

**GREEN
CLIMATE
FUND**

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Policy on incremental cost and full cost methodologies

Summary

This document proposes a policy on incremental costs and full costs. It sets out methodologies for the GCF and its stakeholders to apply in estimating the agreed incremental costs and agreed full costs in its project approval processes. The methodologies proposed are designed to guide stakeholders and the GCF Secretariat in making more transparent and consistent estimations of full and incremental costs as part of the funding proposal approval process. The methodologies make use of qualitative narratives and quantitative data where available, taking into account capacity limitations and availability of data.

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I. Introduction

1. The Governing Instrument for the GCF, paragraph 35, states that GCF “will finance agreed full and agreed incremental costs for activities to enable and support enhanced action on adaptation, mitigation (including REDD-plus), technology development and transfer (including carbon capture and storage), capacity-building and the preparation of national reports by developing countries.”

2. By decision B.11/11, paragraph (j)(vi), the Board decided to review the proposal approval process with a view to, inter alia, strengthening project/programme eligibility criteria, including categories of incremental cost eligible for funding. In paragraph (k) of the same decision, the Board requested the Secretariat to submit a final report on the review at the thirteenth meeting of the Board.

3. In decision B.17/10, the Board requested the Secretariat to submit a proposal addressing, among others, the development and application of an incremental cost calculation methodology. At B19, the Board considered document GCF/B.19/34 titled “Incremental cost methodology: potential approaches for the Green Climate Fund,” and in decision B.19/06, the Board requested the Secretariat to develop an integrated approach to address incremental cost and a range of other the policy gaps identified in decision B.11/11. In particular, the Board noted: (a) the linkages between matters related to incremental costs and concessionality, as well as issues related to co-finance and other matters; and (b) that addressing policy gaps requires an integrated approach that considers their interlinkages.

4. Subsequently, the policy item on incremental cost and full cost methodologies was included in the agenda for the twentieth, the twenty-first and the twenty-third Board meetings, and in preparation for those meetings, numerous iterations of the policy were drafted by the Secretariat, consulted with the Co-chairs, Board and AEs, and published on the GCF website.

5. Prior to B.26 in 2020, the Co-Chairs requested the latest version of the document on incremental costs to be submitted to the Investment Committee for further consultation. The following document addresses a number of the comments and suggestions submitted by the Committee. The presentation of this document is designed to initiate a broader effort to consult and finalize this policy proposal.

II. Policy rationale

6. In Article 4.3 of the United Nations Framework Convention on Climate Change (UNFCCC), it states that developed countries shall provide new and additional financial resources to meet the “agreed full costs” incurred by developing countries in fulfilling the commitments to reporting obligations referred to in Article 12.1 of the Convention. Developed countries shall also provide such financial resources needed by developing countries to meet the “agreed full incremental costs” of implementing measures to meet their commitments, as agreed with an operating entity of the Financial Mechanism of the Convention. UNFCCC discussions on incremental costs are further discussed in Annex III of this document.

7. As reflected in the GCF’s Governing Instrument, both agreed full costs and agreed incremental costs can be financed by GCF in its capacity as an operating entity of the UNFCCC financial mechanism in support of the implementation of developing countries’ activities and investments to address climate change. The GCF will finance such costs for activities to enable and support enhanced action on adaptation, mitigation, technology development and transfer, capacity-building and the preparation of national reports by developing countries. To date, the GCF has not elaborated further policy guidance on the funding of full and incremental costs or on methodologies for determining such costs.

8. A review of practices in the Global Environment Facility (GEF), the Clean Development Mechanism (CDM), the Adaptation Fund, the Climate Investment Funds (CIFs), and the Multilateral Fund was conducted and found that no consistent approach has been applied in the determination of incremental and full costs. The review studied a number of institutions and programs that applied incremental cost calculations in projects. The work of GEF, through the Least Developed Countries Fund and the Special Climate Change Fund, has used a qualitative approach to incremental reasoning, which is applied in the process of project design to ensure that GEF funding is focused on the incremental activities necessary to generate global benefits. On the other hand, both the Multilateral Fund and the CDM have developed quantitative approaches using a baseline scenario to quantify the incremental costs of supported interventions. The review also included institutions that finance full costs that require qualitative justification such as the Adaptation Fund. Finally, in addition to providing incremental cost for many activities, the Multilateral Fund, GEF, the Adaptation Fund and CIFs provide full cost support for a host of supporting activities, including capacity-building, barrier-removing activities and pilot projects designed to demonstrate new technologies. The review of practices of these institutions provides the basis for the principles developed for the proposed policy in Annex II Section IV, where, among others, the Secretariat proposes the use of both qualitative and quantitative approaches, when appropriate, for determining incremental and full costs. The full review of practices in other institutions is also included in Annex III.

9. The purpose of the proposed policy is to outline definitions, principles and methodologies for estimating incremental costs and full costs that seeks to achieve the following objectives:

- (a) Further facilitating the application of the GCF initial investment framework, particularly with respect to the effectiveness and efficiency criterion to ensure that GCF funding targets the full costs or incremental costs of climate-related activities as appropriate;
- (b) Facilitating greater consistency in Secretariat and independent Technical Advisory Panel (TAP) review and Board decision-making by providing a framework for the assessment of the components of a proposed project that are directly related to climate change adaptation and mitigation;
- (c) Guiding national designated authorities (NDAs)/focal points and accredited entities (AEs) in articulating climate change considerations in funding proposals, while limiting any additional burden; and
- (d) Building the capacity of AEs, especially direct access entities (DAEs), through the implementation of the policy to identify and develop transformational climate projects that lead to the most impactful mitigation and adaptation outcomes.

10. The Forward-Looking Performance Review (FPR) by the Independent Evaluation Unit (IEU) discussed in-depth the notable gaps in GCF's policy framework. The FPR particularly mentioned the need to address and adopt policies related to financing issues such as incremental and full costs, concessionality and co-financing. In this review, the IEU also stated that the absence of these policies has resulted in policy discussions being discussed during funding proposal approval at the Board, which in many cases have led to delays in decision-making. It specifically indicated the need for policies and processes that provide clarity and

11. The GCF 1 replenishment summary report presented to the Board at the twenty-fourth meeting also emphasized the need for the GCF to complete outstanding investment and funding proposal policies to increase predictability and efficiency in the project review and approval process. Finally, the updated Strategic Plan for 2020 – 2023 (USP) and the Board 2020-2023 workplan also reflect the aim of the GCF to close remaining investment policy gaps including through agreement on incremental cost and full cost methodologies.

III. Policy proposal

12. The proposed policy includes definitions, principles, methodologies and guidelines which will be used to determine the agreed full and incremental costs in project proposals submitted to the GCF.
13. Specifically, it defines key terms including definitions for the agreed incremental costs, the baseline project and the agreed full costs. It defines agreed incremental costs as “the difference in costs incurred with respect to a baseline project to produce a new output or an equivalent output in a way that results in mitigation and/or adaptation impacts”. The baseline project is defined as “the investment producing the same or equivalent output in a way that does not result in mitigation and/or adaptation impact and would have occurred if the GCF project were not to be implemented”. Finally, agreed full costs are “all costs associated with outputs that result in mitigation and/or adaptation impact”. Additional definitions are further elaborated in the proposed policy.
14. The proposed policy reiterates the provision in the Governing Instrument that provides that GCF can finance both agreed incremental and full costs and states that incrementality provides the means to assess whether activities are prompted by climate needs and is a key consideration for financing climate change activities. It also elaborates on principles derived from a review of practices of similar funds that should guide project proponents in the implementation of the proposed policy in Annex I.
15. In particular, the policy specifies two approaches to determine incremental costs. The first “qualitative” approach, which would be a minimum requirement, would require the related proposal to include a qualitative description of the incremental and full cost aspects of the proposal, connected to a strong theory of change. This approach would be used in proposals requesting incremental costs and proposals requesting full costs.
16. When sufficient data is available, the second approach, a quantitative assessment of incremental cost, would be required. Incremental cost will be determined by the difference between the costs in the project scenario and the costs in the baseline project scenario over the economic life of the project. The counterfactual scenario is already required under the economic analysis and may be equivalent to the baseline project scenario. When the cost of the baseline project is zero, agreed incremental cost is equal to agreed full cost. In addition, the proposal outlines a range of additional activities that qualify for full costs following UNFCCC guidance and practices including capacity-building, barrier-removing activities to climate change, and pilot projects designed to demonstrate new technologies. Finally, in recognition of the wide variety of countries, result areas and AEs involved in GCF projects, the Policy maintains some flexibility in the application of the approach undertaken.
17. Annex I provides further details on the process, requirements and methodologies to be applied to funding proposals submitted to the GCF in light of the proposed definitions and principles. Requirements for incremental costs elaborate on the requested information for the qualitative and quantitative methodologies, while requirements for full costs outline the applicable information requirements for the qualitative methodology and list additional eligible activities. For funding proposals applying a qualitative methodology, the policy would require the presentation of a strong theory of change that would clearly present the climate problem and how the proposed activities are designed to address it. For funding proposals requesting full costs, emphasis is put on the need for proposals to have paradigm shift potential to justify the funding for full cost of an activity as it assesses the degree to which the proposed activity can catalyse impact beyond a one-off project or programme investment looking at the potential for scalability, replicability, knowledge and learning and contribution to an enabling environment. High paradigm shift potential would justify the funding for full cost of an activity. In addition, a list of illustrative examples of how incremental costs and full costs might be

considered in projects and how the issue of incremental costs would arise in each case is also provided in Annex IV.

18. Upon adoption, the policy is proposed to apply to all funding proposals submitted to the Secretariat after the date on which a modified funding proposal template is published. An exception to this requirement would be made for proposals which are in the advanced stages of the project/programme activity cycle (Stage 4 to Stage 7) on that date. For such proposals, AEs will have already completed the feasibility studies and economic analyses that would, in the future, serve to address the incremental cost analysis required by this policy, and the application of the new policy to these proposals would require additional time and resources for the development and resubmission of these documents.

19. The policy proposes that proposals from certain GCF programmes be exempted from the need for incremental cost analysis. These programmes include the Enhancing Direct Access (EDA) Pilot Programme, the Simplified Approval Process (SAP) Pilot Scheme and the REDD plus Results-Based Payment (RBP) Pilot Programme. Because these pilots have been established to support specific stakeholders and achieve targeted results, the application of an incremental cost and full cost methodology is likely to be technically difficult and would tend to run against the existing requirements and/or intended purpose of these programmes.

20. The EDA pilot has been designed to provide DAEs with opportunities to move beyond the financing of individual projects characterised by an enhanced devolution of decision making whereby both funding decisions and project oversight take place at the national or regional level. As such, funding proposals submitted for the EDA often do not have the project-specific activity information required to conduct such incremental cost assessments or calculations.

21. The SAP pilot has been designed to expedite access to GCF climate finance for the most vulnerable countries, including least developed countries and small island states. The Board decision specifically requests that the SAP simplifies the preparation and review requirements compared to regular proposal approval process and promotes the use of SAP for DAEs. As such, the incremental cost policy may impede the purpose of SAP.

22. The REDD plus RBP pilot has been established to operationalize the REDD plus results-based payments and gather experience to further improve the procedural and technical elements of results-based payments using GCF resources at the learning stage. The application of an incremental cost methodology would be inconsistent with the provision of results-based payments that are triggered by specific, predetermined results. The EDA, SAP, and REDD plus RBP each have their own eligibility criteria and set of requirements, while the REDD plus RBP in particular is also assessed against a scorecard that has been adopted by the Board.

23. The proposed policy has been selected among a suite of different iterations in consideration of perceived impacts by AEs and the Secretariat as well as issues raised by the Board from previous consultations (see annex II for more information).

IV. Implementation arrangements and operational impact

4.1 Secretariat

24. The current funding proposal template requests AEs to describe the baseline scenario associated with the proposal. However, in the absence of a clear methodology for estimating incremental costs, funding proposals do not always include a clear qualitative description of the incremental costs or the baseline scenario, or quantitative estimates of incremental costs. The Secretariat should ensure that an update of the funding proposal template includes the requirements detailed in the proposed policy.

25. The review and assessment of the methodologies in the submitted funding proposals will be done by the Secretariat in conjunction with the review of the economic analysis that is submitted with the proposals. The Secretariat should adjust its internal processes and systems as necessary taking into account the requirements for the proposed policy. In addition, knowledge and expertise within the Secretariat should be developed to guarantee proper implementation of the policy. The implementation process and guidelines of the proposed policy is further elaborated in Annex II Section V.

26. The Secretariat recognizes that AEs and other stakeholders will face challenges in the implementation of this policy. As a consequence, the proposal include provision for a capacity-building programme for DAEs. This will be done through the Readiness and Preparatory Support Programme, particularly supplementing overall support provided for developing funding proposals. Support for implementing newly adopted policies will be embedded in such initiatives.

27. The Secretariat will monitor the implementation of the policy on an ongoing basis, synchronizing with other investment framework policies of the GCF. This will be done with a view to advising the Board of any issues arising in relation to implementation of the policy and potential changes needed. There will also be an opportunity to more formally review the policy on incremental cost and full cost methodology in the third year of each replenishment cycle, as part of the overall policy review cycle, should this be needed based on issues identified through ongoing monitoring.

4.2 AEs, NDAs and other stakeholders

28. In many countries, the data required to construct realistic baseline scenarios does not exist because of the cost and time needed to collect quality data. Partners, including NDAs in particularly vulnerable countries, may have difficulty constructing baseline scenarios owing to the imminent and increasing effects of climate change on their societies. Some AEs, particularly DAEs in such countries, may not currently have the analytical capacity to develop a quantitative estimate of incremental costs. Thus, while a quantitative approach would present advantages in terms of a more transparent and objective assessment of projects, these data challenges illustrate that a quantitative approach may not be immediately feasible in certain contexts. Therefore, both qualitative and quantitative methodologies are proposed in the policy.

29. Currently, AEs are already requested to submit the economic and financial analysis as an annex which often includes the cost estimates related to the counterfactual scenario. However, in the absence of the methodology, the economic analysis does not always include the cost estimates related to the baseline scenario, which is necessary to determine the incremental costs. While AEs may already have their own methodology for estimating costs, GCF requires AEs to apply the methodologies in the proposed policy, which provides adequate flexibility in the choice of appropriate methodologies.

30. While the proposed policy tries to maintain flexibility in consideration of data and capacity issues within countries and AEs, the Secretariat aims to further address this through the development of a capacity-building programme to enable the implementation of the policy on incremental costs and full costs. This is recommended to the Board in this document through the Readiness and Preparatory Support Programme with the aim of especially supporting DAEs.

V. Policy linkages

31. The proposed policy has been developed in consideration of prior policies and frameworks that have been adopted by the Board as well as policies and frameworks currently being developed and yet to be adopted.

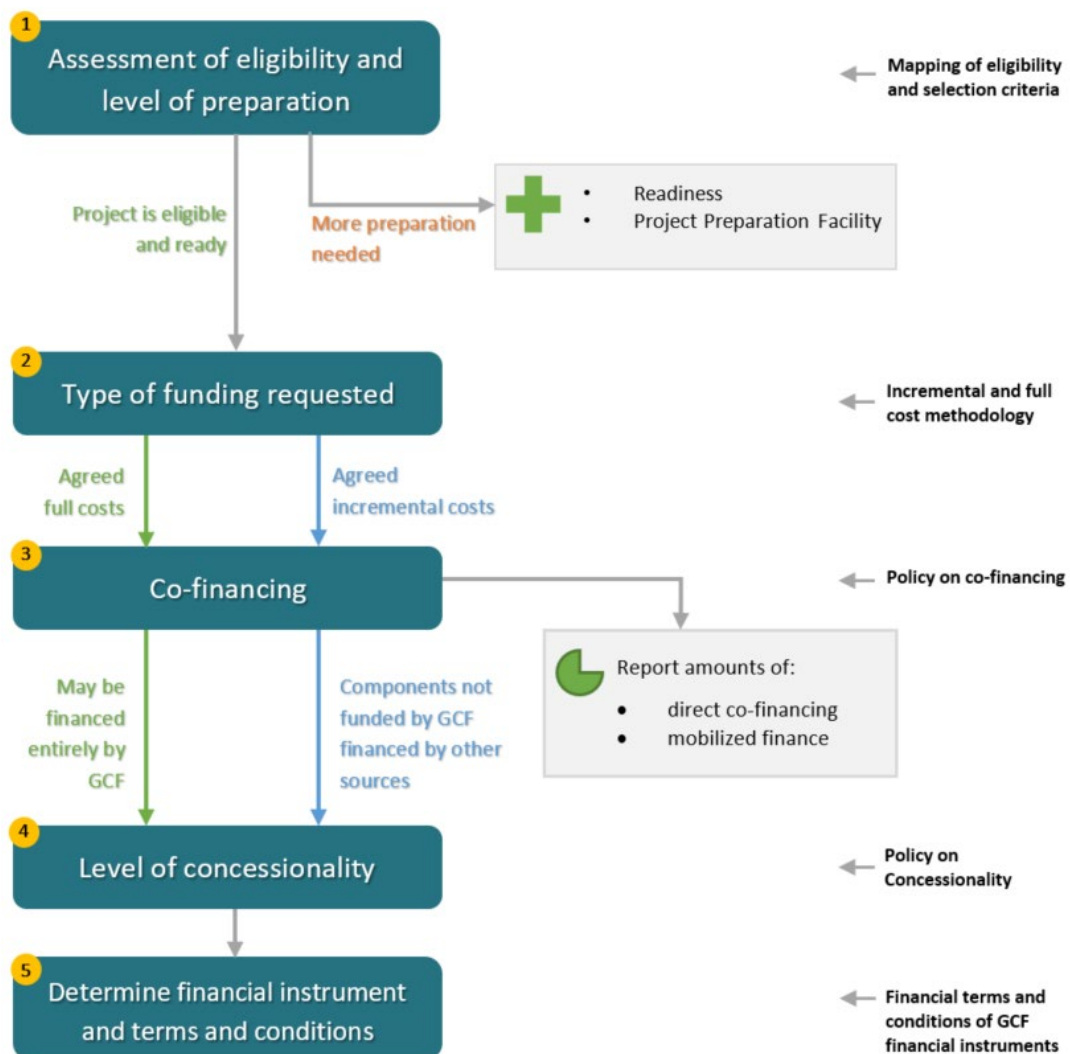
32. Below is a list of Board decisions linked to the development of the policy on incremental cost and full cost methodologies:

- (a) “Policies and Procedures for the Initial Allocation of Fund Resources” (decision B.06/06);
- (b) “Investment Framework” (decision B.07/06);
- (c) “Further Development of the Initial Investment Framework: Sub-criteria and Methodology” (decision B.09/05);
- (d) “Investment Criteria Indicators” (decision B.22/15); and
- (e) “Review of the initial investment framework: Policy on co-financing” (decision B.24/14).

33. In addition, the proposed policy is also part of the interrelated policies requested by the Board in decision B.17/10 and decision B.19/06, which also includes the following matters, which have been published for Board consideration but yet to be adopted:

- (a) Guidance on the approach for adaptation activities (documents GCF/B.23/18, GCF/B.21/INF.03, GCF/B.21/INF.03/ADD.01); and
- (b) Further guidance for concessionality (documents GCF/B.23/19, GCF/B.21/24, GCF/B.20/19).

34. In particular, the alignment of the policies on incremental cost, co-financing and concessionality is important to determine the overall financial structure of the proposed projects/programmes. The methodologies for estimating incremental and full costs helps determine which projects, or parts of the project, is eligible to be fully funded by GCF and which may be better suited for co-financing. The co-financing policy explains how costs funded by other parties are to be classified and reported. Finally, the concessionality guidance and its associated tools would determine the appropriate financial instruments and terms financed by GCF to ensure efficiency and effectiveness. The figure below shows the policy approach for the funding proposal approval process and linkages among the different policies.



VI. Monitoring and review

35. The reviews would examine, among other things, the initial implementation of the policy by the Secretariat and AEs, including the capacity-building programme to be developed, with the Secretariat expected to provide a report of the status of implementation to the Board. Further recommendations to improve efficiency and effectiveness of implementation may be taken up by the Secretariat or proposed to the Board as necessary. This would allow for adaptive management of the policy.

36. The review would also consider alignment with updates to the Strategic Plans and related programming directions and would assess the policy's relevance and practicality in supporting the investment framework in line with GCF's strategic objectives and recommend improvements to the policy as relevant. Third party consultants may or may not be procured to conduct these subsequent reviews, which are intended to be more thorough and meaningful.

VII. Recommended action by the Board

37. The Secretariat recommends that the Board takes note of the Policy on incremental cost and full cost methodologies presented in Annex I, which is based on the information presented above.

Annex I: Policy on incremental cost and full cost methodologies

I. Objectives

1. The purpose of this policy is to outline guiding definitions, principles and methodologies for estimating incremental costs and full costs in funding proposals as part of the Green Climate Fund's project approval process.
2. The policy provides clarity in the information requested from accredited entities (AEs) related to incremental costs and full costs and clarity in the processes in which these costs will be agreed between the accredited entity and the GCF.

II. Scope

3. This policy shall apply to all funding proposals submitted to the Secretariat after the date on which a modified funding proposal template is published that includes the information requirements as set out in the policy, except for proposals which are in Stage 4 to Stage 7 of the project/programme activity cycle on that date. It will also not apply to funding proposals submitted under the following requests for proposals and pilot schemes: Enhancing Direct Access Pilot Programme, Simplified Approval Process Pilot Scheme and the REDD plus Results-Based Payments Pilot Programme, or their subsequent continuation.

III. Definitions

4. The **agreed incremental costs** of a project or programme are the difference in costs incurred with respect to a baseline project to produce a new output or an equivalent output in a way that results in mitigation and/or adaptation impacts.
5. A **baseline project** is the investment producing the same or equivalent output in a way that does not result in mitigation and/or adaptation impact and would have occurred if the GCF project were not to be implemented. The cost of the baseline project may be zero, under the assumption that no action would have been needed or taken in the absence of climate change.
6. The **agreed full costs** of a project or a component are all costs associated with outputs that result in mitigation and/or adaptation impact and which are required because activities are only prompted due to climate change. For adaptation, it means the costs of discrete activities to be implemented to address the adverse impacts of and/or risks posed by climate change. For mitigation, it would refer to the costs of discrete interventions to reduce GHG emissions.

IV. Principles

7. The policy is guided by the following principles:
 - (a) Both agreed full costs and agreed incremental costs should be utilised by the GCF in its capacity as an operating entity of the financial mechanism of the United Nations Framework Convention on Climate Change (UNFCCC) in support of the implementation of developing countries' activities and investments to address climate change, in line with the Governing Instrument for the GCF;
 - (b) Incrementality is a key consideration for financing climate change activities and provides the means to assess which activities are prompted by climate needs. The use of incremental costs and the need to compare the proposed intervention to a baseline

- project scenario provide a clear and transparent framework to directly link the proposed activities with climate change;
- (c) Qualitative approaches connected to a strong theory of change should be used for all funding proposals, at a minimum;
 - (d) Quantitative approaches should be applied to activities when sufficient data is available. These approaches should use baseline scenarios to quantify the incremental costs of the supported interventions. This data is likely to be available for mitigation projects. It may not be feasible for innovative, transformational projects that rely on policy changes to achieve paradigm shift;
 - (e) Funding for full costs can be justified through a qualitative approach if a project or programme is only needed or prompted because of climate change, where there is no baseline scenario. In addition, GCF will also fund full costs for a host of supporting activities, including capacity-building, barrier-removing activities to climate change, pilot projects designed to demonstrate new technologies, projects where the incremental costs are difficult to distinguish or the plausible baseline project scenario is difficult to determine, and project activities that are linked to the paradigm shift criterion; and
 - (f) Given the wide variety of countries, result areas and AEs involved in GCF projects, it is prudent to maintain some flexibility in the approach used to determine whether the GCF funds incremental costs or full costs for any given project.

V. Implementation guidelines

5.1 Requirements for all funding proposals

8. When developing funding proposals, AEs should propose the cost of the project, the portion that should be financed by GCF, and the instruments and level of concessionality GCF should use to finance its portion of the costs. In the funding proposal, AEs should state clearly whether they are requesting GCF support for agreed incremental costs or agreed full costs and justify that request based on the requirements described below.
9. At a minimum, all funding proposals must include a qualitative methodology connected to a strong theory of change as described in the following sections with distinction between proposals requesting incremental costs and proposals requesting full costs. In addition, AEs should apply a quantitative methodology following the requirements as described in section 5.2 for proposals requesting incremental costs.
10. AEs will provide this information in the funding proposal or as a separate annex. The Secretariat shall amend the concept note and funding proposal templates to signal to AEs which information is needed to undertake the assessments described in this policy. The Secretariat will review this information as part of the technical review of the funding proposal package and provide feedback to the AE. Funding proposals containing only qualitative methodologies should justify why quantitative methodologies are not practical and/or appropriate.
11. Based on this, GCF, and AEs in consultation with the national designated authority/focal points to the extent possible, will determine which part of the project is eligible to be funded by GCF and which may be better suited for co-financing, if any. By approving the funding proposal, the Board would be approving the incremental or full costs proposed by the AE.
12. The assessment of costs will inform the choice of financial instruments and amount of GCF participation in order to align with the Governing Instrument and adhere to the Investment Framework, particularly ensuring efficiency and effectiveness.

5.2 Requirements for incremental costs

13. For funding proposals requesting for agreed incremental costs, a qualitative approach connected to a strong theory of change is requested at the minimum. The *qualitative methodology* that GCF prescribes entails an incremental cost reasoning that includes the following:

- (a) A detailed description of the baseline project scenario, assessing ongoing and planned activities in the absence of the GCF, identifying differences in lifecycle costs between the proposed project and the baseline project;
- (b) A clear identification of the project components and associated costs that are directly related to climate change;
- (c) An explanation of how the project components related to climate change will achieve mitigation or adaptation results or reduce barriers to climate change-related activities, which can be established through the theory of change; and
- (d) An estimate of the fraction of the costs of each of the components of the funding proposal that are related to incremental investments.

14. Beyond the minimum requirements, when data and capacity permits, quantitative methodologies should be applied and provided with the submission of the proposal. AEs should choose from the quantitative methodologies elaborated below.

15. The *quantitative methodology* that GCF prescribes calls for quantitative estimates of incremental costs in the economic analysis, which forecasts the costs and benefits of the proposed project over its estimated economic lifetime. Each economic analysis submitted to GCF will forecast three scenarios:

- (a) The counterfactual scenario that would exist without the project;
- (b) The project scenario, in which the project is implemented with climate considerations; and
- (c) The baseline project scenario, in which a similar project is implemented without climate considerations.

16. In this analysis, incremental cost will be determined by the difference between the costs in the project scenario and the costs in the baseline project scenario over the economic life of the project. The counterfactual scenario is already required under the economic analysis and may be equivalent to the baseline project scenario. When the cost of the baseline project is zero, agreed incremental cost is equal to agreed full cost.

17. Any cost expected to be incurred over the economic life of the project shall be taken into consideration in both the project scenario and baseline project scenario, including capital costs, operating costs and any other costs necessary to realise the outcomes of the project. These estimations shall apply standard principles of economic benefit-cost analysis, including appropriate discounting.

18. AEs will submit these calculations in spreadsheet format to GCF as an annex to the funding proposal. A written description of the calculations and their underlying assumptions will be included in the funding proposal or a separate annex.

19. In contexts where detailed quantitative estimations are unfeasible due to data scarcity or capacity limitations, AEs may omit the detailed estimates described above, provided they supply appropriate justification for the omission.

20. Each case will be considered individually, and funding proposals without a detailed estimate shall not be penalized in terms of priority or funding amount, provided the above qualitative methodology requirements are faithfully applied.

5.3 Requirements for full costs

21. Determining agreed full costs will require an assessment of whether the project/programme activities are prompted only because of climate change. If the project/programme would not have been needed without climate change, then the project/programme activities qualify for full costs. Justification for this should be done qualitatively with an explanation of how the activities are prompted because of climate change. This applies to projects or project components where the baseline cost is zero.
22. An additional set of activities are eligible for full project or component costs, including:
 - (a) Adaptation activities in accordance with paragraph 35 of the Governing Instrument;
 - (b) Readiness and preparatory support;
 - (c) Capacity-building activities;
 - (d) Reporting activities where appropriate; and
 - (e) Barrier-removing activities to climate change.
23. AEs should identify and classify activities eligible for full project or component costs in line with the list provided above and provide qualitative justification.
24. Proposals requesting agreed full costs should also have high paradigm shift potential towards low emission and/or climate resilient development supported by a strong theory of change to ensure additionality and efficiency, taking into account how the intervention would contribute to the long-term temperature goal of the Paris Agreement and shifting financial flows consistent with a pathway towards low greenhouse gas emission and climate resilient development.

VI. Monitoring and review

25. The Secretariat will monitor the implementation of the policy on an ongoing basis, synchronizing with other investment framework policies of the GCF. This will be done with a view to advising the Board of any issues arising in relation to implementation of the policy and potential changes needed. There will also be an opportunity to more formally review the policy on incremental cost and full cost methodology in the third year of each replenishment cycle, as part of the overall policy review cycle, should this be needed based on issues identified through ongoing monitoring.

Annex II: Consultations

1. Previous iterations of the proposed policy have been published for Board consideration in the nineteenth, twentieth, twenty-first and twenty-third meetings. At the twentieth, twenty-first and twenty-third meetings, the drafts were consulted with the Board and the AEs through several means including webinars, technical briefings, informal discussions and requests for inputs through email.
2. As per guidance by the Co-Chairs, the document has been under review by the Investment Committee (IC) since B.26.
3. The table below summarizes major comments and feedback received from the Board and IC members that have been incorporated and reflected in the current document.

BM	Comments and feedback	Action taken and proposal
B.20	<p>The incremental and full cost methodology document has been presented at B.20 as part of the document “Integrated approach to addressing policy gaps”. Key comments by the Board members are as follows:</p> <ul style="list-style-type: none"> - Enquiry into applying the precautionary principle and avoid the inability to calculate incremental cost calculations preventing investments which will at least have co-benefits for more sustainable development. - From an adaptation perspective, when looking at counter factual or BAU scenarios – it’s important to consider a definition for ‘Historical impacts’... What are the considerations for historical scenario or before climate change baseline for adaptation projects? 	<p>In recognizing the information gaps present for developing countries, the document proposed a phased approach which will enable GCF to learn about the methods used by various AEs, the quantity and quality of information available to NDAs and AEs to make these assessments and the general capacity among AEs to do so.</p> <p>In addition, as an effort to clarify the baseline scenario, the document took note of the baseline length used by various AEs in funding proposals. After reviewing the various approaches, GCF will be able to develop some more definitive guidelines over time.</p> <p>To address the concerns of the capacity differences, the document also proposes a phased approach. The Secretariat will learn about the methods used by various AEs, along with any data or capacity gaps they face. AEs are encouraged to use the most quantitative approach feasible for any given project. However, the Secretariat recognizes that it may be difficult to apply a quantitative approach to certain projects (adaptation or mitigation), especially in the face of data and capacity gaps. In such cases, the Secretariat will accept a qualitative approach.</p>
B.21	<p>At the guidance of the Co-Chairs, the incremental and full cost calculation methodology document has been separated from the other investment framework policies and presented for Board consultation as a stand-alone document.</p> <p>Key comments and feedback received were as follows:</p> <ul style="list-style-type: none"> - Capacity-building programme – to support AEs and NDAs to fulfil the requirements of such a policy, 	<p>During the consultation prior to B.21, the Co-Chairs have raised concerns that the integrated approach to all investment framework policy papers may not be able to resolve the individual outstanding issues present. As such, the document went stand-alone to address specific issues related to the incremental and full cost methodology.</p> <p>As an extension to alleviate the concerns of the capacity differences, the document has further updated on the phased approach. It is designed in response to these concerns, as the Secretariat will work with AEs and NDAs as</p>



	<p>possibly through the Readiness and Preparatory Support Programme</p> <ul style="list-style-type: none"> - Lessons learned from other institutions – to be used to develop and improve the policy - Funding full costs – to make sure that proposals requesting full costs have high paradigm shift potential and strong theory of change - Flexibility of the approach – principle-based approach instead of one-size fits all due to the complexity of the issue and in particular for adaptation proposals 	<p>the policy develops, ensuring that the eventual policy adopted is feasible for them to implement. As stated above, the Secretariat also proposes to build capacity through Readiness, regional dialogues and strategic partnerships.</p> <p>In addition, best practices of other institutions have been incorporated into annex III of the document to show how the policies are being implemented in organizations such as Global Environment Facility, Clean Development Mechanism, Clean Technology Fund, etc.</p>
<p>B.23</p>	<p>At the request of the Board members at B.21, the document has once again been collated with policy on co-financing and policy on concessionality.</p> <p>Many of the comments received during Board consultation overlap with previous feedback. Comments that pertain specifically to the incremental and full cost methodology are as follows:</p> <ul style="list-style-type: none"> - How can incremental cost requirements be included when faced with difficulties in estimating baseline project costs? - Clarification requested on when/how the 'detailed estimate of incremental cost' turn into agreed (incremental) costs. 	<p>In order to provide clarification on the specific methodologies, the document has been revised to show more in details.</p> <p>For instance, if data and capacity do not permit the more detailed analysis, the incremental cost reasoning must still be provided. This is intended to allow an estimate of the incremental costs using the best data available, whatever it may be. As stated in paragraph 20, each case will be considered individually, and funding proposals shall not be penalised in terms of priority or funding amount if a detailed method is not provided, provided the incremental reasoning is faithfully applied.</p> <p>A fuller description has also been added to "Agreed full costs" and "agreed incremental costs". These would be those cost that meet the definitions spelled out in the policy. When applied to funding proposals, agreement will occur implicitly at various stages throughout the process. By submitting a letter of no-objection to the funding proposal, National Designated Authorities (NDAs) would be agreeing with the incremental or full costs proposed by the AE. By reviewing the FP and submitting to ITAP and the Board, the GCF Secretariat would be agreeing with the application of incremental and full costs proposed. By approving the FP, the Board would be agreeing with the proposed incremental and full costs.</p>
<p>B.26</p>	<p>In an effort to minimize the divergent opinions of the Board, the Co-Chairs have agreed that the paper shall be reviewed by the Investment Committee members prior to wider Board consultation at B.26.</p>	<p>Details on the scope of applicability have been updated for B.26. The policy will be applied only after the FP template is updated by the Secretariat that requests the information set out in the policy. The exception for proposals is for FPs at the advanced stages of the review cycle at the date of the publication of the</p>



	<p>Some of the key feedback apart from the overlapping comments are as follows:</p> <ul style="list-style-type: none">- Clarify that AEs need to have responsibility to ensure that a FP is in line with this policy before submission to the Sec and Board.- Clarify the reasoning behind the exemption of SAP, EDA, and REDD+ proposals?	<p>updated template to lessen the burden because they will have completed all feasibility studies and economic analyses related to the determination of costs. Additional time and resources would be required to resubmit these documents putting additional burden on AEs. This is further clarified in the background document of the policy in para 20.</p> <p>As for the exemptions, the nature of EDA is devolved funding. It would be technically difficult to apply the methodologies on such proposals because these proposals would not have specific project activity information yet when submitted to the Secretariat. The application of an incremental cost methodologies on REDD+ RBP would also be technically difficult because of its nature where disbursements are triggered by specific results that are predetermined. Its requirements and criteria also differ from the regular funding proposal. Finally, the SAP, while having similar requirements as the regular FP, was established specifically to expedite access to GCF in particular for DAEs. Application of the methodologies to SAP would conflict with the request of the Board to simplify the preparation and review of SAP projects and put more burden on DAEs if applied to SAP.</p>
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Annex III: Review of UNFCCC-related discussions and practices of related institutions

I. The United Nations Framework Convention on Climate Change and incremental costs

1. Article 4.3 of the United Nations Framework Convention on Climate Change (UNFCCC) contain provisions applicable for both full costs and incremental costs. This article states that developed countries shall provide new and additional financial resources to meet the “agreed full costs” incurred by developing countries in fulfilling their reporting obligations or commitments as referred to in the Article 12, paragraph 1 of the Convention. It also states that developed countries shall also provide such financial resources needed by the developing countries to meet the “agreed full incremental costs” of implementing measures to meet the objectives of the Convention. Article 12 of the Convention states that developing countries may propose projects for financing including “if possible, an estimate of all incremental costs, of the reductions of emissions and increments of removals of greenhouse gases, as well as an estimate of the consequent benefits.”

2. As part of the discussion to elaborate Article 11 of the UNFCCC on the financial mechanism, the interim UNFCCC secretariat in 1994 prepared a technical note which stated, “Incremental costs will be defined vis-à-vis a baseline situation, which could be not to implement a measure at all, or to implement it in a manner that does not aim at achieving the objective of the Convention. The incremental cost will be the difference between the cost of the baseline activity (which may be zero) and that of the actually implemented measure.”¹ The UNFCCC technical note² also included the following key observations, which continue to be relevant:

- (a) Baseline scenarios, which are essential for defining incremental costs, are hypothetical; defining them constitutes a major issue in the determination of incremental costs and is inevitably a matter for negotiation among the parties concerned. There will be a need to apply rules of economic, environmental, technical and financial reasonableness in defining baseline scenarios;
- (b) Incremental costs are sensitive to proposed measures and the baseline scenario. In cases where the latter is specific to the country situation, this may complicate any attempt to codify standard incremental costs on the basis of an indicative list of measures;
- (c) The determination of incremental costs would be facilitated by the development of model projects, corresponding to the substitution of typical baseline activities by typical alternatives;
- (d) The use of net versus gross incremental costs may lead to different funding levels. If net costs are used, any local economic benefits from the project would be subtracted and therefore the amount of incremental costs would be reduced; and
- (e) The fact that the alternative project has important economic or local benefits does not guarantee that the additional funds required will be available domestically or from external - public or private - sources. For GCF, this illustrates the need finance full costs rather than incremental in certain cases.

¹ *Approaches to the Determination of Agreed Full Incremental Costs*. A/AC.237/50/Add.1. 1994. Intergovernmental Negotiating Committee for a Framework Convention on Climate Change. Ninth session.

² Ibid.

II. Practices of related institutions

2.1 Funds that apply incremental costs calculation

Multilateral Fund

3. The Multilateral Fund for the Implementation of the Montreal Protocol (Multilateral Fund) is the financial mechanism that supports developing countries in complying with their obligations under the Montreal Protocol to phase out the use of ozone-depleting substances (ODS) and reduce their use of high global warming potential hydrofluorocarbons (HFCs).

4. As agreed in the Montreal Protocol and its amendments, the Multilateral Fund provides funding to cover only the incremental costs incurred in converting from these substances to more environmentally friendly alternatives. In that regard, funding is approved for the net agreed incremental cost associated with the difference between a proponent's baseline scenario and the converted project. Costs compensated for are those included in a list of categories of agreed incremental costs incurred to convert to non-ODS/non-HFC technologies. This general rule has been refined over a period of years to consider such factors as technology upgrades and economies of scale.

5. The indicative list of incremental cost categories is applied to proposals under several principles.³ It calls for the incremental cost to be assessed based on the most cost-effective and efficient option available to achieve the reductions. In addition, it calls for both savings and benefits to be considered when calculating incremental costs. This latter point is particularly important, as, if the benefit generated to the project's sponsor exceeds its cost, the project is not eligible for Multilateral Fund support. The indicative list covers three types of activities – those that seek to (i) facilitate the supply of ODS substitutes; (ii) eliminate the use of ODS as an intermediate good in manufacturing; and (iii) eliminate the end use of ODS. For each one of these areas, an indicative list of cost categories eligible for compensation is defined. For example, with respect to the supply of ODS substitutes, there is a list of 11 categories of incremental costs eligible for funding that includes capital investments, operational costs, training and research. In practice, it is up to the Multilateral Fund's Executive Committee to decide how to apply the list, and to determine whether and to what extent costs not on the list should be eligible. For example, agreed costs for capacity-building are not on the indicative list – yet they have been fully supported by the Multilateral Fund.

6. Over time the Multilateral Fund gained significant experience in estimating incremental costs for many of the conversions it supports. This enabled it to define a range of cost-effectiveness thresholds for incremental costs for specific types of activities based on the cost of the tonnes of ODS reduced. Additional experience also enabled the Multilateral Fund to modify those allowable costs further to take into consideration such factors as economies of scale for smaller projects and lower consuming countries. The Multilateral Fund secretariat verifies the consistency of these calculations as well as the eligibility of expenditures as per the indicative list of categories of incremental costs during the process of funding proposal review. One final important factor related to the Multilateral Fund's focus is that the Multilateral Fund generally pays for the net incremental capital and operational cost of converting an existing facility from the use of an ODS or HFC towards the use of a non-ODS or non-HFC. This payment for global benefits is virtually always in the form of a grant. The Multilateral Fund does not pay, for example, for the incremental cost of expanding an existing facility to use a non-ODS or non-HFC technology or building a new greenfield plant that will use a non-ODS or non-HFC technology.

³ This discussion is based on the Multilateral Fund's *Policies, Procedures, Guidelines and Criteria as of April 2017*.

Global Environment Facility

7. The Global Environment Facility (GEF) is one of the entities of the financial mechanisms supporting five major environmental conventions, including the UNFCCC. The instrument for the establishment of the GEF states that it provides “new and additional grant and concessional funding to meet the agreed incremental costs of measures to achieve agreed global environmental benefits”.⁴ In this case, the GEF provides resources to cover the difference in costs between a baseline project that would provide only national benefits and one that would provide global ones. The GEF website explains this concept as follows: “for example, choosing solar energy technology over coal or diesel fuel meets the same national development goal (power generation), but is costlier. GEF grants cover the difference or ‘increment’ between a less costly, more polluting option and a costlier, more environmentally friendly option.”⁵

8. In 2006, the GEF Evaluation Office conducted a review of the application of incremental cost assessments in the project approval process and found that while the incremental cost concept underpinned the design of GEF projects, there was substantial confusion among stakeholders regarding interpretation of this concept. In particular, there was no consensus as to whether incremental costs were meant to be a specific quantitative measure, or a more qualitative form of logic or reasoning used during project design to separate the “incremental” aspects of the project seeking to provide global benefits. The GEF incremental cost guidelines that lay out the requirements for annex reporting in project documents were rarely used, and there was an absence of commonly-accepted “best practice” for incremental cost assessment. The review concluded that incremental cost assessment and reporting required until then did not add value to project design, documentation and implementation, as the bulk of effort was expended on reporting ex post facto, at the end of project formulation, rather than connecting it to the project design. It was recommended that incremental cost assessment and reporting should be dropped as requirements for GEF projects, and that focus should be on integrating incremental *reasoning* into project objectives and design. Incremental cost assessment and annex reporting procedures did 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” that would be universally applicable and would meet the goal of determining incremental cost was clearly unrealistic, according to the review.

9. As a result of this review, a new set of guidelines on incremental costs, currently in use, was approved by the GEF Council in 2007. These guidelines focus efforts on a more qualitative approach underpinned by five steps geared towards requiring incremental reasoning as part of project design: (i) determination of the environmental problem, threat or barrier, and the baseline scenario (i.e. what would happen in the absence of the GEF intervention?); (ii) identification of the global environmental benefit (i.e. the incremental benefit that the GEF is enabling); (iii) development of the result framework of the project describing both the baseline and the incremental activities to achieve the global benefits; (iv) provision of the incremental reasoning; and (v) negotiation of the role of co-financing. In fact, the vast majority of the projects funded under the GEF provide grants to cover the incremental cost of the global benefit. The remainder is meant to be covered by co-financiers with whatever instrument they negotiate with the project partner.

⁴ GEF. 2015. *Instrument for the Establishment of the Restructured Global Environment Facility*. Article 1.

⁵ Available at <<https://www.thegef.org/documents/incremental-costs>>.

Clean Development Mechanism

10. The Clean Development Mechanism (CDM), one of the Flexible Mechanisms defined in the Kyoto Protocol, assists industrialized countries in meeting part of their emission reduction commitments by buying Certified Emissions Reduction units from CDM projects in developing countries. To establish eligibility, projects must show the amount of emission reductions achieved when compared with a baseline, such as a reference baseline project. This baseline is established using CDM methodologies that should be based on (i) existing actual or historical emissions, as applicable; or (ii) emissions from a technology that represents an economically attractive course of action, taking into account barriers to investment; or (iii) the average emissions of similar project activities undertaken in the previous five years, in similar social, economic, environmental and technological circumstances, and whose performance is among the top 20 per cent of their category. Following these principles, the CDM has reviewed and approved close to 200 methodologies as of its most recent update of the *CDM Methodology Booklet* in November 2016. The appropriate methodology is selected based on the project's sector (e.g. energy, manufacturing, construction, transport) and applied technology (e.g. biomass, grid electricity, off-grid electricity, renewable thermal energy).

11. Project proponents use one of the approved methodologies to estimate the emissions generated by the baseline project and to monitor the expected reduced emissions from the proposed project. Proponents can use alternative methodologies, particularly when these are needed to adapt to national circumstances, provided that they are submitted for technical review by the CDM. These methodologies can also be used to define standardized baselines for specific countries (e.g. cookstoves in Senegal).

Clean Technology Fund

12. The Clean Technology Fund (CTF), one of the main funds under the Climate Investment Funds (CIFs), provides resources to scale up low-carbon technologies with significant potential for long-term greenhouse gas emission savings. While the CTF Governance Framework does not explicitly refer to incremental cost criteria, it states that “CTF financing will provide a grant element tailored to cover the identifiable additional costs of the investment necessary to make the project viable”. Further guidance prepared as part of the CTF's private sector operation guidelines states “Financial support through the CTF should be targeted at global benefits of the projects and proportional to incremental costs of their achievement.” Consistent with this approach, project proponents identify in their proposals the incremental costs of the proposed activities.

Scaling up Renewable Energy Program

13. The Program for Scaling Up Renewable Energy in Low Income Countries (SREP), which is under the Strategic Climate Fund of the CIFs, supports the demonstration in low-income countries of the economic, social and environmental viability of renewable energy. In developing its financial instruments, SREP has emphasized the need to focus resources to address the “incremental risks” associated with renewable energy projects as opposed to the usual technical and financial risks that other baseline projects may have and which could be mitigated through other mechanisms.

2.2 Funds that apply full costs calculation

Adaptation Fund

14. The Adaptation Fund, established under the Kyoto Protocol, finances projects and programmes that help vulnerable communities in developing countries adapt to climate change based on country needs, views and priorities. The Adaptation Fund is guided by a series of principles, which includes that “funding for projects and programmes will be on a full adaptation cost basis.” The full cost of adaptation has been defined by the Adaptation Fund as “the costs associated with implementing concrete adaptation activities that address the adverse effects of climate change.” In pursuing this, the Adaptation Fund has gained experience in applying “full cost adaptation reasoning” to projects. This full cost is provided based on a strong climate change adaptation rationale. However, further guidance on financing priorities is still being considered by the Adaptation Fund Board.⁶

15. According to its Operational Policies and Guidelines, the Adaptation Fund “will finance projects and programmes whose principal and explicit aim is to adapt and increase climate resilience. The project proponent is to provide justification of the extent to which the project contributes to adaptation and climate resilience,” which forms part of the climate change adaptation reasoning. In addition, in the Adaptation Fund website, the Adaptation Fund has provided project and programme review criteria related to project eligibility that lists questions to be utilized in reviewing proposed projects and programmes, which support the basis of the full cost of adaptation.⁷ Furthermore, in analysis of climate change adaptation reasoning in projects and programme proposals approved by the Adaptation Fund Board, it states that proposed activities reduce vulnerability and increase adaptive capacity of human and natural systems to respond to the impacts of climate change, including climate variability. However, it is also within the scope of the Adaptation Fund to strengthen the enabling environment through the conduct and update of risk and vulnerability assessments; strengthening of institutional capacities; and integration of climate-resilience strategies into country development plans.⁸

Forest Investment Program

16. The Forest Investment Program (FIP), under the Strategic Climate Fund of the CIFs, provides funding to address the drivers of deforestation and forest degradation both within and outside the forest sector to support forests and development and address climate change challenges. Given the nature of its mandate, FIP can support the full costs of projects and therefore an explicit assessment of incremental costs is not required.

Pilot Program for Climate Resilience

17. The Pilot Program for Climate Resilience (PPCR), which is also under the Strategic Climate Fund of the CIFs, supports climate change adaptation and resilience-building by funding activities to pilot and demonstrate ways to integrate climate risk and resilience into core development planning, while complementing other ongoing activities. While PPCR does not explicitly focus its financing on incremental activities, its focus on supporting pilot activities makes this issue less important. The additionality of PPCR lies in contributing to demonstrating the viability of certain adaptation activities and therefore in this process it may support the full costs of activities.

⁶ Adaptation Fund, 2018. *Update on the Scope and Application of the Full Cost of Adaptation Reasoning Criterion*. AFB/PPRC. 22/25, 12 March 2018.

⁷ *Adaptation Fund Project/Programme Criteria*. Available at < <https://www.adaptation-fund.org/apply-funding/project-funding/project-proposal-materials/>>.

⁸ Adaptation Fund, 2015. *Analysis of Climate Change Adaptation Reasoning in Project and Programme Proposals Approved by the Board*. AFB/PPRC. 17/5, 10 December 2015.

Annex IV: Illustrative examples of how incremental costs and full costs might be considered in a small set of hypothetical GCF project types

Case 1 project proposal: construction of a greenfield solar energy plant and transmission and distribution infrastructure to serve an area currently without electrification.

Baseline project scenario in the absence of GCF support: Expansion of generation capacity of existing coal plant in adjacent region and construction of additional grid transmission and distribution infrastructure. The incremental costs of a related GCF project would be the difference in capital investments and operating costs between the solar plant and the baseline project. In such a case, including operating costs could take into account and net out the expected savings generated by the lower operating costs that the solar plant would have.

Counterfactual scenario in the absence of any project: Continued use of off-grid alternatives, such as diesel or kerosene.

Case 2 project proposal: Retrofit of existing small and medium-sized enterprises production processes for higher energy efficiency. In addition to the capital investments required, operating costs initially increase owing to the need to train personnel and calibrate new equipment.

Baseline project scenario in the absence of GCF support: No capital investments in retrofitting and continuation of existing operating costs (i.e. business as usual). The incremental cost of a related GCF project would be the capital investments of the proposed project plus the difference in operating costs and energy costs. Such operating costs may be initially higher for the project than for the existing baseline, but they would be overtaken in time by the savings from higher energy efficiency.

Counterfactual scenario in the absence of any project: Same as baseline scenario, so incremental costs equal the full costs of the project.

Case 3 project proposal: Expansion of port facilities with increased resilience to climate change using construction standards consistent with expected intensity of weather events due to climate change.

Baseline project scenario in the absence of GCF support: Equivalent expansion (i.e. infrastructure necessary to handle a similar amount of tonnage) with construction standards without considering future changes due to climate change. The incremental costs of a related project could consider the additional capital investments required to build to the enhanced standards and the degree to which those standards were required as a result of climate change (versus historically observed weather). A variation of this example would be one in which the proposed project generates additional co-benefits – if, for example, as a result of the enhanced infrastructure to increase resilience the port can handle larger ships than it could otherwise, and such ships generate additional economic benefits. Those additional benefits could be subtracted when calculating the incremental costs.

Counterfactual scenario in absence of any project: Continued operation and maintenance of existing port facilities with no expansion.

Case 4 project proposal: Enhanced livelihoods and resilience of agricultural communities in semi-arid regions.

Baseline project scenario in the absence of GCF support: Project generating similar improvements in livelihoods with interventions consistent with historical weather patterns and addressing the long-term path of soil degradation without considering future changes due to climate change. In this case, as well as in Case 3 above, an additional element of complexity is the need to estimate and reach agreement on the degree to which the proposed intervention is needed because of climate change.

Counterfactual scenario in absence of any project: No change in livelihoods or agricultural practices.

Case 5 project proposal: Strengthening hydro-meteorological services and development of a multi-hazard early warning system.

Baseline project scenario in the absence of GCF support: Continued operation of existing hydro-meteorological systems. While an effort could be made to distinguish between programme elements that are necessary due to climate change and those that are not, the periodic nature of natural disasters means such a determination could be problematic. Given the new technology and technical capacities, it may be more appropriate to finance the project on the basis of full costs.

Counterfactual scenario in absence of any project: Same as baseline scenario, so the incremental costs equal the full cost of the project.

Case 6 project proposal: Integration of climate mitigation and adaptation needs into national development plans.

Baseline project scenario in the absence of GCF support: National development plans without climate mitigation and adaptation needs. Such an investment facilitates new governance approaches that may be transformational, which would be appropriate for financing of full costs.

Counterfactual scenario in absence of any project: Same as baseline scenario, so the incremental costs equal the full cost of the project.

Case 7 project proposal: restoration of mangrove forests in coastal areas, which delivers protection from waves and storm surges, carbon sequestration and other ecological benefits. Most of these benefits are public goods for which no market exists.

Baseline project scenario in the absence of GCF support: continued deterioration of these forests and increasing costs to society. Because the costs of a baseline project would be zero, the project would be funded on the basis of both incremental *and* full costs.

Counterfactual scenario in the absence of any project: Same as baseline scenario, so the incremental costs equal the full cost of the project.
