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EVALUATION OF INCREMENTAL COST ASSESSMENT

(Prepared by the GEF Evaluation Office)

Recommended Council Decision

The Council, having reviewed the document GEF/ME/C.30/2 Evaluation of Incremental Cost Assessment, and the management response (GEF/ME/C.30/3), takes note of the conclusions of the evaluation. The Council particularly welcomes the conclusion that the principle of incremental funding is being achieved throughout the GEF.

On the basis of the evaluation's conclusion that the process of incremental cost assessment and reporting does not add any value to the quality of projects, the Council agrees that:

1. the current incremental cost assessment and reporting should be dropped as requirements for GEF projects;
2. the incremental reasoning in project objectives and design should be explicitly recognized in appropriate documentation, particularly at the project concept stage, during implementation and at completion;
3. on-going efforts need to be strengthened to have a better identification of global environmental benefits in GEF activities, including improved dissemination and raising of awareness of the focal area strategic priorities and objectives.

The Council requests the GEF Secretariat to incorporate this decision into the paper on operational guidelines for the application of the incremental cost principle in GEF operations to be presented to Council in June 2007. The Council also requests the GEF Evaluation Office to record any follow up actions taken to implement these decisions and to report on these actions through the Management Action Record.

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EXECUTIVE SUMMARY

1. Incremental cost funding is the fundamental operational principle of the GEF. The GEF finances the increment or additional costs associated with transforming a project with national/local benefits into one with global environmental benefits as well. The ‘principle’ of incremental cost funding was originally envisaged to ensure that GEF funds do not substitute for existing development finance but provide new and additional funding to produce agreed global environmental benefits. Its application has been recognized as complex and not transparent by all of those involved in the GEF.

2. The primary objectives of this evaluation were to evaluate the processes and methodologies used for incremental cost assessment, and the process of negotiation of incremental costs. In line with these objectives, the following dimensions of incremental cost were evaluated: the incremental cost annex reporting, the process of incremental cost assessment, the process of negotiation and the methodologies, approaches and requirements for incremental cost assessment and reporting in order to determine whether these are appropriate and sufficient. The evaluation also conducted an assessment of the evolution of the incremental cost concept in relationship to financing global environmental benefits (within the context of Agenda 21) and how its application evolved within the GEF.

3. The evaluation used a series of approaches and tools to collect and analyze information, including quantitative (e.g., structured survey questionnaires) and qualitative (e.g., semi-structured interviews): literature review, review of all projects approved in 2005 from the point of view of compliance with guidelines and procedures and technical quality of the incremental cost assessment and reporting, an on-line survey to gather opinions from a broader set of stakeholders, and interviews with fifty-five key people involved with GEF project design and review. The evaluation reached four main conclusions and three recommendations.

4. First conclusion: **the principle of incremental funding is alive and well in GEF projects.** Although the evaluation found many doubts and concerns expressed about the process of incremental cost assessment as it is carried out, the evaluation found that incremental reasoning underpins the global environmental focus of the design of GEF projects. This reasoning takes place at the concept phase, well before the process of incremental cost assessment, and it ensures agreement on the global benefits and the ways in which the project will secure these benefits and provide additional funding to cover their incremental costs.

5. Second conclusion: **there remains weak understanding and much confusion about incremental cost concepts and procedures.** Confusion still persists on whether incremental cost is a (primarily qualitative) form of logic or reasoning, or a quantitative, numerical calculation. Specific terms associated with incremental cost were also found to be poorly understood, most notably “incremental cost”, “alternative,” “system boundary” and “additionality”. GEF guidance throughout the years never clarified if they substitute for or add to previous ones, adding to the confusion of what is required.

6. Third conclusion: most project documents register low quality and compliance when measured against GEF requirements for incremental cost assessment and reporting. The evaluation found that 64 % of projects only report on half of the six aspects of incremental cost

that are required by policy and guidelines (broad development goals and baseline, alternative, and cost). One of the reasons the compliance quality is low is because the GEF incremental cost guidelines that lay out the background to incremental cost assessment and the requirements for annex reporting in project documents are rarely used, and there is an absence of commonly-accepted “best practice” for incremental cost assessment.

7. Fourth conclusion: **as currently applied, incremental cost assessment and reporting do not add value to project design, documentation and implementation.** The bulk of effort is expended on reporting on incremental cost as a required part of the project document rather than connecting it to the project design. The preparation of the annex is usually carried out ex post facto, at the end of project formulation, by experts. The annex serves merely to summarize or repeat the information contained in the main text of the project document.

8. First recommendation: **incremental cost assessment and reporting should be dropped as requirements for GEF projects.** A shift is required away from the cumbersome, complex and not always useful steps of incremental cost assessment to a focus on integrating incremental reasoning into project objectives and design. Therefore, the incremental cost assessment and reporting requirements should be dropped from the project design and reporting process, in particular the requirement for an incremental cost annex, section, and incremental cost matrix in project documents.

9. Second recommendation: **incremental reasoning in project objectives and design should be acknowledged and recognized, in particular at the project concept stage, during implementation and at completion.** This evaluation shows that the current practice of projects in the GEF is to follow incremental reasoning to ensure that the GEF funding of these projects is (a) directed towards achieving global environmental benefits and (b) additional to existing funding levels. Full accountability for the incrementality of GEF funding would be achieved, during implementation and project completion by monitoring and evaluating for progress towards achieving global environmental benefits and for levels of co-funding.

10. Third recommendation: **the process towards better identification of global environmental benefits needs to be strongly supported, including improved dissemination and awareness-raising on focal area strategic priorities and objectives.** The only way to strengthening integration of incremental reasoning is by providing full clarity and transparency on global environmental benefits that are expected from projects through a better definition and focusing of the focal area objectives and strategies. If there are no clear global environmental benefits incremental reasoning cannot be done and the concept should not be considered a GEF project.

11. The rationale for these conclusions and recommendations is that as currently applied, incremental cost assessment and annex reporting procedures do not enhance either the technical quality of GEF projects, the process of negotiation and agreement that is fundamental to project design and decision-making, or the integration of incremental reasoning and other GEF principles. The original idea that it would be possible to develop a quantitative “methodology” which would be universally applicable and would meet the ambitious goals of determining incremental cost and structuring its negotiation was clearly unrealistic. In reality, and as currently required and applied, it has undermined (or at the best played little role in) the process

of determining incremental cost in GEF projects. A great deal of time, effort and project preparation budget are expended on fulfilling minimum reporting requirements, rather than using incremental cost assessment as a tool to aid in the design of better projects. The evaluation finds that the projects reviewed satisfactorily incorporate the principle of incrementality through incremental reasoning, are targeted at securing global benefits and attracting additional funding – but this is in spite of incremental cost analysis, not because of it. There is no apparent value added from incremental cost assessment and annex reporting requirements as laid out by GEF.

12. The full evaluation report, containing detailed analysis and background information, is available at the GEF Evaluation Office website ([www. thegef.org](http://www.thegef.org), then go to Evaluation Office, On-going Evaluations and then Evaluation of Incremental Cost Calculation).

CHAPTER 1: INTRODUCTION

13. The GEF functions as a mechanism for international cooperation to provide new and additional funding to meet the agreed incremental costs of securing global environmental benefits, working in partnership with GEF Implementing Agencies (UNEP, UNDP, and the World Bank), seven Executing Agencies¹, national governments and civil society.

14. Incremental cost is the fundamental operational principle of the GEF. The GEF funds the increment or additional costs associated with transforming a project with national/local benefits into one with global environmental benefits. The ‘principle’ of incremental cost was originally envisaged to ensure that GEF funds do not substitute for existing development finance but provide new and additional funding to produce agreed global environmental benefits. Its application has been recognized as complex and not transparent by GEF Council, the Secretariat and Implementing Agencies as well as project proponents, Governments and NGOs. Furthermore, it has been identified in several evaluations conducted by the GEF Evaluation Office as an issue that needs further clarification.

15. In June 2005, the Evaluation Office proposed to Council to carry out a short and focused evaluation of how incremental cost calculations have been undertaken in GEF projects and what can be learned from the application of the methodology so far, building on findings from the focal area program studies, and the recently completed evaluation of the role of local benefits in global environmental programs. The proposed evaluation also complements other activities in the GEF Evaluation Office’s work program such as the Joint Evaluation of the GEF Activity Cycle and Modalities, and country portfolio evaluations.

16. The present evaluation is a response to several recommendations from previous evaluations (Second and Third Overall Performance Studies, Biodiversity Program Study), the November 2005 Council decision regarding the evaluation of the role of local benefits and GEF4 donors replenishment agreement which requests the GEF Secretariat and GEF agencies to prepare for June 2007 Council meeting clearer operational guidelines for the application of the incremental cost principle in GEF operations, taking into account the findings and recommendations of this evaluation.

CHAPTER 2: SCOPE AND METHODOLOGY

17. The primary objectives of the incremental cost evaluation were to evaluate the processes and methodologies used for incremental cost assessment, and the process of negotiation of incremental costs. In line with these objectives, the following dimensions of incremental cost were evaluated:

- the **incremental cost annex reporting**, in terms of its quality and compliance to GEF guidelines (in particular the incremental cost annex).

¹ The Executing Agencies comprise the four major regional development banks (the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank) and three specialized agencies (the International Fund for Agricultural Development (IFAD), the Food and Agriculture Organization of the United Nations (FAO), and the United Nations Industrial Development Organization (UNIDO).

- the process of **incremental cost assessment**, in terms of its operational approach, conduct and content (the process of conducting the incremental cost assessment).
- the **process of negotiation** according to who is involved and what is negotiable/negotiated at each of the key stages of project identification, preparation and design.
- the **methodologies, approaches and requirements** for incremental cost assessment and reporting in order to determine whether these are appropriate and sufficient (both as they are reflected in GEF guidance documents, and as they are actually applied in project design).

18. The evaluation also conducted an assessment of the evolution of the incremental cost concept in relationship to financing global environmental benefits (within the context of Agenda 21) and how its application evolved within the GEF.

19. Finally, the evaluation interprets these findings in order to draw conclusions and make recommendations to be presented as feedback to GEF Council, and evidence-based inputs into the forthcoming work of the Secretariat and GEF agencies to clarify the principle and its application in the GEF as requested by the replenishment negotiations for GEF4.

20. The evaluation used a series of approaches and tools to collect and analyze information, including quantitative (e.g., structured survey questionnaires) and qualitative (e.g., semi-structured interviews). The quantitative methodologies were primarily employed to solicit information on ‘what’ the GEF project cycle was doing with regard to the incremental costs assessment (process) and the annex (product). The qualitative methodologies were employed to obtain information on ‘how’ and ‘why’ certain processes or procedures were followed or not, and also on conceptual aspects such as incremental reasoning and use of project ‘case law’.

21. Both quantitative and qualitative data were analyzed in isolation and then verified in order to highlight similarities and differences across findings, and reduce threats to validity. Particular attention was given to the assessment and interpretation of the qualitative data using computerized assisted qualitative data analysis (CAQDAS) software – *Atlas-ti*.

22. Five approaches were used that provided distinct but related data sets and covered a range of stakeholder groups, information types and information-gathering techniques, so as to provide as comprehensive a picture as possible of incremental cost conduct and content (see Annex 3 and 4).

- **Literature Review:** A review of the incremental cost concept and non-GEF use of incremental costs assessment, as well as of existing evaluative and non-evaluative GEF reports, was done in order to establish key issues, advantages and disadvantages of the incremental costs approach and its application. Furthermore, a review of other Global Programs financial and economic decision-making tools was conducted, including included interviews with staff from the Global Fund for HIV, Tuberculosis and Malaria (see Annex 1).

- **Compliance Review:** assessed the extent to which projects are actually complying with the requirements for incremental cost assessment and reporting as established by the Council guidance, especially by the GEF project review criteria paper (approved by the Council in 2000), at the point of CEO Endorsement or Approval. One-hundred and forty projects were reviewed including 79 Full Sized Projects (FSPs) that had been CEO-Endorsed, and 61 Medium Sized-Projects (MSPs) that had been CEO Approved in 2005.
- **Technical Quality Review:** Project Documents and Executive Summaries were reviewed, in order to conduct an in-depth assessment of the technical quality of incremental cost assessment and reporting. A stratified random sample of eight-six projects were selected from Biodiversity, Climate Change, International Waters, Land Degradation and Multi-Focal projects that had reached a stage of CEO endorsement. The sample represents 59% of all 2005 CEO-endorsed GEF3 projects in these Focal Areas.
- **On-line survey:** The on-line survey was designed using existing experiential information on incremental costs and data inputs from eight to 10 semi-structured interviews². A questionnaire instrument based on these documents and data was developed to assess the perceptions of stakeholders on the various incremental costs elements presented above. The instrument was administered online through www.surveymonkey.org. The target group for this survey comprised those involved in the design, review, implementation and/or supervision of GEF projects. The targeted population was contacted primarily via an email request to fill out the survey. The survey was opened on 13th of June 2006 and closed on 31st of July 2006. During this period, 159 respondents participated in the survey. Of these, 119 (75%) respondents completed the survey while 40 (25%) dropped out without completing it. Of the respondents that completed the survey 30% were from IAs, 27% from the STAP roster, 10% were independent consultants, 8% were national focal points, and the remaining 25% were split among respondents from GEF Secretariat³, international and national NGOs, national government agencies, bilateral and other multilateral institutions.
- **Interviews:** Interviews based on a common protocol were conducted with fifty-five key people involved in GEF project design and review. The semi-structured interview protocol was designed to provide information on how incremental cost assessment was carried out, by whom, and why certain procedures were used. Interviews provided an interactive mechanism for “ground-truthing” and elaborating the results of the online survey, compliance and technical quality reviews: they enabled these findings to be explained, described and verified in detail. A purposive / snowball sampling method was employed to ensure that there was representation of key stakeholders such as the GEF Secretariat, Implementing Agencies, Convention Secretariats, freelance consultants and project proponents. Interviews were conducted between May 1st and July 31st 2006. The study team undertook field missions to

² Semi-structured interviews conducted with World Bank and UNEP staff (May 06)

³ Only 4 (3%) respondents were from GEF Secretariat.

Kenya, Malaysia, Panama and Thailand in order to solicit responses from Implementing Agency staff and project proponents who had experience of preparing projects in those countries and regions.

CHAPTER 3: CONCLUSIONS

Conclusion 1: The principle of incremental funding is alive and well in GEF projects

23. Although the evaluation found many doubts and concerns expressed about the process of incremental cost assessment as it is carried out, the evaluation found that incremental reasoning underpins the global environmental focus of the design of GEF projects. Incremental reasoning takes place at the concept phase, well before the process of incremental cost assessment takes place (during project design and writing of the project document). Incremental reasoning was confirmed to be used (mostly implicitly) to justify and agree on the global benefits, and the ways in which the proposed GEF project will secure these benefits, and provide additional funding to cover their incremental costs.

24. Most of the projects reviewed have satisfactorily incorporated incremental reasoning within the objectives, scope and outcomes, including key elements of securing global benefits and funding incremental costs. This finding is based on qualitative assessments as well as on high levels of compliance and quality of reporting in project documents and incremental cost annexes on presenting global environmental benefits, linking the global environmental objective, GEF mandate and focal area priorities.

25. Although the evaluation found that incremental reasoning is the guiding principle for GEF projects, the linkage to the process of incremental cost assessment as it is currently carried out is questionable.

Conclusion 2: There remains weak understanding and much confusion about incremental cost concepts and procedures

26. There is great variation in understanding the concepts and principles underlying incremental costs by the various stakeholders in GEF projects, and widely differing interpretations of the role of incremental cost assessment in project conceptualization, design and implementation. A major area of confusion concerns whether incremental cost is a (primarily qualitative) form of logic or reasoning, or a quantitative, numerical calculation, with Implementing Agency staff favoring the first interpretation, and other stakeholders, such as some Council members, tending to emphasize quantitative aspects. Specific terms associated with incremental cost were also found to be poorly understood, most notably “incremental cost”, “alternative,” “system boundary” and “additionality”. Furthermore, the subsequent guidance, never clear if they substitute or add to previous ones, has omitted fundamental components of incremental cost such as the reference to “full” incremental cost, and the idea that incremental cost includes any cost savings on the replaced or redundant activity.

27. The 1996 policy sets out the basic steps required in incremental cost assessment, and specifies reporting requirements. Subsequent guidance was provided through the 1999 Streamlined Procedures and Principles for the Agreement of Incremental Costs. In addition, GEF

Task Forces have made efforts to provide focal area-specific guidance for international waters, climate change (adaptation) and land degradation. Stakeholder understanding of incremental cost assessment, already weak, has in many cases been further undermined by the accumulation of these multiple and additive sets of policies and guidelines which sometimes make conflicting or contradictory recommendations. Lack of clear Council or GEF Secretariat guidance on which policies or guidelines take precedence, has exacerbated this confusion and left too much room for personal and institutional interpretation.

28. Few stakeholders (especially from government counterpart agencies and national NGOs, but also including IA staff) have received formal guidance or training in incremental cost concepts or procedures. The evaluation found little evidence that the GEF has attempted to coordinate and build understanding through training, outreach and dissemination of documents to the IA staff, project proponents and government agencies who are involved in project design and decision-making.

Conclusion 3: Most project documents register low quality and compliance when measured against GEF requirements for incremental cost assessment and reporting
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29. Key incremental cost concepts and elements of assessment are frequently misrepresented, misunderstood, or suffer from weak analysis and description. The evaluation found that 64 % of projects only report on half of the six aspects of incremental cost that are required by policy and guidelines (broad development goals and baseline, alternative, and cost). Furthermore, incremental costs are not always presented as a separate chapter or annex in project documents as it is also required. Reporting on the process of agreement, scope of analysis (or system boundary) and the global environmental benefits⁴ is absent or not dealt with adequately by the majority, more than 75% of the incremental cost annexes. The evaluation also found weaknesses or omissions among a high proportion of projects in terms of weak or misrepresented baseline scenarios, sketchy treatment of socio-economic and distributional concerns, lack of any economic analysis of costs, and failure to justify the project as the least-cost option.

30. Although there are few differences in the overall technical quality of incremental cost annexes between different Implementing Agencies and Focal Areas, it is clear that each has different areas of emphasis, strength and weakness when carrying out incremental cost assessment. Furthermore, the differences occur for particular sections of the incremental cost reporting. For example, for the cohort of projects reviewed, UNDP was more systematic in preparing a separate incremental cost annex for Medium Sized Projects (about two thirds had it). Project proponents involved in biodiversity and land degradation projects reported challenges in creating baselines of ‘stand-alone’ project. UNEP and biodiversity projects reviewed were particularly weak in analyzing the re-distributional and socio-economic effect of the GEF alternative. Only one half of Medium Sized Projects include an incremental cost matrix. Although projects rarely specified costs in present value terms, the few that did were prepared by the World Bank, including financial and economic appraisals. About 90% of the Implementing Agency staff interviewed were not aware that there was a requirement to report on the process of

⁴ On the other hand, the review of technical quality of the treatment of global environmental benefits elsewhere in the project document was judged to be adequate or better in 80% of the projects.

agreement of incremental cost and therefore, only 17% of projects reported on this issue adequately or better.

31. One of the reasons the compliance quality is low is because the GEF incremental cost guidelines that lay out the background to incremental cost assessment and the requirements for annex reporting in project documents are rarely used, and there is an absence of commonly-accepted “best practice” for incremental cost assessment. The evaluation found that even when Implementing Agency staff and proponents are aware of these guidelines, they were not considered to be useful or relevant. They are perceived to be too complex, academic and jargon-filled, leading to difficulties in application as well as persistent lack of transparency and clarity, leaving too much room for personal and institutional interpretation. At best, the policy and guidance seem to function only as an initial reference point for ascertaining conceptual terminology and definitions — but even then there are problems with understanding of the guidelines as a practical tool.

32. Furthermore, the application of incremental cost principle has evolved by focal area, which have developed their own approaches for assessing incremental costs. No clear consistency in its application was found, although all of them tried to deal with the issue of incrementality. The PRINCE program, which had the objective to develop “a broad interpretation of incremental cost that is consistent across the GEF focal areas,” was cancelled in 2003⁵ without achieving this objective as well as its aim to disseminate its findings, although there was a large amount of financial resources still available.

33. In practice, incremental cost assessment and annex reporting are guided primarily by reference to previous project examples – often termed ‘case law’. Use of case-based learning has increased the opportunities for personal and context specific interpretations of incrementality. While the use of project examples has clear advantages in terms of providing real-world examples, it cannot adequately provide guidance on how incremental cost assessment is carried out and reported. Widespread use of a relatively small number of “successful” project documents as a model for best-practice has also in some cases exacerbated the perpetuation of particular misinterpretations and omissions in incremental cost assessment, and resulted in a “cut and paste” approach to annex reporting. Case law examples are not available to the public at large and their selection is based on the fact that they were successful in getting through the review process, meaning that they are not necessarily the best way of ensuring the quality of specific assessments.

Conclusion 4: As currently applied, incremental cost assessment and reporting do not add value to project design, documentation and implementation.
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34. Complying with minimum requirements for incremental cost reporting does not guarantee a quality project. Clarity of incremental reasoning at the concept phase and clear identification of global environmental benefits does. The incremental cost assessment as a process and annex as a product do not necessarily reflect project objectives, overall design and focus on sustainability, or guarantee that they are incorporated in project design.

⁵ After being inactive since 1999.

Project Design and Preparation

35. The evaluation found that there was limited comprehension by those involved in project preparation of incremental cost assessment as a process which forms a part of project preparation and design. Rather, the bulk of effort is expended on reporting on incremental cost as a required part of the project document. The preparation of the annex is usually carried out ex post facto, at the end of project formulation, in a manner that is largely divorced from the project design and stakeholders. There is a widespread view that the incremental cost annex is a “hoop to be jumped through”, rather than a useful or influential tool in project preparation.

36. In the majority of cases, the incremental cost annex does not present new information or insights. It serves merely to summarize or repeat the information contained in the main text of the project document. This brings into question its utility as a stand-alone component of the project document.

Estimating GEF Financial Support

37. As expected, the GEF is not the only source of funding to cover incremental cost; on average the GEF contributes about 40% of the total incremental cost. The evaluation found that some focal areas have developed more formalized or standardized approaches to estimate GEF contribution to the incremental cost of a project, such as co-financing ratios (international waters), sliding scales (for funding adaptation to climate change projects under the LDCF) and cost-sharing arrangements (land degradation). The incremental cost assessment itself is not used to determine either project funding requirements, or contributions from GEF and other sources. More commonly it is retrofitted to decisions which have been made much earlier in the project development process, which depend on the availability of funds at that time, the country in which the project will be implemented, and the capacity and interest of the implementing agency in implementing the project. A common view expressed was that the available GEF contribution and required co-financing ratios were in most cases decided far upstream in the project cycle, at the early stages of project identification and conceptualization. The incremental cost and budgeting estimations carried out during the course of project design then reflect this pre-determined amount, rather than assisting in determining the magnitude of incremental costs, and identifying GEF and other contributions. Co-financing ratios are widely perceived to be the main factor for project approval.

Cost-effectiveness

38. One of the fundamental reasons to conduct an incremental cost assessment is to estimate different alternatives and then select the most cost-effective one⁶. Over a third of proposals do not describe more than one alternative to the baseline situation, meaning that they provide no evidence that the proposed alternative is the least-cost option to achieve a given global environmental objective (and about 40% of the projects reviewed have a weak presentation of the alternatives). In projects where analysis of cost-effectiveness is provided, it is of strong or adequate technical quality in half of the instances.

⁶ See paragraph 8 of the GEF/C.7/Inf. 5

What is GEFable?

39. The splitting of local and global environmental benefits was perceived by many interviewees to be artificial and in some cases impossible to calculate and counter-productive to the sustainability of the project objectives. Interviewees reported that this sometimes results in incrementality coming into conflict with other important GEF principles such as sustainability, replication (incentives for) and country drivenness. Chapter 4 highlights a couple of specific cases where such conflicts have led to decision-making which has been detrimental to project sustainability.

40. According to GEF policy the incremental cost assessment process should provide the “basis for the negotiated technical estimates of agreed incremental cost for any given project”, and is meant to structure the negotiations and dialogue that are necessary to reach agreement, and are required to ensure fairness, credibility and transparency in terms of host-country participation. Previous evaluations and assessments of incremental costs have identified the concept, assessment process and annex as lacking transparency, and at times in opposition to other fundamental principles of the GEF (such as sustainability, country ownership and stakeholder participation). The current evaluation supports these conclusions.

Who conducts the incremental cost assessment and who prepares the annex?

41. The evaluation found a widespread and often-stated belief that the ability to carry out a “successful” incremental cost assessment (in other words one which results in a project which will be approved by GEF Council) lies in the hands of a small number of “international experts” (usually either international consultants or Implementing Agency staff). The perceived complexity of the incremental cost assessment process, combined with the difficult-to-understand terms and concepts it uses, discourage “non-experts” from participating in the process. The exclusivity of case-based learning has also restricted proponent and country recipient involvement and perpetuated the use of “international consultant experts” and in-house Implementing Agency staff specialists who possess the necessary “expert knowledge” to satisfy the minimum requirements and therefore achieve the main objective of getting the GEF funding.

42. In particular negotiation of incremental costs does not take place, mainly because overall project financing and GEF contributions are often predetermined, and are presented to project proponents and government counterparts as being based on non-negotiable decisions that have already been made. The negotiation then takes place in terms of dividing this pre-determined budget into “GEF-able” and “non-GEF-able” activities.

CHAPTER 4: RECOMMENDATIONS

43. As currently applied, incremental cost assessment and annex reporting procedures do not enhance either the technical quality of GEF projects, the process of negotiation and agreement that is fundamental to project design and decision-making, or the integration of incremental reasoning and other GEF principles. The original idea that it would be possible to develop a quantitative “methodology” which would be universally applicable and would meet the ambitious goals of determining incremental cost and structuring its negotiation was clearly unrealistic. In reality, and as currently required and applied, it has undermined (or at the best

played little role in) the process of determining incremental cost in GEF projects. A great deal of time, effort and project preparation budget are expended on fulfilling minimum reporting requirements, rather than using incremental cost assessment as a tool to aid in the design of better projects. The evaluation finds that the projects reviewed satisfactorily incorporate the principle of incrementality through incremental reasoning, are targeted at securing global benefits and attracting additional funding – but this is in spite of incremental cost analysis, not because of it. There is no apparent value added from incremental cost assessment and annex reporting requirements as laid out by GEF.

44. The GEF as an instrument has evolved considerably since the incremental cost policy and guidance was first developed, over a decade ago. GEF projects and Focal Areas now face changed circumstances, mandates and conditions which cast further doubt on current incremental cost assessment procedures and annex requirements. For example, the increasing importance of the need for GEF to engage with the private sector will require a more tailored and flexible approach; as will the need to place the global environmental agenda at the center of sustainable development, which means the artificial division of local and global benefits is counterproductive. Furthermore, the introduction of the Resource Allocation Framework (RAF) will in some cases reduce still further the relevance of the process of conducting incremental costs assessment. To a large extent the RAF represents a global incremental assessment that has already been carried out far upstream: countries are provided with an indicative maximum of financial resources available from the GEF for biodiversity and climate change projects, mainly according to their global environmental benefits potential (and governance performance). Carrying out an incremental cost assessment at the project level thus becomes redundant, especially for countries with smaller allocations, provided that projects are directed at global environmental benefits and have adequate levels of co-funding

45. For these reasons — changing circumstances and needs, lack of a clearly demonstrated value-added, and continuing questions about clarity and transparency — it is clear that the time has come to rethink and reformulate GEF requirements concerning incremental cost processes and methodologies, while maintaining the core principle and underlying rationale of incremental reasoning.

Recommendation 1: Incremental cost assessment and reporting should be dropped as requirements for GEF projects

46. A shift is required away from the cumbersome, complex and not always useful steps of incremental cost assessment to a focus on integrating incremental reasoning into project objectives and design. Therefore, the incremental cost assessment and reporting requirements should be dropped from the project design and reporting process, in particular the requirement for an incremental cost annex, section, and incremental cost matrix in project documents.

Recommendation 2: Incremental reasoning in project objectives and design should be acknowledged and recognized, in particular at the project concept stage, during implementation and at completion.

47. This evaluation shows that the current practice of projects in the GEF is to follow incremental reasoning to ensure that the GEF funding of these projects is (a) directed towards achieving global environmental benefits and (b) additional to existing funding levels.

48. The evaluation confirms that on average the GEF funds less than 40 % of the costs of the global environmental benefits. The fact that non-GEF co-finance comprises the majority of project funding in itself indicates that the GEF funding is additional. When developing a project idea, the additionality of GEF funding is established *in principle* through reasoning through existing funding levels and additional funding needed to achieve global environmental benefits. *In practice* the additionality is achieved through co-funding. First of all, during the further preparation of the project, co-funding arrangements are secured. Secondly, during implementation this co-funding will materialize and will thus ensure that the GEF-funding is additional. The Annual Performance Report 2005 reported on actual levels of co-financing during implementation, concluding that in general co-funding materialized according to plan.

49. Incremental reasoning is, thus, alive and well in the GEF. It could certainly be improved and strengthened, but in principle it will be possible to ensure the additional nature of GEF funding in project design and in project preparation through the following:

- Better identification of global environmental benefits to be achieved in focal area strategies and operational programs, followed by
- Identification and prioritization of global environmental benefits on a national level in the context of the RAF, leading to
- Adequate attention to demonstrating clear global environmental benefits in the conceptual phase of project design, which will be funded through
- Co-funding arrangements, showing that the proposal assures additionality of the GEF-funding.

50. There will be cases of projects in which the GEF may have to finance 100% of the cost of generating the agreed global environmental benefits, for example enabling activities, initial phases of international waters projects and projects in countries with unique situations (high potential for unique global environmental benefits but low capacity to generate co-financing because they are considered highly risky for investments). In these cases, the total costs are incremental but this will have to be demonstrated at the project concept level and then monitored throughout the project implementation.

51. Full accountability for the incrementality of GEF-funding would be achieved, during implementation and at project completion by:

- Monitoring for progress towards achieving global environmental benefits and for achieving co-funding in Project Information Reports and the Portfolio Performance Report, as well as
- Evaluating achievement of global environmental benefits and co-funding in the terminal evaluations, followed by an independent assessment in the Annual Performance Reports of the GEF Evaluation Office.

Recommendation 3: the process towards better identification of global environmental benefits needs to be strongly supported, including improved dissemination and awareness raising on focal area strategic priorities and objectives
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52. The GEF4 policy recommendations requested that the GEF Secretariat and agencies should develop clearer guidelines for the application of the incremental cost principle in GEF operations for each focal area, without changing the definition in the GEF instrument.

53. The only way to strengthening integration of incremental reasoning is by providing full clarity and transparency on global environmental benefits that are expected from projects through a better definition and focusing of the focal area objectives and strategies (this has been already recommended by OPS3 and the most recent program studies of the Evaluation Office). If there are no clear global environmental benefits incremental reasoning cannot be done and the concept should not be considered a GEF project.

54. The role of local costs and benefits should be clearly explained, taking into account the findings and recommendations of the evaluation of the role of local benefits in global environmental programs. Furthermore, the concept of “full cost” from the 1996 policy on incremental costs should be reinstated. In this policy, it was recognized that generating global environmental benefits could lead to local costs that would need to be included in the incremental funding (leading to “full cost” funding). As pointed out in the local benefits study, a more narrow interpretation of which costs could be funded by the GEF has led to design faults in projects which in turn has led to diminished sustainability of project achievements (or in some cases even a total lack of achievements). The inclusion of local costs for global benefits is of primary importance for the new focal areas of land degradation and POPs.

55. The GEF Secretariat together with the Implementing and Executing Agencies should develop a dissemination strategy to increase awareness of focal areas strategic priorities and global environmental objectives, to fully inform incremental reasoning at the concept phase. Particular attention should be paid to ensuring that language, terminology and presentation are accessible, comprehensible and practically useful to stakeholders, particularly country partners and proponents.