Financing Resilience: A Policy Brief on Climate and Disaster Budgets in Sudurpaschim and Madhesh Province of Nepal

INTRODUCTION

Nepal has developed a well-founded policy and legal framework to integrate Climate Change Adaptation (CCA) and Disaster Risk Reduction and Management (DRRM) into its planning and budgeting processes. While the sixteenth National Development Plan (2024/25 – 2028/29) has targeted increasing the climate-relevant budget from 6% to 20 % in the next five years. Likewise, the Disaster Risk Reduction Strategic Action Plan (2018–2030) requires each development sector, such as agriculture, health, and infrastructure, to allocate at least 5% of its annual budget for DRRM. However, existing evidence highlights a gap in the allocation, availability and utilization of funds for CCA and DRRM interventions. Against this backdrop, this study was commissioned to understand status, opportunities, challenges and gaps in existing policies and examine the factors influencing risk-informed planning and budgeting.[1]

WHAT DID WE DO?

We analysed the allocation and expenditure of public funds for CCA and DRRM at the provincial level and across seven municipalities and rural municipalities from the Madhesh and Sudurpaschim Provinces of Nepal. The study reviewed budgets from the past two fiscal years (FY 2077/78 BS - FY 2078/79BS) for provinces and five fiscal years (FY 2076/77 BS- FY 2080/81 BS)2 for local governments (LGs).

We evaluated the effectiveness of selected CCA and DRRM public investments, focusing on their socio-economic impact on vulnerable communities.

We explored opportunities to leverage innovative financing mechanisms to enhance resilience outcomes.

1 | HOW DID WE DO IT?

We developed a comprehensive framework comprising 65 typologies and 471 qualifiers to ensure accurate budget tagging through a rigorous process that included a setting criteria as per the resilience priority set under the National Adaptation Plan (NAP), used as an ex-post analysis through a detailed examination of budget lines from SuTRA and P-LMBIS, and an analysis of audit reports, budget speeches, and guidelines.

Develop budget tagging criteria	Use of standard activity / plan based criteria and typology to identify and assess climate and DRRM- Relevant public expenditure
Application of crieteria to segregate CCA / DRRM activities allocation and expenditure	• Use criteria to assess and tabulate province and local governmant allocation expenditures. • Review relevant plans, budgets, expenditure reporting and policy frameworks related to climate and DRRM.
Additional Data collection, effectiveness, efficiency analysis and validation	• Data collection stakeholder consultations at all levels both public and private sectors. • Validation of key findings with respective provinces and LGs.
Consolidation of final outputs and dessemination	Final Report, publication and dissemination of findings.

1. The study did not include off-budget and off-treasury investments.
2. In Nepal, government's FY starts and ends in mid-July of Gregorian Calendar Year. BS refers to Bikram Sambat and is a national calendar of Nepal. It is approximately. 56 years, eight and half months ahead of AD.

2 | We reviewed relevant legal and regulatory frameworks, assessed, and tagged province and local government's budget allocation and expenditures to segregate CCA and DRRM activities based on typologies developed in Step 1.

3 | We gathered additional information and engaged stakeholders across all levels, including both public and private sectors. Furthermore, we validated the key findings in consultation with the respective provincial and local governments.

WHAT DID WE FIND?

Despite Nepal's robust legal frameworks, practical integration of climate and disaster risk considerations into budget planning remains limited. LGs and province government struggle to incorporate climate risk assessments due to limited evidences, and inadequate institutional capacity to effectively integrate risk informed planning process.

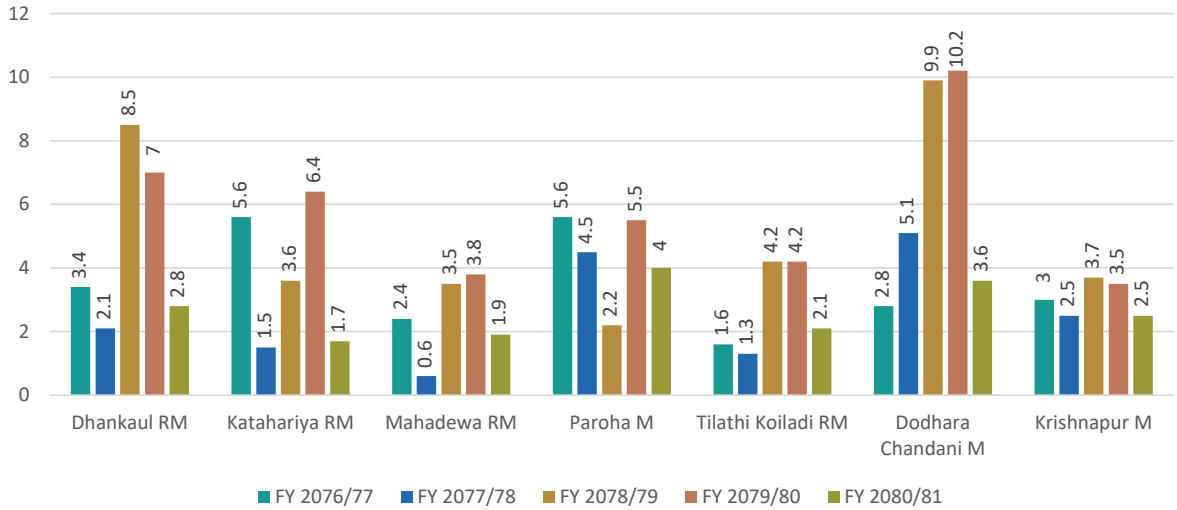
LGs tend to prioritize short-term solutions. The current practice of annual budget and planning process largely overlooks the broader need for long-term climate resilience and disaster risk reduction. One of the reasons for short-term planning is due to a significant gap in funding for long-term climate resilience. Most funding at the local level is found to be directed towards short-term disaster response, with limited resources allocated to anticipatory disaster risk reduction measures. For instance, funding for flood defenses and resilient housing are often neglected due to resource intensive interventions and anticipated long-term commitments.

Budget allocations across local governments varies in the Madhesh and Sudurpaschim Provinces suggesting a need to prioritize climate and disaster investments. While sectors like agriculture, and water, receive comparatively more attention in terms of budget allocation, broader cross-cutting areas such as governance, livelihoods, and climate resilience receive limited focus.

While the budget allocation and expenditure is influenced by the need to respond to disaster events such as floods in Dodhara Chadani, overall budget on climate and disaster resilient infrastructure and governance sectors are underfunded. The budget allocation trend in CCA and DRRM is also inconsistent. This inconsistency is due to no clear strategy for incorporating CCA and DRRM interventions into broader sub- national government plans.

There is a lack of integrated climate risk data at the LG level. This limits LGs to plan effectively for CCA and DRRM.
LGs rely heavily on equalization and conditional grants with limited matching grants/special grants available to address climate and disaster risks.

FIGURE 1:
CCA/DRRM-related budget at local governments over last five fiscal years in Madhesh and Sudurpaschim province



Despite these gaps, there exist positive socio-economic impacts from the public investments at the subnational levels. CCA and DRRM investments contributed to improved food and nutrition security, increased income, and better health and education outcomes for vulnerable populations. Interventions provided immediate relief, such as improved irrigation and drinking water access. While these investments were effective in the short run, many did not adequately address long-term climate and disaster risks. For example, flood-damaged irrigation canals in Saptari were repeatedly rehabilitated without risk informed design and planning . As a result, the irrigation and drinking water facilities led to groundwater shortages and other resource mismanagement issues, further heightening the risk and vulnerability .

The case studies of Buniyad Irrigation Project and Sulav Irrigation Project highlighted several key best practices.

Buniyad Irrigation Project: The transition from an earthen to a cemented canal has been a game-changer for a local farming community. This transition has benefitted hectares of land and improved crop yields, increased food security by ensuring stable water supply and reduced vulnerability to floods and water shortages as the new canal design also addresses drainage issues.	**Sulav Irrigation Project:** The use of naturally occurring spring as the water source for this project has proven to be both sustainable and reliable. The water volume has remained consistent over the years. This approach ensures stability in agricultural production and the project irrigates 125 hectares of land while benefiting a larger community of farmers.
Both projects have enhanced food and nutrition security through increased production of crops, reduced labor requirements for irrigation while saving time and effort for farmers, and diversification of income sources.	

Inclusion and equitable benefit sharing mechanisms: The current climate and disaster interventions at the local and provincial level are more reactive in nature and has failed to specifically address the needs of the vulnerable population, including women and children. The review of the sub-national level plans also shows the limited resources and interventions on improving the livelihoods and critical resources that poor and vulnerable people largely depend. The focus of the sub-national level plan on scattered interventions and largely on the infrastructure has undermined the urgent needs of the people.

Innovative financing mechanism for CCA/DRRM. Nepal has established a foundational policy framework to mobilize private capital for CCA and DRRM, including the Public-Private Partnership Act (2019), green taxonomy, green bond provisions from the Securities Board of Nepal (SEBON), and directed lending mandates from Nepal Rastra Bank. However, significant barriers persist, including underdeveloped capital markets, policy barriers that has created disincentives for the private sector investment in green businesses, and limited technical capacity in financial institutions. The recent introduction of the Green Finance Taxonomy (2024) is a critical step to guide and scale private sector investment using the Environment, Social, and Governance (ESG) framework.

KEY RECOMMENDATIONS

Despite Nepal's strong legal frameworks, along with innovative financial mechanisms facilitating the private sector investments, integrating CCA and DRRM considerations into budget planning, remains limited due to limited resource access and mobilization at the local and provincial level, inadequate institutional capacity, and limited implementation coverage targeting the most vulnerable population. While some investments have shown a positive impact, many do not adequately consider sustainability, as seen in repeated investments in relief without focusing on proactive risk reduction. In addition, budget uncertainties, limited technical expertise, and lack of incentive mechanisms has created obstacles in leveraging climate finance at scale necessary to sustain climate and disaster resilience investments. The following recommendations can help increase investment in CCA and DRRM in Sudurpaschim and Madhesh Province as well as the LGs.

Strengthening Policy Implementation and Vertical Alignment: To implement national frameworks such NAP, NDC, and DRRM Strategic Action Plan, federal government's support in developing contextual action plan at province and local governments and simplified guidelines to ensure integration of these plans in annual budget will be critical. At the sub-national adequate resources and capacity needs to be secured for integrating LAPA and LDCRP directly into their annual planning and budgeting cycles, ensuring these documents become actionable financial commitments.

Establish a Predictable and Risk-Informed Financing Framework: To ensure financing for resilience is predictable and effective, the federal government should support two key reforms. First, integrate community vulnerability and risk assessments into the formulas for allocating fiscal transfers, such as equalization grants. Second, mandate the integration of risk reduction interventions into the Medium- Term Expenditure Frameworks (MTEFs) across all tiers of government. At the sub-national level, these efforts should be complemented by localizing the BIPAD portal to guide risk-informed development planning and by promoting fiscal incentives for climate and disaster resilience investments. To ensure transparency and accountability, the sub-national government must be empowered to consistently use the Climate Change Budget Code and DRRM tagging systems for tracking and reporting on all related expenditures.

Aligning Sub-National Budgets with National and Subnational Resilience Targets: To overcome underfunding for climate and disaster resilience building actions, provincial and local governments should allocate at least 5% of sectoral budgets to DRRM, per the National DRRM Strategic Action Plan, and achieving the 20% climate-relevant spending goal of the 16th National Plan. This alignment necessitates a strategic shift from short-term disaster response to proactive, long-term risk reduction, increased budget allocation for DRR and CCA particularly in underfunded sectors like GESI, livelihoods, and climate finance supported by progressive public and private investment.

Building Technical Capacity and Ensuring Accountability: To ensure the effective implementation of resilience policies, it is crucial to enhance the technical capacity of all stakeholders. This includes training for government officials across all sectors, on risk-informed planning, sectoral mainstreaming of climate action, and the correct application of budget tagging guidelines like the Climate Change Budget Code. Concurrently, raising awareness among local communities, private sector and civil society and political leaders about national climate and disaster policies will foster greater public demand for risk reduction interventions, ensuring these priorities are reflected in annual government plans and budget.

Establish Standardized Metrics to Guide and De-Risk Investment: To improve the effectiveness of resilience initiatives and address the high risks perceived by the private sector, it is essential to establish a national framework of standardized metrics. These metrics should be integrated into all government planning and budgeting processes to consistently measure outcomes. The framework must include clear indicators and methodologies for assessing return on investment, social impact, and the reduction of climate risk exposure. This will provide a consistent basis for evaluating projects, enabling informed decision-making, and attracting private capital by making resilience investments more transparent and measurable.

Institutionalizing Inclusive and Equitable Planning: Ensuring that resilience efforts are equitable can be achieved by institutionalizing the meaningful participation of women, youth, persons with disabilities, and other marginalized groups in all stages of the seven-step local planning process. All disaster management and climate adaptation initiatives should be designed and resourced to address the specific needs and vulnerabilities of diverse and disproportionately affected communities, fostering a more inclusive approach to resilience building.

Unlocking Private Capital for Climate Resilience: To unlock Nepal's potential for green finance, policy efforts must focus on four key areas. First, it is essential to build the capacity of financial institutions to assess and manage climate-related investments. Second, Nepal Rastra Bank should develop necessary regulatory measures to implement green taxonomy with clear incentives for the private sector investment. Finally, the federal government should actively promote and support innovative financing mechanisms, including green bonds, blended finance, and parametric insurance products.

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