TAAS-0072: Support for Strengthening Climate Finance Activities in Nepal

Recommendation Report

Submitted by:

Nepal Development Research Institute (NDRI), Nepal

in collaboration with:

Prakriti Resources Centre (PRC), Nepal

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This project, TAAS-0072: Support for Strengthening Climate Finance Activities in Nepal, was undertaken in close coordination with the Government of Nepal and the private sector, and is supported by Climate and Development Knowledge Network (CDKN).

The work is led by Nepal Development Research Institute (NDRI) in collaboration with Prakriti Resources Centre (PRC).

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Acronyms:

AEPC	Alternate Energy Promotion Centre
AF	Adaptation Fund
CBO	Community Based Organization
CDKN	Climate and Development Knowledge Network
CIF	Climate Investment Fund
CNI	Confederation of Nepalese Industries
DFID	UK Department for International Development
DGIS	the Netherlands Directorate-General for International Cooperation
ESS	Environmental and Social Safeguards
GCF	Green Climate Fund
EPF	Employees Provident Fund
FNCCI	Federation of Nepalese Chamber of Commerce and Industries
FNCSI	Federation of Nepalese Cottage and Small Industries
INGO	International Non-Governmental Organization
LAPA	Local Adaptation Plan of Action
LCEDS	Low Carbon Economic Development Strategy
LDCF	Least Countries Development Fund
MIE	Multinational Implementing Entity
MoF	Ministry of Finance
MoI	Ministry of Industry
MoPE	Ministry of Population and Environment
NAP	National Adaptation Plan
NAPA	National Adaptation Program of Action
NAMA	Nationally Appropriate Mitigation Actions
NCCSP	National Climate Change Support Programme
NDA	National Designated Agency
NDC	Nationally Determined Contribution
NDRI	Nepal Development Research Institute
NGO	Non-Governmental Organization
NIE	National Implementing Entity
NLCEDS	National Low Carbon Economic Development Strategy
NPC	National Planning Commission
NTC	Nepal Telecom Corporation

NTNC	Nepal Trust for Nature Conservation
PPP	Public-private partnership
PPTC	Project Preparatory Technical Assistance
PRC	Prakriti Resources Centre
REDD	Reducing Emission from Deforestation and forest Degradation
SME	Small and Medium Enterprise
UNFCCC	United Nations Framework Convention on Climate Change

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1 Introduction

A project on "Support to Strengthening Climate Finance Activities in Nepal" was implemented by Nepal Development Research Institute (NDRI), in collaboration with Prakriti Resources Centre (PRC) and funded by Climate and Development Knowledge Network (CDKN).

The overall objective of this project was to support the Government of Nepal, particularly the Ministry of Finance (MoF) as well as the Ministry of Population and Environment (MoPE), in enhancing their understanding and capabilities towards accessing and utilizing climate finance to implement climate action in the country. Specific objectives of the project included:

- Enhancing understanding of potential National Implementing Entities (NIEs)with regards to accessing international climate finance through direct access modality through training workshops and production of knowledge products;
- Bridging divergent views /understanding among senior government officials from the MoF, the MoPE and others;
- Raising awareness regarding barriers towards accessing climate finance both within Nepal (delivery mechanism) and internationally (access). It is expected that this will provide the key actors with a broader understanding of the global climate finance landscape.

A number of knowledge products have been prepared by the project team including:

- A note identifying suitable NIEs: this covers the criteria for selection of potential NIEs for accreditation to GCF, and the list of potential NIEs according to GCF strategic impacts areas and national priorities have been identified
- Situation Analysis Report: a baseline analysis of the status of climate finance related work in Nepal, including barriers and challenges faced by relevant actors, and the entry points for further interventions and arrangements needed on climate finance are covered in the report
- Reusable Guide on GCF accreditation: the guide describes the different aspects of GCF, the accreditation procedure and the opportunities available for private sector engagement in GCF.
- Briefing note on Direct Access Modality: describes what Direct Action Modality of climate finance is and summarizes the opportunities and challenges, and the way forward for Nepal in accessing climate finance through Direct Access.

A climate finance sensitization workshop (on 7 March 2017), followed by a capacity assessment workshop (on 27 – 28 March 2017) of potential NIEs (targeting the private sector organizations) was organized in Kathmandu.

This recommendation report summarizes the key recommendations from all the project activities including the capacity assessment exercise and the recommendations made by the potential NIEs and concerned government agencies as part of their feedback on the workshops and in individual follow-up meetings with top management of these entities.

2 Access to GCF by the Private Sector

2.1 Barriers

A key barrier to accessing climate finance by Nepal is a lack of understanding and awareness of the key government, non-governmental and private sector organizations on the available international climate finance. There is also a strong need to bridge divergent views and understanding among key stakeholders like the government ministries and departments, and the implementing agencies in the government and private sector. The Ministry of Population and Environment (MoPE), the focal ministry for UNFCCC, has been formulating various climate change policies and action plans, such as Climate Change Policy (2011), National Adaptation Programme of Action (NAPA), Nationally Determined Contribution (NDC) etc., in accordance with the international commitments. The key sectoral ministries are however more guided by the national development policies, which are found, in some instances, not fully coherent with the climate change policies and action plans. Ministry of Finance (MoF) is more focused on oversight of financial expenditures and fiscal policies, and the economic planning is carried out by the National Planning Commission (NPC). Closer coordination between the Ministry of Finance (MoF), the National Designated Authority (NDA) for GCF, MoPE, NPC and other sectoral ministries is hence needed in accessing and disbursing climate finance more effectively.

International funds such as the Green Climate Fund (GCF) and Climate Investment Fund (CIF) require high social and environmental safeguards and fiduciary standards that countries like Nepal with limited capacity find extremely challenging to fulfill. Moreover processes to access these funds are cumbersome and lengthy. Hence, Nepal has been relying on intermediary agencies like UN agencies and Multi-lateral Development Banks (MDBs) for their assistance to access international climate finance.

The public finance system in Nepal is gradually being reformed. Inbuilt characteristics of the current public finance expenditure system have contributed to lower spending than expected of the government budget in the last few years. This has raised a serious question on the absorption capacity of climate finance within the government financial systems.

The budget tracking method followed by the MoF is limited to only public finance, climate investments made by Community Based Organizations (CBOs), Non-Governmental Organizations (NGOs), International NGOs (INGOs) and private sector are not tracked by the ministry. The climate coding is applied to projects that are likely to contribute to mitigation and adaptation but it fails to track the actual expenditure (percentage of total) that contributes directly to climate mitigation and/or adaptation.

Sources of climate finance are scattered and uncoordinated, posing difficulties in obtaining a true picture of climate finance in the country. The government also faces an uphill task of fully monitoring 80 per cent of climate funds going to the local level for project implementation as stipulated in the Climate Change Policy (2011).

The key government agencies dealing with sectors such as Forestry and Agriculture, Water and Energy, and Industry and Transport have experience in managing projects funded by bilateral and multinational donors and generally meet the fiduciary, environmental and social safeguards (ESS) and gender requirements of such development partners. On the other hand, most of the private sector, NGOs and small and medium enterprises (SME) do not have that experience. Hence, their capacity to meet the required fiduciary, ESS and gender requirements of climate funds like GCF, and to prepare concept notes and proposals for funding, are limited.

Nepal has prepared a National Climate Change Policy in 2011 that sets seven different objectives focusing on institutional strengthening, climate change mitigation and adaptation, promotion of use of clean energy, strengthening the capacities of local communities, low carbon development pathway, institutional capacity on impact assessment and maximizing the benefits from climate finance. The policy has also set certain time-bound targets, such as establishing a Climate Change Center within one year, preparation of a national strategy for carbon trade by 2012 and low-carbon economic development strategy by 2014, etc. Accordingly, the National Adaptation Programme of Action (NAPA) and the National Framework for Local Adaptation Plan of Action (LAPA) have been formulated. The National Adaptation Plan (NAP) is now under preparation. The reducing emission from deforestation and forest degradation (REDD+) strategy and Low Carbon Economic Development Strategy (LCEDS) that were prepared to implement the Climate Change Policy are however still in draft stage. The draft LCEDS has identified and set the targets for seven prioritized strategic areas. The Nationally Determined Contribution (NDC) has been submitted by Nepal after the Paris COP. The Nationally Appropriate Mitigation Action (NAMA) is yet to be prepared. The sectoral policies that are needed to support the climate change policies and action plans however will need to be harmonized accordingly. Similarly, there is a need to ensure that the regulatory framework (acts and regulations) in the key sectors, such as the Forestry and Agriculture, Water and Energy and Industry and Transport, are updated to support the climate change and sectoral policies.

Nepal does not have a clear national climate financing modality. There has been some work through the National Climate Change Support Programme (NCCSP) but it has its own challenges. Better coordination between the Ministry of Population and Environment (MoPE), the focal ministry of UNFCCC, Ministry of Finance (MoF), the National Designated Authority (NDA) for GCF and the other ministries and stakeholders remains the major challenge to access climate finance. There is also a need to review the climate finance modality in the future as country evolves towards a federal governance structure.

The key barriers to accessing international climate finance can be summarized as follows:

- Lack of awareness and understanding of climate finance access
- Divergent views of key government, non-government and private sector leading to incoherent planning and prioritization of Nepal's needs
- Capacity barriers –potential NIEs/EEs have low capacity to meet the fiduciary, ESS and Gender requirements, development of concept note and proposal preparation
- Policy and regulatory barriers- the different policies are not fully supported by the required regulatory framework and actions plans
- The long process for both accreditation and project/programme development and approval are also the barriers for the NIEs as they lack internal capacity

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2.2 Opportunities

The challenges that Nepal embraces also come with wide variety of opportunities. The international community is ready and willing to work with the Government of Nepal to address climate change. Currently, various projects to address adaptation needs and low carbon development strategy are underway. Ministry of Finance (MoF) stresses that, over the past few years, investments by international donors for climate action have increased, which is an opportunity to tackle climate change but also to make development climate smart and resilient.

Nepal is one of those LDC countries that have the required policies, plans and structures to be put in place to address climate change as discussed above. These policies and opportunities should incentivize Nepal to move towards climate compatible development.

Access to climate funds by the private sector is limited at the moment, and there is need to focus on activities targeting private sector to make them aware of the opportunities to access funds especially from GCF and investment in technology upgrading/transfer through established market mechanisms. The private sector investments in the infrastructure, services and manufacturing sectors are currently funded by the private banks in Nepal. There are also some infrastructure projects like hydropower projects that are co-financed by national funds such as the Employees Provident Fund (EPF), Citizen Investment Fund (CIF), Nepal Telecom Corporation (NTC) and Nepal Army Welfare Fund. Public-private partnership (PPP) is also a modality promoted by the government to support large infrastructure projects. Access to climate funds by such projects will not only provide needed investment in these sectors, but, more importantly, it will ensure that these investments are both climate smart and resilient.

Climate related funds, specifically GCF, support low carbon, climate resilient development in developing countries. Nepal, being a least developed country, needs to prepare itself to access GCF to finance nationally prioritized climate change projects and to use mechanisms that maximize the participation of the private sector.

GCF promotes Direct Access of funding through National Implementing Entities (NIEs), in which case institutions can better use the fund based on their strength, aiming to achieve the greatest impact in terms of climate change mitigation and adaptation.

Commercial banks in Nepal are well regulated institutions and are one group of potential NIEs. Although, commercial banks currently focus on internal resource mobilization and lending, a shifting focus on climate resilient development shall provide them better opportunities for business and growth. Commercial banks, because of their experience and function as financial institutions, have suitable fiduciary standards in line with GCF, in place, though they may need some capacity enhancement for environmental and social safeguards, and gender policy compliance. Hence, with proper capacity building, commercial banks are considered one the most suitable potential NIEs in Nepal.

3 Recommendations

The recommendations are based on:

- Situation analysis on climate finance in Nepal, including barriers and challenges faced by relevant actors and the entry points for further interventions and arrangements needed on climate finance. Discussion during the training workshop held on accreditation to Green Climate Fund (GCF) with potential implementing entities (NIEs) on March 28 – 29, 2017 in Kathmandu
- Inputs from the participants on the feedback questionnaire sent after the workshop
- Discussion with top management of some of the potential NIEs

3.1 Capacity Development

This assessment covers three aspects:

- Understanding the working of GCF and other sources of climate finance
- Understanding and capacities to assess and fulfill GCF requirements (Fiduciary, Environment and Social Safeguards and Gender)
- Capacities to prepare bankable projects in line with national priorities and UNFCCC objectives

Understanding the working of GCF and Other Sources of Climate Finance:

- Many government ministries/departments and, public and private sector institutions still do not have complete understanding of GCF's mandate to speed up sustainable development and GCF's strategic areas and how they relate with Nepal's national priority programs/projects. In the context of local bodies being encouraged to plan and implement programs, awareness programs targeted at subnational and local level are needed for Nepal to really benefit from GCF.
- Financial institutions, including commercial banks, need interactive meetings with Ministry of Finance (the National Designated Authority for GCF in Nepal) and the Central Bank of Nepal to understand what opportunities and support is available to them, and the GCF financial instruments which can be accessed.
- Private sector institutions involved in hydropower and other renewable energy development and industry sector should be engaged by concerned government bodies to help them understand how GCF funds can be utilized whilst mobilizing domestic private investment.

Understanding and capacities to assess and fulfill GCF's accreditation requirements (Fiduciary, ESS and Gender)

- All eight entities[1] that attended the capacity assessment workshop and responded to the feedback questionnaire said that they meet the fiduciary requirements. However half of them thought they needed to develop more procedures to fully meet the requirements. Similarly, all except one (who was not sure) met the specialized

[1] Two were banks, three were government agencies, two were private sector entities (Federation of Nepalese Chamber of Commerce and Industries- FNCCI and Federation of Cottage and Small Industries- FNCSI) and one was an autonomous government institute which is in the early stages of accreditation process.

fiduciary requirements, but five of the eight think they will need some form of restructuring. Only half of the respondents think they meet the environmental and social safeguard requirements. But most of the respondents (five out of eight) think they will need some restructuring and additional procedures to meet the ESS requirements. Similarly, while most (six out eight) think they meet the gender policy requirements, all except two think they will need additional procedures to meet the full requirements.

- Government ministries and departments with experiences of implementing major donor funded projects can meet the basic fiduciary requirements and also the specialized requirements of GCF. Similarly, the ESS requirements can also be compiled with some minor restructuring of institutional arrangements. It is recommended that training programs are organized on GCF financial requirements for officials working in the finance and administration divisions/sections of government ministries and public sector institutions. Similar training programs on ESS and gender requirements with the concerned officials working in the Environment/Climate Change divisions/sections/units of the government ministries/departments and public sector institutions are also required.
- Commercial banks can comply with the fiduciary and gender requirements but they do not have the necessary arrangements to address the environmental and social safeguard standards of GCF. Organization of training programs on ESS requirements by experts working on the environment should be enabled.
- Capacities to prepare bankable projects in line with national priorities and UNFCCC objectives are needed. Government ministries and departments have some experience in preparing bankable project proposals for multi-national donor agencies but smaller, private sector entities lack this experience. These are however prepared by consulting firms, on the recipient entity's behalf, under Project Preparatory Technical Assistance (PPTA) provided by the donor/funding agencies. Potential NIEs, especially the small and medium enterprises/entities, require training programs on concept note and project/program proposal development. It is critical that NIEs and also EEs develop bankable projects/programs which are approvable by GCF's standards. MOF and the MoPE can utilize the readiness support fund to plan and execute such training programs for national institutions.
- Specific training programs should be provided to sector specific institutions like major infrastructure development institutions to develop relevant and appropriate bankable projects.

3.2 Enabling environment

Policy and Regulations

Government of Nepal has already mainstreamed climate change into many national and sectoral development policies. Although initiated three years ago, the National Low Carbon Economic Development Strategy (NLCEDS) is yet to be approved by the Council of Ministers. In order to establish the linkages with UNFCCC objectives and fulfill the commitment, Nepal submitted its Nationally Determined Contribution (NDC) in 2016.

Despite the changes made in many policies, provisions of these policies are yet to be transferred into legal documents. Legal instruments particularly use of economic instruments such as lower taxes for clean technology, renewable energy, and energy efficient appliances and highly productive systems or carbon taxes based on potential emission or energy consumption by industry, vehicles or technology is still lacking. - The enabling environment that supports the private sector to promote low carbon and climate resilient development should be formulated; for instance, low taxes for industries that switch to renewable energy or other incentives to banks that contribute to climate compatible development.

It is to be ensured legally that private investments in low carbon and climate resilient technologies/infrastructures are provided sovereign support and incentives to access funds from GCF.

It is highly recommended that the supporting acts and regulations needed to implement the climate change policies and strategies are put in place at the earliest. The sectoral policies also need to be harmonized with the climate change policies and strategies, to overcome the barriers discussed in **Section 2.1**.

Institutional Arrangements

In addition to the coordination mechanism established by the Ministry of Finance (MoF), there is need to establish systems in key sectoral ministries so they can engage in GCF processes. As such, each development ministry and public sector institution should have a climate finance unit/personnel that engages with MoF's coordination mechanism to ensure support is provided to implementing arms (departments) and subnational bodies, where needed, especially with development of project proposals for GCF.

As the country prepares for more proposals to be submitted to GCF through a number of accredited NIEs in the future, the current strength of climate finance section (one undersecretary and two section officers) at Foreign Aid Coordination and Cooperation division of MOF will be insufficient, it needs to be expanded and capacity strengthened.

While the MOF is the key government agency responsible for financial oversight of all government spending, the National Planning Commission (NPC), as the national development planning and coordinating body, should take the lead to coordinate with development ministries to design projects/programs to be supported by the GCF. The country is planning to merge the two agencies as the Ministry of Finance and Planning in the new federal structure and, hence, this coordination issue should be taken care of by the new Ministry.

MoPE, as the focal ministry of the UNFCC, has a special role to ensure that the proposals are aligned with the national climate strategy and priorities. The Climate Change Council under MoPE, although not functional at present, can guide the prioritization of the projects/programmes. Other existing committees within MoPE can also play the role of ensuring that climate finance is operationalized under various sectors, levels of government and at the sub-national and local levels.

3.3 Private sector engagement

It is the policy of GON to engage private sector in every sector of the economy, and opportunities provided by the GCF, can be instrumental in attracting the private sector investment in the GCF strategic focus areas. For example, about 13 billion USD (54.7% of the total investment requirement of 24 billion USD in the current three year plan from 2016/17 – 2018/2019) is expected to come from the private sector. The government has formulated policies and strategies such as tax incentives, single-window system etc. to promote private sector investments. The Ministry of Industry (MoI) is the lead government agency that promotes private sector participation in different sectors of the economy.

NDA needs to take initiatives to make aware/educate the investors to avail GCF's funds in areas that fall within GCF strategic areas, as part of their investment.

NDA needs to strengthen the institutional capacity of institutions like Ministry of Industry, Industrial Enterprise Development Institute, Cottage and Small Industries Development Board, and Industrial District Management to be implementing entities to facilitate the flow of funds in the development of micro and small enterprises in the country that contributes to the eight strategic impact areas of the GCF.

GON needs to engage the private sector through federations like Federation of Nepalese Chamber of Commerce and Industries (FNCCI), Confederation of Nepalese Industries (CNI), Federation of Nepalese Cottage and Small Industries (FNCSI in bringing funds from GCF with particular focus relevant strategic impact areas of GCF. Example of some of the projects or activities that these entities can work are on enhancing the productivity, energy efficiency, waste heat recovery, cogeneration, development of common treatment facilities with energy generation, pollution prevention and waste management in an environmentally sound manner.

The participation of the representatives from the private sector (banks and funds like the Employee Provident Fund) in the steering committee and working groups under MoF and MoPE is recommended so that private sector engagement with GCF is ensured. There is a need to raise funds from GCF or other donors to build capacities of the private sector. Potential executing entities from the private sector should be matched with MIEs or NIEs for project proposals. MoF, MoPE and the sectoral ministries should establish a system that continues to broker this.

DA needs to support Ministry of Energy to be accredited to GCF to attract private sector investment in large scale low carbon energy generation and to expedite the process of accreditation of AEPC to promote private sector investment in the renewable energy sector.