Policy Brief

Policy, Planning and Finance

Climate Change Financing and Planning in Nepal:

Key Areas for Mainstreaming Climate Finance into the Planning and Budgeting Processes

The Cost of Climate Risks

Climate change is emerging as a dominant risk multiplier, interacting with development policies and undermining development gains. Due to changing climatic conditions, Nepal witnessed a higher number of climate-induced disaster events: water-related disasters alone accounted for 80 percent of property loss (MoFE, 2018). Studies claim that the estimated direct loss due to climate change in Nepal is equivalent to 1.5 – 2 percent of GDP per year—approximately US$270–360 million per year in 2013 prices—and loss is much higher in extreme years, rising to 5 percent or more (IDS-Nepal, 2014).

Economic findings using an integrated assessment model also suggest that the total climate change cost in Nepal will increase over time, with the GDP loss at more than US$62 billion by 2050 (Ahmed and Suphachalasai, 2014). In the face of apparent climate impacts on the national economy, climate risk-informed decision-making and mainstreaming climate finance in national planning and budgeting have both been integral for the climate-proofing of development gains.

Climate Change Financing Framework (CCFF) 2017

The Ministry of Finance (MoF) formulated the Climate Change Financing Framework (CCFF) in 2017, with technical support from UNDP Nepal. CCFF blends a top-down and bottom-up approach of planning process, in identifying priority climate action-related activities and resource allocation processes, together with an improved Public Finance Management (PFM) system for effective climate financing. CCFF is also expected to serve as a set of national guidelines that can be replicated at the provincial level, by linking policy decisions to budget allocations and expenditure tracking in a more structured manner.

The framework guides the Government of Nepal (GoN), helping it to structure climate finance in terms of (a) integrating Mid-Term Expenditure Framework (MTEF) and Public Finance Management (PFM) reform areas; (b) integrating climate change (CC) into planning and budgeting; (c) mobilizing resources to manage and target finance in support of realizing the country's strategic and climate goals, and (d) tracking and reporting expenditures. It provides pathways for national entities so they can integrate climate change adaptation measures into national and sub-national plans; also, so they can budget in order to make development resilient to climate risks, which is a prerequisite to achieving Sustainable Development Goals.

Mainstreaming Climate Finance into the Development Planning Processes

A review of CCFF 2017 demonstrates that challenges exist to mainstreaming climate change issues in climate resilient public planning financing system and public investment processes in the country. Similarly, there is a disconnect, not only in national and sectoral climate change targets but also in climate-related local, provincial, and national priorities. There is a lack of practical tools with which to assess climate loss and damage. There is also a lack of benchmarking for a climate budget ceiling at three tiers of government; this makes it difficult to track the channeling of over 80 percent of the total climate budget at the local level. Climate change has not been fully incorporated into the national and sub-national PFM system. Likewise, there is an absence of climate expenditure tracking at the sub-national level, and social returns on climate investments are not assessed, among others.

Building on CCFF 2017, this policy brief outlines six major entry points that can be used as a reference by the national, provincial and local governments—including sectoral ministries and line agencies—to contribute to climate change mainstreaming processes.

1. Climate Policy Provisions

The National Climate Change Policy (NCCP) 2019 requires sectoral agencies to integrate climate concerns into their policies, strategies, and plans. Despite some progress made in the 15th Five-Year Plan (15th FYP-2019/20-2023/24)—improving institutional mechanisms, climate resilience planning, promoting green growth and development, accessing international climate finance, capacity building—most policies have yet to consider climate change issues in a far-reaching way. To truly harmonize those policies with NCCP

2019 and promote climate finance as part of development planning, sectoral policy reforms are required.

For example, the Local Government Operating Act 2017 ought to integrate climate adaptation at the local level (MoFE, 2020). Sectoral strategies and plans at the provincial level must integrate climate change adaptation and financing, and consider climate change resilience (MoFE, 2020).

In addition, a common hurdle is that most policies across three levels of government lack a defined standard for climate actions. The lack of definition of norms and of an established standard of services mean that climate risk-informed planning remains challenging.

2. Climate Change Planning, Budgeting, and Financing Cycle

CCFF 2017 guides climate change financing so that it is integrated into sectoral policies and plans. It envisions a bottom-up climate planning approach so that local-level climate change-related activities can access funds from federal and provincial governments, as well as mobilize their own resources for climate actions. Thus, it is important to comply with the processes followed by public planning systems and integrate climate change issues into public planning, budgeting, and financing.

Though the public planning and budgeting cycle calendar practiced by the three tiers of government is a parallel exercise, taking place almost at the same time, there is a slight mismatch in timelines.

This presents a challenge, making it difficult to integrate priority climate risk-informed development plans identified at the local level with sectoral plans, both horizontally and vertically.

Moreover, the low absorptive capacity of local governments—especially in terms of capital expenditure, politicization of project selection, limited technical capacity, and lack of public participation—is a major reason for a poor performance in the overall planning, budgeting, and implementation of government development programs (DRCN, 2019). These gaps can debase climate risk-informed decision-making in the planning cycle, which must be addressed.

3. Climate Change Adaptation Resource Needs Estimation

The Inter-Governmental Fiscal Arrangement (IGFA) Act, 2017 makes it mandatory for three tiers of government to prepare a Mid-Term Expenditure Framework (MTEF), to align developmental projects with those related to budget formulation. This is an institutional mechanism to link the country's annual budget and periodic plan at both the federal and provincial level, as MTEF details the expenditure priorities of the development sectors.

However, an MTEF does not reflect climate change priorities, nor does it indicate the fiscal impact of loss and damage. Assessment of loss and damage is identified as an important aspect of resource estimation for adaptation gaps in the CCFF, 2017. Loss and damage must be considered a priority area while preparing an MTEF. Understanding the risks and extent of loss and damage would enable the government to develop climate and disaster risk-informed plans, and estimate resources.

Various studies show that Nepal would require more than USD 272 million per year during 2026-30 (NPC, 2018). However, there is no formally institutionalized method in place to calculate and establish the total, exact funding required to address climate change actions in the country. The practice of estimating loss and damage must be instated as part of the planning and budgeting cycle at all three tiers of the government.

4. Climate Budget Coding in Public Finance Management (PFM) and Climate Expenditure Tracking

The GoN has developed the Chart of Accounts as per the Government Finance Statistics Manual (GFSM) 2014 with computer-friendly numerical codes, in a manner that is compatible with Classification of Functions of Government (COFOG). Classification of budget codes is based on (a) organizational classification, (b) program classification, (c) functional classification, (d) economic classification, and (e) classification by funding source.

The Climate Change Budget Code was developed by the National Planning Commission (NPC), with the support of the UNDP in 2012. The code has been aligned with the GoN budgetary planning process through the Line Ministry Budget Information System (LMBIS) since FY 2013/14. The IT based PFM system has also been strengthened at provincial and local level. This IT-based planning, budgeting, and reporting on climate change is also expected to produce evidence-based, result-oriented climate budget and expenditure reporting; establish transparent climate budget and expenditure tracking; and promote good governance practices, thereby attracting more external funding from donors and development agencies. However, it is challenging to track actual information on climate activities because climate coding happens at the program budget head-level, not at an activity-level.

The criteria and methods defined in the Climate Change Budget Code, 2012 provide a process for tracking public expenditure. After all the information including budget heads, expenditure heads, activities, funding sources, several project information, amount of budget etc. is entered into LMBIS, the user has the option to select the program budget head as per relevance to climate actions. If the particular program is expected to expend more than 60 percent of the total budget allocation on climate-related activities, it would be classified as 'highly relevant' and coded as option 1. Similarly, if the program is expected to expend between 20-60 percent of the budget, it would be classified as 'relevant' or option 2. Lastly, if less than 20 percent of the total allocated budget is going to be spent on climate change-related activities or if the program is not related to climate change, the program would be classified under the category of 'neutral' in terms of climate change, and coded as '3'.

The subjective criteria used to identify the climate relevant programmes through coding process, presents vague and confusing ideas about the climate related activities.

In addition, weightage-based criteria used for climate budget coding stand the chance of being interpreted incorrectly, with the risk of unrealistic assessment results (Resch, et al., 2017). There are other challenges to capture real time climate expenditure in the country. Climate expenditures are captured under just two expenditures categories assigned separately for climate expenditure with limited options. In addition, several budget allocations made under climate expenditure categories are not entirely climate related. Climate budget allocations to provincial and local level are made under conditional capital grants are made under separate expenditure category.

Regardless of the challenges in climate coding, this system has the potential to be rolled out at the sub-national level, towards tracking the public response to climate change actions in the country. To improve systems on climate public expenditure tracking, developing a predefined set of criteria for sectoral planning, upgrading CoA of sub national government to match the CoA of national level, developing separate chart of "climate related activities" developing better understanding on relevance of budget code during the budgetary planning process could be considered, meeting the specific needs to institutionalize the climate resilience across fiscal planning, budgeting and public investment areas in the country.

5. Climate Change Budget Monitoring and Accountability

CCFF 2017 calls for annual reporting on climate change expenditure, but it is not practiced regularly. Monitoring the key climate indicators concerning the national and sectoral targets could be valuable in providing information on climate change planning and financing. National Monitoring and Evaluation Framework in the NPC, incorporating climate dimensions in the annual National Economy Survey, aligning the national and international, climate commitments with Mid-Term Expenditure Framework (MTEF), provides avenues to improve climate change accountability. Similarly, considering qualitative and quantitative reporting on climate expenditures during the annual programs of government, a four-monthly basis reporting on the outputs and activities of the ministries would improve climate transparency and disclosure mechanism in the country.

6. Gender and Poverty in Climate Change Planning, Budgeting, and Financing

CCFF 2017 lacks a mechanism with which to inform the government on how climate change actions will contribute to addressing SDG-related poverty and gender targets. Although the MoFE is coordinating overall climate change-related activities through thematic working groups, there is a clear gap in linking climate change with poverty and gender-related implications. Though the LMBIS provides a discrete coding mechanism with which to track poverty and gender-related data, the existing system does not correspond to the climate change finance data on gender and poverty. The government uses a log-frame matrix of projects to review and track the results, which do not necessarily inform gender and poverty dimensions of climate change planning. Thus, it is necessary to develop a system that provides detailed information about sectoral climate impacts across different geographical regions and how they affect poverty and gender, towards equitable development in the country. As suggested in the methodological note (on Incorporating Gender and Poverty Analysis) in the CPEIR Review (UNDP, 2014), it is required that CPEIR review methods incorporate poverty and gender analysis and dimensions so as to contribute to gender equity, poverty reduction, and climate resilience.

Recommendations

Policy provisions: At the federal level, there are a good number of policies that are related to the sectors susceptible to climate change as defined in the NCCP, 2019. However, these need to incorporate climate change issues and targets, benchmark climate budget, to promote climate finance in development planning. At the sub-national level, evidence-based climate change-related policies and climate action planning and financing should be prepared with due consideration of mainstreaming risk assessments to establish risk-informed decision-making culture.

Climate change planning, budgeting, and financing: It is essential to improve and roll out CCFF at sub-national and local level, improve awareness on relevance of using climate code during climate resilient fiscal planning, budgeting and public investment, climate auditing of national and sectoral policies, strategies, Developing a separate "Chart of climate related activities" to avoid contradiction and duplication of activities , develop climate relevance criteria to be used as reference and provide more conceptual clarity during climate budget coding, and synchronization of NDC targets with the MTEF, five-year plans, and strategic plans. Also, there should be a mechanism for integrating local and provincial-level climate change targets at the national level: into planning, budgeting, and financing. Climate change being a cross-cutting issue, it is important to update the Business Allocation Rules, 2017 to ensure that climate change is a common, priority responsibility of all concerned ministries by explicitly mandating all the Ministries and sectoral line agencies to establish a Climate Change Unit and incorporate climate actions in the overall planning cycle.

Climate change adaptation resource needs estimation: It is recommended that a simple methodology and a set of tools are developed, which can easily be used by governments to assess climate induced loss and damage. Moreover, it is instrumental for overall climate change resource estimation to devise and pilot a set of tools to estimate the economic cost of climate change-induced loss and damage, to quantify the adaptation benefits of current expenditure, and to assess the impact of climate change on public expenditure through changes in revenues and tax base due to unprecedented climate events that is usually not foreseen in the projected finance. Most importantly, it is also recommended to consider a mechanism to reflect off-budgetary climate expenditure in the public expenditure reporting to understand the needs for a holistic climate change adaptation resource.

Climate budget monitoring andaccount-ability: The ongoing GoN's PFM reforms (PFMRP -II, 2016/17-2025/26) provide an opportunity to work closely on climate issues to improve climate finance institutional mechanism for credibility, enable climate policy-based budgeting, and enhance accounting, recording, and reporting on climate finance and climate budget auditing.

Similarly, two Parliamentary Committees (Committee on Natural Resources, Economic Rights and Revenue Sharing, and Development Committee) are directly associated with climate change mainstreaming processes. Their active engagement can be effective to monitor the climate budgeting and financing system in the country. In addition, capacity building is required to enable the federal as well as provincial assembly to guide the line ministries in climate budgeting and financing matters. Also, it is necessary to train and build capacity of the staff, especially the planning and finance officers on a regular basis at the sectoral ministries and department at the federal and provincial governments. To promote climate smart planning, budgeting and investment practices, together with developing long-term and short-term strategies on climate finance, thus demonstrating public accountability.

Gender and poverty in the climate change planning, budgeting, and financing: A climate change impact database must be created to track and inform gender and poverty dimensions in public climate actions. More importantly, introducing a system of gender auditing in climate change policy and strategies will enhance the gender outcome of climate actions.

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