

**PROJECT INFORMATION DOCUMENT (PID)
IDENTIFICATION/CONCEPT STAGE**

Report No.: PIDC72794

Project Name	Climate Mitigation Action Support
Region	SOUTH ASIA
Country	Sri Lanka
Lending Instrument	IPF
Project ID	P160552
Borrower Name	Ministry of Finance, Democratic Socialist Republic of Sri Lanka
Implementing Agency	The Ministry of Mahaweli Development and Environment
Environment Category	C - Not Required
Date PID Prepared	07-Sep-2016
Estimated Date of Approval	31-Oct-2017
Initiation Note Review Decision	The review did authorize the preparation to continue

I. Introduction and Context

Country Context

Among its neighbors in the region, Sri Lanka stands out for its environmental stewardship, and for being one of the most progressive, clean and sustainable nations. Sri Lanka's CO₂ emission from fossil fuel combustion was about 0.86 tons of CO₂ per capita in 2013, far below the world average value of 4.44, and lower than most of its neighboring countries. Sri Lanka, a country highly vulnerable to climate change impacts, simultaneously faces at challenges to ensure the protection and the sustainable development of the country's natural resources, increase the preparedness against natural disasters, and enhance resilience to climate change across sectors are important priorities for the new Government as well.

Sri Lanka currently spends 50 percent of its total export income (approximately US\$ 5 billion per year) to import fossil fuels, and over 40 percent of Sri Lanka's primary energy is dependent on imported fossil fuels, mainly coal, fuel oil and petroleum. Given that Sri Lanka heavily relies on imported fossil fuels to meet the growing energy demand, diversifying energy generation away from imported fossil fuels is critical to accommodate fluctuations in international oil and coal markets to improve the country's fiscal resilience. According to Sri Lanka's previous Long Term Generation Expansion Plan (LTGEP 2013-2032), coal-based power is considered the least cost option based on the capital costs and economic lifespan of the plants, and is expected account for 70 percent of the total generation mix by 2025, which would significantly raise the country's dependence on coal imports.

Sri Lanka's growing fossil fuel dependence has also led to increased air pollution and greenhouse gas (GHG) emissions. As an island nation, Sri Lanka recognizes its high vulnerability to the impact of climate change. Model simulations under different scenarios indicate a past warming trend of about 0.75 degrees Celsius per century in annual mean temperatures over the South Asia region.

Future temperature projections suggest anomalies may reach 4 to 5 degrees Celsius by the 2080s for high-emission scenarios. Conservative estimates of the impact of climate change on the Sri Lankan economy indicate a 1.2 percent loss of annual GDP by 2050 by directly impacting several economic sectors, such as power, transport and agriculture.

Sectoral and Institutional Context

In its Intended Nationally Determined Contributions (INDCs) submitted to United Nations Framework Convention on Climate Change (UNFCCC) on October 22, 2015, Sri Lanka has committed to achieve emission reductions of 4.88 million tCO₂ by 2030 from the energy sector, a 4 percent reduction compared to the 2010 baseline. The cumulative emission reduction for the period of 2015-2030 will be 74.56 million tCO₂ from the energy sector. In addition, Sri Lanka has set a voluntary target to achieve 3.33 million tCO₂ reduction in 2030, and cumulative emission reductions of 30.21 million tCO₂ for the period of 2015-2030 through development of non-conventional renewable energy under international external support, which would further reduce emissions by 16 percent against the 2010 baseline.

Sri Lanka's National Climate Change Policy provides overarching guidance and direction for all stakeholders in meeting the challenge of climate change. The policy articulates the guiding principles for energy, transport, industry, waste management, and agriculture and livestock. Resource mobilization including international resources to support implementation of the national climate change policy is key to accelerate mitigation measures in these sectors, including the use of market/ non-market mechanisms. The national policy and strategic framework for development and growth in Sri Lanka between 2010 and 2016, aims at accelerating growth, with particular emphasis on the achievement of equitable development.

Sri Lanka has taken several other policy measures to realize guiding principles stipulated in the National Climate Change Policy, including Climate Change Vulnerability Profiles; Water, Health, Agriculture and Fisheries, Urban Development, Human Settlements and Economic Infrastructure in 2010, Technology Needs Assessment and Technology Action Plans for Climate Change Mitigation and Adaptation in 2014, the National Action Plan for Haritha Lanka Programme in 2009 and Urban Transport Master Plan 2032 based on the National Transport Policy in 2009.

Further, Nationally Appropriate Mitigation Action (NAMA) on Energy Generation and End Use Sectors is being implemented, and the NAMA on Transportation is being prepared, in addition to the afore mentioned, the Long Term Electricity Generation Expansion Plan 2015-2032 and the National Solid Waste Management Strategy 2000, the Corporate Plan 2014-2018 by the Central Environmental Authority and various legal amendments made by government entities related to environment are being implemented.

Relationship to CAS/CPS/CPF

The national policy and strategic framework for development and growth in Sri Lanka between 2010 and 2016, aims at accelerating growth, with particular emphasis on the achievement of equitable development. The proposed project aligns with the main strategic objectives of the Country Partnership Strategy (CPS) FY2013 - FY2016, which aims to help GoSL achieve the goals set out in its development policy framework. In particular, the proposed project will facilitate sustained private and public investment necessary for corresponding to national commitment on climate change as well as development of appropriate mitigation measures and instruments,

monitoring, reporting, and verification systems. Further, new Country Partnership Framework FY 2017 - FY2020 expects to strengthen the Bank's ongoing efforts on enhancing resilience and management of national assets from the threats of natural disasters including climate change as one of the main three pillars while promoting green development such as tapping non-convention renewable energy sources. The proposed project is fully aligned with the pillar by improving the capacity of the country to better manage and govern its climate strategies and action plans as well as increasing access to international climate finance for sustainable and green development in more effective and sustainable manner, thereby supporting the country's strong commitment on climate mitigation and adaptation stipulated in the INDC and contributing to achieve the twin goals of the World Bank Group.

II. Project Development Objective(s)

Proposed Development Objective(s)

To help Sri Lanka develop capacities and systems to: (a) implement national climate change policies, strategies and actions; and (b) design or strengthen market/non-market mitigation instruments.

Key Results

Preparation Phase:

i) A qualified Market Readiness Proposal prepared;

Implementation Phase:

i) National Monitoring, Reporting, and Verification (MRV) and registry systems for Greenhouse Gases designed and established;

ii) Capacity to implement domestic carbon market and its supporting instruments and infrastructure improved; and

iii) Domestic carbon market and its supporting instruments such as Sri Lanka Carbon Offset Scheme strengthened.

III. Preliminary Description

Concept Description

The project will be supported by multilateral trust funds in order to achieve PDOs including the Partnership for Market Readiness, a grant-based, capacity building multi-donor trust fund that provides funding and technical assistance for the collective innovation and piloting of market-based instruments for Greenhouse Gas (GHG) emissions reduction. Additional funding sources will be identified as needed.

The Partnership for Market Readiness (PMR), which was launched in December 2010 and became operational in April 2011, provides support to prepare and implement climate change mitigation policies, including carbon pricing instruments in order to scale up GHG mitigation. The PMR also serve as platform to share lessons, countries work together to shape the future of cost-effective GHG mitigation. Implementing Country Participants use PMR resources to support the design, development, and piloting of instruments to price carbon and/or create a carbon market. Some countries are ready to design the instruments themselves, others are at a stage of capacity building.

The PMR consists of three phases: i) Expression of Interest (EOI) and Organizational Framework Phase; ii) Preparation Phase; and iii) Implementation Phase. At the EOI Phase, a country submits an EoI to the PMR Secretariat, which is subsequently presented to the PA for confirmation as an

Implementing Country Participant. Following confirmation, a country presents to the Partnership Assembly (PA) an organizational framework of proposed PMR activities in order to receive the preparation phase of PMR funding. At the Preparation Phase, an Implementing Country Participant will receive a Preparation Funding allocation from the PA of US\$ 350,000 in order to formulate its Market Readiness Proposal (MRP), which details the country's roadmap for its proposed market-based instrument and market readiness components, as well as a funding for its implementation. At the Implementation Phase, an Implementing Country Participant implements readiness components outlined in the MRP, which will be supported by PMR funding up to \$3 million depending on the readiness components proposed along with other funding sources identified.

Sri Lanka is already granted to start the Preparation Phase by the PA. Sri Lanka has submitted its EoI and presented the Organizing Framework for the scoping of PMR activities at the PA meeting held in Lima, Peru on April 26-29, 2016. Participation of Sri Lanka as an Implementing Country Participant and US\$ 350,000 preparation grant were approved at the same meeting. The proposed project will support Sri Lanka to prepare a MRP and implement PMR activities under the Implementation Phase, which is expected to start in early 2018 subject to an approval of US\$ 3 million implementation grant by the PA.

The proposed project will consist of two phases as per the PMR process: Preparation Phase and Implementation Phase. The proposed components for the Implementation Phase will be further elaborated and materialized in the market readiness proposal with the use of US\$ 350,000 preparation grant. Further, these components could be further modified at the PMR Implementation Phase or complemented by other multilateral trust funds or donors.

Preparation Phase (October 2016 - December 2017) with US\$ 350,000 PMR Preparation Grant:

The World Bank Group will support the Government of Sri Lanka to formulate a Market Readiness Proposal as per the guideline provided by the PMR Partnership Assembly. The proposed activities, though will be formulated better and finalized during MRP preparation phase, are the following:

- (i) Conduct an assessment and studies in the areas identified in the Sri Lanka's Organizational Framework for the PMR activities;
- (ii) Prepare terms of references for activities to be included in the Market Readiness Proposal and undertaken during the Implementation Phase; and
- (iii) Organize consultation with key Ministries, Government entities, local offices, and other multi-stakeholders to formulate the Market Readiness Proposal.

Implementation Phase (January 2018 - June 2020) with up to US\$ 3 million PMR Implementation Grant:

The World Bank Group will support the Government of Sri Lanka to implement the following activities which will be further stipulated in the Market Readiness Proposal and subject to approval by the PMR Partnership Assembly.

1. National MRV Systems and registry tracking

Sri Lanka has implemented an excel based carbon registry and tracking under Sri Lanka Carbon Crediting Scheme. Sri Lanka's current participation in the World Bank's Carbon Partnership Facility and some other mitigation activities with the support of UNDP is expected to strengthen the support

for MRV in the energy sector. Development of an effective national MRV system helps to streamline monitoring, reporting, and verification of the mitigation activities in different sectors. At present, Sri Lanka's MRV systems have not been well developed due to under developed carbon markets (also demand issue), limited institutional capacity and low awareness of carbon offsetting scheme processes.

The project with support from the Partnership for Market Readiness can help develop a suitable national MRV system to be linked with future domestic carbon market while it will also strengthen Sri Lanka's MRV systems, thereby encouraging investments in climate-friendly development activities by:

- i) Conducting a market analysis to assess a suitable market instruments for Sri Lanka;
- ii) Improving data management and validation processes;
- iii) Building institutional capacity to develop domestic carbon markets so as to effectively engage in international markets (e.g. through bilateral offset schemes);
- iv) Building awareness and confidence in the carbon offsetting scheme process, especially with banks and financial institutions; and
- v) Identify sectors that show the greatest potential for development of domestic carbon offsets market (e.g. energy efficiency in industry and manufacturing, waste heat recovery, renewable energy).

2. Institutional/regulatory capacity building

Institutional capacity building would be required across stakeholders for creating effective domestic carbon markets as well as supporting the proposed national MRV and registry system. Capacity to develop necessary regulations and policies that support development, implement and enforcement of market instruments is needed in the beginning. Considering this, Sri Lanka is expecting support from PMR for:

- i) Developing national capacity to better manage international grants for climate change activities through establishment of a Project Management Unit of the PMR;
- ii) Facilitating stakeholder consultations to promote private investment in green growth and increase domestic demand for Sri Lanka Carbon Offset Scheme; and
- iii) Conducting a market analysis on domestic carbon markets to identify suitable instruments.

3. Sri Lanka Carbon Offset Scheme (SLCOS)

Sri Lanka has instituted domestic carbon standards through its carbon offset scheme (SLCOS) for regulation and registry of projects that provide carbon offsets. Projects that meet SLCOS eligibility criteria are registered and are eligible to receive SCERs (Sri Lankan Certified Emission Reductions). The SLCOS could support generating voluntary offsets for promoting Sri Lanka's carbon neutrality. It also incentivizes projects for blue-green development under Sri Lanka Next. Expansion of carbon footprint registry can accelerate green growth and facilitate the achievement of INDCs. The Sri Lanka Climate Fund provides carbon footprinting certification services ranging from organization to product footprints in line with GHG Protocol, ISO 14064 -1 & 2 and PAS 2050 carbon footprinting standards. SLCOS requires further strengthening through:

- i) Research on mitigation potential in Sri Lanka to target sectors with the greatest potential;

- ii) Development & design of market-based instruments that supports the scheme;
- iii) Improving data management to build a national registry; and
- iv) Help identify measures to improve tradability of carbon offsets to improve uptake of the scheme.

IV. Safeguard Policies that Might Apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		x	
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09		x	
Physical Cultural Resources OP/BP 4.11		x	
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12		x	
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

V. Financing (in USD Million)

Total Project Cost:	3.35	Total Bank Financing:	0
Financing Gap:	0		
Financing Source			Amount
Partnership for Market Readiness			3.35

VI. Contact point

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