

PMR PROJECT IMPLEMENTATION STATUS REPORT (ISR)

The PMR Project Implementation Status Report should be prepared by the Implementing Country or Technical Partner, with the support of the Delivery Partner and/or the PMR Secretariat. For any questions related to the preparation of the PMR Project Implementation Status Report, please contact the PMR Secretariat at: pmrsecretariat@worldbank.org.

1. SUMMARY INFORMATION

Implementing Country/Technical Partner:	Costa Rica
Reporting Period:	From 01/01/2016 to 04/31/2016 with project inception stage from 10/2015.
Report Date:	04/12/2016
Implementing Agency:	Directorate of Climate Change, Minister of Environment and Energy (MINAE)
Contact Person:	Andrea Meza, Director, Climate Change, MINAE (Focal Point), Silvia Charpentier / Felipe De León (PMR Coordination Unit)

Grant Executed By:	World Bank
Grant Effectiveness and Closing Dates:	03/07/2016 to 06/30/2019, with retroactive financing for period 10/2015 – 02/2016
Grant Amount (USD):	USD 3,000,000
Funding Mobilized (USD):	

2. OVERVIEW

Please provide a general description of the progress made towards the Grant's Objectives and Activities (as per the Project Development Objective(s) Indicator(s) and Intermediary Results Indicator(s) included in the World Bank's Project Paper's Results Framework). Please also highlight critical issues as well as pending actions that may require the PA or the PMR Secretariat's attention.

Costa Rica, through its Ministry of Environment and Energy (MINAE) participates in the Partnership for Market Readiness (PMR). Following the elaboration and endorsement of a 'Market Readiness Proposal' (MRP), the PMR Assembly awarded funding in the amount of US\$3 million (this grant) to assist Costa Rica in the implementation of the readiness activities laid out in the MRP. The Costa Rican PMR counterpart agency, MINAE, requested the Bank to execute these PMR grant resources.

The activities financed by this grant are centered on three work areas:

- (i) **Support completion & implementation of the domestic market design**, including consolidation of market conceptual framework, governance and institutional arrangements; development of registry system and related tools; development of prioritized MRV protocols & methodologies for UCC offset generation;
- (ii) **Strengthening of demand side by assessing a range of policy instrument options**, including assessment of INDC burdensharing at the national level and analysis of enabling policy instruments; Voluntary Demand (supporting participation of organizations in the National Carbon Neutrality Program; Regulatory Demand (adoption & implementation of the annual emissions levy ('canon de emisiones'))).
- (iii) **Consolidation of supply through the development of sector mitigation programs in three priority sectors**: activities in support of UCC supply from the electrical sector (supply and demand side energy efficiency and conservation; non-conventional renewable options for self-supply (distributed energy and low-enthalpy geothermal power)); activities in support of UCC supply from the transport sector (electrification of the private vehicular fleet and the public transport system; public transport sectorization in the San Jose Greater Metropolitan Area (GAM); gradual substitution of fossil fuels with biofuels); and activities in support of UCC supply from the livestock and agriculture sector (support to GHG crediting component of two NAMAS currently in development phase (Coffee NAMA and Livestock NAMA)).

One of the most important lessons learned during the period between the PA endorsement of Costa Rica's MRP and grant effectiveness is that the plausibility of project objective and activities lies largely on their insertion in a broader national policy context. In the Costa Rican case, PMR supported activities are part of the National Development Plan, the climate change strategy and action plan, and sector plans (National Energy Plan, including Transport, and Agriculture and Livestock) with a detailed scope of action and strong political endorsement.

The revised MRP was thus prepared using the Contribution Analysis methodology framework. The country objective is: *The Costa Rican National Climate Change Strategy and the recently submitted INDCs are the main pillars for an integrated, long-term strategy for sustainable development that seeks to transform Costa Rica into a low-carbon climate resilient country, and the key expected result is: The carbon mitigation component of the strategy focuses on aligning with a carbon neutral economy. Central to this aspiration goal is the design and operation of carbon pricing mechanisms, both as policy and financing instruments. The contribution of the project is to advance Costa Rica's integrated long-term strategy through the development, design and implementation of market readiness activities, and a Results Framework was produced to reflect specific interventions and expected results. In general terms, the revised MRP is designed to provide a solid MRV 'backbone' to those activities that will*

contribute to achieving the key expected result in carbon mitigation while contributing directly to credible and transparent national level reporting. Project components and expected outcomes are discussed in Section 3 below.

3. IMPLEMENTATION REPORT BY COMPONENT

Differences between the Objectives/Activities in the Market Readiness Proposal and the Grant Agreement

<p>Are there any important and material differences between the objectives/activities proposed in the Market Readiness Proposal and endorsed by the Partnership Assembly of the PMR and those agreed to in the Grant Agreement with the Delivery Partner and described in the Project's Results Framework?</p>	<p>Yes</p>
<p>The PMR Partnership Assembly endorsed Costa Rica's MRP in 2013. Difficulties posed by the adequate selection of an appropriate grant- executing agency, together with the change in administration in Costa Rica in early 2014 caused substantial delays that have just recently been resolved. Bank-executed implementation is currently beginning in earnest. The project's three technical core components continue to express Costa Rica's main readiness needs, and thus remain as the underlying structure of the revised MRP.</p> <ol style="list-style-type: none"> 1. Development of the domestic carbon market (Mercado de Carbono de Costa Rica, MCCR) infrastructure, encompassing governance matters (e.g., capacity development and operational support to the MCCR Carbon Board, its subsidiary bodies, and its technical secretariat), review, update and completion of legal and institutional framework, and design & implementation of technical elements pertaining GHG data management and national MRV system; 2. Strengthening of demand side, through, inter alia, the assessment of policy options to enhance mitigation action against the backdrop of Costa Rica's current sector development plans, its recently finalized Nationally Determined Contribution (NDC) under the UNFCCC, and progress made in its National Carbon Neutrality Program (Programa País Carbono Neutral); 3. Stimulation of supply side, with particular focus in supporting the assessment of sector mitigation options and the design of GHG sector offset programs in prioritized sectors (urban transport, energy, and agriculture sectors), including development of underlying emission reduction crediting methodologies and MRV systems. <p>The current MRP approved by the project's Steering Committee contains certain adjustments to these main components that reflect changes mainly in the national and international context of climate change mitigation efforts, the Costa Rican NDC and the Paris Climate Agreement (PCA), as described in detail in Section 4 below.</p> <p>In addition, the revised work plan contains more precision in the scope of the proposed activities and a strong political endorsement from the Ministry of Environment and Energy, the Ministry of Transportation and Public Works, and the Ministry of Agriculture. Mitigation measures expressed</p>	

broadly in the original MRP have been narrowed down to the activity level, all of which will be implemented in seamless collaboration with sector ministries.

Implementation Progress by Component

A. Component 1: Market infrastructure	
Status:	<p>Ongoing</p> <p>Costa Rica already has a Carbon Neutrality Program (Agreement 36-2012-MINAE, June 2012) and has taken steps toward setting the framework for MRP implementation by establishing certain elements of a domestic carbon market, (Decree 37926-MINAE, September 2013). The Carbon Board - maximum authority of the MCCR- and the Methodological Committee have met periodically and have issued 11 procedures and protocols including initial guidance for participants, a procedure for evaluating proposed methodologies, procedures on the submission of project and protocol documentation and reporting requirements as well as guidance for validation and verification by accredited Validation and Verification Organs.</p> <p>This structure, however, requires adjustments – particularly in the governance and institutional arrangements-- to align them with current national and international circumstances.</p> <p>The revised component 1 focuses on market governance, MRV system design and deployment, and methodological development. These sub-components will be adjusted to current circumstances according to the recommendations issued by a top-tier international expert with an up-to-date external perspective and clarity on key concepts, definitions and institutions necessary for the successful implementation of the domestic carbon market. Selecting and hiring this expert is one of the first activities in the PMR implementation phase.</p>
Comments:	<p>In terms of outcomes, the project, working with the Directorate of Climate Change, will have <u>direct control</u> of certain intermediate outputs of Component 1 (Development of Market Infrastructure): update market conceptual framework, development of registry/tracking tool MRV protocols and methodologies, and capacity building, communications and consultation. The project will have a <u>direct influence</u> (through the production of technical inputs) in measures that require political decisions, such as those related to governance and institutional arrangements, and an <u>indirect influence</u> in those results involving emissions reduction co-benefits.</p>
B. Component 2: Strengthening UCC demand	
Status:	<p>Ongoing</p> <p>Component 2 is the most directly affected by the changes in the international context that took place since the original MRP was endorsed. Costa Rica now has specific mitigation targets under the NDCs/PCA. Local demand will be a key element of the MCCR, with voluntary demand likely to expand through the increased visibility of the Carbon Neutrality Program. Compulsory demand is expected to come into play by a combination of measures generated in the context of the NDC/PCA. Among them, the project will</p>

	<p>support the development of a levy on stationary and mobile emissions sources potentially linked to the MCCR by a reverse auction mechanism. The convergence between these two potential demand drivers (voluntary and compulsory) is considered an integral part of the project, as it is required for robust supply-demand balancing. All activities in this component have been revised.</p>
Comments:	<p>Project scope is being adjusted to the broader backdrop of Costa Rica's NDCs and the PCA. The project will have a <u>direct influence</u> on both the design of the levy on stationary and mobile emissions sources and the implementation of the PCA (through the support of technical inputs). It will have an <u>indirect influence</u> on the long-term (2030) strategic thinking of Costa Rica's transformation into a low-carbon climate resilient country.</p>
C. Component 3: Strengthening UCC supply	
Status:	<p>Pending</p> <p>UCC supply activities were consolidated from 5 sectors in the original MRP to 3 sectors in the current version (energy, transport, and agriculture). This component aims at supporting the assessment and preparation of sector mitigation programs/actions and generation of UCC offsets in three priority sectors:</p> <p>(I) Activities in support of UCC supply from the electrical sector</p> <p style="padding-left: 20px;">I.1 Supply and demand side energy efficiency</p> <p style="padding-left: 20px;">I.2 Non-conventional renewable options for self-supply (distributed energy and low-enthalpy geothermal power)</p> <p>(II) Activities in support of UCC supply from the transport sector</p> <p style="padding-left: 20px;">II.1 Electrification of the private vehicular fleet and the public transport system</p> <p style="padding-left: 20px;">II.2 Public transport sectorization in the Greater Metropolitan Area (GAM)</p> <p style="padding-left: 20px;">II.3 Gradual substitution of fossil fuels with biofuels</p> <p>(III) Activities in support of UCC supply from the livestock and agriculture sector</p> <p style="padding-left: 40px;">III.1 Feasibility of GHG crediting instrument for the CR Coffee NAMA</p> <p style="padding-left: 40px;">III.2 Feasibility of GHG crediting instrument for the CR Livestock NAMA</p> <p>The project will support MRV-able supply-generating measures that lead to emissions reductions within the project scope. These were selected in direct consultation with the relevant sector ministries and comply with the requirement of being national priorities aligned with PMR objectives. Activities in the energy and transport areas are part of the recently approved National Energy Plan 2015-2030, a broadly consulted set of measures with ample political support.</p>
Comments:	<p>The project will have <u>direct control</u> of the MRV inputs for supported activities and through them, a direct influence in the success of the proposed mitigation measures.</p>

4. PROGRESS, CHALLENGES, AND LESSONS LEARNED

Important policy or regulatory developments related to the Grant's objectives and activities:

Developments: *Please describe important policy and regulatory developments related to carbon pricing that have occurred during the Reporting Period and/or that are expected in the future.*

- The National Energy Plan (PNE) 2015-2030 was developed by the Ministry of Environment and Energy and the Ministry of Transport and Public Works, approved by the President and formalized on September 14, 2015 by Decree N°39219. This is the first energy plan developed through a collaborative effort between these ministries and was widely consulted within government and with other stakeholders. The MRP is expected to strengthen the link between activities in these sectors and emissions reductions through robust MRV schemes and technical support. The PNE is available at:
<http://www.minae.go.cr/recursos/2015/pdf/VII-PNE.pdf>
- Costa Rica presented its Intended Nationally Determined Contribution to COP21, which includes a specific emissions target for 2030 as well as a long-term decarbonization pathway aimed at reaching net carbon neutrality before the end of the century. The NDC, which was broadly consulted before submission, represents another important anchor point for the revised MRP. Costa Rica's INDC is available at:
<http://www4.unfccc.int/submissions/INDC/Published%20Documents/Costa%20Rica/1/INDC%20Costa%20Rica%20Version%202%200%20final%20ENG.pdf>
- On the international scale, the Paris Climate Agreement resulting from COP21 and which Costa Rica intends to ratify early on, sets out a new context for mitigation activities and their reporting that must be taken into consideration by the MRP.

Challenges: *Please describe how such developments might affect the achievement of the Grant's objectives and/or the implementation of specific activities under the Grant, either positively or negatively and how possible policy and regulatory challenges may be addressed going forward. Please also refer back to any potential policy and regulatory challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

- The VII National Energy Plan provides a detailed action plan with specific activities, with results that converge with PMR objectives (based on the project logical framework). The availability of this action plan provides a rare opportunity for the Government to select activities for PMR Support (Components 2 and 3) that are politically endorsed and have been thoroughly consulted.
- The creation of an emissions levy for both mobile and static combustion sources is the major carbon pricing initiative with which the PMR-CR will have to coordinate. This levy is described in the PNE and is one of the most important emission-reduction actions proposed by the Costa Rican government, with high level of buy-in from all relevant Ministries. The main objective of the levy is to strengthen the mitigation financing framework. The project will support the development of this levy from the technical, legal and financial standpoints.

- The GHG emissions target for 2030 and the long-term decarbonization pathway set out in the NDC require aggressive emissions cuts, mainly from notoriously difficult sectors to address like transport and agriculture. This is an ambitious goal and a strong policy signal upon which the MRP should be aligned.
- The PCA includes a number of elements that will impact everything from finance availability to MRV and transparency requirements to international emissions trading. Although the full impact of the PCA will depend largely on the detailed rules and mechanisms which still have yet to be developed, there is no doubt that the PCA will have a dramatic impact on climate change related policy around the world.
- The policy developments described above have a substantial effect on the context in which the PMR-CR will evolve. This warrants an objective analysis of existing infrastructure and institutional arrangements related to the MCCR and the updates necessary to meet current and upcoming needs.

Lessons learned: *If applicable, please provide a brief description of the lessons learned regarding carbon pricing policy and regulatory developments during the last Reporting Period.*

Important changes in the technical design or approach related to the Grant's activities:

Developments: *Please describe any important change in the technical design or approach related to the Grant's activities that have been made during the Reporting Period or that are expected in the future.*

- The 2013 MRP focused on developing a voluntary domestic offset mechanism that could generate an internationally recognized tradable offset unit (UCC- cost-effective for the small-offset-volume projects common in Costa Rica) that would enable its large-scale export as a way to attract and channel international climate funding. The Paris Climate Agreement fundamentally changes the context for international GHG emissions offsets by establishing, among other things, that exported offsets must be accounted for and reflected in the exporting countries emission inventory.
- Under the 2013 MRP the onus for leading and implementing the mitigation activities fell almost entirely on the MINAE and in particular its Climate Change Directorate. The current version builds upon measures and activities already part of mainstream national policy with significant political and social buy-in.
- The Costa Rica NDC establishes a specific cap for 2030 and a long-term trajectory to decarbonization and reaffirms the use of market instruments as a key component of the strategy to achieve its targets.
- The emissions levy described in the PNE and the reverse-auction mechanism proposed to complement it are new structural elements to be considered.
- The number of sectors in the UCC supply component was reduced from five to three to provide a more concrete, focused input into key sectors rather than a more limited support in a wider array of sectors.

Challenges: *Please describe how such changes might affect the implementation of the Grant's activities, either positively or negatively, and how possible technical design challenges may be addressed going forward. Please also refer back to any potential technical design challenges that may*

have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.

- Given Costa Rica's highly ambitious NDC goals this means that every offset ton that is exported will eventually have to be replaced with some other form of offset in order to reach net carbon neutrality. These fundamental changes require a conceptual re-evaluation which might reveal the need for deeper institutional changes. This conceptual reevaluation will be among the first activities to be implemented.
- Another challenge related to the technical and design changes that will be carried out relating to the MCCR and the Carbon Neutrality Program will be to transition into an updated program without alienating the organizations already participating in the existing Program and active under current regulations and modalities.

Lessons learned: *If applicable, please provide a brief description of the lessons learned regarding the technical design or approach related to the implementation of the Grant's activities during the last Reporting Period.*

Key capacity issues (implementation, technical, financial management, procurement) related to the Grant's activities:

Developments: *Please describe key capacity issues (institutional, technical, financial management, procurement) related to the implementation of the Grant's activities encountered during the Reporting Period or that are expected in the future.*

- Difficulties in identifying a local implementation agency led to significant delays under the country-executed scenario.
- The agreement and transition to a Bank-executed grant represent substantially different procurement processes and requirements which made it necessary to restructure activities to accommodate WBG procurement procedures and rules.
- Carbon pricing and MRV topics are highly technical and require both training for core teams and the ability to translate these concepts into working language for other specialists, stakeholders and users.
- The relationship between actions taken today and the final result of emissions reduction is not evident. It is necessary to think these issues through, particularly in the framework of the country's NDCs.

Challenges: *Please describe how such issues are affecting the implementation of the Grant's activities, either positively or negatively, and how possible challenges may be addressed going forward. Please also refer back to any potential challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

- Re-structuring activities, especially those in support of UCC supply, to meet WBG procurement requirements meant reducing the number of contracts from an estimated 30 contracts to less than 10.
- The smaller number of contracts was necessary to maintain efficiency under Bank execution but this becomes a challenge in the development of TORs, as they must to account for, and manage more complex activities under a single TOR document.
- The team foresees the use of knowledge sharing platforms, experts and partnerships to expand learning and share experiences.

- The use of a project-wide logical framework facilitated the analysis of activities for coherence with PMR objectives and allowed for clearer prioritization and budget-related decision-making.

Lessons learned: *If applicable, please provide a brief description of the lessons learned regarding the key capacity issues related to the implementation the Grant's activities during the last Reporting Period.*

Coordination with other carbon pricing initiatives, including those funded by other donors:

Developments: *Please describe any developments related to other carbon pricing initiatives, including those funded by other donors, that have occurred during the Reporting Period or that are expected in the future.*

- There are a variety of programs, projects and initiatives that relate directly or indirectly to climate change which are being carried out by various agencies. Coordination with these activities is of paramount importance to ensure consistency and avoid duplication of activities and to maximize synergies. This is especially true of other WBG projects and programs including the FCPF and the Productive Landscapes Programs.
- Coordination will be especially relevant with:
 - FONAFIFO and the REDD+ Strategy,
 - the MRV component of the IADB transport program, NAMAs,
 - the Regional Accounting Rules Project and Transport and Mobility Energy Efficient led by GIZ,
 - the EUROCLIMA initiative, the Enhancing Capacity for Low Emission Development Strategies project by USAID, Low Emissions Capacity Building Project by UNDP, and
 - some specific project in the power sector from World Bank and Inter-American Development Bank.

Challenges: *Please describe how such developments might affect the implementation of the Grant's activities, either positively or negatively, and how any coordination challenges may be addressed going forward. Please also refer back to any potential coordination challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

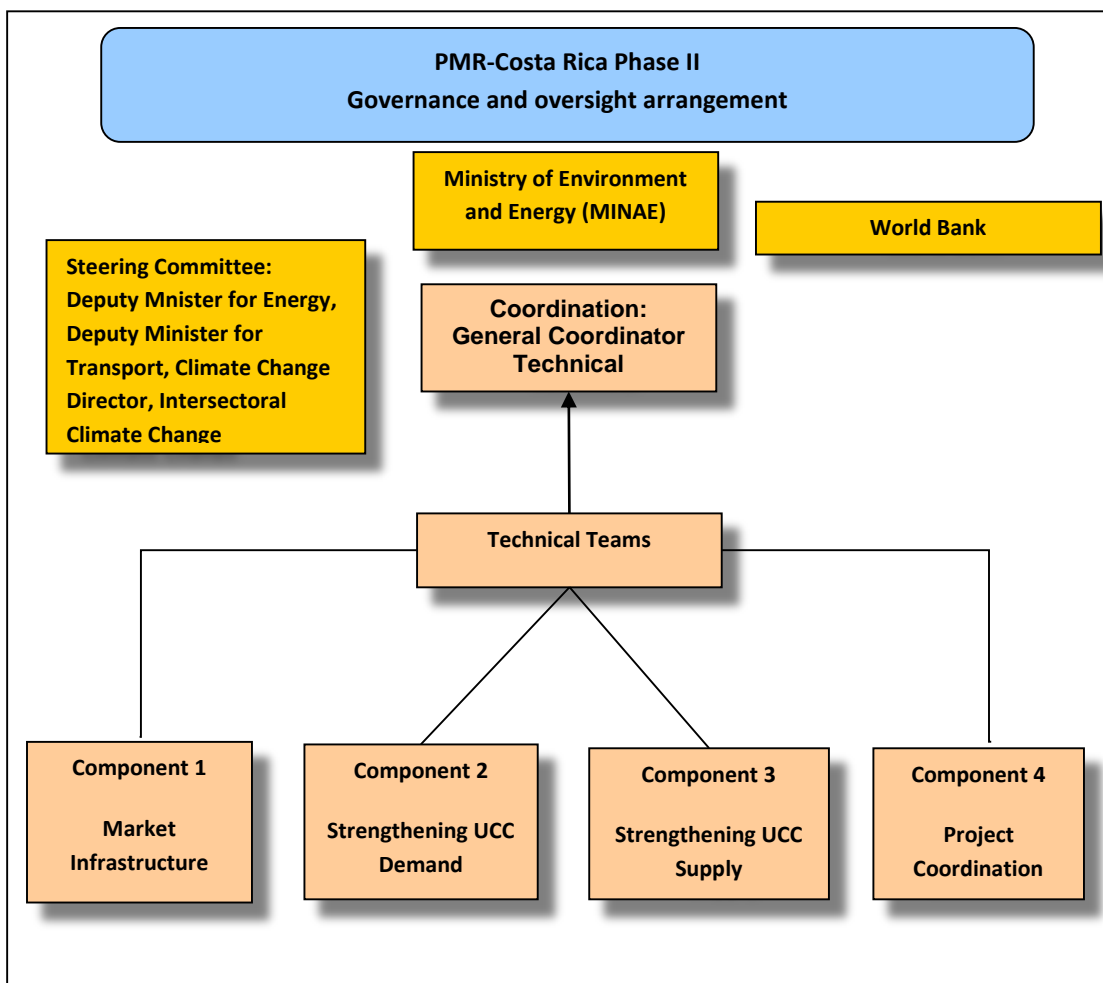
- The emissions levy, if approved, would be a key component of the MCCR will probably face opposition from some sectors of society.
- There are non-trivial technical and operational hurdles which must be addressed for the implementation of the levy.
- Substantial resources have been allotted for levy support activities, including a consultant specifically tasked with supporting the process.
- Given the risk that the levy will face sufficient challenges to be substantially delayed it is important for the MCCR< the Carbon Neutral Program and the PMR-CR to avoid becoming dependent on it for their success.
- Sufficient effort and resources must be allotted for other demand drivers, both as complimentary to the levy and as a potential Plan B. The NDCs and strengthening voluntary demand for the Carbon Neutral Program are key to this endeavor.

Lessons learned: *If applicable, please provide a brief description of the lessons learned regarding coordination with other carbon pricing initiatives during the last Reporting Period.*

Stakeholder engagement related to the Grant’s activities:

Developments: *Please describe any developments related to stakeholder engagement (consultation, participation and disclosure), that have occurred during the Reporting Period or that are expected in the future.*

- A high level Steering Committee has been created specifically to oversee the PMR-CR implementation. The members of the SC are the Minister of Energy and Environment, Vice-Minister of Energy, Vice-Minister of Transport, Climate Change Director, Intersectoral Climate Change Coordinator and the PMR-CR Coordination Unit. The SC met on February 19, 2016 and approved the revised MRP budget and procurement plan. It will continue to meet as required and no less than twice a year to follow up on implementation and provide continued strategic leadership to the project.



Challenges: *Please describe how such developments might affect the implementation of the Grant's activities, either positively or negatively, and how any stakeholder engagement challenges may be addressed going forward. Please also refer back to any potential stakeholder engagement challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

- High level visibility and buy in mean we have access to and support from key stakeholders in all of the Ministries. This is key to achieve high-impact results. However, it also means expectations are high and the pressure to start delivering results is also high, making expectation management and fluid status communications extremely relevant.

Lessons learned: *If applicable, please provide a brief description of the lessons learned regarding stakeholder engagement during the last Reporting Period.*

- It is still early in the implementation process of the MRP, with the vast majority of activities still in the process of implementation. However, two initial lessons have already become apparent:
 - The importance of a high-level governance structure to secure and maintain both strategic cohesion and high-level buy in. In the case of the MRP, this would be the Steering Committee, the highest decision making body for the project.
- The value of an operational focal point and a core team of experts with their own networks within key Ministries to facilitate coordination and cooperation with various dependencies at various levels beyond the formal Steering Committee.
- Communication with the Bank is key, especially as a Bank-executed grant.

Other issues related to the Grant's activities

Please describe any developments, challenges and lessons learned regarding any other issue related to the achievement of the Grant's objectives and the implementation of the Grant's activities.

- The strong links to technical teams in the relevant ministries has proven invaluable for this process. These relationships allowed for detailed technical discussions about Ministry priorities and how they related to PMR objectives to find high-impact activities that were relevant and coherent in both frameworks

5. ADDITIONAL INFORMATION

In this Section, please provide any additional information that may be relevant for the achievement of the Grant's objectives and/or the implementation of the Grant's activities. Please also provide any relevant information related to carbon pricing and the use of market-based instruments for climate change mitigation.