Briefing

Policy and planning

Keywords: Climate change, finance, adaptation, mitigation, Nepal

iied

Issue date April 2014

Policy pointers

Policymakers could use Nepal's planning and budgeting systems to ensure more effective use of climate finance, unlocking capital and supporting longer-term

Establishing a climate change fund as envisaged by the climate change policy would help policymakers leverage better synergy between different sources of finance.

Using additional

investment.

economic and financial instruments could help leverage or incentivise private sector investment in climate change-related initiatives in the long term, while continuing to leverage additional public sources in the short and medium terms.

Building institutional and personnel capacity, particularly at local level, could ensure effective financial resource management. Addressing procedural delays in project and programme implementation would also lead to more effective investments.

Climate change financing in Nepal

Nepal is determined to address the impacts and opportunities of climate change, and has taken the remarkable step of introducing a climate change budget code to prioritise and track climate-sensitive initiatives and expenditure. The government allocated 10.3 per cent of its budget to climate change in 2013/14, while total adaptation-friendly commitment from international sources was US\$236.62 million for 2009–2012. Although the wide range of intermediaries, instruments and planning systems used by Nepal have been effective to date, increasing synergy between them would help avoid fragmentation and duplication in resource allocation and disbursement. Establishing a climate change fund to pool and disburse resources and building local capacity would also help the government reach its target of investing 80 per cent of climate-sensitive budget at a local level.

Nepal has adopted a low-carbon climate-resilient development (LCRD) pathway to address the impacts and opportunities of climate change. The country's National Adaptation Programme of Action (NAPA) addresses immediate adaptation needs. It has a well-defined climate change policy and a climate budget code to prioritise and track climate change-related fund flow to different sectors and ministries.

Nepal's recent approach paper for its 13th three-year plan explicitly indicates the country's commitment to adopting a green economy to minimise the impacts of climate change on its natural resources and sustain the economy. Its National Framework for Local Adaptation Plan of Action (LAPA) aims to provide a bottom-up approach by channelling at least 80 per cent of funds to support local adaptation.

But this transition to a green economy has significant costs. The cost of implementing the NAPA priorities alone has been estimated at US\$350 million; addressing local adaptation priorities will also have specific financing needs. A recent Oxfam report¹ indicates that between 2009 and 2012 Nepal received a total commitment of approximately US\$236 million from international sources to finance its climate change adaptation initiatives.²

The government of Nepal works with a number of financial intermediaries, economic and financial instruments and financial planning systems to mobilise resources from various sources for investment in LCRD. This briefing provides policy pointers to help ease Nepal's transition to a climate-sensitive development pathway.

Sources of climate finance

Nepal accesses various international sources of climate finance. Multilateral and bilateral public sources committed a total of US\$236.62 million for adaptation between 2009 and 2012. Multilateral finance comes from the Climate

Investment Funds through the Scaling Up Renewable Energy Program in Low-Income Countries (SREP), the Pilot Program for Climate

The government needs to build the capacity of local-level institutions to enable them to manage resources

Resilience (PPCR), the Least Developed Countries Fund and the Forest Fund. Bilateral funds come from the United Kingdom and European Union, primarily through the National Climate Change Support

Programme (NCCSP); the United States through its fast-track finance initiative; Switzerland, Germany, Korea, Finland and Cyprus.

National sources include funding from the national revenue. The government allocated 10.3 per cent of the national budget to climate change-related investments for the 2013/14 financial year.³ Added to the funds from international on-budget sources of climate finance, it totals approximately US\$550 million. This includes climate-sensitive expenditure through the budget code, but excludes the annual block grant to local bodies for development activities.

Nepal is also actively involved in the carbon market. By March 2014, six projects and one programme of activities had been registered by the executive board of the UN Framework Convention on Climate Change (UNFCCC) Clean Development Mechanism, and another two projects had requested registration. Clean Development Mechanism investment comes from what is referred to as innovative or carbon finance. These funds are in addition to public and private finance.

Intermediaries

As well as mobilising resources to LRCD in Nepal, multilateral and bilateral banks and

agencies also play a disbursing role, often in partnership with national financial agencies. For example, the World Bank, Asian Development Bank and International Finance Corporation all draw from the multilateral Climate Investment Funds to leverage investment into renewable energy from the SREP and climate resilience from the PPCR. The following UN agencies have also been successful in drawing down on resources from the Least Develpoed Countries Fund to implement NAPA projects:

- UN Environment Programme: US\$5.75
 million for catalysing ecosystem restoration for
 resilient natural capital and rural livelihoods in
 degraded forests and rangelands.
- Food and Agriculture Organization:
 US\$2.95 million for reducing vulnerability and increasing adaptive capacity to respond to the impacts of climate change and variability for sustainable livelihoods in the agriculture sector.
- **UN Development Programme:** US\$6.93 million for community-based flood and glacial lake outburst risk reduction.

National government agencies also act as financial intermediaries, mobilising and disbursing climate finance. For example, the Ministry of Finance accesses multilateral finance from the PPCR, SREP and bilateral climate finance from the UK/EU NCCSP through a special account created in the Nepal Rastra Bank. The Ministry of Science, Technology and Environment plays a key role in coordinating the allocation and disbursement of these resources. Local bodies will also play a key role in mobilising, managing and disbursing financial resources in LCRD investments.

Specialised funds and national intermediaries are emerging in Nepal's climate finance landscape. SREP funds will flow through the Ministry of Finance and the Nepal Rastra Bank into the

Table 1. Nepal's climate change financial landscape

Sources of finance	Intermediaries	Economic and financial instruments	Financial planning systems and institutional arrangements	Uses and users of finance
International public finance (multilateral and bilateral funds) National public finance (government revenue) Carbon finance	Multilateral agencies and banks Bilateral development partners National government agencies National financial institutions (commercial banks)	Economic: Targeted subsidies Tax concessions Tax exemptions Financial: Grants (mostly) Concessional loans	Policy systems: Periodic plans NAPA LAPA Climate change policy Budget and planning systems: Medium-term expenditure framework Annual budget Climate change budget codes	Adaptation Mitigation Government agencies (national and local) International non- governmental organisations Non-governmental organisations Multilateral agencies

Central Renewable Energy Fund (CREF), a small fund mechanism for the renewable energy sector. SREP will provide subsidised long-tenure loans via the CREF to pre-qualified partner commercial and development banks, which will on-lend to commercial hydropower developers, making CREF the core financial mechanism responsible for the effective delivery of subsidies and credits to the renewable energy sector.⁴ The government also proposes to use a trust fund model to secure and disburse REDD+ funds, making payments on the basis of a public carbon registry maintained by the REDD cell.⁵

Establishing a national climate change fund to act as a chief intermediary for the country's climate finance would help increase synergy between intermediaries, enabling more effective LCRD financing and avoiding fragmentation and duplication in resource allocation and disbursement.

Economic and financial instruments

Nepal mainly uses grants, and occasionally loans, to finance its transition to LCRD. With its focus on adaptation rather than mitigation, these instruments are better suited to the country's needs. Almost all (91 per cent) of Nepal's adaptation projects are financed through grants; 9 per cent are funded through loans.1 The government has decided not to take any further loans for climate change initiatives, so grants are likely to remain the dominant financial instrument in the foreseeable future. However, there is another option: as the private sector is the engine of growth, the government could consider accessing national and international private finance in the form of equity or other instruments to incentivise private sector investment in Nepal's LCRD pathway.

Financial planning systems and institutional arrangements

The government relies on a number of financial and institutional arrangements to mobilise and manage climate finance. Its periodic plans prioritise and allocate resources to sector-specific programmes and budgets, which are all brought together by the medium-term expenditure framework — a three-year rolling budget system that bridges its periodic plans and annual budget to ensure that resources are mobilised in priority sectors.

In 2012, the government introduced a climate change budget code into the planning and budgeting system, enabling ministries to prioritise, allocate and track expenditure against activities that will reduce the negative impacts of

Table 2. General trend of climate budget in Nepal over three years

	2011/12	2012/13	2013/14
Annual budget (thousand NPR)	384,900,000	424,824,700	517,240,000
GDP (thousand NPR)	1,375,000,000	1,536,000,000	1,702,200,000
Climate budget (thousand NPR)	27,628,848	27,282,629	53,482,516
Climate budget (% of total budget)	7.2	6.74	10.3
Climate budget (% of GDP)	2.0	1.78	3.1
Ministries with climate budget allocation	8	9	11
Budget heads	83	99	124

Source: National Planning Commission, 2013 (see note 3)

climate change. Table 2 shows that this budget has increased over the years, as have the number of ministries with a climate change allocation and the number of climate-relevant budget heads.

Tracking climate-sensitive expenditure within the national budget enables policymakers to assess the cost of addressing climate change and the effectiveness of targeted investments. Similarly, integrating LCRD interventions into a broader portfolio of investment will help unlock other sources of public capital.

Because climate finance is a cross-cutting issue, all sectors of development — including trade and commerce — should understand and address the key challenges of climate change in Nepal. The agencies concerned may need guidance in how to mainstream climate finance, and tracking aid that is currently outside of government channels would help bring it within the climate code frame.

Nepal has a number of institutional arrangements in place to ensure that climate finance flows to targeted sectors and areas (see Box 1). This has increased coordination between implementing institutions, enhancing the effectiveness of climate-sensitive activities.

Nepal's climate change policy states that 80 percent of climate-sensitive budget should be allocated at the local level. Nepal's LAPA framework guides bottom-up adaptation planning and implementation, giving local bodies the mandate to coordinate adaptation planning. But climate finance and impact both remain poorly understood at the local level. To date, 70 LAPAs have been prepared in four districts and one

Box 1. Climate change: institutional set up

Ministry of Science, Technology and Environment (MoSTE): the UNFCCC's focal point and climate change coordination ministry.

Climate Change Management Division, led by the MoSTE joint secretary: coordinates climate change responses in Nepal.

Climate Change Council, headed by the prime minister: offers strategic and political guidance.

Climate Change Initiatives Coordination Committee, chaired by the secretary of MoSTE: coordinates with different ministries and development partners.

Alternative Energy Promotion Centre: works to develop and promote renewable and alternative energy technologies in Nepal.

municipality, to be funded by US\$21.5 million from the EU and the UK. However, for 2013/14, only 12 out of 124 programmes identified as climate-sensitive by the climate budget code are local. That is around 11 per cent of the climate change budget.

The dearth of elected local bodies over the last 11 years — the result of political transition — has hampered local capacity. But the Prime Minister has indicated that holding local elections is a priority, with these likely to take place in the next six to twelve months. At the same time, the government needs to step up its efforts to build the capacity of local-level institutions and staff to enable them to absorb, manage and disburse resources. It should also consider dealing with procedural delays and project staff transfers, which both hamper progress.

Recommendations

The government of Nepal aims to graduate from least developed to developing country by 2022. This briefing recommends that by taking the following steps, the government could use climate finance to reach this goal:

- Use existing planning and budgeting systems to unlock capital and support longer-term investment. The climate budget code already helps identify and prioritise each ministry's climate-sensitive activities every year and for the longer term. The government can use this for its strategic climate-sensitive planning.
- Establish a climate change fund, as envisaged in its climate change policy. Such a fund would allow the government to pool and disburse

resources, and thus leverage better synergy between different sources of finance. It will also encourage development partners to channel aid through the government system. Off-budget aid is one of the challenges to aid mobilisation in Nepal.

- Widen the economic and financial instruments it uses to draw down climate finance to leverage and incentivise both public and private sector investment. Instruments such as grants and loans are more friendly to public, rather than private, sources of finance. The government should consider introducing equity and other instruments to access private as well as public sources.
- Build institutional capacity including climate change awareness — particularly at local level. This will ensure effective financial resource management by enhancing absorptive and management capacity of local bodies. Coordinating with concerned stakeholders will allow the government to address the frequently mentioned procedural delays in project and programme implementation.

Hari Prasad Sharma

Hari Prasad Sharma is a section officer in the Ministry of Finance's International Economic Cooperation Coordination Division (IECCD).

This briefing is an outcome of an action-learning writeshop organised by the Government Network on Mainstreaming Climate Change in Addis Ababa from 14–21 March 2014. Public policy planners from Bangladesh, Kenya, Nepal, the Gambia and Zanzibar used a 'financial landscape framework', 6 adapted to include the role of financial planning systems to assess their respective governments' plans for financing their transition to a climateresilient green economy. Its policy recommendations were developed after a learning and experience exchange with around 35 people from finance ministries, national planning commissions and research and civil society organisations following the writeshop.



Knowledge Products

The International Institute for Environment and Development (IIED) promotes sustainable development, linking local priorities to global challenges. We support some of the world's most vulnerable people to strengthen their voice in decision making.

Contact

Hari Prasad Sharma sharmahari2009@gmail.com; hsharma@mof.gov.np

Nanki Kaur nanki.kaur@iied.org

80-86 Gray's Inn Road London, WC1X 8NH United Kingdom

Tel: +44 (0)20 3463 7399 Fax: +44 (0)20 3514 9055 www.iied.org

IIED welcomes feedback via: @IIED and www.facebook.com/theiied

This research was funded by UK aid from the UK Government, however the views expressed do not necessarily reflect the views of the UK Government.



Notes

Oxfam Country Office Nepal. 2014. Stocktaking study on climate change adaptation finance in Nepal (Draft under consultation). / 2 These figures around the demand and supply of climate finance are an estimate only. / 3 National Planning Commission. 2013. Climate change budget code application review. / 4 CREF. 2013. Central Renewable Energy Fund – financial intermediation mechanism. Final draft prepared by CREF senior advisor and working group. Alternative Energy Promotion Centre. / 5 Government of Nepal, Ministry of Forests and Soil Conservation. 2010. Nepal's readiness preparation proposal REDD 2010-2013. Available at: http://mofsc-redd.gov.np/wp-content/uploads/2013/11/RPPNepal.pdf / 6 Buchner, B et al. 2013. The global landscape of climate finance. Climate Policy Initiative. http://climatepolicyinitiative.org/wp-content/uploads/2013/10/The-Global-Landscape-of-Climate-Finance-2013.pdf