

PMR PROJECT IMPLEMENTATION STATUS REPORT (ISR)

MEXICO

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:	Mexico
Reporting Period:	From 01/01/2017 to 09/30/2017
Report Date:	10/04/2017
Implementing Agency:	General Directorate of Climate Change Policies, Ministry of Environment and Natural Resources (SEMARNAT)
Contact Person:	Juan Carlos Arredondo Brun, General Director, Semarnat (Focal Point) Victor Hugo Escalona Gomez (PMR Coordination)

Grant Executed By:	World Bank
Grant Effectiveness and Closing Dates:	07/01/2017 – 06/30/2019
Grant Amount (USD):	USD 3,000,000
Funding Committed (USD) as of 09/30/17	USD 250,000

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.

Mexico participates in the Partnership for Market Readiness, through the Ministry of Environment and Natural Resources (SEMARNAT) as focal point and main agency, and in one component with the National Housing Commission (CONAVI). The PMR Partnership Assembly endorsed Mexico's MRP in 2013, and awarded funding for US\$3 million to help Mexico in readiness activities

At the beginning, the grant was going to be executed by the Climate Change Fund (an instrument created by the Climate Change Law in Mexico), but to changes in the fund operation it was decided by SEMARNAT to proceed with a Bank-executed project in April 2017.

Building upon Mexico's MRP, the updated and refined implementation work program encompasses the following main areas (as per update offered by Mexico and discussed with the PA during its 16th Assembly Meeting):

1. Support the development of crediting mechanisms for policies, in this case, a NAMA for urban strategies including transportation and housing.
This component will foster mitigation in urban sites considering common subsectors in new housing developments, streetlights, domestic water distribution, drainage systems and waste management. The Urban NAMA design will incorporate methodologies that allow it to become a Crediting NAMA, thus being able to obtain economic benefits by participating in carbon markets.
2. Support the development of a National Emissions Trading Scheme in Mexico, specifically on (i) capacity building with private & public sector, (ii) technical infrastructure, with particular focus on emissions registry & MRV matters, and (iii) regulation design and methodological development (e.g., related to offsets).
The first activity includes the implementation of a Simulation Exercise, that will give participant a firm grasp on ETS concepts and design elements to improve communication between authority and stakeholders.

Over the past twelve months the design and implementation of a National ETS became a priority for the administration. Carbon pricing is considered as one of the most important policies for the country to fulfill the mitigation goals the nation has adopted. A carbon tax is being implemented since 2014, as the first effort to put a price on carbon. More ambitious measures are required to achieve the 2°C goal from the Paris Agreement, on that regard Mexico is also looking for the most cost effective solutions to reduce its emissions, including an ETS.

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><i>Please choose one of the above options.</i></p>
<p><i>If yes, please explain the reasons for these changes and how the revised objectives/activities will contribute to market readiness (i.e., the establishment of core technical components and/or the piloting of specific activities related to carbon pricing and the use of market-based instruments). Please also provide details about when and how the PA was informed about and endorsed the change(s).</i></p> <p>The Government of Mexico (GoM) has adopted the strategy to put a price on carbon beyond the initial efforts (through a carbon tax implemented since 2014) to pursue further and more ambitious mitigation goals aligned with the Climate Change Law, and Mexico's NDC.</p> <p>Since the endorsement of the MRP by the PMR PA, Mexico has announced that the carbon pricing will be continued by the implementation of an ETS. From the internal experience, Mexico understands that an ETS is the most cost effective option for some sectors to achieve meaningful mitigation goals that will help the country to comply with their international mitigation commitments.</p> <p>Mexico has gone through many carbon pricing milestones since the endorsement of the MRP. Some of them includes becoming a member of the CPLC, issuing declarations for carbon markets collaboration with the Canadian Provinces of Ontario and Quebec, and the announcement the Mexico will pursue the development of a National ETS.</p> <p>Some adjustments were made from the proposed activities in the MRP to the activities now scheduled, though the components did not change, the scope is now primarily focused on the support for the ETS implementation, though the support to develop a crediting NAMA is still considered in the grant activities. The main elements of the updated and refined implementation work program were presented by Mexico and discussed with the PA during its 16th Assembly Meeting.</p>	

Implementation Progress by Component

<p>A. Component 1: Urban NAMA</p>	
<p>Status:</p>	<p>Pending</p> <p><i>Please choose one of the above options.</i></p> <p><i>Please describe the progress made towards the achievement of the expected results, as per the date of the Report, in relation to each of the Intermediary Results Indicators.</i></p>

	<p>Mexico is pursuing aggressive action to curb greenhouse gas (GHG) emissions growth through sustainable economic development. To achieve these goals, the country is instituting a range of actions, including the deployment of sustainable urban environments.</p> <p>The Urban NAMA will be designed around an MRV system that is simple enough to deploy quickly and at a manageable cost, and for the last topic it is necessary the financial design for a crediting NAMA, comprising: Implementing costs, Financing needs and Financial Mechanisms. The final activity comprises the design and implementation of a pilot project.</p>
<p>Comments:</p>	<p><i>Please describe the reason(s) for the early/timely/delayed achievement of the expected results.</i></p> <p>The National Housing Commission is the agency from the Government of Mexico in charge of the Urban NAMA, who is developing TORs for the activities included in the component.</p>
<p>B. Component 2: ETS Support</p>	
<p>Status:</p>	<p>Under implementation</p> <p><i>Please choose one of the above options.</i></p> <p><i>Please describe the progress made towards the achievement of the expected results, as per the date of the Report, in relation to each of the Intermediary Results Indicators.</i></p> <p>This component is meant to support the design and development of the ETS through 3 sub-components:</p> <ul style="list-style-type: none"> i) Development of Emissions Reductions Registry <p>The emissions reductions registry will support the ETS by providing the platform for offsets to enter the program, it will cover emissions reductions as stated in the Climate Change Law as well as reductions from the forest sector, among others.</p> <ul style="list-style-type: none"> ii) Regulatory development for the ETS offset program (offset protocol development) <p>This activity will complement the ETS regulation by supporting the development of offsets protocols, it will have to follow the ETS regulation for offsets usage within the program.</p> <ul style="list-style-type: none"> iii) Capacity building (ETS Simulation) <p>SEMARNAT recognizes the need for building capacity on ETS design and operation among the authority and the stakeholders. On August 2016, signed an MOU with the Mexican Stock Exchange to launch an ETS Simulation as a capacity building tool for the private and public sectors.</p>

	<p>The simulation requires the service of a software provider for an electronic tool to serve as a registry, auction platform, and trading platform for allowances issued within the simulation. Participants will have a grasp of how an ETS works and the differences with other carbon markets (voluntary and CDM for example).</p> <p>The exercise will last for 10 months, with different scenarios that will be tested and simulated. The exercise includes in-person trainings, webinars, and continuous support for the participants.</p>
<p>Comments:</p>	<p><i>Please describe the reason(s) for the early/timely/delayed achievement of the expected results.</i></p> <p>This component is meant to support the ETS efforts in Mexico managed by the Climate Change Office in Semarnat. For the other activities, the registry and the protocol development, a regulation is being drafted in order to have the legal framework to develop the TORs.</p>

If necessary, please add components in the table above.

4. PROGRESS, CHALLENGES, AND LESSONS LEARNED

Important policy or regulatory developments related to the Grant's objectives and activities:
<p>Developments: <i>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.</i></p> <p>The Congress in Mexico is discussing a proposal for amendments to the Climate Change Law with the goal to harmonize the law with the Paris Agreement and the Mexican NDC, through:</p> <ol style="list-style-type: none"> Elaboration of a roadmap to meet the 2050 mitigation goal, with intermediate goals Strengthening of the MRV mechanisms Development of a mandatory ETS <p>In parallel, Semarnat is working on drafting the regulation for an ETS, with the current legal framework, that could be easily adapted in the amendments for the Climate Change Law are approved.</p> <p>Consequently, other Carbon Pricing Milestones are:</p> <ul style="list-style-type: none"> Mexico is Government Partner of CPLC President Pena Nieto and other Heads of State launch the Carbon Pricing Panel Mexico, Canada and US issue Leaders' Statement on a North American Climate, Clean Energy, and Environment Partnership (June '16) Mexico issues Joint Declaration with Ontario and Quebec on Carbon Markets Collaboration (August '16) Mexico is launching an ETS Simulation in collaboration with MexiCO2 and the Mexican Stock Exchange (MOU signed in August, 2016)

Furthermore, Mexico is member of the Pacific Alliance, an initiative comprised of Chile, Colombia, Peru and Mexico, in which every country is collaborating for deeper integration to drive further growth, development and competitiveness; while each country is pursuing carbon pricing policies that could converge in collaboration in that matter.

The goal for Semarnat is to have the regulation by the second half of 2018, and to have a pilot for two years up to 2020, as announced in several forums and events. Therefore, phase 1 of the ETS is expected to start in 2021.

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 policy and regulatory developments will impact positively the grant's objectives, by giving a strong and better legal framework to the design of the carbon pricing policy in Mexico.

There are other international development and regulatory agencies supporting the process for the ETS, including Dehst and GIZ from Germany. Their support focuses on data reporting and verification, data analysis, competitiveness studies, among others.

The big challenge for such an ambitious project (ETS implementation) is time, but Semarnat is working together with the PMR team to have robust contracts, and clear deliverables among all grant's components.

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.*

Among the lessons learned, the main is the need for every policy to be consulted with stakeholders. It has been fundamental for ETS process to be in continuous communication with the private and civil sectors in order to provide with enough details and purpose of the carbon pricing policy in Mexico. This has helped to identify the sectors that support the ETS, and create better communication strategies for everyone else.

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.*

In order to have an ETS that could be linked in the future (after 2020) with other jurisdictions, Semarnat has to consider that the regulation, design elements and infrastructure has to be developed with compatibility in mind.

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.*

Given the requirement for compatibility, it could imply that some aspects of the system would need to be adapted or updated as the work progress.

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.*

- a) An initial challenge for implementation was to navigate the processes with the agency originally chosen to get the grant's funds in order to keep the money from being considered donation and be placed in the national budget.
- b) In 2016, it was proposed that the project became bank-executed. In order for the agreement to be in place, Semarnat and the Ministry of Finance had to agree on the terms, and make sure it was the fastest way to start implementation.

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.*

Once the agreement with the Bank was accepted, Semarnat had to adjust the procurement plan according with the requirements from the Bank, in order to have more efficiency. Less contracts will be needed, but at the same time TORs have to be clear and simple enough for the contract to be delivered in time.

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.*

As stated before, in Mexico there is already a Carbon Tax implemented. The law that regulates the carbon tax indicates that it can be compensated with carbon credits, so far it only allows the use of CERs from the CDM, regulation for the compensation process will be published this year. In the future

it could accept allowances or offsets from the ETS, the regulation can be amended in order to allow for such an option.

Conversations with the Ministry of Finance have taken place, but no decision has been made so far.

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 registry for the ETS should allow for the Ministry of Finance to open an account, and become another participant, however it does not represent a big challenge for the registry itself, but the ETS regulation should take into consideration that the number of allowances could be altered if they are used for other purposes.

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.*

Stakeholders are fundamental for the overall ETS process, the engagement is carried out by Semarnat at various levels and ways. From high level conversations to workshops and presentations for operations people from different sectors.

Specifically, the grant's activities contemplate the engagement through capacity building approach. The ETS simulation exercise is one of the ways in which Semarnat deals with stakeholders with different backgrounds (many of them, without any knowledge of carbon pricing instruments) this creates a level playing field for all stakeholders to be better prepared to engage in conversations and consultations.

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.*

As with any consultation, the challenge is to deal with opposition to the ETS. Concessions are expected, as long as they don't impact the integrity of the program. Work is being done to alleviate stakeholders' concerns and issues with the ETS. Semarnat acknowledges that many concerns and doubts are purely technical and come from unknown facts and basic concepts, they can be tackled by the simulation exercise, workshops, seminars among other.

Nonetheless, the political opposition, high expectations represent pressure and a bigger challenge to the ETS overall efforts.

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

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.

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.

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