



# Project Information Document/ Identification/Concept Stage (PID)

Concept Stage | Date Prepared/Updated: 22-Mar-2023 | Report No: PIDC270317



## BASIC INFORMATION

## A. Basic Project Data

Project ID	Parent Project ID (if any)	Environmental and Social Risk Classification	Project Name
P179746		Low	Chile Partnership for Market Implementation
Region	Country	Date PID Prepared	Estimated Date of Approval
LATIN AMERICA AND CARIBBEAN	Chile	22-Mar-2023	
Financing Instrument	Borrower(s)	Implementing Agency	
Investment Project Financing	Chilean Agency for International Cooperation for Development (AGCID)	Ministry of Energy, Ministry of Environment	

## PROJECT FINANCING DATA (US\$, Millions)

## SUMMARY

Total Project Cost	5.00
Total Financing	5.00
Financing Gap	0.00

## DETAILS

## Non-World Bank Group Financing

Trust Funds	5.00
Partnership for Market Implementation Facility	5.00

## B. Introduction and Context

## Country Context

**Fueled by a strong fiscal response to the economic impacts of COVID-19 and emergency response measures taken in 2020, Chile's economy rebounded in 2021; but a sharp deceleration took place in 2022, which is expected to continue into 2023.** The growth of 2021—among the fastest in the world—was propelled by consumption, large fiscal transfers, and pension fund withdrawals. A remarkably fast vaccine rollout that reached over 90 percent of adults, firms' implementation of sanitary operational measures, and an expansionary monetary policy also contributed to the recovery. After growing 11.7 percent year-on-year



(y/y) in 2021, the economy grew only 6.4 percent y/y in the first half of 2022, and only 0.3 percent compared to the second half of 2021. Gross domestic product (GDP) grew by 2.1 percent in 2022 and is expected to contract by 0.9 percent in 2023, while a gradual acceleration is expected from 2025 on. At the same time, the country faces significant challenges to increasing total factor productivity and economic diversification, both needed for long-term, sustainable growth.

**Chile is facing significant challenges to its social contract and economic model.** Social unrest in 2019–20 exposed the vulnerability of the socioeconomic system, with protesters demanding several changes to the country's direction, prompting a constitutional reform process. On September 4, 2022, Chile held a referendum on a draft constitution; 62 percent of voters rejected the proposal. Congress negotiated a new agreement, the *"Acuerdo por Chile,"* initiating yet another constitutional reform process, subject to approval in a referendum planned for November 2023. Still, enhancing productivity reforms—and, specifically, increasing human capital, fostering innovation, and boosting female labor force participation—and advancing decentralization to improve the allocation of resources and reduce interregional and municipal disparities, will need to further be reinforced.

**The Government of Chile's *Programa de Gobierno Apruebo Dignidad 2022–26* aims to foster inclusive and sustainable economic growth.** The administration of President Boric has set an ambitious reform agenda centered on tax and pension reform; preserving fiscal discipline; equitable access to quality education and health services for the vulnerable; gender parity; and economic growth based on digital transformation and greener, more sustainable, and innovative growth. As part of this vision, Chile is reformulating environmental and energy policies to put local populations at the center, with a special focus on reducing regional inequalities across Chile and transition to a net-zero economy.

**The country is deeply committed to decarbonization and to reaching carbon neutrality by 2050.** Chile's economy and the competitiveness of various productive sectors are vulnerable to risks associated with the increased intensity and frequency of extreme weather events (as experienced over the past decade). Among Chile's efforts to address these challenges, the Climate Change Framework Law (LMCC, No. 21455) codifies its pledge to reach carbon neutrality by 2050. The law includes: (i) the obligation for Chile to comply with its updated Nationally Determined Contribution (NDC), to limit greenhouse gas (GHG) emissions to 95 MtCO<sub>2</sub>eq by 2030; and (ii) a Long-Term Climate Strategy (LTCS, *Estrategia Climática de Largo Plazo, ECLP*, presented at COP26). Chile's NDC describes a detailed list of measures to reduce net CO<sub>2</sub>eq emissions, such as decarbonizing the energy matrix, promoting a sustainable industry, and incorporating green hydrogen into the energy matrix. The country is also pushing on other fronts under the energy sector, such as electromobility, sustainable buildings, and most significantly the phase-out of coal power plants, which as of 2018 represented 37% of electricity generation. These measures account for 93% of the projected CO<sub>2</sub>eq reductions. A second important pillar to achieving the goal of carbon neutrality by 2050 is centered around maintaining the current capability of the Agriculture, Forestry, and Other Land Use (AFOLU) sector to capture emissions and remain a net carbon sink.



## Sectoral and Institutional Context

**Chile joined the Partnership for Market Readiness (PMR) in 2010, receiving a US\$ 3 million grant under an initial phase, plus US\$ 1.98 million under a second phase to implement its Market Readiness Proposal (MRP).** The work program focused on: i) building technical and institutional capacities across stakeholders for the design and implementation of Market-based carbon pricing mechanisms and their Monitoring, Reporting and Verification (MRV) systems; ii) informing the necessary regulation to implement a GHG Emissions Trading System (ETS) in Chile, including the implementation of an MRV framework and registry; iii) drafting a regulatory decree for the reduction of GHG, establishing the obligation to report GHG emissions; and iv) studying complementary instruments (such as green certificates or offsetting systems) to enhance the GHG mitigation effectiveness of the ETS. With the approval of the Carbon tax in 2014, the program shifted some of its focus from the ETS to the carbon tax implementation.

**The PMR played an important role in advancing policy and technological know-how for the design of an effective climate policy mix.** Preliminary Climate Policy Modelling helped inform decision makers by providing recommendations for the development of a cost-effective and environmentally sound mix, paving the road for recent climate policy developments. Studies and analyses developed under the project were key to inform several national policies and strategies, such as the updated NDC, the 2020 Green Tax reform, the LMCC as well as the national commitments to phase out coal by 2040 and reach carbon neutrality by 2050. **The successful implementation of the carbon tax in 2014 can be attributed, to a large extent, to the PMR.** The PMR activities supported the development of MRV guidelines, provided qualified capacities to the implementing authorities and installed a registry system. Furthermore, the inclusion of offsetting into the carbon tax was strongly advocated for through the PMR project and partners.

**While Chile has made huge progress on its climate change policy, there are still significant challenges ahead on the roadmap for net zero, including improving/expanding existing CPIs and the successful implementation (and integration) of more recent ones.** As of 2022, the only active CPIs are the \$5/tCO<sub>2</sub>eq Carbon Tax (covering only 35% of national emissions) and, to a lesser extent, the tax on diesel and gasoline, which need to increase their price signal in line with the country's mitigation ambitions. Starting in 2023, the latest green tax reform mandates a new offsetting system for the carbon tax. This mechanism facilitates increased mitigation in sectors not covered under the current tax. A new tax reform is currently under consideration, which is expected to impact the current design of the carbon tax and offsetting system aiming to increase their impact in climate change mitigation. The LMCC approved in 2022, also institutes new CPIs (GHG emission baseline and crediting mechanism) and opens the door to sectoral CPIs.

**The proposed Project is part of the Partnership for Market Implementation (PMI) and is designed to support the Government of Chile (GoCh) to continue and expand the work initiated under the PMR, in line with the NDC and the LTCS.** The climate funds mobilized through the proposed Project will be directed towards the implementation and improvement of carbon pricing instruments and mechanisms, including the implementation of a roadmap for future CPI developments to accelerate decarbonization. This entails moving conceptual infrastructure developments into production, as well as strengthening activities such as the development of MRV methodologies, processes & procedures. The design of the carbon tax and its offset



system is still evolving and requires significant support to incorporate in its design aspects such as socio-economic impact assessments and interaction with other CPIs. The new administration has set up an inter-ministerial working team, with the participation of the Ministries of Finance, Energy, Economy, and Environment to evaluate the capacity available for the implementation of CPI instruments and propose improvements. While the government has a political commitment to increasing the carbon tax, there is a need for further analysis to define the best trajectory for increasing the tax over the coming years, especially in the context of the current economic outlook of limited GDP growth. If a progressive increase is approved, mitigation mechanisms for negative socioeconomic impacts, such as increasing energy costs, should be evaluated to assure a just transition to a low-carbon economy.

#### Relationship to CPF

**The Project is well aligned with the Systematic Country Diagnostic (SCD) 2017 priority areas.** The SCD 2017 emphasizes Chile's growing challenges not only in the areas of social inclusion and fiscal stability, but in addressing environmental sustainability and climate change. The rapid economic development in combination with the country's geographical position have raised concerns about the environmental impacts on Chile's major commodity-based activities, which have the potential to threaten the longevity of economic sustainability. Controlling the use of natural resources, air pollution, and emissions of GHGs are key to ensuring continuous and inclusive growth.

**The project is also aligned with the High-Level Outcomes (HLOs) currently proposed under the Country Partnership Framework (CPF) for FY24-FY27, to be discussed with the World Bank's (WB) Board of Directors in April 2023.** The CPF supports two HLOs through five CPF objectives. On the one hand, HLO 1 will accompany efforts to increase equitable access to quality social and financial services. On the other hand, HLO 2 supports improved environmental outcomes and climate change resilience through an ambitious climate change adaptation and mitigation agenda in the face of significant national vulnerability. The Project will contribute to the CPF's proposed high-level objective to *"Promote low-carbon development of the energy, transport and industrial sectors"*, and to *"Strengthen water resource management and increase water security"*, by providing direct incentives to achieve these goals through the use of carbon pricing instruments.

**Finally, the Project is aligned with the Green, Resilient, and Inclusive Development (GRID) framework, the World Bank Group Roadmap for Climate Action in Latin America and the Caribbean, as well as the Paris Agreement and the country's updated NDC and its commitment to reach carbon neutrality by 2050.** The proposed Project is supportive of the GRID approach as it leverages public and private resources to advance the country's energy transition, build technical capacities for sound climate policy development, and contributes to sending clear signals to national and international stakeholders on Chile's commitment to its decarbonization pathway.



### C. Project Development Objective(s)

#### Proposed Development Objective(s)

The proposed PDO is to provide technical assistance to the Government of Chile for the design and implementation of domestic carbon pricing instruments and support the development of policy frameworks and infrastructure systems to enable and foster the country's participation in international carbon markets.

#### Key Results

1. Support the implementation and sophistication of the mix of carbon price instruments (CPIs) proposed by the government, carbon tax, GHG emission standards and a ETS pilot in the Energy Sector.
2. Strengthening of the national knowledge base and the capacity of decision makers for integrating the different CPIs in line with national climate and development priorities.
3. Establishing of the institutional governance, as well as the legal and technical foundations for the definition and operationalization of National Article 6 policies.
4. Support the definition of Just Transition strategies in the context of the design and implementation of CPIs.

### D. Preliminary Description

#### Activities/Components

The PMI project will provide the GoCh with the support needed to advance with the implementation of the instruments and policies the PMR helped design, adopted by the GoCh through the LMCC. The project activities will be structured along the following components:

#### Component 1. Implementation and sophistication of the CPI mix

Building on the existing carbon tax, the project will support the implementation of more sophisticated CPIs, including an offsetting system, a GHG emission standard and emission reductions certification system, and the implementation of a roadmap for future CPI developments to accelerate decarbonization. This entails moving conceptual infrastructure developments into production, as well as strengthening activities such as the development of MRV methodologies, processes & procedures, and the governance of the offsetting system. This component will be divided into the following sub-components:

- **Component 1.1: Implementation of carbon offsets and GHG Emission Standards**

The GoCh approved the LMCC in March 2022. The LMCC strengthens the current institutional framework, making the NDC legally binding. It strengthens existing instruments, such as the carbon tax, that will now allow the use of offsets, and creates new instruments, such as the GHG emission standard and emission reductions certification system. Under this subcomponent, the project will provide design recommendations for these two mechanisms as well as recommendations on which GHG standards to prioritize (for different sectors/technologies/activities) based on i) relevant experiences from other jurisdictions; ii) cost-benefit analysis of the different options; and iii) priorities defined in the NDC and the LTC. The PMI is expected to



support methodology development and capacity building for a set of priority sectors and technologies under the GHG standards system. The project will also support the implementation and improvement of MRV systems and methodologies, as well as capacity building for relevant stakeholders, as follows:

- a. **Cost-Benefit Analysis and lessons learned for GHG emission standards:** Given the need to prioritize among the many sectors and technologies where the new CPI can be implemented, the project will inform the GoCh providing recommendations on how to prioritize the implementation timeline of possible GHG standards based on the local conditions, as well as a state-of-the-art review on the implementation of similar instruments in other jurisdictions.
- b. **Enabling Activities for Offsets and GHG emission Standards:** the project will support current efforts led by the Ministry of Environment (MMA) through the definition of additional regulations, methodologies, and procedures for the offsets scheme and GHG emission standards. It will also support the implementation of a national certification scheme, including the certification process and requirements for eligible environmental audit firms. Finally, the project will identify and implement, when possible, the required systems and processes to ensure the compatibility among MRV systems, and with future Art. 6 transactions. Other enabling activities comprise the preparation of a proposal for clear governance structures and/or procedures for the interaction between all relevant agencies working with these CPIs.
- c. **Improvement of MRV systems for offsets:** The first phase of implementation for carbon offsets is currently ongoing and, as mandated by law, it is expected to be completed by early 2023. This includes the MRV components for evaluation and monitoring of projects. The verification and certification components should be completed by the end of 2023, and the trading platform should be operational no later than February 2024. By then, a limited number of methodologies will be available, together with external certification schemes. MMA and the Superintendency of the Environment (SMA) will use PMI support to accelerate and expand the process for the design and implementation of these MRV modules. The MRV modules will first focus on a set of sectors and technologies, as defined by the MMA. The project will provide support for the expansion of these initial MRV systems to include more sectors/technologies, as well as associated methodologies for offsets and emission reduction certificates.
- d. **Piloting of a trading/exchange platform for offsets and emission reduction certificates:** To date, there is no available trading or exchange platform for the use of offsets and/or emission reduction certificates. On the one hand, the project will support the design and implementation of this platform, with relevant studies/analyses. Additionally, the project will also support the development of criteria for the selection of projects as well as the piloting for trading/exchanging offsets/reduction certificates and inform the design of a full-scale platform.
- e. **Institutional capacity building on offsets and GHG standards:** In order to allow public agencies to accelerate the learning curve to operate with these new CPIs, the project will provide targeted support to relevant national agencies, such as SMA to: i) be able to evaluate mitigation projects for offsets/GHG standards and; ii) work with the relevant MRV platforms, as needed, to enable the registration and processing of new mitigation projects in various sectors and technologies. With support from PMI, MMA and SMA will prepare a series of institutional capacity building activities for





several agencies linked with the offset process, such as MMA, SMA, CONAF or the Regional Ministerial Secretariats (SEREMIs).

• **Component 1.2: Improvement of CPI mix**

While the implementation of CPIs is expected to have overall positive effects, further research is still needed to improve the current instruments and to fine-tune the interaction between current and future instruments proposed under the LMCC. The project will support these continuous improvement efforts as follows:

- a. **Support the alignment of fuel taxation with climate change commitments:** Chilean fuel taxes are among the lowest among OECD countries and have been found to be economically inefficient as they do not reflect the health and environmental cost. The project will support additional studies to inform the best strategy for increased carbon prices, removal of tax distortion, such as subsidies and exemptions, as well as its impact on other CPIs.
- b. **Improve the GoCh capacity for carbon pricing modelling and assessment:** This includes activities to improve and strengthen in-house modeling and simulation capacities in relevant agencies to explore an increased carbon pricing trajectory and CPI mix. The assessment of CPIs is expected to continue through the duration of the work program, to incorporate the latest information available and provide relevant inputs to other activities such as improvements to the current carbon tax (price signal for electricity dispatch, inclusion of other GHG emissions, low price of carbon, etc.).
- c. **Analysis and improvement of socio-economic modelling of CPI mix:** While the GoCh has expressed its commitment to increase carbon prices through existing and new CPIs, more in-depth analysis and improved modelling capabilities are required to identify and measure the redistributive impact of proposed policies on vulnerable populations and sectors (such as mining and other export-oriented industries). The project will provide technical assistance to help identify these actors and develop policy proposals for the low carbon economic transformation. Studies will also identify and measure co-benefits of low-carbon policies and explore opportunities for revenue recycling.

• **Component 1.3: Cap & Trade Pilot under the Energy Sector**

As defined in the LMCC, the Sectoral Authorities (line Ministries) can develop and implement specific climate change instruments for their respective sectors to comply with their respective mitigation goals. Aligned with the LMCC, the Ministry of Energy (MoE), as sectoral authority, strives to develop a voluntary C&T pilot to inform the design and build the political commitment for a full-scale sectoral CPI. While a large number of studies and significant consensus were developed throughout the PMR project for the implementation of an ETS in the Energy Sector, this instrument has not yet materialized. Given the new framework conditions with ambitious commitments in terms of the LMCC, the NDC and LTCS goals, the MoE is planning to design and implement this C&T instrument to accelerate the process for carbon neutrality in a flexible and cost-effective way.

The project will support the MoE (in coordination with MMA), to implement this mechanism as a sectoral CPI, following the general framework for the GHG emission standards in the LMCC. The MoE currently has a Monitoring, Reporting and Verification mechanism (MRV of Mitigation Actions under the Energy Sector,





developed under the PMR) that, together with other systems such as the MRV for Green Taxes, can be used as building blocks for this instrument. The C&T pilot corresponds to the first stage of ETS implementation, a voluntary stage that will allow both public entities and the private stakeholders invited to participate in the pilot to learn about this instrument and inform the regulatory authorities of its design and best practices. The project will support the implementation of the LMCC through the design and implementation of the ETS for the energy sector, aiming to accelerate the mitigation ambition in the energy sector.

The work program under this subcomponent will entail the technical and economic design for the C&T pilot. It will cover a wide range of activities, such as defining the size of the pilot and determining whether the pilot participants are representative of the sector as a whole. Other activities to be developed include the definition of entities eligible under the pilot, strategies for allocation of emissions permits as well as considerations for possible revenue recycling. This last activity should be coordinated with the activities proposed under Component 1.2 - Socio-Economic modelling of CPI mix (impacted actors, redistributive impacts and revenue recycling).

Once designed, the pilot will go through a simulation phase of a C&T operation for the energy sector. Using a dedicated platform; companies and private sector participants will be able to react to different CPI scenarios and draw lessons/recommendations for the implementation of a full-scale instrument. Given that the pilot needs to be compatible with the regulations for a GHG emission standard, the pilot is expected to run after the corresponding GHG standard is defined for the Energy Sector.

## **Component 2. Communication strategy and stakeholder engagement**

This component will support cross-cutting capacity building, stakeholder engagement, communication and knowledge sharing activities to build consensus and disseminate progress under each of the instruments, as well as to participate on relevant international initiatives, drawing on lessons from Chile's own experience with and that of other countries having sought to implement CPIs. This component will also include capacity building activities for the sub-national public entities in charge of the implementation and supervision of the projects under the proposed CPIs. These activities will be divided into the following sub-components:

### **• Component 2.1: Communication and stakeholder engagement**

Chile has an extensive track-record of broad stakeholder engagement and co-construction in its policy design processes. Experiences such as the long-term energy planning lead by the MoE exemplifies this, with expert committees and general public consultations implemented at the different stages of policy design, ensuring a broad support. Like in the PMR, it is expected that the communication strategy will inform the establishment of national priorities.

As a cross-cutting support to the implementation of the proposed program in Chile, a strategy for stakeholder engagement will play a key role to ensure progress in implementing and improving the proposed mix of CPIs. At a national level, the PMI will develop a communication strategy, stakeholder workshops, and information campaigns for the broader public to disseminate knowledge, create support for pricing carbon and communicate progress. This strategy will also include activities on social media and effective community



management. The work undertaken under this Component will inform and support ongoing technical and political dialogue at a broad and public level, discussing the advantages, difficulties, and opportunities that the implementation of carbon pricing instruments can bring to the country. This may improve stakeholder engagement and buy-in in the design, implementation, and evaluation of climate policy instruments.

The strategy will have a strong component on strengthening capacities and fostering technical exchange among public and private entities involved in the new CPIs, such as offsets and GHG standards. On the private sector side, this will include sectors new to CPI and their associations, public sector agents on all levels (national, subnational, sectorial) as well as civil society representatives.

Implementation and operation of the new Offset and GHG emission standards mechanism will require significant capacity building within entities covered by these new CPIs. Both mechanisms are expected to introduce new sectors and technologies, and bring needs for corresponding GHG and MRV methodologies while ensuring compliance with relevant regional requirements (in the case of local pollutants). For the set of entities already covered under the tax this will require strengthening professional capacities. For entities new to the CPI, more substantial capacity building efforts will be needed to help with learning the necessary processes and tools. In a process similar to the capacity building prepared for the roll-out of the carbon tax, specific training and workshops will be required throughout the country. The new CPIs are incentives for a clean transition and generate opportunities for developing emission reduction projects. However, compliance and success are dependent on ensuring sufficient capacity and knowledge are provided to relevant stakeholders.

- ***Component 2.2: Capacity building at sub-national level***

The project will support capacity building activities throughout the different regions in the country for both, regional representations of ministries (SEREMIs) and other agencies, as well as project developers. These agencies need to understand the eligibility criteria for mitigation projects and be able to advise prospective implementers. These regional agencies should acquire these and other competencies to support the design, implementation and monitoring of regional climate change action plans, that will in turn allow to identifying eligible activities and foster the creation of GHG mitigation projects with strong co-benefits for the development of small and medium enterprises (SMEs), inclusive approaches, direct environmental benefits, and other sustainability indicators (in line with the objectives of the LTCS).

- ***Component 2.3: International leadership and knowledge exchange***

Chile plans to continue its international leadership and active engagement in carbon pricing topics. The PMI will support Chile's proactive and productive participation in several international platforms like the Climate Market Club, Climate Warehouse and other bi- and/or multilateral initiatives. This will provide international visibility, serve to inform implementation in Chile of national CPIs, share experiences with other jurisdictions on national and international mechanisms and explore implications and options for the potential development of Internationally Transferred Mitigation Outcomes (ITMOs) pilots in the energy sector.



International leadership will also be demonstrated through participation in international dialogue platforms, conferences and other events with active contributions and knowledge sharing.

### Component 3. Chile in international carbon markets

Under this component, the project will support the GoCh implementing a National Policy for the use of Art. 6 of the Paris Agreement, by developing the guidelines to define its structure, contents and governance, and supporting the development of a national registry for NDCs. Furthermore, it will provide support to strengthen Chile's role in South-South Cooperation, by sharing experiences and knowledge with other jurisdictions, and supporting the development of other national and regional initiatives. This component will be divided into two main sub-components, as follows:

- **Component 3.1: Article 6 of the Paris Agreement**

The adoption of the Guidance on Cooperative Approaches on Article 6.2, and the Rulebook for the mechanism under Article 6.4 of the Paris Agreement have been a very positive progress for the operationalization of these articles in participating countries. These new rules cover both government-to-government and government-to-private sector markets. Despite providing key elements, many provisions still require additional clarifications. The project will support various elements of the Chilean Article 6 policy as follows:

- Recommendations on National Policy for Art. 6:** the GoCh, with support from PMI, intends to develop guidelines to define the structure and content necessary to implement a National Policy for the Use of Art.6. Studies elaborated under this component will be based on the guidelines for the National Policy to be defined by a public-private roundtable by 2023. For the development of its National Policy the use of the WB Mitigation Action Assessment Protocol (MAAP) tool will be explored as a means of assessing/evaluating compliance with the requirements defined under Article 6.
- Definition of a governance structure for Art. 6:** In order to transform the Article 6 national guidelines into an operational system for the transfer of emissions units internationally under the Paris Agreement Article 6., there is a need to identify and implement the required processes and capacities within the relevant public agencies (MoE, MMA and others). The project will support the design of the Art.6. operations system, including a clear governance, processes, and the required public sector capacities. The activities will also help establish provisions to avoid overselling, create conservative baselines and/or marginal abatement cost (MACC) curves.
- Definition and implementation of a registry for Art. 6 transactions.** The project will support the implementation of knowledge products and IT solutions as identified by the National Policy for the Use of Art.6 to enable ITMO transactions with environmental integrity, traceability and avoiding double-counting. This MRV system is expected to be integrated with other CPIs.
- Support the design of a No-Regret Strategy for Corresponding Adjustments:** There are still many uncertainties regarding the implementation of the Paris Agreement Art. 6 and how to design and establish robust processes for international transactions and Corresponding Adjustments that would not jeopardize meeting NDC objectives. With this in mind, the GoCh would like to explore options for



the use of international market instruments to support its climate goals. The project will thus support the definition of conservative strategies, identifying sectors/technologies best positioned to generate positive outcomes through international transactions. This activity will be supported by modelling activities under component 2, strengthening analytical tools, refining and updating MACC curves, and estimating the marginal cost of NDC compliance by sector/technology to identify which may be suitable for generating ITMOS under Art. 6. Piloting is also planned building on Chile's bilateral engagements on carbon pricing (Quebec, Sweden, Switzerland, etc.).

• **Component 3.2: International Cooperation and linked carbon markets**

Chile would like to strengthen its role in South-South Cooperation. This comprises developing a concept for a regional carbon club as a way to bundle negotiation power and generate common standards for the generation and transaction of ITMOs in the Latin America and Caribbean (LAC) region. In line with this, the project will support:

- a. **Opportunities for linking CPIs:** The project will aim to identify opportunities of linking elements of Chile's CPI mix with other jurisdictions and develop rules for any such linkage. In this regard, experiences such as the MRV technical group under the Pacific Alliance, and other Market Clubs could be explored. Additional analysis will quantify the impacts of collaboration and identify potential regional opportunities based on criteria such as cost-efficiency and potential for raising (climate change) ambition.
- b. **Assessment and design of a potential carbon club:** The GoCh intends to implement Article 6 pilots to help develop capacities and generate lessons. With support from PMI, Chile could identify and develop opportunities for regional collaboration and the creation of a regional carbon club, expanding on existing initiatives, such as other LAC PMI countries, the Pacific Alliance or the WB Climate Club. Participating countries could together fill the gaps in their institutional frameworks with respect to the new rules of the Paris Agreement and Article 6. This carbon club could act as a regional platform that allow not only the purchase and sale of ITMOs within the participating countries, but also, the sale of ITMOS with other existing clubs, international sectoral agreements or to other countries, including developed countries that require ITMOs to meet their NDC targets or to achieve their carbon neutrality goals by 2050. The activity is expected to generate insights into aspects of governance and application of methodologies that are common to the countries or jurisdictions in the region that potentially join the club.
- c. **Assessment of regional carbon market hub:** the project will help to explore the opportunities and gaps for transforming Chile into a regional carbon market hub, building on the solid financial market of the country as well as the high level of climate ambition.
- d. **Regional cooperation agreements to provide capacity building on CPIs:** with PMI support, the GoCh would like to support other countries in the region on their path towards designing and implementing carbon pricing instruments, through cooperation agreements and experience exchanges, sharing of lessons learnt and promotion of carbon pricing in the region.



## Component 4: Articulation of Just Transition with carbon pricing instruments

Under this component the project will support the identification of vulnerable groups impacted by CPIs, and the development of new sectoral/technology strategies for a Just Transition to mitigate potential negative impacts associated with the implementation of CPIs.

In 2021, the MoE published the first Strategy for Just Transition for the Energy Sector, focusing on the impacts that closing all coal-fired power plants by 2040 would have on the local communities. The proposed work program will follow a bottom-up approach identifying the most vulnerable population in each region and develop targeted actions, such as capacity building activities to promote employment. Similar strategies are currently under development for other initiatives under the MoE, as well as under other Ministries.

As a complementary process, the PMI project will review and incorporate the findings from the socio-economic analysis of the CPI-mix (under the Carbon pricing policy assessment activity). This component will support in-depth analysis to help identify and measure redistributive impact of proposed policies on vulnerable populations and sectors. Studies will also identify and measure co-benefits of low-carbon policies and explore opportunities for revenue recycling, providing relevant input for the elaboration and strengthening of Just Transition Strategies. The project will support the GoCh by:

- a. **Supporting the identification [and definition] of vulnerable groups:** Just Transition Strategies defined at the Ministry level are later disseminated following a top-down approach to each of the regions through a participatory process, all the way down to the municipal levels. Following this process of sharing and collecting inputs from the local communities, the strategies will later be revised to reflect the feedback at the various levels from the civil society, public and private stakeholders. This feedback process will be used to refine and update the identification [and definition] of vulnerable groups impacted by the different strategies and provide feedback for the improvement of CPIs.
- b. **Supporting the definition of new Sectoral/Technology strategies for "Just transition":** In addition to the first Strategy for Just Transition linked to the closing of coal-fired power plants, the MoE is already working on specific strategies linked to other initiatives, such as the Strategy for Electromobility and the Strategy for Green Hydrogen. The project will provide support to inform the definition and/or improvement of the new strategies and the development of key performance indicators.
- c. **Providing Capacity building for the Public Sector:** Targeted capacity building would include initial assessments to identify relevant capacity building needs/gaps for the implementation of just transition strategies. The project will also inform just-transition considerations for the identification/approval of offset projects.

## Component 5. Project Management

This component will fund the key staff to be hired for the Project Implementation Unit (PIU).

This project will be financing mainly consulting services, training, and operating costs.



## Environmental and Social Standards Relevance

### E. Relevant Standards

ESS Standards		Relevance
ESS 1	Assessment and Management of Environmental and Social Risks and Impacts	Relevant
ESS 10	Stakeholder Engagement and Information Disclosure	Relevant
ESS 2	Labor and Working Conditions	Relevant
ESS 3	Resource Efficiency and Pollution Prevention and Management	Relevant
ESS 4	Community Health and Safety	Not Currently Relevant
ESS 5	Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
ESS 6	Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
ESS 7	Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Not Currently Relevant
ESS 8	Cultural Heritage	Not Currently Relevant
ESS 9	Financial Intermediaries	Not Currently Relevant

### Legal Operational Policies

Safeguard Policies	Triggered	Explanation (Optional)
Projects on International Waterways OP 7.50	No	
Projects in Disputed Areas OP 7.60	No	

#### Summary of Screening of Environmental and Social Risks and Impacts

Environmental and Social risk classification risk of the Project is considered Low. Based on the information available, the proposed environmental and social (E&S) risk classification for the project is Low under the Environmental and Social Framework (ESF). The project will finance technical assistance (TA), and does not include any physical interventions or actions with the potential of generating adverse impacts and/or risks to specific social groups, to human health and safety, on the biophysical environment, on valued environmental components, and/or on cultural values. The bulk of project activities are focused on enhancing existing carbon pricing instruments and improving their use (such as by promoting a more efficient mix of CPIs), deploying policy and fiscal incentives so as to achieve net gains for the climate. Besides promoting alignment with the Paris Agreement, such actions are expected to promote broad, longer-term sustainable development objectives, many of which would be socially oriented, such as the generation of social co-benefits for local populations, or the creation and maintenance of SMEs. With the information available at this stage, no downstream environmental effects are expected from studies to be financed under





components 2, 3 and 4. Regarding Component 1, it will build on the existing Chilean carbon tax to implement more sophisticated carbon pricing instruments. Since the carbon tax has been under implementation in Chile since 2014, impacts from its implementation on differentiated consumer groups, and on the environment, are not relevant for this project. Regarding each of the instruments to be implemented under this component: (i) Carbon tax offsetting system: not expected to have a significant effect in terms of carbon leakage, as the carbon tax in Chile is still low by international standards, having a limited impact on the different sectors. (ii) GHG emission standard mechanism: even though the definition and implementation of GHG emission standard limits has a potential for carbon leakage, the consideration of targeted mitigation policies will be included as part of the corresponding analysis. These include, for example, support programs to accelerate transition towards cleaner technologies, the exclusion of vulnerable sectors/activities from the mechanism, or the definition of border adjustment taxes. (iii) The cap and trade (C&T) pilot under the energy sector: will take into consideration measures to minimize potential (low) carbon leakages to other sectors/countries, as well as potential impacts on vulnerable groups. The C&T pilot to be implemented under the PMI will support testing and modelling of different designs to inform the carbon pricing mix. On one hand, the GoCh is putting forward a policy to reduce its dependency on fossil fuels and increase the use of Green Hydrogen. On the other, as defined in the LMCC, it will not be possible for Chilean entities to compensate for project emissions with international transfer mitigation outcomes (ITMOs), which has the effect of forcing the entities to generate mitigation nationally, thereby discouraging leakages to other countries. Also, given the nature of the TA-oriented activities to be supported by the grant, some negative downstream social effects are possible, such as higher energy prices on certain population segments. In response, the project has already incorporated measures and mechanisms to evaluate and/or counteract these effects. Project-supported studies will look into possible impacts on vulnerable social groups, analyzing the feasibility, benefits, and costs of the enhancement of different carbon pricing instruments, and recommending measures to account for the distributional impacts of certain economic shifts, including in labor markets. For example, studies supported by PMI that help prioritize sectors/technologies for the implementation of GHG standards, including the adoption of specific limits, will include modeling of the possible impacts on vulnerable social groups. And where possible studies will identify, measure, and promote the co-benefits of low-carbon policies, such as the adoption of emission reductions certificates targeted for vulnerable populations/sectors (e.g. implementation of energy efficiency improvement measures as a priority among vulnerable customers). In addition, any negative consequences of the improved deployment of CPIs will be addressed via ?just transition? activities that are also in line with the Paris Agreement and the subsequent agreements issuing from it. This is part of Chile?s commitment to developing a ?Strategy for Just Transition? for all relevant sectors to protect the rights of the most vulnerable in decarbonizing the energy matrix. The first such strategy, for the energy sector, was delivered in 2021, with an initial focus on the populations impacted by the early retirement of coal-fired power plants. Although initial definitions of vulnerability were limited to this population, for future strategies the most vulnerable populations in each region will be identified following a bottom-up approach. With this in mind, each strategy will develop targeted actions, such as capacity building activities to promote employment. The possibility of revenue recycling as a means of financing just transition strategies and actions will also be explored. All ToRs, work plans, or other documents defining the scope and outputs of the proposed activities will have to be consistent with the relevant ESSs, and will be reviewed and approved by the Bank. This, to ensure potential downstream effects are duly considered in the development of project outputs. The Bank?s ToR and final





product review, together with its no-objection processes, will be described in the project's Operational Manual and reflected in the project's ESCP. The client will prepare and disclose an ESCP prior to the Appraisal/Decision step, which will detail those actions to be taken during implementation to ensure compliance with the relevant Environmental and Social Standards, including monitoring and reporting requirements.

## CONTACT POINT

### World Bank

Contact :	Ines Perez Arroyo	Title :	Energy Specialist
Telephone No :	5220+81305 /	Email :	
Contact :	Janina Andrea Franco Salazar	Title :	Senior Energy Specialist
Telephone No :	458-9860	Email :	

### Borrower/Client/Recipient

Borrower :	Chilean Agency for International Cooperation for Development (AGCID)		
Contact :	Valeria Sanhueza Belmar	Title :	Head of International Resources Financial Unit
Telephone No :	56228275715	Email :	vsanhueza@agci.gob.cl

### Implementing Agencies

Implementing Agency :	Ministry of Energy		
Contact :	Juan Pedro Searle	Title :	Head of Climate Change Unit
Telephone No :	56223673711	Email :	jsearle@minenergia.cl
Implementing Agency :	Ministry of Environment		
Contact :	Rodrigo Arriagada Cisternas	Title :	Head of Information and Environmental Economics Division
Telephone No :	56225735838	Email :	RArriagada@mma.gob.cl
Contact :	Isabel Rojas Astorga	Title :	Head of Environmental Economics Department
Telephone No :	56225735756	Email :	IRojas@mma.gob.cl

## FOR MORE INFORMATION CONTACT



**The World Bank**

Chile Partnership for Market Implementation

---

The World Bank

1818 H Street, NW

Washington, D.C. 20433

Telephone: (202) 473-1000

Web: <http://www.worldbank.org/projects>

Public Disclosure Copy