

**GLOBAL ENVIRONMENT FACILITY  
PROPOSAL FOR PROJECT DEVELOPMENT FUNDS (PDF)  
BLOCK B GRANT**

**Country Name:** Costa Rica  
**World Bank/GEF Project Name:** Ecomarkets Project  
**Total Project Cost:** US\$ 63 million  
**Financing Plan:**  
GOCR: US\$ 25 million  
IBRD: US\$ 20 million  
GEF: US\$ 8 million  
PCF: US\$ 10 million

**Requesting Agency:** World Bank  
**Executing Agency:** Ministerio de Ambiente y Energía (MINAE)  
**PDF Block B Request:** US\$330,000  
**PDF Co-financing:** PHRD: US\$305,000 for components related to GEF activities  
PHRD: US\$195,000 for components related to renewable energy  
PCF: US\$200,000 for components related to renewable energy  
GOCR: US\$50,000

**Block A Grant Awarded:** No

**PROGRAM OBJECTIVES**

1. The proposed Ecomarkets Project aims to support the conservation and sustainable use of biodiversity in Costa Rica by developing markets and private sector providers for environmental services contributed by forest ecosystems. As such, the project directly supports the implementation of Forestry Law No. 7575: providing compensation to forest owners in buffer zones and interconnecting biological corridors surrounding national parks and biological reserves for the conservation and maintenance of the varying environmental services, including biodiversity conservation, their lands provide at the local, national, and international levels.

2. The GEF-financed components of the proposed project will support the Costa Rican link within the Mesoamerican Biological Corridor, building upon existing work in Costa Rica and elsewhere in Central America through activities which include:

- establishing a sinking fund within the National Fund for Forestry Finance (FONAFIFO), which will be used to compensate small- and medium-sized landowners for conserving biodiversity on privately owned lands;
- strengthening the technical system for monitoring, supervision and evaluation of Costa Rica's innovative Environmental Service Payments program;
- strengthening of programs for forest protection and supervision in priority areas outside of those protected areas designated as priority in the 1996 GRUAS Report (UNDP/GEF/MINAE/CCAD);

- increasing local capacity within governmental and non-governmental institutions involved in the valuation and marketing of environmental services provided by forest ecosystems; and
- strengthening of regional NGOs, in above-mentioned priority areas, which are promoting activities compatible with the conservation and sustainable use of biodiversity and providing solutions to problems resulting from deforestation and environmental degradation.

## BACKGROUND

3. Costa Rica is one of the world's leading proponents of sustainable development, pursuing social and economic development in conjunction with a strong and healthy environment. The environmental policy of the Government has been progressive, resulting in the development of instruments such as electricity surcharges, reforestation incentives, and private conservation credits which are targeted at protecting forest ecosystems throughout the country. Currently, 25% of the national territory is under some type of legal decree related to conservation; of this area, approximately one-half of this area consists of national parks, biological reserves, and wildlife refuges. Although it is not a large country, Costa Rica has an estimated six-percent of the world's tropical plant species. Costa Rica's natural assets have led to the development of a thriving tourism industry, which have earned over US\$700 million annually since the mid-1990s.

4. More than half of Costa Rica was covered by forest in 1950. However, Costa Rica was beset with one of the highest rates of deforestation worldwide during the 1970s and 1980s. Agricultural expansion, especially for pasture, was the leading cause of forest conversion. Conversion was driven by rapid expansion of the road system, cheap credit for cattle, and land titling laws, which rewarded deforestation. As a result, Costa Rica lost one-half of its forested areas between 1970 and 1995. Deforestation and inappropriate land uses (e.g., overgrazing) continue to cause serious losses in terms of loss of biodiversity, ecological integrity of forests, and environmental services provided by forest ecosystems. For instance, estimates of the non-site erosion costs resulting from deforestation, measured in terms of lost nutrients, total approximately US\$60 million annually. Likewise, erosion within watersheds reduces water quality, imposes higher maintenance costs upon hydropower and transportation investments, and reduces the economic life of these facilities.

5. The expansion and strengthening of Costa Rica's protected area system was vital in arresting conversion of forests on public lands. Outside of state-owned lands, however, deforestation and forest degradation has resulted in fragmented forest landscapes in which the long-term maintenance of biodiversity is in jeopardy and critical environmental services are threatened. Because most biodiversity in Costa Rica today exists in private lands, the maintenance of functioning ecosystems and corridors within private lands is required to achieve sustainable biodiversity conservation at the national level. The 1996 GRUAS Report and Forestry Law No. 7575

6. In aiming to safeguard environmental values provided by forest ecosystems, the government proposed a strategy of supporting buffer zones around key national parks and biological reserves, and conserving biological corridors which inter-connect or assist in maintaining connectivity between existing protected areas and buffer zones. In 1995-1996, the Ministry of Environment and Energy (MINA E) and the National System of Conservation Areas (SINAC) carried out the GRUAS Project, financed in part by the GEF, which aimed to determine priority conservation areas with the

objective of maintaining the highest level of biodiversity compatible with national development objectives. The GRUAS Report determined priority biological corridor areas throughout Costa Rica, which likewise serve as key links within the Mesoamerican Biological Corridor.

7. Likewise, the GRUAS report identified the dimension of problems concerning Costa Rican state-owned protected areas (national parks and biological reserves), noting that a significant portion of priority areas within established national parks and biological reserves are indeed privately-owned and therefore outside of the legal patrimony of the State. Given that Costa Rica's traditions and constitution strongly emphasize private property rights, there has long been uncertainty about the degree of actual protection afforded to properties in protected areas that are not securely registered as legally owned by the State as well as privately-owned lands outside of protected areas.

8. Legislative efforts to safeguard environmental values provided by forest ecosystems outside of protected areas date back to 1979, with the passage of the first Forestry Law and the establishment of economic incentives for reforestation activities. Subsequent laws strengthened incentives for reforestation, broadening opportunities for land owners to participate in reforestation programs and making the program accessible to even the poorest sectors of rural society. In 1996, Costa Rica adopted Forestry Law No. 7575, which explicitly recognizes four environmental services provided by forest ecosystems. These include:

- mitigation of GHG emissions such as CO<sub>2</sub>;
- hydrological services, including provision of water for human consumption, irrigation, and energy production;
- biodiversity conservation; and
- provision of scenic beauty for recreation and ecotourism.

The law: (a) delegates responsibilities and duties to municipalities, the National Fund for Forestry Finance (FONAFIFO)<sup>1</sup>, the National System of Conservation Areas (SINAC)<sup>2</sup>, the National Forestry Office (ONF)<sup>3</sup>, and the National Certification Commission; (b) provides the legal and regulatory basis to compensate landowners for environmental services provided by their lands (hereafter known the Environmental Service Payments program—ESP) and establishes a financing mechanism for such purposes; and (c) empowers FONAFIFO to contract with land owners, subject to provisions such as the availability of a forest management plan certified by a licensed forest regent, for the environmental services offered by their lands.

9. Regulations within Forestry Law No. 7575 establish the conditions for and levels of environmental service payments. Payment levels are:

- For forest conservation: US\$230 per hectare disbursed over a five-year period with a commitment on the part of landowners to preserve the forest for an additional fifteen years. Such payments are typically made to provide compensation for landowners in riverine-forested areas and steep hillsides, where law prohibits harvesting of trees.

<sup>1</sup> FONAFIFO: Responsible for financing projects by the private sector through credits and payments for environmental services.

<sup>2</sup> SINAC: Responsible for developing state-owned protected areas, protecting biodiversity, and facilitating private sector in the forestry sector.

<sup>3</sup> ONF: Responsible for representing the private sector in the definition and implementation of forest policy.

- For forest sustainable use: US\$310 per hectare disbursed over a five year period with a commitment on the part of landowners to keep the forest in natural forest management for an additional fifteen years.
- For plantation forestry: US\$510 per hectare disbursed over a period of five years, paid in advance during the first five years, 50% during the first year, 20% during the second year, 15% during the third year, 10% during the fourth year, and 5% during the fifth year. Landowners must make a commitment to maintain reforested areas throughout the rotation period (fifteen to twenty years).

The principal source of funding for the conservation and sustainable use of forest ecosystems is a dedicated tax on fuel sales, with priority given to forest owners holding an international green seal designation which meets standards acceptable to the Forest Stewardship Council. Other sources of financing include payments from owners of run-of-river hydropower plants to landowners within adjacent watersheds and through the international sales of certified tradable offsets (CTOs). CTOs are an innovative environmental commodity that provides global environmental and economic benefits, as they represent certified emission reductions of GHG expressed in metric tons of carbon. FONAFIFO's ESP program places priority to watershed areas providing water for human consumption, private reserves, buffer zones of key national parks and biological reserves, and areas identified by the 1996 GRUAS Report.

## PROGRAM DESCRIPTION

10. The proposed project aims to conserve natural forest ecosystems in Costa Rica by developing local and global markets for the environmental services provided by them. As such, the project will support the implementation of environmental policies in the forest and renewable energy sectors and contribute to sustainable human development. Likewise, the project will strengthen offices within the Ministry of Environment and Energy (MINAE) as well as local and regional non-governmental organizations responsible for the execution, promotion, supervision, and monitoring of the ESP program.
11. Costa Rica's pioneering efforts to achieve environmental goals through the sustainable use of forest ecosystems entails developing commercially viable activities based upon environmental services provided from the nation's forests. The project will assist in developing markets, attracting financing and investment, and consolidating the institutional framework for:
  - a. the payment for environmental services at the global level relating to the mitigation of greenhouse gases, through the development of renewable energy projects as well as projects promoting forest conservation and reforestation;
  - b. the payment for environmental services at the global level relating to the conservation of biodiversity in buffer zones surrounding protected areas, thereby protecting a critical link within the Mesoamerican Biological Corridor;
  - c. the payment of environmental services at the local level relating to hydrological services provided by forest ecosystems, including protection of water quality and quantity in watersheds where run-of-river hydroelectric projects are presently operating or planned.

The integrated project will have the following complementary components:

### A. Support for Costa Rica's Environmental Service Payments program

12. The proposed project will support Costa Rica's novel program to compensate landowners for the environmental services provided by privately owned forest ecosystems. Over the next five years, Costa Rica has programmed approximately US\$45 million in payments through the ESP program. This IBRD-financed component will provide US\$20 million in bridge financing for the government budget allocated to the ESP program while long-term revenue-capture mechanisms are designed and institutionalized. Such mechanisms may include energy and forestry carbon offsets, water surcharges, protected area revenues, genetic rights, and other financing sources. This financing will permit the Government of Costa Rica to meet its commitments acquired through MINAE with private landowners that have been incorporated into the ESP program.

### B. Consolidation of the Mesoamerican Biological Corridor

13. This GEF-financed component will provide incremental support to the ESP program to provide an economic incentive to private landowners to conserve priority areas as determined in the 1996 GRUAS Report within the Mesoamerican Biological Corridor. As such, the incremental benefits of the international benefits related to biodiversity conservation in buffer zones will be assured. Furthermore, the project will support the design and implementation of mechanisms that guarantee the monitoring, verification, and supervision of the ESP program. Finally, the component will support the involvement of regional non-governmental organizations in the ESP program.

Specifically, this component will include:

- a. Establishment of a sinking fund within FONAFIFO, whose proceeds will be used to internalize the value of the biodiversity conservation and protection services provided by small- and medium-sized landowners in forest ecosystems that participate in the ESP program. The sinking fund of approximately US\$5.0 million would total ten percent of the ESP program payments made by FONAFIFO over the five-year life of the project.
- a. Strengthening of the technical system for monitoring, supervision and evaluation of ESP program activities carried out by FONAFIFO and SINAC within the execution of the ESP program. This monitoring system would allow for the generation of technical data relating to land ownership, forest ecosystems, forest type, forest quality and growth variables, coverage area, identification of priority zones for the conservation of biodiversity outside of protected areas, and the monitoring of the consolidation of the MBC utilizing *inter alia* satellite imagery and geographic information systems with field verification to monitor changes in land use. Sub-component activities would also include refining the system of financial controls and disbursements of the ESP program as well as technical training for personnel within FONAFIFO and SINAC. The estimated cost of this component is US\$500,000.
- b. Strengthening of the programs for forest protection and supervision within SINAC in priority areas of the MBC. This strengthening will allow for the preparation and implementation of effective field supervision of the ESP program as well as for compliance with existing environmental legislation regarding forest ecosystems. The estimated cost of this component is US\$1,000,000.

- c. Increase local capacity within governmental and non-governmental institutions involved in the valuation and marketing of environmental services designated within Forestry Law No. 7575. The estimated cost of this component is US\$500,000.
- d. Strengthening of regional NGOs, in priority areas of the MBC, which are promoting activities compatible with the conservation and sustainable use of biodiversity and providing solutions to problems resulting from deforestation and environmental degradation. This strengthening will be directed to organizations that provide technical assistance to small landowners whose forests qualify for financing under the ESP program, and, likewise guarantee the contract compliance relating to the ESP program. The estimated cost of this component is US\$1,000,000.

### C. Promotion of Renewable Energy

14. This component will support the generation of renewable energy that would meet rising energy demand in Central America. Through the purchase of "carbon offsets" (or "carbon credits") generated through existing and new renewable energy projects by the Prototype Carbon Fund, the project will:
- a. Provide technical assistance to private sector developers to carry out preliminary studies and global analysis necessary for defining the viability of developing new projects.
  - b. Consolidate the internalization of environmental services, in particular hydrological services, provided by forest watersheds to developers of renewable energy projects.
15. The purchase of carbon offsets by the Prototype Carbon Fund will assist the renewable energy projects to become more competitive with non-renewable energy (i.e., diesel and fuel oil) alternatives in the region. Furthermore, the purchase of carbon credits by the PCF will enable developers to leverage their financial resources into greater deployment of private capital in renewable energy. The certified emissions reductions derived from these projects will also enhance the development of the international carbon offset market. No GEF resources will be utilized to finance these activities.
16. Prototype Carbon Fund resources will be utilized to create a Fund for Renewable Energy Resources (FRER), as a trust fund incorporated under the laws of Costa Rica, which will:
- a. purchase certified emissions reductions generated by eligible renewable energy projects that have already been reported by Costa Rica as Activities Implemented Jointly (AIJ) to the Secretariat of the United Nations Framework Convention on Climate Change (UNFCCC Secretariat). Additionally, six to eight new renewable energy projects (to be financed separately) would participate within the framework of the project, under the auspices of the Clean Development Mechanism (CDM), as per the Kyoto Protocol. It is expected that the existing AIJ projects will file for CDM status, under new guidelines to be adopted by the Conference of Parties (COP).
  - b. finance the certification and verification of certified emissions reductions generated by projects that participate in the FRER. This could be achieved either by reimbursing the projects for the cost of baseline certification and periodical verifications or by funding these activities directly.

- c. coordinate with related institutions active in the generation and distribution of energy in Costa Rica, such as the Costa Rican Institute of Electricity (ICE) and the Costa Rican Association of Energy Producers (ACOPE).

17. Through this component, the project will support renewable energy developments which, utilizing the ESP program framework described above, will pay landowners for maintaining upstream watersheds through sustainable land use practices. More specifically, private sector renewable energy developers will compensate landowners for hydrological services provided by intact forest ecosystems, including maintenance of water quality and quantity. It is expected that the institutionalization of such reimbursements, as supported by the project, will promote financial sustainability of the ESP program.

### ELIGIBILITY AND COUNTRY COMMITMENT

18. Costa Rica ratified the Convention on Biological Diversity on August 26, 1994; furthermore, Costa Rica ratified the United Nations Framework Convention on Climate Change on July 4, 1994. The proposed project is eligible for GEF financing under two of the four Operational Programs supporting the conservation and sustainable use of biodiversity: Forest Ecosystems and Mountain Ecosystems (O.P. Nos. 3 & 4). The project likewise strengthens protection of freshwater ecosystems. In accordance with Article 6 of the Convention on Biological Diversity, the project focuses on *in situ* conservation of biodiversity in priority areas as identified in the 1996 GRUAS Report. The project is likewise consistent with Article 6 of the Convention on Biological Diversity insofar as it aims to integrate, as far as possible and as appropriate, the conservation and sustainable use of biodiversity into relevant sectoral and cross-sectoral plans, programs and policies.

19. The participation of the GEF within the project is consistent with the Conference of the Parties guidance as it: addresses *in situ* conservation; includes capacity building at the local level for biodiversity conservation; strengthens conservation management and suitable use of forest ecosystems outside of state-owned lands; and strengthens the involvement of local peoples and supports conservation-oriented poverty alleviation in rural areas. The project is also part of a larger strategy for the conservation and sustainable use of the Mesoamerican Biological Corridor, building upon efforts carried out within Costa Rica and neighboring countries.

### DESCRIPTION OF PDF ACTIVITIES

20. PDF activities financed by the Global Environment Facility will be targeted towards studies to identify and evaluate the existing conservation mechanisms in Costa Rica in order to support the long-term financial and social sustainability of the program. Substantial co-financing from a PHRD grant and the GOOCR would complement GEF resources. The PDF preparation funds, in combination with co-financing indicated in Table 1, would finance the following preparatory activities:

- A. Evaluation and Strategy for ESP Program:** PDF resources would complement co-financing to determine and field evaluate the advances already obtained through the ESP program in the consolidation of the MBC in Costa Rica and assess the "lessons learned" in previous forest and conservation incentive programs (e.g., the CAF reforestation incentives program). ESP program evaluation would also include the identification of potential financial needs as well as the preparation of a strategy for scaling-up the program to meet existing demand. Finally, PDF

resources would be used to design a sinking fund to be administered by FONAFIFO as part of the ESP's biodiversity program.

- B. **Design of Technical Strengthening Component:** PDF resources would be used to design an investment plan to strengthen financial monitoring, controls and supervision of the ESP program, both within FONAFIFO and SINAC, which carries out field supervision of the ESP program.
  - C. **Design of Ecosystem Monitoring:** PDF resources would be used to refine the GRUAS report's identification of those key areas to be incorporated into the Costa Rican portion of the MBC, and prepare critical and priority zone maps to orient future MBC-related disbursements from the ESP. PDF resources would likewise finance the design of a biodiversity impact assessment process geared at the MBC, proposed sustainable forest management activities, and other cross-sector projects compatible with biodiversity conservation.
  - D. **Design Plan of Support for Field Supervision Evaluation & Strategy:** PDF resources would be used to design a training program for SINAC and other institutions involved in monitoring biodiversity, sustainable forest management plans, and local compliance with the ESP program. The program would directly support the implementation of project activities developed under "C. Design of Ecosystem Monitoring".
  - E. **Enhance Valuation and Marketing of Environmental Services:** PDF resources would be used to assess technical, social and financial feasibility of currently proposed and 'next generation' environmental services fees (e.g., 'water quality maintenance' charges to be channeled to forest owners in selected, high biodiversity areas of critical watersheds. Specific mechanisms for differentiating and targeting based on biodiversity objectives would be identified, as would require institutional and legal elements to support the execution of these mechanisms.
  - F. **Strategy for Regional Technical Support for ESP via NGOs:** PDF resources would be used to prepare project activities related to forestry and product certification, to ensure that management activities are compatible with sustaining forests and biodiversity and are implemented in a manner which optimizes biological diversity conservation.
  - G. **Social and Environmental Assessment:** PDF resources would finance stakeholder assessments and the development of a participation plan for project implementation as well as any reviews of biodiversity values required within the project's environmental analysis.
  - H. **Economic/Incremental Cost/Financial Analysis:** PDF resources would finance a study to determine the incremental costs of activities related to sustainable forest management, with the objective of determining national and global benefits from sustainable forest management. PHRD resources would be utilized to carry out economic and financial analyses of the ESP program.
  - I. **Coordination, Management, and M&E:** PDF resources would co-finance expenses related to coordinating and managing project preparation, consultant supervision, quality control, intra- and inter-institutional coordination, and general administrative costs
21. The PDF grant will finance preparation only of those components of the project which are expected to have an entirely or largely biodiversity conservation global benefits. PDF grant would



finance studies, workshops, seminars, local participation activities, local and international consultants, training, operational expenses directly related to preparation of the biodiversity components, and limited equipment.

#### **JUSTIFICATION FOR PDF SUPPORT**

22. Substantial project preparation work has already been accomplished, financed by the Government of Costa Rica, the World Bank, USAID, as well as national and international NGOs. The PDF grant would help complete preparation by financing additional preparation activities needed for those components of the project, which are expected to have significant global benefits. Further preparation of components that are expected to generate significant national benefits would be financed with preparation funds from a PHRD grant, the Government of Costa Rica, and the private sector.

#### **PROJECT PREPARATION COSTS (IN US\$)**

23. The total cost of the proposed preparatory activities listed above is US\$685,000. This includes US\$330,000 requested as a PDF Block B Grant. These resources are complemented by a PHRD grant to prepare the Ecomarkets project, of which US\$305,000 is directly related to GEF-financed activities as well as contributions from FONAFIFO, SINAC, and MINAE. FONAFIFO, which will contribute technical staff time, background materials such as forest cover and biological corridor maps, and field studies to evaluate the performance and advances of the ESP program; SINAC will contribute staff-time from technical staff as well as background materials; the Ministry of Environment and Energy will contribute staff-time from technical and administrative staff as well as background materials.

#### **EXPECTED DATE OF PROJECT PREPARATION COMPLETION**

24. Project preparation will be completed and the project will be ready for Bank management approval by November 1999. It is expected that the project will be submitted to the GEF Council at the May 1999 Council meeting.

**Table 1**  
**PROJECT PREPARATION BUDGET**  
(US\$)

<b>Preparation Activity</b>	<b>PDF</b>	<b>PHRD</b>	<b>GOCR</b>	<b>Total</b>
<b>A. Evaluation and Strategy for ESP program, as well as design of Sinking Fund for ESP program</b>	\$75,000	\$75,000	\$10,000	\$160,000
<b>B. Design of Technical Strengthening Plan</b>	\$25,000	\$25,000	\$10,000	\$60,000
<b>C. Design of Ecosystem Monitoring</b>	\$40,000	\$5,000		\$45,000
<b>D. Design Plan for Field Supervision &amp; Evaluation</b>	\$15,000	\$25,000		\$40,000
<b>E. Enhance Valuation and Marketing of Environmental Services</b>	\$40,000	\$25,000		\$65,000
<b>F. Strategy for Regional Technical Support for ESP via NGOs</b>	\$20,000	\$20,000	\$10,000	\$50,000
<b>G. Social Assessment</b>	\$40,000			\$40,000
<b>H. Environmental Assessment</b>	\$ 10,000	\$30,000		\$40,000
<b>I. Economic/Incremental Cost Financial Analysis</b>	\$ 20,000	\$50,000	\$10,000	\$80,000
<b>J. Coordination, Management, and M&amp;E</b>	\$45,000	\$50,000	\$10,000	\$105,000
<b>TOTAL</b>	<b>\$330,000</b>	<b>\$305,000</b>	<b>50,000</b>	<b>\$685,000</b>

**FUNDECOOPERACION***Para el Desarrollo Sostenible*

San José, October 7, 1998

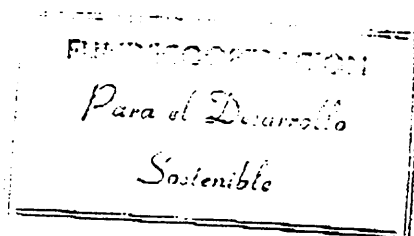
DE-426-98

Mrs. Donna Dowsett-Coirolo  
Country Director, LCC2C  
The World Bank  
1818 H. Street, NW  
Washington, D.C. 20433  
U.S.A.

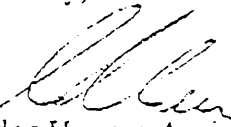
Dear Mrs. Dowsett-Coirolo:

I am pleased to inform you that the Board of Administration of FUNDECOOPERACION in its Agreement No. 5 of Sesión 09-98, held on October 1<sup>st</sup>, 1998, endorsed the Ecomarkets Project (GEF-25-98). Accordingly in my capacity as Global Environment Facility Focal Point, we hereby request funding for this project. The proposed Ecomarkets Project, a priority for the Government of Costa Rica, aims to preserve natural ecosystems in Costa Rica by marketizing the environmental benefits of forests such as protection of biological diversity, carbon sequestration, provision of hydrological services, and support for the nation's increasingly important tourist industry.

To this end, we are writing to request your support for this project, including financing for both project preparation and project execution. This letter also serves to confirm our agreement that the Costa Rica Office of Joint Implementation (OCIC) should be the recipient of project preparation finances for the above-cited project.



Sincerely,

  
Carlos Herrera Amighetti  
Delegate Executive

CC: John V. Kellenberg, Natural Resources Economist  
Environmentally & Socially Sustainable Development  
Sector Management Unit, Latin America and the Caribbean Region  
File

CHA/mf

**GEFSEC Project Tracking System**

***Response Due Date: 03/12/99***

**Correspondence Description**

Addressed to: <i>Mr. Kenneth King</i>	Correspondence Date: 03/09/99
Date Received: 03/09/99	Organization: WB
From: Lars Vidaeus	

<b><i>Assigned To: M. Ramos</i></b>	<b><i>Re-Assigned to: K. Kumari</i></b>
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<b><i>Status: Open</i></b>
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Type: Memorandum
Topic: PDF B: COSTA RICA: Ecomarkets Project

**Action Instructions**

- For Bilateral meeting
- For information only. No action needed.
- Please handle/respond on behalf of Mr. Kenneth King and provide a copy.
- Please handle/respond on behalf of Mr. Mohamed El-Ashry and provide a copy.
- Please prepare a draft response and return to Program Coordinator
- Please reply directly and provide a copy.
- Please review and/or technical comments

**Special Instructions**

Mario, please enter your review in the PRS database. GEF staff, please provide your technical comments to Mario by March 12 prior to the prebilateral. *K King*

**Information Copies Sent To:**

A. Duda, M. Cruz, W. Lusigi, K. Kumari, H. Acquay, J. Taylor

<b><i>Projects File Room Location:</i></b>
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**Note: A copy/original of the document is being sent directly to your attention.**

**Please return this page with a copy of the incoming correspondence and the reply/action taken to Program File Manager (GEFSEC Project File Room) before or by due date with the original copy of the correspondence and the reply/action.**



**GEF Program Coordination** (gcoordination@worldbank.org)

MA

From: GEF Program Coordination on 06/17/99 12:25 PM  
 Sent by: Ramon Prudencio C. De Mesa  
 To: Lars O. Vidaeus/Person/World Bank  
 cc: GEFBIO-IW, Kenneth King/Person/World Bank, Alan Miller/Person/World Bank, Colin P. Rees/Person/World Bank  
 Subject: Results of Bilateral meeting with World Bank held on June 17, 1999

Lars,

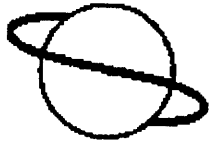
Please find attached the updated Project Review Sheets for the proposals reflecting under "Further Processing", the result of discussions between the GEF Secretariat and the World Bank held on June 17th, 1999. This transmission has been cleared by Alan, Team Leader for Climate Change and Ozone and Kenneth King, Assistant CEO.

With best regards,

Ramon C. de Mesa  
 Program Coordinator

Type	Title	PRS
PDF B	Senegal River Basin Management. <i>Recommended for CEO approval upon receipt of revised project brief.</i>	Senegal Basin IW9.pd
PDF B	Chad: Gas Flaring Reduction. <i>Recommended for CEO approval upon receipt of revised project brief.</i>	Chad CC STRM.pd
MSProj	Seychelles: Marine Ecosystem Management. <i>Not recommended for inclusion in the work program in its present form. Project brief needs to reflect review comments and resubmit at next bilateral meeting.</i>	Seychelles.PDF
MSProj	Vietnam: Marine Protected Areas. <i>Recommended for inclusion in the work program upon receipt of letter of endorsement.</i>	Vietnam.PDF
FP	Costa Rica: Ecomarkets. <i>Not recommended for inclusion in the work program in its present form. Needs further preparation and resubmit when completed.</i>	Costa Rica.PDF
PDF B	Philippines: Rural Electric Cooperative System Loss Reduction. <i>Not recommended for CEO approval in its present form.</i>	

Missing a word



GEF

## Costa Rica: Ecomarkets Project (World Bank)

Operational Program: 3,4 (Biodiversity)

GEF Secretariat Review: Work Program Inclusion

*Financing (millions):* \$8.66                      *Total (millions):* \$70.56                      860

### **Summary**

The project will foster conservation and sustainable use of forest biodiversity in Costa Rica through conservation easements on privately-owned lands outside protected areas in the Mesoamerican Biological Corridor. It will do so by developing markets and private sector providers for environmental services provided by forest ecosystems. The project would specifically support: (a) payment of compensation to owners of privately-owned forests that provide environmental services through the Environmental Services Payments Program (ESP); and (b) strengthen the technical system for monitoring, promotion, supervision, and evaluation of ESP program activities. The larger project will support the generation of renewable energy that would meet the rising demand for energy in Central America.

*Expected Project Outputs:* (a) environmental service payment program supported; and (b) Mesoamerican Biological Corridor, Costa Rica component, consolidated. As part of the larger project, (c) certified emissions reductions sold in international markets.

*Project Duration (months):* 60

**Basic Project Data**

Project GEF ID:

**Staff**

Program Manager	Ramos
Implementing Agency	World Bank
Regional Coordinator	Christina Kimes
Executing Agency	National Government

**Processing Status**

Processing Stage	Date
Concept Pipeline Discussion	
PDF A - Agency Approval	
PDF B - CEO Approval	
Bilateral Project Review Meeting	
Work Program Submission and Approv	
CEO Endorsement	
Agency Approval	
Project Completion	

**Cost Summary**

Cost Item	Years	Amount (USD'000)
<b>Implementation Fee</b>		
- Phase I		\$0.00
- Phase II		\$0.00
- Phase III		\$0.00
- Phase IV		\$0.00
<b>Preparation</b>		
- PDF A		
- PDF B		
- PDF C		\$0.33
<b>Project Allocation</b>		
- Executing Agency Fees and Costs		\$0.00
- Project Managment Costs		\$0.00
- Other Incremental Costs		\$0.00

**Completeness of Documentation**

- Focal Point.....  Budget.....  Logical Framework.....   
 STAP Review.....  Increment Cost.....  Length.....   
 Disclosure of Administration Cost.....  Complete Cover Sheet....

## **1. Eligibility of the Country**

Costa Rica ratified the CBD on August 26, 1994. It is, therefore, eligible for GEF funding.

## **2. Conformity with GEF Program and Policies**

### ***Portfolio Balance***

Costa Rica already has two GEF projects under implementation (total cost \$15.2 million). Nevertheless, the proposed project would contribute to portfolio balance because it would be the first one related to the Mesoamerican corridor. A number of Medium-sized projects are under development or early approval phases which contribute to these efforts.

### ***Evidence of Country Ownership***

The project has been endorsed by the GEF Operational Focal Point (letter dated October 7, 1998) and the Government is expected to provide co-financing for preparation (7% of total cost) and for implementation (40% of total cost). The government is also borrowing from the World Bank to implement part of the program.

### ***Replicability***

The potential replicability of the project is good. However, considering the sophistication needed in terms of commitment to sustainable development, valuation of ecological services, complex, implementable policy framework, and even complex payment and accounting procedures, the project is been treated as a pilot experience. Four or five years may be needed to evaluate the results of the approach before similar efforts in other countries may be supported by the GEF.

### ***Potential Global Environmental Benefits of Project***

The project is expected to result in improved conservation of biodiversity of global significance by supporting the protection of biological corridors and developing markets and private sector providers for environmental services contributed by forest ecosystems.

### ***Baseline Course of Action:***

Fairly well described. The expected baseline would cover environmental service contracts for about \$45 m over five years. The World Bank loan would cover approximately 44% of these costs. In addition, funds would be available directly related to forest conservation/sustainable use activities covering program administration costs, field supervision, aspects related to financial sustainability of the ESP program, and activities carried out by municipalities. Bilateral and international NGO activities have been included as well. Total baseline scenario costs are estimated at \$68.1 m. Both the World Bank and the Government contribution would be used to support similar efforts throughout the country.

### ***Alternative Action Supported by project***

The proposed alternative would build on the baseline scenario through explicitly targeting GEF resources for conservation easements in buffer zones of three protected areas within the Mesoamerican corridor. As a result of this, it is expected that habitat quality and species richness will be maintained. In addition, investments in institutional strengthening, and mobilization of investment that support sustainable development and biodiversity conservation is likely to support long-term sustainability of proposed interventions. On the compensation scheme, It is estimated that the GEF increment would be equivalent to \$10/ha/year, which is roughly equivalent to "the value of biodiversity conservation within primary forests over a period of 5 years for each hectare within the MBC. FONAFIFO will, as part of a baseline, pay for conservation easements at a cost of \$42/ha/yr over 5 years. The proposal further states that "the incremental cost of biodiversity conservation is



approximately one-quarter of the total cost of conservation easements," and that the remainder would be in-country costs "through payments for carbon sequestration, hydrological services, etc". On the revenue capture mechanism, as noted in p. 9, the project will facilitate establishment of a National Fund for Environmental Services, which is supported by Law, but which will gain incomes through various forms of compensatory payments. This would involve a trust fund "to pay for environmental services provided by forest owners in critical areas of the MBC beyond the life of the project.

Key issues that need further addressing are: (a) nearly seventy percent of GEF resources will be used through sinking and trust fund mechanisms. However, no mention and/or application of best practice generated by the GEF seem to be applied. What is the status on the design of the sinking fund, What would its components be? (b) financial resources under the proposed sinking fund would add 50,000 ha under conservation assessments and there are approximately 327,000 ha more awaiting contracts. How many new sites would be included? What type of biological assessment has been conducted to determine which areas are the top priorities? What are the biological criteria being used to select those priorities? (c) on financial issues: Who will capitalize the resulting trust fund to deal with conservation easements? What happen to those key sites that may not be able to be included under the ESP program with GEF support? (d) considering that not enough financial resources seem to have been mobilized for full funding of baseline activities, What are the government plans if funding is limited for the ESP? the financial management strategy for long-term financial sustainability seems incomplete. When all its key elements will be in place? This is key given the amount of GEF resources committed for the sinking and trust funds; (e) on the compensation scheme, it is not clear how these figures were derived, but the Secretariat suspects that the process of "buy-in," especially by landowners, would be critical. This may be an issue that could "explode" say a few years into implementation, and it may be worthwhile for GEF to be transparent about the equity concerns; (g) on revenue capture mechanisms. " It is not clear how long (number of years) "long-term" is defined, but it may, in the end, be less an issue of how long payments will be sustained, but also how much compensation is due to a broader set of stakeholders. The most vulnerable ones, of course, are likely to be indigenous and tribal groups in and around these areas, as well as women, and women headed households who would have less access to compensatory mechanisms; (i) given the innovativeness of the project, the project document should identify explicitly its high risks and the need to have a clear risk management strategy to overcome them, and these should include but not be limited to those identified in the M&E indicators.

### ***Conformity with GEF Public Invo***

The project is directed for national execution with very little local involvement. As noted by the STAP reviewer, based upon a random survey of people involved in the project, there are a lot of groups who remain "uninformed and uninvolved" (para 7, p. 31). The reviewer cites such deficiency especially among indigenous and campesino groups. Because preparation is not complete to date, there is little information in the document on the number of groups consulted and frequency of consultations. However, a social assessment is planned to determine the socio-cultural problems.

The target population is some 1,570 landowners within and around the vicinity of state national parks (para 7, p. 18). Local groups involved in the project, as listed in para 6, p. 18, are: WCS, CI, FUNDECOR, RRP, TNC, ACOPE, and FPN (para 6, p. 18). The proposal says that there are no current or anticipated problems associated with resettlement, so it is presumed that existing occupants of lands will be allowed to remain, but will be supported for alternative livelihoods by the project.

The compensation scheme is based on studies that calculated the value of ecosystem services. It is not clear, however, whether the calculations included the costs of communal management (in areas such as the commons), and whether this was realistic in terms of some market index. It would be important to follow-up, using sufficient documentation, the sequence of decision making regarding the turnover of lands for state management, or as compensated for non-use. Transparency in criteria for selection and rewards (compensation) will be a key concern.

The implementation structure and arrangements for stakeholder involvement may benefit from a more rigorous review of the beneficiary population, which may be included in the social assessment. It may be necessary to find a way to ensure representation of the landowners, but also to be cognizant of the representation of workers

and other residents in the area. This criterion would be consistent with the safeguard policies on forestry (OP 4.36), indigenous peoples (OD 4.20), and cultural property (OPN 11.03).

Transparency is needed in the selection of those regional NGOs and private sector associations that are likely to be strengthened to provide technical assistance to interested private landowners. A social assessment is underway but there is not enough information on how advance it is in identifying key stakeholders and the means for maximizing biodiversity conservation along with the identification of economic and social activities. The proposal does not describe an approach for ensuring broad-based consultations with stakeholders outside of the identified landowners. Some NGOs are involved, but it is not clear whether outreach would be an activity assigned to them, or if there are intentions of applying a community based approach in some areas.

### **3. Appropriateness of GEF Financing**

#### ***Incremental Cost***

The proposal request \$8 m of GEF funds to contribute to the overall project off approximately \$70 m. Numbers between the front page of the proposal, the budget and the incremental cost matrix do not match. This should be corrected. Program management and supervision costs seem a bit high (\$8.4 m including the GEF component, 12% overall). GEF proposed management and supervision costs are estimated at 18.5% (\$1.5 m out of \$8.0 m requested). These seem to be high too. Could these be further rationalized?

#### ***Appropriateness of Financial Modality Proposed***

The Secretariat had requested the Bank to consider alternative financial modalities (concessional funding) to grants during the PDF implementation. The project brief is mute on this issue. The Bank should explore alternative modalities for GEF funding.

#### ***Financial Sustainability of the GEF-Funded Activity***

The GEF contribution would provide capital for a sinking fund to include additional private land owners to the proposed scheme in three key sites, Tortugero, La Amistad-Caribe, and Osa Conservation Areas. In addition, it will support the analysis, design, and implementation of revenue capture mechanisms established in the new policy framework, including the design of a trust fund (by yr. 2005) likely to be capitalized by a number of donors.

The larger project (non-GEF resources) project would also establish and provide initial capitalization of a Fund for Renewable energy resources). These measures should provide for long-term financial sustainability. A key question that remains to be clarified is the role of the GEF in capitalizing the trust fund aimed at conservation easements.

### **4. Coordination with Other Institutions**

#### ***Collaboration***

A substantive portfolio of project is under development by the Agencies which is not included in the current brief. For example, the pilot Phase project for Osa Peninsula and La Amistad, coordinated through UNDP; the World Bank Biological Resources Project focuses on some of the areas under this proposal; a number of Medium-sized projects are also under development that also contribute to the Mesoamerican corridor are not included either. A better job of integrating the various initiatives under the current draft and how they complement each other could be helpful.

#### ***Complementarity with Ongoing Activities***

Not well addressed as described in the preceding paragraph. This should be improved.

## **5. Responsiveness to Comments and Evaluations**

### ***Consistency w/previous upstream consultations, project preparation work, and processing conditions***

Comments provided at the time of approval of PDF B were incorporated on the revised draft of April 1, 1999.

### ***Monitoring & evaluation: Minimum GEF Standards, ME plan, proposed indicators, lessons from PIPs and Project Lessons Study***

There are no clear indicators included in the project brief to assess proposed indicators. These should be completed at the latest at the time of endorsement.

### ***Implementing Agencies' Comments***

None yet.

## **STAP Review**

Very good review provided and one which is very supportive of the project and its objectives. Key issues have been addressed but some remain. Given the strong focus of Council member on STAP comments, it is recommended that the project addresses all issues raised by the review.

### ***Council members' Comments***

None yet

### ***Other Technical Comments***

During the PDF B, clarification on the following points was requested (and provided): (a) we are not clear whether the proposed project components and PDF activities are consistent with the project's objective of supporting "the conservation and sustainable use of biodiversity in Costa Rica by developing markets and private sector providers for environmental services contributed by forest ecosystems."; We would have expected that activities supporting the objective of developing markets would focus, for example, on developing transparent mechanisms: (i) to bring (actual or potential) sellers of environmental services and buyers together; (ii) to determine prices that reflect the true economic value of forest resources; and (iii) which in the long-term would minimal Government intervention in the form of compensation payment, etc.. The promotion of renewable energy component refers to bringing "buyers" and "sellers" together, but no information is provided on whether at the PDF stage, there would be an analysis of possible mechanisms whose development would be supported under the project to support this to happen; (b) whether GEF funds would be used to pay direct compensation to landowners under the ESP Program (see para. 13a). Please note that GEF funds cannot be used to pay direct compensation. GEF typically compensates some stakeholders in the form of support for livelihood activities; (c) how biodiversity on privately-owned lands can be conserved in the long-term if landowners who receive compensation under the Environmental Services Program make a commitment to preserve the forest for an additional 15-20 years (para. 9); (d) preliminary information on the capacity building needs of SINAC (\$1 million proposed for capacity building activities) and the regional NGOs that provide technical assistance to landowners (\$1 million proposed in the project); and (e) the relationship between the Promotion of Renewable Energy component (a technically sound component) which will "support the generation of renewable energy that would meet the rising energy demand in Central America" and the overall project objective of supporting "the conservation and sustainable use of biodiversity in Costa Rica by developing markets and private sector providers for environmental services contributed by forest ecosystems." An implementation schedule for the PDF was requested too. It was recommended developing this project at specific pilot sites as this would make it more manageable and the impacts can be more readily assessed.

The following technical issues emerged during the review of the project brief: (a) How the figures under the compensation scheme been derived?. The process of "buying" especially by landowners is critical. Hence social assessment data are key; (b) the compensation scheme is based on studies that calculated the value of ecosystem services do these calculations include the costs of communal management? (c) identification of key sites to be included under the program with GEF support; (d) information on who will capitalize the resulting trust fund as the proposal is inconclusive about the role of the GEF on this issue; (e) full financial contribution to baseline expenditures are not assured at this time; (f) the financial management strategy for to trust fund seems incomplete; (g) management and supervision costs for the overall project and for the GEF component in particular seems high; (h) better integration with the current portfolio of GEF projects (and those in the pipeline, including medium-sized projects) is needed; (i) a social assessment is underway but there is no enough information on how advance it is in identifying key stakeholders and the means for maximizing biodiversity conservation along with the identification of economic and social activities; (j) transparency in the selection on regional NGOs and private sector association that will provide technical assistance is needed; (k) M&E indicators are poorly defined and not quantifiable. This needs improvement; (l) particular risks of the energy sector on biodiversity (e.g., fish migration) appear not have been fully addressed yet.

### **Further Processing**

The Program Manager (H. Acquay) highlighted the following issues during the PDF B: (a) the relationship between the project's objective, proposed components, and the PDF activities; (b) whether GEF funds would be used as part of the ESP to provide direct cash payments to landowners; (c) long-term conservation of biodiversity on privately-owned lands; (d) preliminary capacity building needs for SINAC and the regional NGOs; (e) the relationship between the project's objective and the Promotion of Renewable Energy component (see "Other Technical Comments" section for details); and (f) implementation schedule.

Agreements reached at the bilateral meeting on March 23, 1999: (a) It was agreed that the PDF will be approved when the Bank provides additional information to respond to the above comments..

Revised Project Document (April 1, 1999): A revised project document which fully addresses the issues raised at the bilateral was submitted to GEFSEC. The PDF proposal is, therefore, cleared for further processing within GEFSEC leading to approval by the CEO.

The Program Manager (M. Ramos) reviewing the project draft for inclusion in the work program finds the conceptual development of the proposal very sound and innovative. However, the project brief submitted for the bilateral meeting on June 17, 1999 is still substantially incomplete on key project design issues and would like to discuss the following issues ASAP:

- (a) fairly advance development of the sinking fund is needed as a substantive GEF contribution is allocated for this purpose;
- (b) the need to have the social assessment well-advanced to identify specifically key stakeholders, contributions to global benefits, etc.
- (c) selection of sites for addition to the ESP. Preference should be given to large, continuous blocks of forested areas with significant global environmental benefits versus small patches of forests thought the MBC. What criteria would be used for establishing priorities for conservation easements?;
- (d) collaboration and complementarity with other projects in Costa Rica, particularly the large Medium-sized portfolio under development, and the larger Mesoamerican Corridor Program;
- (e) given the innovativeness of the project, the project document should identify explicitly its high risks and the need to have a clear risk management strategy to overcome them, and these should include but not be limited to

those identified in the M&E indicators;

(f) why has the Bank rejected alternative funding modalities (e.g., concessional funding) as suggested by the Secretariat during the PDF bilateral meeting?

An Upstream consultation on project issues took place on June 16 with Bank Staff (C. Kimes, G. Castro, J. Kellenberg) and Secretariat staff (M. Ramos). Key issues under further processing were discussed. The meeting agreed that points (d), (e), and (f) above, could be handled with some re-drafting but that the first three issues needed to be addressed at the bilateral meeting.

A bilateral meeting took place with Bank and Secretariat staff on June 17, 1999. The meeting considered issues of the sinking fund, and the completeness of project preparation on the social assessment and selection of sites and block of forests to be incorporated under the project, two key issues. A clarification was made by the Bank regarding the sinking Fund. GEF funding would be channeled through a regular disbursement procedure through an account managed by FONAFIFO, and not really establishing a sinking fund. On the other issues the Bank made a brief presentation documenting the level of detailed information available for project design. However, these issues needed further preparation for which the GEF had made resources available through the PDF B. As this was the case, the Secretariat recommended the Bank to continue project preparation and return with a more completed project brief at a later date, perhaps in September, 1999.