Sri Lanka's Market Readiness Proposal (MRP)

Country: Sri Lanka

Responsible Government Agency: Ministry of Mahaweli Development and Environment (MMDE)

Date of Submission: December 2017

Outline

1. Overview

- MRP preparation process
- Economic growth and development objectives
- Nationally Determined Contributions (NDCs)
- Summary of Building Block (BB) activities
- Objectives and focus of BBs

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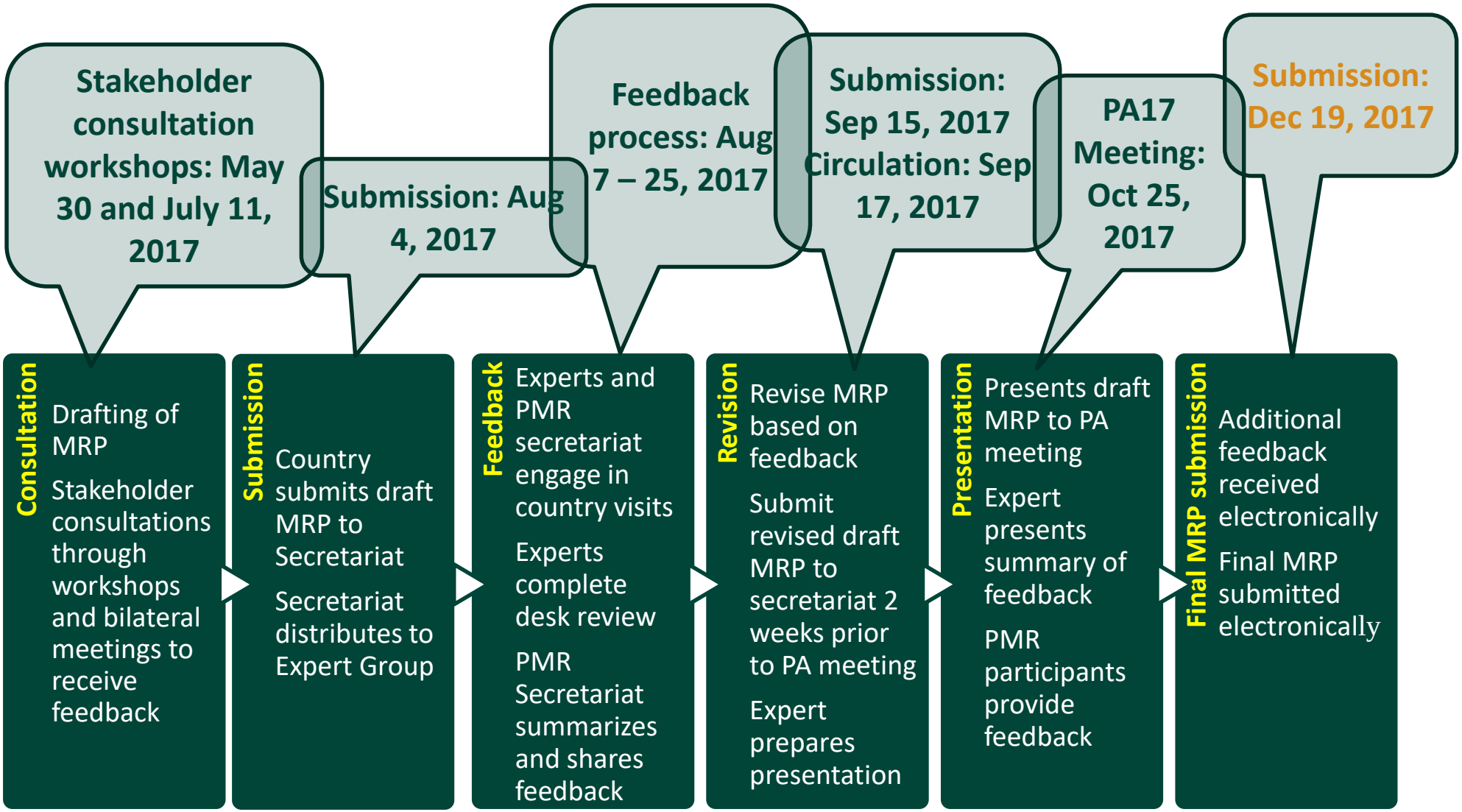
OVERVIEW

MRP preparation process



Economic growth and development objectives

- Sri Lanka is a rapidly-growing lower middle-income country with a total population of 21 million people and per capita income of USD 3,924 in 2015
- After a 30-year civil war that ended in 2009, Sri Lanka is considered to be, in many respects, a development success story. For example:
  - Growth has averaged over 6% per year in the past decade
  - Poverty rates have declined dramatically from 22% in 2002 to 9% in 2010
  - Inequality in per consumption expenditure has declined, as reflected by a drop in the Gini coefficient from 0.40 in 2002 to 0.36 in 2010
- Enhancing climate change adaptation and mitigation efforts will be critical as the country strives to become an upper middle-income country:
  - **Adaptation:** Coastal regions are highly susceptible to changes in sea level, increased frequency and intensity of disasters (esp. drought and flooding) are expected to have direct adverse impact on major economic sectors, such as power, transport, agriculture and fisheries
  - **Mitigation:** Economic growth is expected to increase demand for fossil fuel imports. Sri Lanka does not have any domestic production of coal, petroleum or natural gas, and is spending 50% of its total export income (approx. US$ 5 bil per year) to import fossil fuels
- Government is prioritizing and started taking many steps to address these challenges

Nationally Determined Contributions (NDCs)

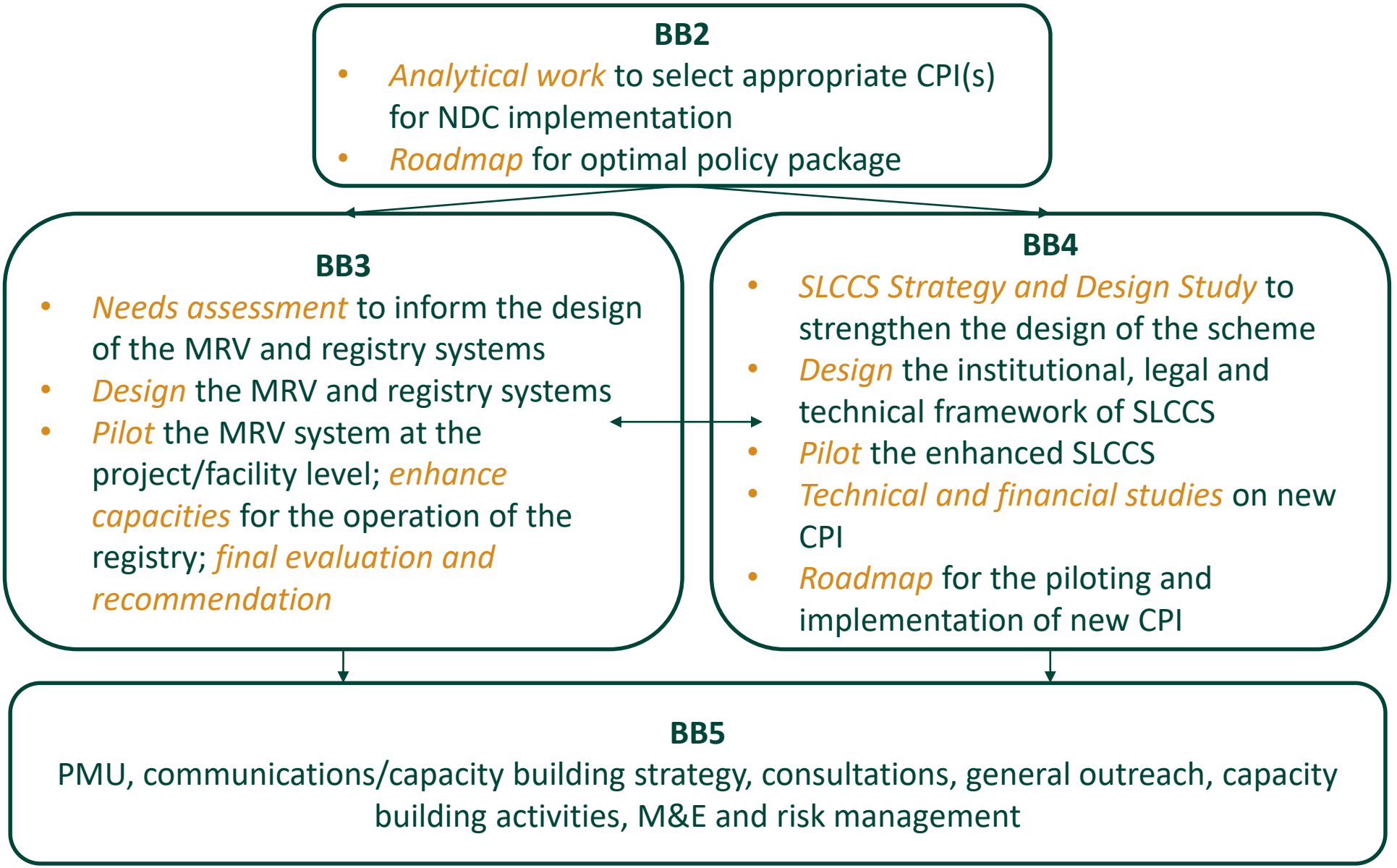
(1) By 2030, reduce GHG emissions in the energy sector against the Business-As-Usual (BAU) scenario by 20% (4% unconditionally and an additional 16% conditionally).

(2) By 2030, reduce GHG emissions against BAU scenario in other sectors by 10% (3% unconditionally and an additional 7% conditionally).

Specific mitigation plans and actions provided for the energy (mainly electricity generation), transport, industry and waste sector, as well as the forestry sector (which is not covered by PMR)

- **The NDC Planning and Monitoring Committee** was established to inform the development of strategic policies and implementation plans for each NDC sector.
- **"The Readiness Plan for Implementation of NDCs"** was prepared in 2016 to lay out capacity building needs and targets from 2017 to 2020

Summary of BB activities



Objective and focus of BB2

The key objective of BB2 is:

- To provide the rationale and context for supporting the proposed activities under BB3 and BB4 in Sri Lanka
- To design an optimal policy package for NDC implementation
- To identify whether an additional CPI would be required
- To evaluate which additional CPIs would be the most suitable as part of the optimal policy package

In this regard, BB2 seeks to produce two pieces of analytical work:

(1) Assessment of mitigation potential in different sectors and identification of suitable CPI(s) for potential sectors

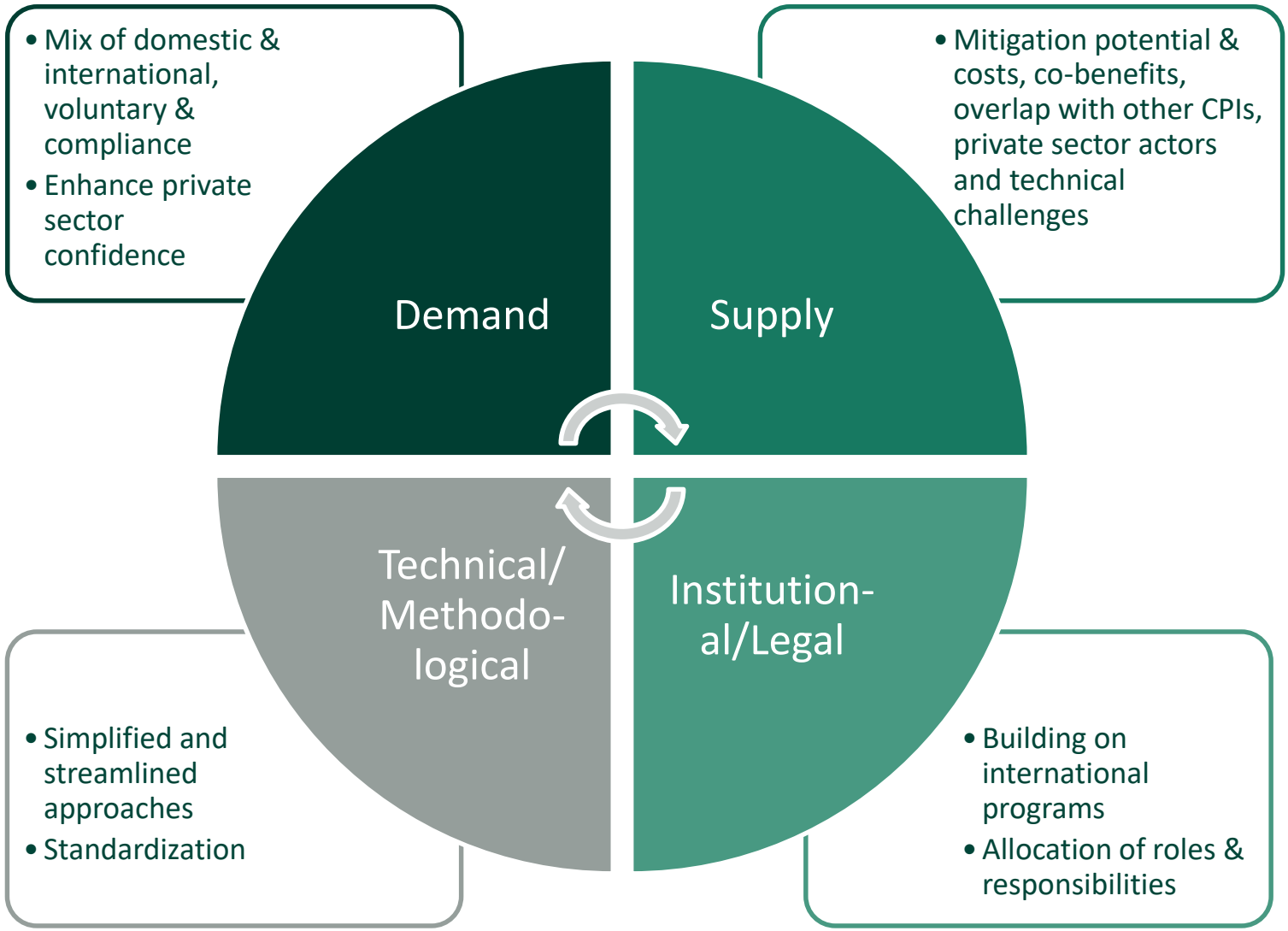
(2) Roadmap for designing and implementing an optimal policy package

Objectives and focus of BB3

- Given the need to support readiness quickly, and commitment to project- and facility-level readiness components, BB3 will start with support for SLCCS and GHG inventory
- Longer-term goal is to support additional CPIs, but specific objectives will be identified during MRP implementation
- Main focus for BB3 activities and outputs will be project-/facility-level data collection, MRV and registries
- Additional focus will be linking project/facility-level data to GHG inventory
- Build on existing experience in data collection, registries, MRV: mainly project-level and mainly energy sector (e.g. GHG Inventory, Energy Balance, SLCCS, CDM, Carbon Partnership Facility program, NAMAs, etc.)

Objectives and focus of BB4 (Part I)

- Enhance the domestic offset scheme, Sri Lanka Carbon Crediting Scheme (SLCCS), with a specific focus on the following components:

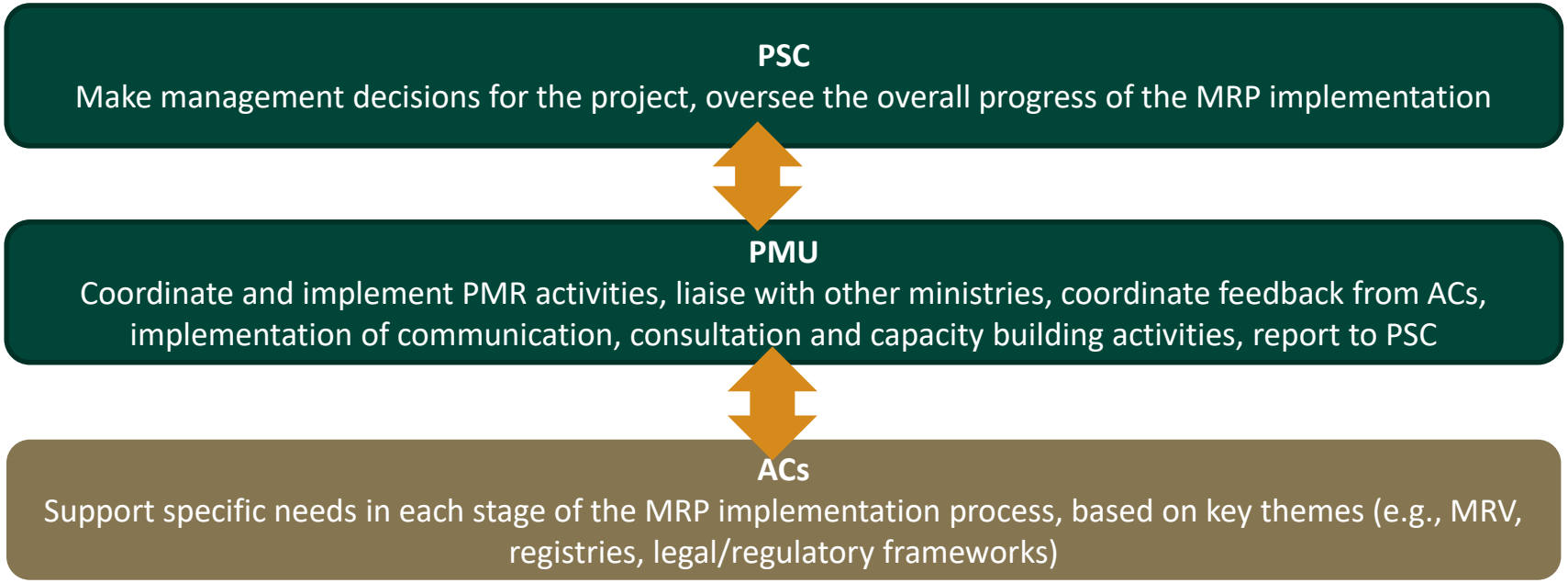


Objectives and focus of BB4 (Part II)

- Building BB2's analysis of an optimal policy mix, BB4 (Part II) will develop a roadmap for designing one new selected CPI
- Objectives of the new selected CPI:
  - Support NDC implementation and other major policy objectives
  - Help Sri Lanka move to more sustainable low carbon development pathway: "Sri Lanka Next – Blue-Green Development" strategy
  - Build local institutional capacity to develop, implement and participate in low carbon development markets
  - Create domestic demand for schemes like the enhanced SLCCS
- Focus:
  - Prepare detailed technical and financial feasibility study
  - Consult stakeholders throughout the design process, particularly with the potential private sector actors
  - Design new CPI on basis of the strategic plan for CPI contribution to NDC goals
  - Analyze options for using new CPI to create demand for SLCCS

Objectives and focus of BB5

- Set up the organizational framework for coordinating PMR activities.
- The Project Management Unit (PMU) will be responsible for the overall guidance of day-to-day project management activities
- PMU is also responsible for establishing an Inter-Ministerial Project Steering Committee (PSC) to ensure institutional coordination; and Advisory Committees(ACs) to receive technical advice on specific project deliverables.



Objectives and focus of BB5

- PMU will also be responsible for implementing the following cross-cutting activities

Commmunication strategy	• Develop comprehensive strategies and work plans for general outreach, consultation and capacity building
Stakeholder consultations	• Annual workshops; topic-specifc workshops; progress reports/quarterly workshops; bilateral interviews; external outreach. Topics to be informed by BB3 and BB4
General outreach	• Publications such as policy briefs, press releases; educational workshops and seminars; website
Capacity building	• Training workshops; guidance documents; how-to videos; e-learning modules. Topics to be informed by BB3 and BB4
Risk management	• M&E reports; risk mitigation strategies

COMMENTS AND TEAM RESPONSE*

**The draft MRP was updated based on comments and suggestions provided at PA18, as well as written comments provided afterwards*

BB2: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Electricity sector: What is the role of coal/fossil fuels in Sri Lanka's national energy and climate policy and its latest long-term electricity generation plan? Can these plans and emission projections be clarified in BB2? MRP should further elaborate on the projected expansion in the electricity sector from now to 2030, and should emphasize the fact that coal has been identified as the least cost option.	• Section 2.1.1 has been updated based on recent developments in the sector and the draft expansion plans that are already available. Since renewable energy options are not integral parts of the assessment (due to planning model limitations), it is not entirely correct to say that coal is identified as the least cost option. Given that the regulator recommended to include externalities in to the assessment, the scenario is likely to change from now onwards. • Section 2.3.3 has been updated to show that a key criteria for selecting a new CPI under BB2's policy analysis depends on its effectiveness in decarbonizing the electricity sector specifically. • BB4 Part II, which seeks to develop a roadmap for a new CPI, will build on the outcome of this analysis under BB2.

BB2: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Carbon Partnership Facility (CPF): What do you see as the role of the Sri Lanka Renewable Energy Program proposed in CPF in relation to the analysis and instruments proposed in the MRP? To what extent would it be possible to achieve the targets for NCRE also without support from CPF, as the plans for the long-term electricity generation plan have changed?	• The World Bank's CPF is supporting the renewable energy sector in the country. This is intended to pilot elements of the next generation carbon mechanisms through results based climate finance (RBCF). • The additional revenue sources generated from RBCF is also considered critical for addressing sector barriers and ensuring complementarity with other tools and resources. • The analysis in BB2 will explore how CPF would impact the effectiveness of new CPIs. This will involve evaluating how they may interact with each other, and whether the existing support is sufficient to achieve renewable energy targets. Section 2.1.1.3 has been updated to reflect this.

BB2: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Fossil fuel subsidies: Will BB2 address fossil fuel subsidies in Sri Lanka and functioning of the electricity market?	• While fossil fuel subsidy reform is not within the scope of PMR's activities, a key component of BB2's activities is to analyze how carbon pricing may interact with other policies, including fossil fuel subsidies. • Section 2.1.1.3 has been updated to provide further details on Sri Lanka's fossil fuel subsidies. • Section 2.3 has also been updated to indicate that GHG mitigation assessments have already been initiated during the MRP preparation phase to estimate the impact of various low carbon growth scenarios, taking into account Sri Lanka's sector policies, domestic and international mitigation targets/plans. The Terms of Reference for this work has been added to the annex 1.

BB2: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Existing policy analysis: How BB2 (and BB4) will address the analysis put forward in the report "100 % Electricity Generation through Renewable Energy by 2050- Assessment of Sri Lankas Power Sector" by Asian Development Bank and UNDP	• UNDP and ADB's analysis seeks to serve as a robust foundation for Sri Lanka's Long Term Expansion Plan (2018 – 2037). BB2 highlights the need to take account of Sri Lanka's domestic plans and policies, such as the LTGEP, into its analysis in order to understand how CPI could be designed to best support Sri Lanka's mitigation goals. Sri Lanka will closely coordinate with UNDP, ADB, as well as institutions involved in the development of LTGEP to ensure that the analysis under BB2 builds on existing work. This assessment has already been initiated during the MRP preparation phase, and the ToR of this work has been added in annex 1. The findings of UNDP and ADB's analysis is now also cited in section 2.1.1.1.
Policy interaction: The policy interaction and issues of policy alignment should also be addressed in BB2.	• See responses above.

BB4: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
SLCCS & new CPI: Why do you choose to move on with development of SLCCS at this moment? Maybe SLCCS is not the instrument that is considered most effective from mitigation and fiscal perspectives to curb emissions, especially from the energy sector	• BB4 presents developing additional CPIs in parallel with the SLCCS - the issue is mainly timing. • Strong political, institutional and practical reasons to start right away enhancing the SLCCS (particularly given the limited time frame for MRP implementation – see section 2.3.1). • Decision on the new CPI should come out of the analysis under BB2. Because it is not possible to say right now what that choice will be, BB4 Part 2 needs to start later than BB4 Part 1. • Revised MRP includes more overlap in timing of BB2 and BB4, but the more detailed work in BB4 Part 2 still needs to wait for both the technical analysis under BB2 as well as the political decision-making process to select a set of policies. • Revised summary timeline in BB6 shows how the SLCCS work will start in 2018 Q4 and the new CPI design will start in 2019 Q1.

BB4: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Carbon tax vs. SLCCS: A carbon tax could be a more effective/direct mechanism to decarbonize the electricity sector. BB4 Part 2 should also address this.	• Across all key sectors the options like carbon taxes and the role/appropriateness of such instruments need to be considered from long term perspective. The revised BB2 section on policy analysis explains how priority sectors would be selected, and how different CPI options would be evaluated within those sectors. • The revised BB2 and BB4 also reiterate the role SLCCS will play to support implementation of instruments like a carbon tax, and cite examples of this from South Africa and Singapore. At the same time, committing to a specific instrument at this stage, prior to the analysis suggested under BB2, would be premature. The PMR support can help bringing more awareness of the topic, support diagnosis of application of such instruments for Sri Lanka, and can support the political dialogue. However, to initiate the dialogue on the role of carbon tax to decarbonize, PMR is commissioning the study in January 2018 on this and make use of its outcomes during BB4 Part II implementation.

BB4: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Range of CPIs: BB4 also aims to develop a roadmap for other another CPI. Which are potential CPI(s)?	• The range of CPIs is discussed in the revised MRP sections 2.3.2, 4.4.1, as well as in Annex 2. The revised BB2 and BB4 Part 2 also discuss in more detail how to choose from among these CPIs. As mentioned earlier, a study on assessing the role of Carbon Tax to decarbonize the power sector is likely to inform such identification of potential CPI(s).

BB4: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Article 6: The MRP could further describe the extent to which SLCCS expects to link with future international markets, and what additional factors should be considered to supply credits internationally	• Section 4.1.1.1 discusses the importance of international demand (e.g. Art 6 crediting) over the longer term, and the analysis that will be conducted on how to tap this demand. Revisions to section 4.1 highlight the importance of designing the SLCCS system with future international markets in mind. The more detailed analysis on this will be conducted during the MRP implementation phase

BB4: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
NDC: Sri Lanka could further describe how activities under the MRP could support unconditional/conditional NDC targets.	• This aspect is highlighted in the revised building blocks. Also, note that, as part of the MRP preparation support, Sri Lanka has already started undertaking GHG mitigation assessments to identify what mitigation interventions will be required to support unconditional/conditional NDCs and whether already identified mitigation measures are sufficient to meet the current targets. These findings will be incorporated into to the MRP implementation phase to clarify how activities support unconditional/conditional NDC goals. • The proposed MRV system supported under the MRP will also play a key role in better understanding how activities under the energy, transport, waste and industry sectors can contribute to unconditional/conditional targets.

BB4:COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Scope of SLCCS: All projects under SLCCS support hydropower. How does Sri Lanka expect to expand the scope to include other types of projects in the pipeline? What are the incentives for private sector participation? CDM projects also primarily support hydropower projects. What is the distinction between CDM and SLCCS?	• SLCCS is the only domestic mechanism in place. To expand SLCCS, Part I of BB4 will build on the analysis under BB2 to select and prioritize sub-sectors and technology areas that could enhance the supply of credits. The process considers various criteria, such as mitigation potential, feasibility, private sector actors, technical challenges, etc. The work program would then consider approaches to expand the scope of SLCCS by considering how to simplify the methodology and MRV approach for high priority supply sectors. As indicated in section 4.1.1.2, a key component of BB4 is to develop a strategy for private sector engagement and promotion of SLCCS. This will involve (a) exploring factors that influence private sector participation on both the buying side and the project development side; and (b) identifying measures to enhance private sector confidence. Revisions to the MRP also explain more about increasing private sector interest in SLCCS project development.

BB5:COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Institutional arrangements: Can the MRP address how the climate issues should be handled in a systematic way within the government? In addition, an overview and analysis of how the different strategies and policy instruments interact would be important to support the organizational issue. Implementation of the MRP could be challenging since the institutional structure for climate change policies is somewhat fragmented. The MRP should further describe what governance structure and policy alignment would be required to mitigate this risk.	• The revised BB1 (section 1.3.5) highlights the institutional coordination challenges, and introduces the goals of how the MRP should be implemented to address this. • The revised BB5 (section 5.2) further illustrates how the governance structure for MRP implementation seeks to ensure institutional coordination. • In terms of policy alignment, BB2 (section 2.3) has been updated to further emphasize that a key component of BB2 is to evaluate the coherence of existing and proposed policy instruments and design an optimal policy package for key sectors. As mentioned, this analysis has already been initiated during the MRP preparation phase. The ToR for this work has been included in Annex 1.

BB5: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Long-term GHG emission strategy (LTS): We wonder if Sri Lanka has started to work on a LTS, in accordance with Article 4 in the Paris agreement? And to what extent can the analysis in the MRP on the role of carbon pricing inform the work to develop an LTS?	• We have identified 6 sectors for developing a Low Carbon Development Strategy such as Energy, Transport, Industry, Waste, Forestry and Agriculture. We expect that results from the analytic work undertaken by the PMR will be incorporated to finalize the strategy next year. • Private sectors are involved in the development of the strategy through stakeholder consultations. The role of carbon pricing instruments will be considered as one of the topics to be discussed during the consultation.

EXECUTION:COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Grant agreement: How does Sri Lanka plan to expedite the grant agreement process?	• CCS will consider the options for Bank or Recipient-Execution for the implementation phase. Sri Lanka also seeks to request for electronic approval in December 2017, instead of at the PA18, in order to expedite the grant agreement process. • A GHG mitigation assessment to support the policy analysis under BB2 has been already initiated under the MRP preparation phase to kick start the process. The ToR has been included in Annex 1.

EXECUTION: COMMENTS RECEIVED AND ACTION TAKEN

Comment	Response
Timeline: Sri Lanka should bear in mind that the procurement process could take a long time (at least 2 or 3 months) to complete. Given the ambitious timeline, Sri Lanka should start the procurement process in Q1 of 2018, which also means that the Project Management Unit needs to be ready by early next year.	• Noted.

SUMMARY OF TIMELINE AND BUDGET

Timeline

Output	Description	2018				2019				2020			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
2.1	Identify suitable CPI(s)												
2.2	Roadmap for optimal package												
3.1	Needs assessment												
3.2	MRV and registry design												
3.3	Pilot												
4.1	SLCCS Strategy & Design Study												
4.2	Designing the institutional, legal and technical framework												
4.3	Piloting the enhanced SLCCS												
4.4	Developing a roadmap for a new CPI												
5.1	Project Management Unit												
5.2	Communication & capacity building strategy												
5.3	Stakeholder consultations												
5.4	General outreach												
5.5	Capacity building												
5.6	Monitoring and evaluation												

Budget

Total PMR Funding request of US$ 3,000,000

Building Block	Estimated support from PMR (US$)			Funding source		
	Year 1	Year 2	Year 3	PMR	Govt	Total
BB2	363,500	201,500	0	565,000	56,500	621,500
BB3	335,000	367,500	272,500	975,000	97,500	1,072,500
BB4	135,000	655,000	320,000	1,110,000	111,000	1,221,000
BB5	109,000	132,000	109,000	350,000	35,000	385,000
Total	***942,500***	***1,356,000***	***701,500***	***3,000,000***	***300,000***	***3,300,000***

Thank you

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