GEF/C.7/12
March 7, 1996

GEF STRATEGY FOR ENGAGING THE PRIVATE SECTOR

RECOMMENDED DRAFT COUNCIL DECISION:

The Council reviewed the document GEF/C.7/12, *GEF Strategy for Engaging the Private Sector,* and approves the strategy presented therein for seeking to promote private sector participation in GEF activities.

INTRODUCTION

1. The GEF Council has recognized the importance of the private sector for realizing GEF's objectives and the special issues that need to be addressed in the GEF's strategy for engaging the private sector. This paper was developed in close cooperation with the three Implementing Agencies, including the World Bank's affiliate, the IFC.

2. The preparation of this paper involved substantial consultation with some 60 private sector representatives during meetings in Jakarta, Paris, and Washington. An earlier draft of the paper was the subject of discussion at a luncheon seminar held at the time of the October 1995 Council meeting. Attendance at that meeting included representatives of Council, as well as the Convention Secretariats, Implementing Agencies, and NGOs.

THE IMPORTANCE OF THE PRIVATE SECTOR FOR THE GEF

3. From the start of the Global Environment Facility(1) (GEF) there was recognition of the importance of the private sector for achieving GEF's objectives. During the pilot phase, Implementing Agencies and project executing agencies gained certain experience with a variety of approaches to private sector participation in the GEF. In the process of examining numerous potential GEF private sector project concepts, business groups, companies, government representatives and NGOs were consulted, and several projects were initiated. Examples of pilot phase projects with a significant private sector involvement are presented in Annex A. They were managed through the World Bank Group's private sector affiliate, the International Finance Corporation (IFC), World Bank, United Nations Development Programme (UNDP), and the Interamerican Development Bank (IDB). For a more detailed description of a number of private sector projects under implementation or development, see Annex B.

4. The importance of engaging the private sector in a substantial way was reaffirmed during the process of restructuring the GEF. The *Instrument for the Establishment of the Restructured GEF* (the Instrument) lists the private sector among the various partners which the GEF is expected to

engage (para 28): " .. The Implementing Agencies may make arrangements for GEF project preparation and execution by multilateral development banks, specialized agencies and programs of the United Nations, other international organizations, bilateral development agencies, national institutions non-governmental organizations, private sector entities and academic institutions, taking into account their comparative advantages in efficient and cost-effective project execution." (emphasis added).

5. Particular responsibility is envisaged for the World Bank Group (including IFC): "The World Bank will draw upon its investment experience in eligible countries to promote investment opportunities and to mobilize private sector resources that are consistent with GEF objectives and national sustainable development strategies. (2)

6. There are a number of reasons why the GEF should actively seek to engage the private sector (3) in efforts to protect the global environment. First, net private capital flows (foreign direct investment, portfolio equity flows, bond issues, and commercial bank loans) are now three times greater than official development assistance flows (ODA). As documented in Figure 1, of total net resource flows to developing countries of $233 billion in 1994, net private flows totaled $173 billion while ODA totaled about $60 billion. As recently as 1989, public and private flows were roughly equal.(4)

[Figure 1 - Net Private Capital Flows to Developing Countries, 1987 - 1994]
(Available on request from the GEF Secretariat)

7. The balance of economic activity in developing countries and economies in transition continues to shift from public towards private sector investment. Turbulence in some emerging markets not withstanding, the trend of rising private investment seems likely to persist. Reasons include: economic liberalization in increasing numbers of countries and a renewed emphasis on private markets in the provision of goods and services. By contrast, public investment in developing countries continues to decline. (5) With the private sector representing an increasingly dominant part of the economy's transactions, it is evident that the mitigation of global environmental impacts cannot be realized without the private sector's intensive involvement.

8. There are a number of prime examples of the intimate link between the private sector and many of the factors affecting the global environment. Demand for power supply investments in developing countries has been estimated at $100 billion per year (50% of expected total infrastructure investment levels).(6) In 1994 project finance on a commitment basis to developing countries totaled $22.6 billion of which nearly $6 billion was in the power sector. Similarly oil and gas development investment in developing countries is now variously estimated in the range of $50-100 billion per year. (7) The bulk of total investment is in the private sector, so is technology development and choice. Given the GEF's interest in global environment-friendly technologies, private sector GEF participation is important for the transfer of desired technologies as well as further development of commercial markets for such technologies. The private sector is also important to biodiversity-linked sectors such as forestry, agriculture and tourism. Tourism is also relevant to the international waters focal area. Likewise, the shipping industry can contribute to the efforts to combat international water pollution.

9. The challenge for the GEF is to find effective modalities to influence ("leverage") these investment flows in ways that are beneficial to the global environment. Leverage (8)occurs when the use of specified resources for a given objective *causes* more financial resources to be applied for that objective than would otherwise be the case. Leverage occurs through

(a) *additionality,* when additional resources are mobilized for the objective; or

(b) *substitution,* when existing resources are channeled to activities consistent with that objective rather than to other activities.

10. Under existing operational policies, GEF is able to leverage resources in four main ways: mainstreaming global environmental considerations into regular development efforts of the Implementing Agencies; supporting substitute projects; inducing programmatic effects; and removing market barriers to investment in economically attractive ways of protecting the global environment.

THE IMPORTANCE OF THE GLOBAL ENVIRONMENT FOR THE PRIVATE SECTOR

Strategy

11. Over time it is expected that the national and global environmental impact of a private company's operations will be under increasing scrutiny by its financiers as well as national environmental and regulatory agencies, NGOs and consumers. International policies towards the global environment may present an important opportunity to participate in new business developments. The global environmental issues are also governed by international conventions. There is evidence that the private sector has recognized the benefits of acting in an environmentally responsible manner by integrating environmental concerns into its corporate planning. Companies that successfully anticipate future environmental regulatory requirements may place themselves in an advantageous competitive position. New market opportunities in sustainable use of natural resources (renewable energy, energy efficiency, sustainable agriculture or forestry, etc.) also are increasingly attractive to private firms. However, even where promising business opportunities with global environmental benefits and new technologies nearing commercialization exist, private firms may still be reluctant to invest in such opportunities in developing countries and economies in transition. Consequently, an effective GEF leveraging strategy will have to focus on ways to help business to overcome such reluctance to offset known risks, or to embrace cleaner production activities where new business opportunities and environmental benefits are inseparable.

Risk

12. As prime users of natural resources private sector companies would be expected to have an interest in the condition of a particular country's natural resource base. For a number of them this interest extends itself to the global environment, such as pollution of the atmosphere and the oceans, and the global stock of biodiversity. In addition, some companies, such as those in the

insurance industry, have a direct business interest in global environmental trends in climate change, international water pollution and the ozone layer.

13. Except in the case of a national regulatory regime that already prescribes certain legal environmental provisions [(9)], or of companies with a special business concern in the global environmental condition, business will normally require commensurate financial returns in undertaking projects that benefit the global environment. In such financial calculations it will consider both the expected return and the uncertainty (risk) to which this return is perceived to be subjected, i.e. the risk-adjusted rate of return. New technologies that tend to benefit the global environment often face formidable market barriers, especially in developing countries and economies in transition, with accelerated introduction dependent upon provision of financial incentives or risk reduction techniques. Therefore, a company's specific interest in access to GEF funds would depend upon the extent that extra costs and risks inherent in a global environment-focused project could be mitigated.

GEF ENGAGEMENT OF THE PRIVATE SECTOR: STRATEGY, ISSUES AND RECOMMENDATIONS

Strategy

14. Given the importance of private sector involvement for reaching GEF's global environmental goals, the GEF needs to devise a strategy to determine how it can most effectively facilitate the involvement of the private sector in eligible recipient countries. It has to be decided whether this would be most effectively done indirectly, by affecting the conditions under which the private sector operates - e.g. by removing market barriers, or compensating for regulatory changes - or directly, by helping the entry of a local firm into a market as yet untested in the recipient country. Often affecting the overall market conditions that business faces may well be the approach with the most leverage potential. However, in many other cases concrete investment projects may be required to lead the way.

15. Since many of the most environmentally advanced technologies become first available to developed country companies, a key focus of the GEF's strategy will have to be how it can promote appropriate joint ventures of private sector parties. This could involve facilitating ventures of interested developing country companies with existing industrial/technological networks such as the MIGA operated IPANET. The comparative advantages and networks of GEF's Implementing Agencies and executing agencies would also be utilized.

16. In the search for cost-effective leveraging opportunities, the removal of market, information and other barriers will be paramount[(10)]. This is in line with the GEF Operational Strategy, which was approved by the GEF Council at its October 1995 meeting. It has in its climate change component two Operational Programs which focus on barrier removal:

(a) Removing barriers to energy conservation and energy efficiency; and

(b) Promoting the adoption of renewable energy by removing barriers and reducing implementation costs.

17. In meeting the objectives of the GEF's Operational Strategy towards the private sector, a number of principles should be adhered to:

(a) complement or augment rather than replace activities that the private sector was planning to implement fully on its own account;

(b) avoid causing a significant distortion of competitive market conditions locally or internationally; and

(c) continue to focus on catalytic demonstration projects with significant replication promise.

Issues and Recommendations

18. In moving from the broader GEF strategy to engage the private sector to a number of specific steps that can be taken in its support, a number of specific issues have been raised during consultations between the private sector and the GEF.

19. Furthermore, the inherent incremental risk to a company interested in an alternative incremental project with global environmental benefits must be taken into account. Part of this effort may relate to upstream preparation costs. Such costs are eligible for grant funding through the GEF's Project Preparation and Development Facility (PDF).

Recommendation I: within the principles of the Council approach to incremental costs, develop guidelines for private sector projects that meet at least four criteria:

(a) avoid subsidizing activities the private sector would do anyway, so as to safeguard GEF's limited resources ("moral hazards" problem);

(b) provide rigorous yet practical guidance to potential private sector applicants; and

(c) be consistent with a competitive market setting and seek out reasonable and pragmatic rules to cover issues related to potential differences between incremental cost guidelines at the national level and at the level of the firm.

20. The GEF Secretariat envisages to develop, over time, best practice guidelines for defining incremental costs in private sector projects.

Concessional Loans as the Private Sector Financing Modality

21. Several financing modalities may be tailored to help to mitigate certain kinds of risks perceived by the private sector. Three major options beyond the grant modality come to mind: concessional loans; guarantees; and equity. The first option is clearly within the scope of the Instrument: "..a mechanism .. for the purpose of providing new and additional grant <u>and concessional</u> funding to meet the agreed incremental costs .." (emphasis added). The other two options may need to be revisited. Council issues note, "*Financing of GEF Projects (*GEF/C.7/Inf.4)" explores in more detail how increasing the menu of financing modalities can

help the GEF in its pursuit of increasing cost effectiveness of its funding, so that maximum global environmental benefits be realized.

22. Of the three major financing modalities mentioned here concessional lending would be the simplest to apply. It would appeal to the business ethic of financial discipline that is weaker in the case of a pure grant, while at the same time it would address concerns expressed by some Council Members on past occasions how one could be sure that the GEF funding to the private sector was truly needed to realize the additional global environmental benefit, rather than simply sweetening an already commercial project proposition.

Recommendation II: that the following approaches be pursued:

(a) Non-grant financing, including concessional loan arrangements, should be presumed to be the standard financing modality in the GEF's direct dealings with private sector financing. A special case would need to be made why in certain circumstances the grant modality would be more appropriate. Conceptually, the grant element of the concessional loans would be expected to be related to the unrecoverable incremental cost that can be attributed to the recasting of the project in order to benefit the global environment. The concessionality might be in terms of lower interest rates or of longer repayment periods than commercial loans. In time, GEF might design loans as a part of a project with a revolving loan facility; and

(b) Investment or venture capital funds should also be considered. GEF grant or concessional financing might be provided for funding certain specified activities (such as project development and investment monitoring) or incremental costs and/or incremental risks. The GEF should also consider the modalities of making equity investments in such funds. Moreover, modalities for use of financial sector intermediaries ought to be explored.

23. When new financing modalities are prepared for GEF funding, the project proposal would be accompanied by a policy note prepared by the Secretariat so that the Council could explicitly consider, for possible approval, any policy needed to address the issue.

24. Exploring other forms of financing in addition to grants offers a number of attractions to GEF. The consultations with private companies have all pointed out that private sector sponsors are generally more concerned whether financing is readily available, rather than with grants per se. Using non-grant financing allows a financial discipline that may be more commonly appreciated by many private sector participants. Further use of non-grant financing extends GEF resources and allows regeneration of funds along with potential returns on funds invested.

Project Approval Process

25. An important point raised in the consultations is that in order to facilitate involvement of the private sector, the GEF must be able to work under clear and simple decision rules, so that its financing may be consistent with the time frames for private project financing, and with a level of detail that does not stifle promising initiatives. Speedy decisionmaking is essential in order to maintain private sector involvement in projects.

26. The GEF may need to consider whether a streamlined decision process tailored to private sector financing is desirable. While such a decision process would be faster, it would need to include special provisions to ensure as solid a system of checks and balances as for the GEF's public sector financing. One option that could be considered in this context would be greater use of programmatic or "umbrella" approaches building on a model such as the Small and Medium Enterprise (SME) Program and the Biodiversity Enterprise Fund for Latin America that are currently being developed by the IFC (see Annex B). Such intermediary mechanisms for GEF private sector funding would function under clear and approved decision rules for sub-projects and might thus be able to offer a streamlined decision process. It might also involve the inclusion of a GEF representative on the Fund Board. GEF grants to such funds could be managed, for example, as a revolving fund by the executing agency in question, who would be able to guarantee the private sector that once its approval had been obtained, GEF financing was guaranteed. And the fund manager/executing agency would be required to provide annual progress reports to the GEF.

Other Important GEF Considerations

27. *Replicability Potential.* An additional benefit of GEF project financing may relate to the potential for broadcasting business opportunities, through demonstration.

Recommendation III: Private sector proposal sponsors should be encourage to highlight in their GEF project proposal any replicability potential and technological transfer benefits that they may be able to identify. From GEF's perspective, replicability will be most effectively broadcast to other business entities in the case of non-grant, market-based, financing. The GEF should also consider the leverage value of developing complementary mechanisms. This could include: (i) a project to systematically raise awareness concerning the global environmental dimension; and (ii) an information dissemination project, to effectively broadcast newly proven business opportunities with beneficial global environmental effects.

28. *Consistency with Recipient Country Priorities.* Like GEF public sector projects, GEF private sector projects have to be consistent with recipient country priorities. For this purpose, GEF projects need to be endorsed by the GEF Country Operational Focal Point. It will be desirable to satisfy this requirement in a manner which does not encumber private sector's typical pace of project development.

Recommendation IV: All private sector projects will need endorsement from the GEF Country Operational Focal Point that they are consistent with country priorities.

In the case of *regional umbrella projects*, all GEF recipient countries concerned would be asked to endorse the framework project. This could be done on a no objection basis with, e.g., a two month response period. All recipient countries, except for those which would have objected, would then be potential hosts for sub-projects under the umbrella project. The GEF Country Operational Focal Point would be notified in advance of any sub- projects that are being developed in their country. In the case of *global umbrella projects*, the letter requesting Country Operational Focal Point endorsement would be sent to the countries where sub projects were envisaged (further letters would be sent at a later date when new countries would be added to those where sub projects were planned). As in the case of regional projects, the Operational Focal Points would receive advance notice of sub-projects in their country.

29. *Recipient Country Counterpart.* Under the standard process the GEF provides financing of incremental costs to the recipient country. Certain operational issues will have to be worked out in the case of a GEF private sector project when the counterpart is a private company in a recipient country.

Recommendation V: A recipient country private sector company should normally be identified as the lead party in the project.

30. *Transparency and Consultation.* As tends to be the case in public sector projects, some of the information related to private sector projects concerns confidential business matters, at times including proprietary technologies and financial information. GEF private sector partners are generally aware of requirements for use of transparent and participatory processes in project design and execution so as to optimize the environmental and social aspects of its portfolio. They will be looking for reasonable assurances from the GEF's Implementing Agencies and executing agencies that proprietary data and confidential business information will not be compromised.

Recommendation VI: Standard information disclosure requirements of the GEF should apply to GEF private sector projects. It will be the responsibility of a GEF Implementing Agency (11) to ensure that a private sector sponsor meets that organization's and the GEF's information disclosure requirements, while not compromising confidential and proprietary business information.

31. *Distorted Incentives* Certain distorted policy environments (e.g. in a country with highly subsidized energy pricing) may make it questionable that the GEF financing can achieve its global environmental benefit in a cost-effective manner. GEF grant financing itself could cause a slanted playing field. Therefore, GEF funding to private or public sector in a seriously distorted setting will be avoided.

PROSPECTIVE GEF PRIVATE SECTOR PROJECTS

32. Table 1 provides an overview of activities with the potential for GEF-funded private sector initiatives.

TABLE 1: OVERVIEW OF PROMISING PRIVATE SECTOR ACTIVITIES

1. Biodiversity	Sustainable Forestry and Agriculture Tourism Non-timber forest products
2.Climate Change	Renewable Energy; solar thermal, photovoltaic, biomass Energy Efficiency Sustainable Forestry

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3. International Waters                 Contaminant-based programs

4. Ozone Depletion           CFC Substitution in Refrigeration and
                                        Foam Insulation
                                        Replacement of Solvent Use in
                                        Industrial
                                        Cleaning
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ANNEX A

SELECTED PILOT PHASE PRIVATE SECTOR EXPERIENCE WITH GEF PILOT PHASE PROJECTS

1. In addition to the IFC/GEF Pilot Phase projects described in Annex B, a number of other GEF Pilot Phase projects involve private sector organizations or technologies in significant capacities. This selected list was prepared to acquaint Council members with the range of ways in which the private sector already participates either directly or indirectly in public sector GEF projects.

2. **World Bank Poland Coal-to-Gas Conversion Project** - among the project beneficiaries to which the Polish Environmental Protection Bank is providing GEF-assisted financing are enterprises in the process of privatization or which are already private.

3. **World Bank India Alternate Energy Project** - among the project beneficiaries to which the Indian Renewable Energy Development Agency (IREDA) has provided GEF-assisted financing are private sector sponsored wind farm, hydroelectric, and photovoltaic developments.

4. **World Bank Thailand Promotion of Electricity Energy Efficiency -** the Electricity Generating Authority of Thailand (EGAT) and its newly formed Demand-Side Management Organization (DSMO) are actively working through GEF funding to encourage local private companies to manufacture more energy efficient lighting, refrigerators, motors and other key energy-consuming devices and consumer appliances.

5. **World Bank Tunisia Solar Water Heating Project** - Tunisia's Agence pour la Maitrise de L'Energie has obtained commitments of $13.6 million in private sector co-financing to accompany the $4 million in GEF financing.

6. **World Bank Brazil Biodiversity Project** - Brazil's Ministry of the Environment has been actively discussing mechanisms to ensure that private sector businesses and business foundations with an interest in biodiversity protection can participate in GEF-funded project activities.

7. **UNDP Brazil Biomass Integrated Gasification/Gas Turbine Project** - a public-private sector consortium was formed to further development of BIG/GT technology. An application for GEF support of a $70 million commercial demonstration BIG/GT plant under World Bank sponsorship is likely. In this follow-on stage private equity would be invested alongside GEF funds.

8. **UNDP Chile Reduction of Greenhouse Gases -** the project includes a component designed to help stimulate formation of private Chilean energy service companies (ESCOs) to help commercialize energy efficiency activities within Chilean industry.

9. **UNDP Mauritania Wind-Electric Power for Social and Economic Development -** the project brings together local companies and international wind electric equipment suppliers to establish collaborative ventures. Participating communities will have equity investments in the systems.

10. **UNDP Pakistan Fuel Efficiency in the Road Transport Sector -** the project aims to enhance private-sector garage owners to engage in instrumented tune-ups of gasoline vehicles and diesel buses, as a means to increase the energy efficiency of the road transport sector.

11. **UNDP Cote d'Ivoire/Senegal Control of Greenhouse gas Emissions through Energy -** Efficient Building Technology in West Africa- the project aims to establish with the help of policy measures and financing mechanisms the local capacity to attract private sector participation in energy-efficient building projects, both for retrofit and in new buildings, thus helping to develop private sector markets in this area.

12. **World Bank/Inter-American Development Bank Costa Rica Tejona Wind Power Project -** the project was originally prepared by a private wind energy developer as an independent power project (IPP). Subsequent to the decision of the Instituto Costaricense de Electricidad (ICE) to develop the GEF project as a public sector project, the government decided to restart its IPP procurement program. Several private wind farm developers are now negotiating project financing arrangements for new wind power developments under power purchase agreements with ICE.

ANNEX B

SELECTED GEF PRIVATE SECTOR PROJECTS

EXAMPLE 1 - IFC/GEF POLAND EFFICIENT LIGHTING PROJECT (GEF PILOT PHASE)

1. GEF has provided IFC with $5 million for a three-year pilot demand-side management (DSM) program to accelerate the development of the Polish market for energy efficient lighting technologies to realize global and national environmental benefits. The project gives financial incentives to Polish consumer and small business purchasers of compact fluorescent lamps (CFLs) and related products through a private sector approach. The mechanism used is a manufacturer wholesale price reduction approach pioneered by a U.S. investor-owned utility. Some 1.3 million CFLs are expected to be distributed and sold to consumers at reduced prices through the project. Funds for the first year program have been competitively awarded among four Polish lighting manufacturers who are required to pass on the full value of the price incentive throughout the wholesale and retail sales process. The approach aims to achieve greater cost-effectiveness and administrative efficiency than what commonly achieved through CFL financial incentives employed in utility DSM programs. The project is also undertaking pilot

DSM activities at Polish electric utilities being privatized as well as consumer/lighting professional education programs. A Dutch private utility company is responsible for administering the project with support from a Polish energy efficiency NGO.

EXAMPLE 2 - IFC/GEF SMALL & MEDIUM ENTERPRISE PROGRAM (GEF PILOT PHASE)

2. GEF has provided $4.3 million to this experimental program administered by IFC to stimulate greater involvement of private small and medium scale (SME) enterprises in addressing GEF's biodiversity and greenhouse gas mitigation objectives. The Program has been designed to gain experience in several areas: a) the ability of SMEs to implement projects that address GEF objectives, b) the financial viability of these activities and the potential for commercial financing of these activities, and c) the ability of financial intermediaries to deliver GEF program funds to SMEs. Five or six experienced SME institutions (e.g., banks, venture capital companies, or NGOs) selected by IFC to act as Intermediaries for the Program will receive a low interest loan of $500,000 to $1 million from the Program. The Intermediaries in turn will provide debt or equity financing of about $20,000 to $200,000 to SMEs for the incremental costs of GEF eligible projects. The total capitalization of SME projects leveraged by the program may be in the range of $ 6 million. To encourage the Intermediaries to participate in the Program and to consider GEF-eligible SME projects, the Intermediaries may be able to retain 50% of all capital recovered from the SMEs. The Intermediaries and IFC will monitor and evaluate financial and global environmental aspects of the Program.

EXAMPLE 3 - BIODIVERSITY ENTERPRISE FUND (GEF 1)

3. IFC is examining the use of investment or venture capital funds to encourage the private sector to invest in "sustainable" or environmentally sensitive businesses. Businesses that sustainably use or protect natural resources may include renewable energy, energy efficiency, sustainable forestry, alternative/organic agriculture and aquaculture, ecotourism, and recycling. These businesses in developing countries often encounter difficulties in obtaining financing for a variety reasons: small size, newer technology, lack of access to debt at reasonable interest rates, and project development or transactions risks and costs. Through a fund, IFC and private sector investors would bring together investment management expertise, advanced sector know-how, and local and foreign capital and make these resources available to businesses in these sectors of interest to the GEF. IFC is considering a $20-30 million Biodiversity Enterprise Fund to invest in forestry, agriculture, and ecotourism projects in South America. In addition, $5 million in grant funding from the GEF for the "incremental costs" of investing in biodiversity-linked investment projects (including higher than normal project and review and biodiversity screening costs, the costs of an advisory board, and monitoring and evaluation activities) was approved by the GEF Council in October 1995. The fund will invest in projects with a capitalization of about $100 million.

EXAMPLE 4 - RENEWABLE ENERGY AND ENERGY EFFICIENCY FUND (WORK PROGRAM GEF 1, APRIL 1996)

4. IFC is also examining possibilities for a $100-200 million global Renewable Energy and Energy Efficiency Fund to catalyze and finance investments (of generally less than 20 MW) in developing countries that use GEF-eligible technologies. New sources of largely private capital must be found to meet an estimated $160 billion in demand for energy supply projects financing in developing countries by the Year 2000. A feasibility study indicates a fast growing "pipeline" of renewable energy and energy efficiency projects providing the proposed fund with adequate investment opportunities However, it is presently difficult for these projects to attract interest from investors because they tend to be small transactions, require more time and support to bring them to investment quality than large conventional projects, and often involve newer technologies or new markets. The proposed fund will offer an opportunity to explore how commercial funding and a smaller amount of concessional funds might be integrated. IFC has applied for $30 million in grant and concessional funds from or grant the GEF Council at its April 1996 meeting for project development costs, eligible incremental costs for some promising new technologies, and to monitor and track the greenhouse gas mitigation benefits (or carbon offsets) of the funded projects.

EXAMPLE 5 - HUNGARY ENERGY EFFICIENCY CO-FINANCING FACILITY (WORK PROGRAM GEF 1, APRIL 1996)

5. IFC proposes to establish and administer a US$5 million co-financing facility dedicated to energy efficiency project financing in Hungary utilizing GEF funds. The Facility would support financing activities of qualified domestic financial intermediaries such as commercial banks and bank-owned leasing companies by providing credit enhancement, co-financing and targeted technical assistance to energy efficiency investments. Its goals are to implement cost-effective projects, promote development of the energy efficiency market and build domestic energy efficiency financing capacity. The three target subsectors will be (i) lighting; (ii) district heating; and (iii) industrial motors and processes. GEF resources would be used to facilitate and leverage private sector capital, (including domestic bank capital and credit lines supplied to local FIs by IFC, EBRD, EIB, KfW and other international financial institutions or IFIs). Over its proposed five year life, the HEECF would facilitate total energy efficiency investments of an estimated US$25 to 30 million or more. Funds would be used for three purposes: (i) direct energy efficiency project financing support; (ii) technical assistance; and (iii) Facility establishment and administration. Direct energy efficiency project financing support would be provided via: (i) credit guarantees, whereby Facility funds would be reserved to cover the guarantee liability; and (ii) medium-to-long term co-financing loans. Technical assistance funds would support marketing and delivery of energy efficiency financial services and preparation of specific energy efficiency investments. The Facility would use financing methods that seek to preserve and leverage the capital of the Facility to the maximum extent.

Endnotes:

1. Instrument for the Establishment of the Restructured Global Environment Facility, Washington, DC 1994, preamble (a). Article 2 prescribes the GEF's mission as "..a mechanism for international cooperation for the purpose of providing new and additional grant and

concessional funding to meet agreed incremental costs of measures to achieve agreed global environmental benefits" in the focal areas of climate change, biodiversity, international waters and the atmospheric ozone layer.

2. Instrument, Annex D, paragraph 11 (c).

3. Private sector, for purposes of this paper, includes all types of non-government economic activities of a for-profit character, including all sizes of corporations, as well as business associations. This paper’s primary focus is on private enterprises that are based in recipient countries and majority owned by recipient country nationals. In this context corporations include micro, small, and medium-sized enterprises, including individual and family-owned businesses. It is recognized that many NGO's are increasingly engaged in associations with companies or other ventures to undertake innovative private sector activities designed to address global environmental issues.

4. Source: "Financial Flows and the Developing Countries", World Bank, August 1995.

5. Source: "Trends in Private Investment in Developing Countries 1994: Statistics for 1970-92", International Finance Corporation, 1994.

6. Source: "Capital Expenditures for Electric Power in the Developing Countries in the 1990's", World Bank, February 1990.

7. ”Energy Transition in Developing Countries" World Bank 1983, and subsequent unpublished industry sources.

8. Another form of leverage is of a technological nature, e.g., through the promotion of the transfer of equipment skills.

9. Typically environmental regulations are designed with enforcement through fines and penalties, thus also using the financial incentive to affect business behavior.

10. See also the Issues Note on Financing of GEF Projects, GEF/C.7/Inf.4.

11. Including IFC.