

**PARTNERSHIP FOR MARKET READINESS (PMR)
Fourth Meeting of the Partnership Assembly (PA4)
Sydney, October 22-24, 2012**

Feedback on draft Market Readiness Proposals (MRPs): COSTA RICA

Summary compiled by the PMR Secretariat

Background

Costa Rica submitted a draft Market Readiness Proposal to the PMR Secretariat in September, 2012, and presented it for consideration by the Partnership Assembly (PA) at PA4.

Resolution PA2/2011-3 endorsed a process for providing feedback on Market Readiness Proposals. It consists of two parts: (i) feedback from PMR Experts; and (ii) feedback from PMR Participants.

A PMR Expert Group consisting of Mr. Michael Lazarus (United States), Mr. Pedro Barata (Portugal), Mr. Derik Broekhoff (United States) and Mr. Franz Tattenbach (Costa Rica) provided feedback on Mexico's draft MRP, as did the PMR Secretariat and the World Bank, acting as the Delivery Partner. A compilation of the this feedback was shared with Costa Rica during a two-day in-country visit to San Jose, September 17-18, 2012, led by Mr. Lazarus, the PMR Secretariat and the World Bank's regional staff.

Incorporating the feedback collected, Costa Rica submitted its revised draft MRP on October 5, 2012, which was circulated to all the PMR Participants. A representative from Costa Rica presented the draft MRP at PA4 in order to seek feedback from Participants and to allow all PMR Participants to view a complete proposal prior to the submission of the final version. Subsequently, Participants were invited to submit written feedback on the draft MRP.

This note contains two parts: Part A includes a summary of the feedback and comments made during Costa Rica's MRP presentation at PA4 and Part B includes written comments on the MRP that were submitted by Participants following PA4. Comments in Part B are recorded in this summary as they were submitted, without further summarization. The secretariat received written feedback on Mexico's MRP from Australia, the European Commission, Germany, and The Netherlands.

Action:

Costa Rica is invited to take into account the feedback included in this summary as it finalizes its MRP. It is important to note that some of the feedback is applicable for the finalization of the MRP while some will be relevant during the Implementing Country's PMR Implementation Phase.

A final MRP should be submitted to the PMR Secretariat 3 weeks prior to the PA meeting during which the Implementing Country Participant seeks a PA decision on the allocation of Implementation Funding.

COSTA RICA

Costa Rica's presentation was made by Mr. Alvaro Umaña, Advisor, Climate Change Direction, Ministry of the Environment and Energy (MINAEC).

MRP Objectives:

The MRP focusses on (i) the design and initial implementation of a domestic voluntary carbon market, including legal, institutional and regulatory aspects; (ii) strengthening of demand; and (iii) consolidation of the supply of offsets from Costa Rica's domestic market in line with the country's carbon neutrality goal.

A. Feedback and clarifications made during PA4

a) General Feedback

- The Partnership Assembly (PA) congratulated Costa Rica for its draft MRP. Overall, the PA found Costa Rica's draft MRP inspiring, interesting, and detailed. The PA was impressed by Costa Rica's willingness to progress on climate change and pay the cost related to it; the degree of demonstrated private sector buy-in; and the considerable progress made since the Organizing Framework was presented in May 2011 (PA1).

b) Specific feedback and request for clarifications

Expert feedback process

- Does the draft MRP incorporate the comments and suggestions from the Expert Feedback process?

Work program and milestones

- What are the key milestones for Costa Rica in implementing its MRP? Can you describe the specific work program to be supported by the PMR? This is deemed essential to assess the proposal for the purposes of PMR funding.

Rationale behind Costa Rican offset standard (UCC)

- What is the rationale behind introducing the UCC standard as a new crediting mechanism? CDM may not have worked well for Costa Rica's sectors, but developing a whole infrastructure may be costly.

Ensuring credibility of new UCC standard

- Need for credits to be robust enough to meet international standards. Costa Rica's proposal, including international *third-party review* seems like a sensible step.

Governance

- Several participants stressed the importance of ensuring independence of the Carbon Board to build confidence in robustness of the Costa Rican Offset Standard and overall the corporate carbon neutrality program.

CDM Lessons

Feedback on draft Market Readiness Proposals (PA4)
(November 29, 2012)

- Some participants highlighted the importance of drawing lessons from CDM experience, especially with respect to transaction costs associated with small projects

Covered sectors and participation

- Has Costa Rica undertaken an analysis of marginal abatement costs in the covered sectors?
- Could the list of covered sectors expand?
- With regards to participants in the domestic market: how many actors are expected to be involved in the market?

Development of methodologies and protocols for baselines and MRV

- Given the proposed mechanism, several participants recommended that proper emphasis should be given to the development of standards, protocols and methodologies for crediting baselines & MRV.

GHG accounting framework

- How will Costa Rica avoid double counting and overlap between potential suppliers and buyers of credits?
- One key challenge ahead is to ensure integrity and consistency between GHG accounting at the national level (carbon neutrality pledge) and at the corporate level (domestic offset program). How Costa Rica addresses issues of GHG accounting will be very important for the concept of carbon neutrality. Several participants highlighted the need for early assessment on linkages between a domestic offset program and the carbon neutrality goal.

Cost of administration of domestic carbon market

- What is the estimated cost of the (corporate-level) carbon neutrality program/domestic carbon market? Have the investment needs for Costa Rica's national carbon neutrality goal been assessed?

International third-party audit

- This element is critical to ensure credibility of the proposed domestic scheme and, in particular, to enable 'fungibility' between UCCs and other international offset categories.
- What is the proposed timing and frequency of the process? How will the process work? Who will be involved?

Linking with international market(s)

- Will the prospects for international linking be considered? When and how will this happen?

Linkages between credited/supported NAMAs and UCC offset programs

- Some sector mitigation programs lend themselves for international support as a NAMA (rather than through domestic carbon market incentives).

c) Costa Rica's Clarifications

Expert feedback process

- All relevant comments from the Experts were discussed and, as appropriate, incorporated in the current draft version.

Work program and milestones

- The MRP will be revised to describe the proposed work program in more detail and identify the key milestones.

Rationale behind Costa Rican offset standard (UCC)

- Costa Rica has a small number of success stories under CDM vis-à-vis early and broad engagement of various national stakeholders in different sectors. The development and adoption of the Costa Rican UCC respond, inter alia, to the fact that CDM does not cover several areas that are critical for Costa Rica, and the high transaction costs under the CDM.

Governance

- Costa Rica is aware of the crucial role the Carbon Board will play. Independence of the Board is essential, including for ensuring credibility of the domestic carbon market. It was noted that this is a challenge for all governing bodies including the CDM Executive Board. Costa Rica should be given a chance given its track record, and will ensure that the institutional setting addresses potential conflicts of interests and warrants technical competencies.
- Costa Rica welcomes suggestions from participants on how to ensure independence (which is a general issue and not only relevant for Costa Rica).

CDM Lessons

- In moving forward, Costa Rica will review CDM lessons carefully, in particular in regards with prohibitive transaction and operation costs for rather small-scale project/program activities. It was noted that Costa Rica found way to deal with the issue of small-scale activities in the forest sector (through payment for environmental services). The team will also take a closer look at working with intermediaries for technical assistance and to lower transaction costs.

Covered sectors and participation

- The representative of Costa Rica recalled that marginal abatement costs in priority sectors have been assessed as part of the NEEDS country study. The MRP will be revised to include references to relevant sources of information.
- Modeling of supply/demand is still outstanding, including expected supply of GHG offsets. This will be assessed during the Implementation Phase.
- As for participation in the domestic market, the preliminary estimate for the industrial sectors is between 100-200 entities. In the forestry sector, the estimate is around 9000 individual participants. Number of potential participants in the agriculture sector still has to be assessed. The MRP will be revised to clarify this.

Development of methodologies and protocols for baselines and MRV

Feedback on draft Market Readiness Proposals (PA4)
(November 29, 2012)

- Recommendations and suggestions with regards to setting priorities for development of country-specific methodologies/protocols have been noted. The MRP identifies work on this regard and will be revised to describe this with proper level of detail.

GHG accounting framework:

- As for risk of double counting of achieved emission reductions, it was explained that it is primarily addressed by separating the procedures for (corporate) emission reduction plans ('R') and issuance and transfer of GHG offsets ('C'). Moreover, the carbon neutrality standard provides for independent verification procedures for emission reduction plans and for offsets. An emissions reduction plan is prepared at the corporation level, and is intended to (i) formalize a corporation's scope for own emission reductions (as opposed to offsets), and (ii) allow reductions to be verified independently.
- Among other provisions, a company cannot simply shift from "R" to "C", due to different monitoring and verification procedures. Emissions reductions achieved by participating companies/entities and offsets produced by project owners are verified independently. Offsets (UCCs, VERs) will be rendered by companies against their emissions balance.
- The risk of double counting will be further addressed through proper design of the national tracking/registry system.

Cost of administration of domestic carbon market

- The cost of the corporate carbon neutrality program, including administration cost of the UCC mechanism, has not been assessed yet.
- As for the national carbon neutrality pledge, the preliminary estimation is 1% of annual GDP (hence subject to international support).

International third party audit

- The scope and timing for the proposed international third party audit will be determined during the implementation phase, taking into account relevant developments in the international market. Current thinking is to plan the first international audit within the first three years of market operation.

Linking with international market(s)

- Prospective linking to international markets is inherently considered in the design of the domestic offset program. However, at this stage it is not clear what international market Costa Rica can link to. Ultimately, this will be a function of the timeline by which the international markets develop.

Linkages between credited/supported NAMAs and UCC offset programs

- Costa Rica will indeed pursue the design of NAMAs in priority sectors, and will seek international support to finance those actions. The role of priority sectors as GHG offset suppliers in the domestic carbon market will be assessed and clarified during the PMR implementation phase (assessment of 'market suitability' by key sectors).

B. Written feedback on Costa Rica's draft Market Readiness Proposal submitted by PMR Participants

Participant	Feedback on Costa Rica's draft Market Readiness Proposal
Australia	<p>Australia welcomes Costa Rica's detailed Market Readiness Proposal and presentation at PA4, which provides a well-structured a plan to work towards the objective of carbon neutrality by 2021. The work programs for the regulatory and institutional framework and each of the five sectors are clearly set out. We suggest that Costa Rica consider including milestones in its MRP to evaluate the effectiveness of its efforts to deal with identified barriers and risks to implementation.</p> <p>Australia appreciates the work that Costa Rica has undertaken to analyze the mitigation potential and market readiness of different sectors to participate in the domestic carbon market. The MRP suggests that offset projects will be implemented within the sectoral programs and refers to processes to establish sector baselines. Further to this work, the MRP could clarify the process for setting boundaries and reference/crediting levels– whether at the project or policy level, or separately for each sector.</p> <p>The MRP suggests that there could be an indicative cap for the agriculture and livestock sector based on emissions per unit of production, with internal trading (page 44). We would welcome further detail on how this approach would generate offsets from the sector. In particular, we suggest that Costa Rica further consider how to address permanence and leakage issues in the sector, given that participation in the proposed scheme will be voluntary, with caps based on emissions per unit of production. Australia is also considering how to address these issues in the context of our Carbon Farming Initiative.</p> <p>A number of issues could be further clarified during the implementation stage. Australia followed with interest the discussions at PA4 on how to enable the independence and impartiality of the Carbon Board. We look forward to seeing in the MRP and its implementation how Costa Rica will address this challenge so that the domestic carbon market is underpinned by robust institutional and governance arrangements.</p> <p>The approach proposed in the MRP for the sustainable building sector is particularly ambitious and greater specificity of activities in this sector would be helpful. The MRP states that the estimates of emissions reductions will have a cross-sector perspective given that construction does not exist as an independent sector in Costa Rica's emissions inventory (page 72). At the implementation stage, we encourage Costa Rica to consider how it will put this proposal into practice to address the overlap between construction and other sectors, and potential double counting that may arise.</p> <p>Australia also supports comments made at PA4 that encourage Costa Rica to further examine potential sources of demand for Costa Rican compensation units (UCCs). Costa Rica explained at PA4 that demand for UCCs would be limited to domestic markets, given the low price of carbon credits on international markets (including CERs and VERs). But given that companies seeking to obtain carbon neutral certification will be able to purchase CERs and VERs to offset their emissions, it would be useful to elaborate why companies are more likely to purchase UCCs if they were at a higher price than CERs and VERs.</p>

<p>European Union</p>	<p>The European Commission welcomes the clear commitment made by Costa Rica at PA4 of establishing a "Domestic Voluntary Carbon Market" within its MRP. In particular we take notice of the important structural and institutional changes that are anticipated by the Costa Rica's MRP. With this respect the establishment of the "Carbon Board" is a key element. Due to the fact that the Carbon Board will be the entity responsible for approving all the main MRV methodologies for each of the covered sector it is recommended that appropriate criteria for independence are developed and implemented.</p> <p>Moreover it is recommended that the proposed system, especially in relation to its MRV component, takes into account as much as possible recognised international standards, as those developed by ISO, due to the fact that Costa Rica intends to reach international alignment of its domestic carbon market initiative. This is particularly important for such sectors as the agriculture and livestock.</p> <p>Finally, with respect to the other selected sectors, such as transport and sustainable building, it is recommended that the MRP should take as much as possible into account the definition of clear baselines and the development of additionality criteria.</p>
<p>Germany</p>	<p>Germany understands that Costa Rica is proposing to develop of a domestic voluntary carbon market (DVCM), where demand for credits is generated through the CSR and competitiveness considerations of companies striving for the goal of carbon neutrality. In order for the reader of the document to grasp Costa Rica's innovative intentions right from the start, we recommend to clarify already at the beginning of the paper (e.g. in the Executive Summary) what system is intended to be developed under PMR. This includes a short but concise elaboration on a) market participants b) character of cap (voluntary or obligatory) c) whether the system would entail trading or crediting elements.</p> <p>We understand that Costa Rica proposes to introduce the new domestic offsetting standard UCC because the CDM (and in parts also the voluntary standard) was not able to tackle mitigation in the Costa Rican focus sectors appropriately. However, we would recommend to consider that the introduction of a standard with an international credibility – as foreseen by Costa Rica – will likely also result in considerable transaction costs (e.g. for setting up governance structures, developing baselines and methodologies, providing regulatory oversight etc.) during both the creation and the lifetime of the system.</p> <p>Against that background, we would also recommend to develop a vision or safeguards on how it can be guaranteed that the governing Carbon Board can work independently from potential private sector interests in the country. In the CDM Executive Board, this has been a challenge in a number of occasions. For the credibility and long-term international fungibility of the UCC and in consequence potentially also the credibility of the Costa Rican carbon neutrality goal, the independency of the governance structures will be crucial.</p> <p>In addition, we would appreciate a clarification of the scope of the UCC mechanism, as the MRP in a number of instances refers to projects, which suggests that the UCC would focus on project-based offsetting. If this was the case, it is likely that the UCC might be facing similar difficulties as the CDM (and voluntary standards) where few projects e.g. in the transport sector were so far developed. Therefore, the advantage of a domestic project-based standard as opposed to existing standards might be less clear. An upscaled mechanism, albeit even more challenging, might be more suited to the choice of sectors.</p> <p>It would also be interesting to know whether Costa Rica envisages in the future to also</p>

	<p>allow credits other than the UCC and outside of the MRP focus sectors (e.g. credits from CDM, VCS projects). Similarly, we would be interested in whether the registry would only cover UCCs or also CERs and VERs – which would help avoid double counting of emissions under different standards.</p> <p>We appreciate the MRP stressing in a number of occasions that the UCC should be guided by international standards such as ISO or IPCC. We would stress that this will be a crucial point if Costa Rica would like to eventually link to other systems in the spirit of a global carbon market and would welcome if an ambitious approach towards environmental integrity and additionality were taken. The foreseen auditing of the system is therefore a very sensible step. However, it might be challenging to re-design an existing scheme after an audit if it was already up and running. Therefore, smaller audits and reviews along the way of developing the system might be worthwhile and might save overall transaction costs. We feel that also the experience sharing within the PMR can contribute to elucidating common points and principles in systems both under development and already in place.</p> <p>As to the agricultural sector, we would suggest to include considerations how a potential double counting between agricultural projects under the DVCM and a national REDD+ strategy and respective targets might be avoided. The same holds for the work on a supported NAMA in the waste sector.</p>
The Netherlands	<p>Costa Rica is one of the early movers in carbon markets and has to be commended for its objective to become totally carbon neutral. This very interesting and holistic approach is also new under the PMR and very much welcomed.</p> <p>The formula $E - R - C = 0$ is intriguing, mainly because of the C (offset credits) which may represent the well known CERs, the somewhat less well known VERs and finally the UCCs. It is obvious that the credibility of the C is crucial for the claim of being carbon neutral. And so it is obvious that the UCC is the least known component and hence most critical part of that formula.</p> <p>While Costa Rica's proposals are well received the most question marks remain on the credibility of the UCC and the independence of the national Carbon Board, which by definition must have a national conflict of interest. Doubts here could however be compensated by conservative assumptions in baselines and additionality of underlying measures and/or by only inviting independent (international?) experts to participate in this Board or assess its results through peer review. Costa Rica is invited to provide more clarity on this part of its proposal.</p>