had a longer cycle for receiving a project (5-6 years) than the length of replenishment period (3 years). This may not be an issue for the GEF. In any event, we support returning unused allocations to the general pot.

On **ceilings**, the US requests more analysis. The figure of 20% is a high number compared to ceilings in other PBA systems. For comparison, the ceiling for IFAD is 5%.

On **floors**, this should be set in conjunction with the exclusion, and there should be a total number or percentage for exclusions and floors.

On excluding **EU accession members,** this is a matter that is worthy of consideration.

7. Conventions/Instrument:

The World Bank General Counsel's office has provided a clear opinion that a PBAS is not inconsistent with the GEF Instrument or the two relevant UN environment conventions, and that the GEF is an autonomous financial institution that does not require convention approval for its decisions, including a decision to establish a PBAS (Para. 5 & 6). The Secretariat has concurred that a PBAS is fully consistent with the conventions.