Global Environment Facility

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FINANCE FOR GEF PROJECTS THAT HAVE INCREMENTAL DOMESTIC BENEFITS

INTRODUCTION

1. At the meeting of the Council in October 1996, some Council Members expressed concern over the financing of GEF projects having incremental domestic benefits, i.e., activities that appeared to have negative incremental costs. The Secretariat was requested to prepare a short note explaining the financial modalities issue in such cases[1]. The Council suggested that in cases of incremental domestic benefits, the GEF might more appropriately provide loans rather than grants and requested a case-by-case justification, including an explanation for the reason as to why financing could not be mobilized from other sources.

2. The issue of finance for GEF projects that appear to have incremental domestic benefits was originally raised in the Secretariat cover note on the proposed work program at the Council meeting in October 1996. This response has been prepared by the Secretariat after consultation with Implementing Agency staff[2] involved in the projects in that work program.

INCREMENTAL DOMESTIC BENEFITS

3. In many cases, the same action can yield both domestic benefits and global environmental benefits. For example, energy conservation projects based on the use of fossil fuels provide both domestic benefits (energy savings, reduced air pollution) and global environmental benefits (reduced greenhouse gas emissions). In such projects, energy savings outweigh the project's capital costs. Therefore, such projects need not incur incremental costs while achieving their global environmental benefits. In these cases, where the domestic benefits alone provided adequate economic justification, the project should therefore be implemented without GEF grant financing. As there would be no positive incremental costs, no GEF financing would be provided.

4. GEF-supported activities should normally deliver the same level of domestic benefits as the country would obtain if it had pursued a course of action that did not explicitly address global environmental issues. When a GEF-supported activity seems to deliver *additional* domestic benefits, the GEF approach to incremental costs[3] provides a way to treat the incremental costs of these additional domestic benefits, as set out briefly below:

(a) Those costs of the proposed GEF activity associated with an expansion of the project beyond what is strictly required for global environmental

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[1] Decision 10(c), GEF/C.8/12 dated October 15, 1996.
[2] Climate Change Task Force, September 19, 1997
[3] GEF /C.7/Inf.5

benefits are ineligible for GEF support. Neither the costs nor the benefits of such an expansion become a part of GEF project analysis. For example, where this is the case for an ecotourism component of the overall project of which the GEF-financed activity forms a part, both the costs of that component and the revenues accrue to the project sponsors.

(b) Some of the additional benefits help a country avoid costs it would have otherwise incurred. In this case the avoided costs would be deducted from project costs when the incremental costs are estimated. For example, if upstream habitat protection will reduce downstream water treatment costs, this reduction in treatment costs would be taken into account in the calculation.

(c) Any additional benefits that are not national priorities would not be used to reduce the estimated incremental costs of the activity because they do not help the country to avoid costs they would otherwise have been willing to incur. For example, no costs would be avoided by actions to the extent that they improved ambient air quality *beyond* reasonable national standards.

(d) In the case of barrier removal, two types of incremental costs need to be distinguished: (i) Incremental costs of the resulting follow-on “win-win” activities, which are negative. (ii) The incremental costs of removing the barriers to such win-win activities, which are positive. The incremental costs are positive where project costs cannot be easily recovered from diffuse subsequent beneficiaries of the *resulting* win-win activities.

5. Only the costs of removing barriers are eligible for GEF financing; the costs of the resulting win-win activities are ineligible. Financing of demonstration projects and reduction of high first costs are two examples of barrier removal where special care is necessary to show that barriers actually exist and that the GEF activity can remove such barriers in a sustainable way. The Secretariat is consulting with the Implementing Agencies in preparing operational criteria for the identification of such situations.