FISCAL FEDERALISM AND LOCAL GOVERNMENT FINANCE IN NEPAL

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By

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Acronyms and abbreviations

ADB	Asian Development Bank
ADDCN	Association of District Development Committees of Nepal
CA	Constituent Assembly
CASU	Constitutional Advisory Support Unit
CBS	Centre Bureau of Statistics
CCD	Centre for Constitution Dialogue
CDO	Chief District Officer
CEDECON	Central Department of Economics
CIT	Citizenship Investment Trust
CLGF	Commonwealth Local Government Forum
DASU	Decentralization Advisory Support Unit
DANIDA	Danish International Development Assistance
DDC	District Development Committee
DIMC	Decentralization Implementation and Monitoring Committee
DIP	Decentralization Implementation Plan
e.g.	For example
etc	Etcetera (and so forth, and so on)
FY	Fiscal Year
GDP	Gross Domestic Product
GST	Goods and Service Tax
GoN	Government of Nepal
GTZ	German Agency for Technical Assistance
HLGs	High Level Governments
HMG	His Majesty Government
IFIR	Institute for Federalism & Intergovernmental Relations
IIDS	Institute for Integrated Development Studies
Inlogos	Institute of Local Governance Studies
LBFC	Local Body Fiscal Commission
LDF	Local Development Fee
LDO	Local Development Officer
LGAs	Local Government Associations
LGCDP	Local Government and Community Development Programme

LGs	Local government
LLGs	Lower Level Governments
LSGA	Local Self Governance Act
LSGAR	Local Self Governance (Administration Regulation)
MoF	Ministry of Finance
MoLD	Ministry of Local Development
MuAN	Municipal Association of Nepal
NAVIN	National Association of VDCs in Nepal
nd	Date not mentioned
NGOs	Non-Governmental Organizations
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NRs.	Nepalese Rupees
OECD	Organization for Economic Co-operation and Development
Ph.D.	Philosophy of Doctorate
PM	Prime Minister
PRIs	Panchayati Raj Institutions
SCGs	Sub-Central Government
SDC	Swiss Agency for Development and Cooperation
SNGs	Sub-National Governments
TAF	The Asia Foundation
TU	Tribhuvan University
ULBs	Urban Local Bodies
UCLG	United Cities and Local Government
UDLE	Urban Development through Local Effort
UNCDF	United Nations Capacity Development Fund
UNDP	United Nations Development Programme
VAT	Value Added Tax
VDCs	Village Development Committees
WB	World Bank

- **Exchange rate (February 15, 2012):** 1 US$ = 78.51 NRs.; 1 Euro = 103.55 NRs.

  (Source: The Himalayan Times Daily, February 15, 2012)

Glossary

1. **Local Bodies:** According to Local Self Governance Act, 1999, local bodies represent Village Development Committees, Municipalities and District Development Committees in Nepal. Moreover, this is also known as local authorities. However, the researcher has used local government instead of local bodies and local authorities in some places of this dissertation.

2. **Central Government:** The word central government is used instead of Government of Nepal in Nepalese context.

3. **Total local development expenditure** includes all the programs supported through Ministry of Local Development. They include the grants of local government bodies including LGCDP topping up block grant, Gumba management and development committee, disadvantaged focus program and development committee, trail bridge sectoral program, rural drinking water and sanitation program, local infrastructure development program, decentralized rural infrastructure and livelihood project, remote and special region development program, rural access promotion and decentralized program, local transport infrastructure sector program, rural re-construction and rehabilitation project, social security (aged, disabled and single women support) and adhibasi/janajati protection and promotion program.

4. **Total district expenditure** includes all the expenditure to be incurred by all line agencies including local government bodies at village, municipal and district level which are transferred though all the ministries and departments.

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CHAPTER-I

1 INTRODUCTION

1.1 General Background

There are lot of theories and strong rationale for decentralized governance on the basis of efficiency, accountability and autonomy. However, for the better service it is needed to be the closer government to the people and the people should have the right to vote for the kind and amount of public service they want (Stigler, 1957). The efficiency of service delivery increases at local level (Musgrave, 1959). The decentralization helps to increase efficiency because local governments have better information about the residents' need than the central government (Tiebout, 1956). The decentralization theorem says that each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalize benefits and costs of such provision" (Oates, 1972).

Decentralization is one of the most important vehicles to reduce poverty and inequality in both rural and urban sector. Furthermore, the local government should be more functional, for that, devolution of function to local government with more tax authority. The local government should be given a share of revenue generated from extraction of resources within their area (World Bank, 2000). More specifically, local self-government deals with needs of every citizen to solve her or his day-to-day problems because its goal is to be as closer as possible to people. It also forms sense of responsibility for solving local problems and prompts people to be active.

The main goal of fiscal decentralization is to move governance closer to the people, and this does require strengthening local government finances. It means that fiscal decentralization requires local government with some autonomy to make independent fiscal decisions. A very important feature of public finance is fiscal federalism. It is more convenient if some services are the responsibility of state and local authorities. It is because it ensures a better connection of the real needs of the people (World Bank, 2000). The *subsidiarity* principle (decentralization principle) recommends competencies in the provision of public service should be vested to the lowest possible level in the fiscal hierarchy (Bardhan, 2002). Finance can very well express a federal government structure because the fair and balanced distribution of government spending and public revenue is essential for smooth functioning of a confederation.

In the absence of fiscal decentralization to the sub-national governments, political and administrative decentralization alone does not work properly. The proper fiscal balance between central and sub national governments are more important in both developing and transition countries in order to maintain balanced development (Oates, 2006). The issue is also important in industrialized countries, which choose quite different levels of fiscal decentralization. At present, the United States is in the midst of trying to decide how to off-load more expenditure responsibility on to the state and local government. The German government faces an equalization issue related to their decentralized structure (Oates, 2006).

Peoples' movement of April 2006 has made historical changes in the political arena of Nepal. As a result, Nepal has been declared federal republic and secular country. The institution of monarchy was abolished by the first meeting of Constituent Assembly *on May 28, 2008*. The Constituent Assembly is in the process of drafting new constitution. It is predetermined that the new constitution would be inclusive in term of caste, ethnicity, gender, backward classes, geography (Mountain, Hill, Terai) through the Constituent Assembly. Economically viable, socially suitable and politically acceptable state restructuring is the crucial task for the Constituent Assembly. Although it is foremost political agenda to have a new constitution in consistent to the aspiration of the people, it is equally challenging and opportunity for political leaders and the Constituent Assembly to promulgate new constitution within the stipulated time line.

In general, there are two main categories of current revenue for local authorities in Nepal: (i) ‘own revenue’, which includes taxes, user fees, and various licenses, and (ii) transfers from the central levels, usually in the form of grants and revenue sharing (HMG/N, 1999). In some countries, municipalities have authority to borrow money for capital investments in infrastructure. To move ahead with fiscal decentralization, the government of Nepal has established permanent Local Bodies Fiscal Commission (LBFC) in 2002 under the control and direct supervision of Ministry of Local Development (LSGA, 1999). One of the main objectives of this commission is to develop the fiscal transfer system from central government to local government that currently lack transparency both in the vertical share and in the horizontal distribution. After the enactment of Local Self Governance Act (LSGA) in 1999, the pace of decentralization process has been initiated rapidly. Therefore, LSGA is considered as milestone to establish, promote and internalize the devolution process in Nepal. The 10th plan (HMG/NPC, 2002) also realized decentralization as a crosscutting sector reassuring commitment for fiscal decentralization as a means of devolution. Moreover, present local authorities will be converted as a strong unit of local government by the process of restructuring of the state based on the geography, population, resource availability and the service delivery status at the local level. Similarly, the commitment of Government of Nepal is that the devolution implementation action plan will be prepared for the implementation of full devolution to the local authorities (GoN/NPC, 2007, pp. 356,357). Furthermore, the principle of subsidarity will be implemented properly by enhancing capacity of local authorities (GoN/NPC, 2010, p.174)

Both theoretical works and empirical studies have shown that without bottom up pro-development course, wellbeing and socially excluded people would be almost impossible (Khanal, 2003). Decentralization means the transfer of political, administrative, and fiscal authority to lower levels of government. It is a kind of process of governance reform. However, locally elected bodies[1] (VDCs, Municipalities and DDCs) still have limited scope for action because fiscal decentralization has been lagging behind political decentralization.

1.2 Research questions

This study deals with the following issues which are generally talked and discussed in the public forum. The study aims not only to provide information but also at to seeking answer to the following questions.

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[1] *The term 'Local Authorities', according to the article 46c of the English version of the Constitution of the Kingdom of Nepal, 1990, published by Law Books Management Board, Ministry of law, justice and parliament affairs, HMGN, was used, whereas the term of 'Local Body" is used in LSGA, 1999 (Part I section 2a) to refer to VDCs, Municipalities and DDCs in Nepal.*

1.4.1 What is the best arrangement of fiscal powers and responsibilities among the different levels of government?

1.4.2 What are the patterns of revenue and expenditure sharing between central and local government in Nepal?

1.4.3 How is the local revenue mobilized by local government in Nepal?

1.4.4 How is the central government grant allocated among DDCs, VDCs and Municipalities?

1.4.5 What is the ratio of local government budget/grant and total national budget and GDP?

1.4.6 What the relationship is among own source of DDCs, district level GDP and devolved sectors' expenditure in Nepal?

1.4.7 How have LGCDP and LDF played role in local development in Nepal?

1.4.8 What is the relationship between local government budget and foreign aid?

1.4.9 What is the self-reliant rate of DDCs in Nepal?

1.3 Statement of the problem

Although there is no single model for improved local government in the world, improving local government capacity is an important strategy in dealing with resource constraints. Improving local government means not only strengthening the competence of councilors, officers and services but also making sure it has a sound financial base and not downsizing or cutting budgets necessarily (CLGF, 2009). The adequate local revenue is necessary to improve the financial base of local government that includes both taxes and innovative ways to mobilize local assets and community resources (ibid). There is a vast gap of share of tax income in GDP between developed countries and developing countries 38% and 18% of GDP respectively (Bird, 2005). The growing problems to the local bodies in raising revenue and in augmenting internal funding capacity become quite visible when revenue trend of the local body is observed. The important element of fiscal federalism beginning has thus been recognition of the probable need for intergovernmental grant to close the revenue gap.

Local governments almost invariably rely in part and sometimes very heavily upon transfers from upper-level governments to finance the services for which they are responsible. So, the system of unconditional fiscal equalization grants is an essential component of an efficient and equitable fiscal federal system (Boadway and Flattters, 1982). Own revenues of local government are a necessary but not a sufficient condition for fiscal decentralization (Fjeldatad, 2006). There is no similar type of decentralization in the world in practice. Federal systems differ enormously in the ways they allocate money, power, and authority across level of government. Some federal arrangements are therefore likely to foster corruption and inefficiency while others foster economic growth (Maite and Barry, 2001).

Central governments are more able to deal with a revenue flow that is unstable than are local government, precisely because the latter cannot usually borrow. Local government cannot run deficits, and they provide more essential services that are not easily postponed. Similarly, the issue is that the higher taxes on natural resources can address the national deficit issue and can help keep the domestic tax burden lower. Moreover, shifting natural resource revenues to local government would allow it (versus the national government) more latitude or autonomy to direct investment. A major reservation about sharing natural resource revenues with local government is that they will squander/waste the money. One concern is just that sub -national governments do not have the capacity to deliver many types of public services at adequate levels. Although fiscal decentralization has emerged as a focus of public sector reform in many less-developed nations, the substantial body of theory and research on public finance in developing countries includes little substantive work on the fiscal role and performance of local government (Paul, 2001). The fiscal design needs to be restructured because functions and responsibilities assigned to local bodies are unclear, and overlap with the central government's role and responsibilities. Local revenue power is limited. The grant system lacks transparency. Moreover, implementation of decentralization has been difficult due to the civil conflict. Despite some progress, the internal conflict in the country has stalled and even reversed the process of devolution (ADDCN, 2009).

The existing practice of transferring grant (about 9% of the total national budget) to local government bodies is not sufficient to meet the expenditure assignments of local government bodies in Nepal. The amount of central government grant to be transferred to local government bodies should be gradually increased year by year (LBFC, 2000, pp.87). It is also identified that there is lack of resources at local government bodies to discharge the functions and recommended to strengthen the role of Local Body Fiscal Commission and local bodies' associations to speed up the process of fiscal decentralization in Nepal (Ligal et al, 2004 a). The study has also recommended that suitable local government (LGs) financial system should be developed for effective fiscal decentralization in Nepal (ADDCN, 2001).

1.4 Objectives of the study

The main objective is to review the theories of fiscal federalism, fiscal decentralization and local government finances in Nepal. However, the specific objectives are to:

I. review the global practice on fiscal federalism and local government finance of India, South Africa, Uganda, Brazil, Switzerland, Germany, Denmark, Republic of China and Nepal,

II. examine the pattern of revenue and expenditure of local government (Village Development Committees Municipalities and District Development Committees,) in Nepal,

III. assess the revenue and expenditure assignment between center and local government in Nepal from FY 1996/97 to 2011/12,

IV. analyze the relationship of local government expenditure with total national revenue, foreign grant, foreign loan and domestic loan/borrowing.

1.5 Statement of hypothesis

The following hypothesis is tested in this thesis.

Hypothesis:

The null hypothesis (H_0) is that there is no relationship of local government expenditure (Grant to local bodies from Government of Nepal) with the total national revenue, foreign grant, foreign loan and domestic loan. It means that the local government expenditure is not affected by the changes in total national revenue, foreign grant, foreign loan and domestic loan.

<u>The alternative hypothesis</u> (H_1) is that local government expenditure (Grant to local bodies from Government of Nepal) depends on the total national revenue, foreign grant, foreign loan and domestic loan. The significance (α) is measured at 5% level.

1.6 Significance of the study

It is explicitly vowed about the balanced development through equitable revenue sharing among all tires and spheres of government and redistribution of national resources. It is the fact that there is vast resource gap in local level to meet the need and aspiration of people (GoN, 2007). Moreover, Nepal's Interim Constitution, 2007 also declared Nepal as decentralized federal democratic republic state and has a provision of high-level commission in order to recommend on state restructuring to the constituent assembly but it has not been formed yet because of various political reasons (ADDCN, 2008b). At the same time, it has also been reviewed and made commitment to expand the bases of revenues sources of local government such as tax, non-tax, and the grant from central government to local government by strengthening the fiscal foundation (GoN.NPC, 2007). Moreover, the plan has focused to develop and implement the scientific formula to allocate and transfer all kinds of grant to be given to local government by the central government (GoN/NPC, 2007).

The draft reports submitted by the various thematic committees of the Constituent Assembly (CA) have not explicitly provisioned the fiscal decentralization in new constitution as a part of democratic governance system (Constituent Assembly, 2009). However, CA committee namely Natural Resource, Fiscal Authority and Revenue Sharing has indicated the poor or lower transfer of national budget to the local bodies as compare to the increase of national revenue and total annual budget of government of Nepal. According to the legal provision, municipalities mobilize more local development fee at their own jurisdiction. Therefore, the dependency on central grant of municipalities is lower than of DDCs and VDCs.

The government of Nepal has also expressed strong commitment on the devolution of responsibility and revenue to the local government through the policy and program. Now, Nepal is at the new juncture of restructuring of state in terms of tire of governments; number and size of both state and local governments; functions of all tires of governments; and bases of resource sharing among all tires of governments. Therefore, based on these backgrounds, the study has recommended some important aspects of fiscal decentralization, which would be useful for Constituent Assembly (CA) and policy makers in course of state restructuring for viable and economically sustainable local government in Nepal. The study has briefly reviewed some general principles for revenue assignment between different levels of government, and challenges in securing fiscal responsibility at sub-national levels with respect to transfer systems and borrowing.

1.7 Limitations of the study

The study has the following limitations:

1.7.1 This study, in general, tries to analyze the revenue assignment (financial allocation) between central government and local government (DDCs, VDCs and municipalities) of Nepal. However, due to the lack of availability of time series data, regression analysis has been done only of 16 years' (from FY 1996/97 to 2011/12) of central government grant to local government bodies, total national revenue (tax and non-tax revenue) and total foreign aid received by the Government of Nepal (central government).

1.7.2 The self reliant rate of VDCs and municipalities of Nepal has not been analyzed to centralize the study only in DDCs.

1.7.3 The income and expenditure pattern of the selected countries have been reviewed, despite inconsistent data of consolidated revenue and expenditure of the selected countries. For example, revenue and expenditure of local governments of India (2002/03), division of revenue and consolidated expenditure of South Africa (2007/08 and 2009/10), own source of revenue of local government (2001/02) and share of local government expenditure of Uganda (2002/03), consolidated revenue and expenditure of Brazil (2007) and consolidated revenue and expenditure of China (2003) are looked at for the income and expenditure model of various spheres of governments.

1.8 Organization of the study

This study is divided into eight chapters in line with the general research methodological approach. The first chapter covers general background, research questions, statement of the problem, objectives, statement of hypothesis, significance of the study and limitation of the study. In addition, the organization of the study is also mentioned in this chapter. The second chapter presents the review of related literatures. The third chapter describes the research methodology of the study. Likewise, the fourth chapter deals with the global practices of fiscal decentralization of the selected countries. The chapter five is about the fiscal decentralization on the size of budget. The chapter six is related to the analysis of revenue and expenditure of central and local government bodies in Nepal. Similarly, the chapter seven gives the glimpse of perception of stakeholders. Finally, major findings, conclusion and recommendations are presented in the chapter eight. Some important information relating to the thesis is presented in the appendices.

CHAPTER-II

2 REVIEW OF LITERATURES

The conceptual and theoretical framework of local governance, decentralization and fiscal federalism; the historical perspective of local governance in Nepal and empirical studies are reviewed in this chapter in brief.

A. Global context

2.1 Local governance and decentralization

The first generation of fiscal decentralization theory says that the local governments act in best interest of constituents because it focuses on allocative efficiency gain and economic reality (Oates, 1972). Besides, political behavior of local officials is a very important aspect for decentralization. The second generation of fiscal decentralization theory, merging political and economic reality, assumes that local government may not act in local interests of constituents (Oates, 2005).

The expenditure policies must be implemented locally but the expenditure should be financed nationally. The last function of government is efficient allocation of resources where sub-national governments can play pivotal role because local governments have better information with regard to the demand, expectations, and needs of their own residents (Sewell, 1996). The notion of good governance is not new. It is primarily concerned with the proper 'exercise' of economic, political and administrative authority to manage a country's affairs at all level of governments (UNDP,1997). In addition to raising revenues, local revenue mobilization has the potential to foster political and administrative accountability by empowering communities (Oates, 1999). However, prescriptions deriving from the theory and from good international practice impose huge constraints on the choice of revenue instruments for local government.

Not only political and fiscal decentralization but also the administrative decentralization is very important component of decentralization. The form of administrative decentralization can be defined in the following three different types such as deconcentration, delegation, and devolution (Bird and Vaillancourt, 1998).

Deconcentration is often considered to be the weakest form of decentralization; it redistributes decision-making authority and financial and management responsibilities among different levels of the central government. It can merely shift responsibilities from central government officials in the capital city to those working in regions, provinces or districts, or it can create strong field administration or local administrative capacity under the supervision of central government ministries. Specifically speaking, deconcentration means the redistribution of decision making power among different levels within the central government.

Delegation is a more extensive form of decentralization. Through delegation central government transfers responsibility for decision-making and administration of public functions to semi-autonomous organizations not wholly controlled by the central government, but ultimately accountable to it. Governments delegate responsibilities when they create public enterprises or corporations, housing authorities, transportation authorities, special service districts, semiautonomous school districts, regional development corporations, or special project implementation units (Bird and Vaillancourt, 1998).

Devolution is the third form of decentralization. When governments devolve functions, they transfer authority for decision-making, finance, and management to quasi-autonomous units of local government with corporate status. Devolution usually transfers responsibilities for services to municipalities/district councils etc. that elect their own executive board and councils, raise their own revenues and have independent authority to make investment decisions. In a devolved system, local governments have clear and legally recognized geographical boundaries over which they exercise authority and within which they perform public functions. More specifically it is said that transfer of powers and responsibilities from central government to independent local government is devolution.

The four model of local government are as follows (Stephen, 1999).

1. Local government knows best and acts to maximize the welfare of its residents, conforms to the ***benevolent despot*** model,

2. Local government provides services consistent with local residents' willingness to pay, conforms to the ***fiscal exchange*** model,
3. Local government focuses on public service provision to advance social objectives conforms to the ***fiscal transfer*** model,
4. Local government is captured by self-interested bureaucrats and politicians conform to ***leviathan*** model, which is consistent to the public choice perspective.

The concept of local governance has emerged as a significant issue in the process of democratization. The local government means to specific institutions or entities created by national constitution, by state constitutions, by ordinary legislation of higher level of central government, by provincial or state legislation, or by executive order to deliver specified services to a relatively small geographically outlined area (Shah and Shah, 2006). However, local governance is the broader concept.

Decentralization is often used as concepts without strict definitions. The term of ***"decentralization"*** is used to describe a broad range of public sector reorganizations (World Bank, 1999):

> *Decentralization - the transfer of authority and responsibility for public functions from the central government to intermediate and local government or quasi-independent government organizations and/or the private sector - is a complex multifaceted concept. Different types of decentralization should be distinguished because they have different characteristics, policy implications, and conditions for success.*

Decentralization is the means to the ends. It is neither good nor bad. The successful decentralization improves the efficiency and responsiveness of public sector. Therefore, the success of decentralization depends on its use and design. Ultimately, decentralization means the transfer of political, fiscal and administrative power to sub-national units of government (World Bank, 2000). The purpose of decentralization is to deepen democracy, enhance local participation, ownership and autonomy and to promote partnership between state and society. On the other hand, purpose of ideal decentralization is to democratize lower levels of government as a substitute for democratization at the central level, off-load tasks that the central government finds costly or inconvenient and obtain local resources that are exploited by party bosses or to please donor agencies (OECD, 2004). Moreover, decentralization is the transfer of authority and responsibility from the central government to local government and the empowerment of people through their local government (Boex et al, 2005).

It is crucial that the people are able to select the decision-makers, to reject them freely if those decisions are unsatisfactory, and that there is opportunity for the people to participate, influence and shape the decision-making process. This is the essence of public accountability, and of the importance of transparency. Modern democratic government also means constitutional government, which is in other words predictable government. The local self-government is essential because it ensures relatively accessible participation of people in decision-making (Kumar, 2006). It helps to make the system more accountable, responsible and transparent. Moreover, it provides services and goods efficiently, and promotes residents to articulate their need. It gives opportunity to be informed about the service delivery mechanism, system and procedures and finally it creates the platform to develop the local leader. With a view to give some knowledge about the role of local government under new vision of local governance is explained in appendix-1. Democracy at the local level rather than national level may well prove the decentralized governance system. Further, democracy at the local level can play the vital role in local government accountability (Weingast, 2007).

Decentralization can help to reform the governance system by improving efficiency (links mix and level of services to the local citizen demand), improving political and financial accountability (brings government closer to the people), and improving effectiveness (mobilizes citizen's participation, innovation and ownership and allows competition in public services as best practices). Finally it can be said that decentralization is in essence a political decision not mechanical dilemma (Kelly, 2010).

2.2 Fiscal federalism and decentralization

The first generation theory of fiscal federalism argues that the central government should take the lead in macroeconomic stabilization policy, introduce basic measures for income redistribution, and provide efficient levels of output of national public goods (Oates, 1972). Moreover, the theory of fiscal federalism is directly related to the division of public sector functions and finance in all layers of government (King, 1984). The role of fiscal federalism is to define the appropriate tasks and finances of local government for effective service delivery that helps to maximize the social and community welfare (Bird, 1986). The traditional theory of fiscal federalism argues a general normative framework for the assignment of functions to different levels of government and the appropriate fiscal instruments for carrying out these functions (Musgrave 1959; Oates 1972). Furthermore, "local public goods" can be provided by local government that meets the demands of the residents of their respective jurisdictions (Oates, 2004).

The fiscal decentralization is to strengthen finance (Taxation power and expenditure responsibility) of local government. Local government should have autonomy to make independent fiscal decision. To carryout decentralized functions effectively, an adequate level of resources either rose locally or transferred from the central government and the authority to make decision about expenditure. There are four forms of fiscal decentralization such as (i) self-financing or cost recovery through user charges (cost recovery pricing), (ii) Co-financing or co-production arrangement through which the users participate by monetary or labor contribution, (iii) Inter-governmental transfers from central and provincial to local government, and (iv) authority of borrowing through loan guarantee (World Bank, n.d.).

The fiscal decentralization refers to the degree of independent decision-making power in the provision of public services at different levels of government (Oates, 1972). The degree of fiscal decentralization may be defined by three criteria: (1) the importance of local taxes relative to central taxes, (2) the importance of local expenditures relative to central expenditures, and (3) the importance of central subsidies to local resources (Prud'homme, 1990). Intergovernmental fiscal relations also includes the assignment of taxing powers and expenditure responsibility, the method of transfers between levels of government (both central-state and state-local), borrowing powers, local autonomy in taxing and budgeting decisions, and many civil service issues. It is a big set of issues, and most are politically charged. Furthermore, a sound revenue system for local government is an essential pre-condition for the success of fiscal decentralization (Olowu & Wunsch 2003).It is true that the local government are always more efficient to provide the Pareto-efficient levels of output for their respective jurisdictions than for the central government to provide *any* specified and uniform level of output across all jurisdictions (Oates, 2006). However, fiscal federalism is defined and measured in various way, the following elements regarding fiscal federalism is recommended as ideal type (Sorens, 2008).

1. Sub-central governments (SCGs) enjoy programmatic autonomy (creating, repealing, and adjusting programs and regulations);
2. SCGs face a hard budget constraint[2] (SCGs enjoy the authority to set rates, base, or both, and may not have access to unlimited credit);
3. There is a common market (no barriers to the free flow of goods, capital, and labor across their borders);
4. The system is institutionalized (central government may not modify/change).

Devolution without adequate responsibilities for revenue collection, public officials at lower levels may face looser budget constraints and hence greater opportunities to engage in corruption practice. Incomplete devolution of power may also result in a proliferation of regulation emanate from different levels of government with a proper increase in opportunities for corruption (ibid.). The theorem on fiscal federalism argues that local government can provide public services more efficiently and be more responsible to their residents through competition among local government (Aoki, 2008). The fiscal federalism helps to improve the living standard of people in terms of good governance; acceleration of economic growth; reduction of poverty; achieving gender balance; empowerment of backward, marginalized, and disadvantaged group of the society by the efficient use of resource and inclusive participation in decision making process at the lower level of governance (Sharma, 2009).

It is not sure that the fiscal decentralization may necessarily obtain economic development, better quality of the public services, efficiency and responsibility, but it is the most adequate "weapon" for providing national unity (the case of South Africa and Uganda); potential political solution for preventing the civil war (the case of Sri Lanka and Sudan); preventing the secessionists tendencies (the case of Bosnia and Herzegovina and to some degree Ethiopia); enough power and competences for preventing the aspirations for succession of different republics (the case in the Russian federation); the

[2] A limit to spending by some private and public body, where the results of breaching are expected to be catastrophic. For example, the firms that fail to achieve the required rate of profit/result may expect to be closure.

effect of the "grass–root" democracy as a support to the politics of the central government (the case of Columbia and other states). Therefore the model of asymmetric decentralization is considered as a possibility for resolving the conflicts of political and ethnical nature in fragmented societies. However, it is not confirmed that the fragmented societies will become more coherent if the central authorities merely apply an asymmetric political, administrative, and fiscal decentralization (Veljanovski, nd). Inability of central government to meet increasing demand for local services underpins moves towards decentralization in developing countries. Decentralization of fiscal responsibilities is envisaged to increase efficiency in service delivery and reduce information and transaction costs associated with the provision of public services. The summary of the arguments for fiscal decentralization are as follows (De Mello, 2000b):

1. Fiscal decentralization enables sub-national governments to take account of local differences in culture, environment, endowment of natural resources, and economic and social institutions.
2. Information on local preferences and needs can be extracted more cheaply and accurately by local governments, which are closer to the people and hence more identified with local causes.
3. Expenditure assignments to the local government closer to revenue sources can enhance accountability and transparency in government actions.
4. Fiscal decentralization can help promote streamlining public sector activities and the development of local democratic traditions.
5. Fiscal decentralization can be supportive to influence macroeconomic governance, promote local growth and poverty alleviation directly as well as through spillovers.

The adverse effects of decentralization on service delivery arise due to the lack of capacity at sub-national government level, misalignment of responsibilities owing to incomplete decentralization or political factors and political capture by local elites when civic participation in local government is low (Elhiraika, 2007). Similarly a soft budget constraint that leads to over borrowing by sub-national governments is the major problem of service delivery. To overcome these challenges, optimal assignment of expenditure and tax responsibilities should be based on such criteria as economies of scale, spillover benefits, and cost of administering taxes, tax efficiency, and equity. In practice, however, fiscal decentralization often depends on political realities/ expediencies and historical legacies (Ahmed et al 2005).

2.3 The pillars of fiscal decentralization

There are 'four pillars' or 'building blocks' of fiscal decentralization. They are (i) expenditure responsibilities, (ii) revenue assignments, (iii) Inter-governmental fiscal transfer, and (iv) sub-national borrowing (Boex, 2001). Moreover, fundamentally expenditure responsibilities, revenue assignment, inter-government transfers and local level borrowing/debt are four major pillars of fiscal decentralization (Kelly, 2010). The four pillars are explained very briefly in the following ways.

2.3.1 Expenditure responsibility

The expenditure assignments are the base of fiscal decentralization. It is the first step in designing an inter-governmental fiscal system (Martinez, 1994). Without role and responsibility, there is no need of revenue. The functions should be assigned on the basis of principle of efficiency. Revenue assignment without solid expenditure assignment would weaken the decentralization process. Therefore, expenditure assignment is the first step in designing an intergovernmental fiscal system (Martinez, 1994). The information about the international practice of possible detail expenditure assignment is presented in appendix-2. There should be an equitable provision of public services and redistributive justice. The assignment should be based on economies of scale, benefits/cost spillovers, consumer sovereignty and political proximity. The principle of finance should follow function must be practiced properly. Moreover, revenue should match with expenditure needs. It indicates the fiscal deficit must be addressed. The major objectives of revenue allocation are to provide sufficient revenue for macroeconomic stabilization functions, redistribution functions, essential government goods and services.

Fiscal federalism does not provide a clear guidance to expenditure assignment (Hemming and Spahn, 1997). Although the system of inter-governmental relations varies from country to country and country specific conditions determine the outline of expenditure assignment, an effective decentralization a well-defined framework is necessary in the assignment of expenditure responsibility. Fiscal decentralization involves shifting some responsibilities for expenditure and revenue to lower levels of government. Expenditure assignment means the functions and expenditure responsibilities for each level of government. The essence of expenditure assignment is who will do what? And who will pay for what (Ligal et al, 2004a) Similarly, functional assignment ideally requires good analysis and consensus among all stakeholders with due care which takes much time otherwise conflict arises and stalls the process across the level of governments (GTZ, 2009).

Approaches in expenditure assignment

The four criteria with regard to assign the functions, roles and responsibilities to different spheres of governments are recommended as follows (Oates (1972).

(1) There are no equal economies of scale across services and goods. Therefore, economies of scale must be considered while providing particular goods and services to the residents. Oates argues that the economies of scale are ensured at a higher level of government for the special sectors.

(2) Decentralization of responsibilities is appropriate if the society or groups are separated by border due to heterogeneity in terms of preference owing to different climate and topography, and different language for delivery of services.

(3) The activities, which have externalities may be positive or negative, should be centralized or those functions to be carried out by local government must be coordinated properly at local level. So that externalities might not be appeared. It is because it has an important impact on the individuals or business of other jurisdiction.

(4) Lastly, competition at local level promotes to increase or introduce best practices in the society. Decentralization of functions helps to create the favorable environment to compete each other and initiate best experience in the community.

In general, there are two different approaches in expenditure assignment such as "Expenditure-led" and the "Revenue-led" approaches. In expenditure led approach, functions are first designed with clear responsibility based on *"subsidiarity"* principle. Likewise, in revenue-led approach, public revenue resources are first allocated in general way between levels of governments. This approach is regarded as politically sensitive rather than cleaning up the confusion and ambiguity due to overlapping of functions at different level of government (Ligal et al, 2004a). As compare to the revenue assignment approach, expenditure assignment approach is considered as best approach to categorize the expenditure assignment to all levels of government. It helps to minimize the problems of duplication and overlapping of the functions across the level of governments.

The fundamental thing is that the basic rule of efficient expenditure assignment is to assign each function to the lowest level of government consistent with its efficient performance. This is referred as the principle of subsidiarity by the European Union (Bird and Vaillancourt, 2006). At the same time, the public services to sub-national government (local or regional) can be based on considerations such as economies of scale, economies of scope (appropriate bundling of public services to improve efficiency through voter participation and cost recovery), cost benefit spillovers, proximity to beneficiaries, consumer preferences, and flexibility in budgetary choices on composition of public spending. The expenditure assignment could be asymmetric which can be based on size of population, rural-urban classification, and fiscal capacity (WB n.p.).

The activities of government should be separated into three sectors such as macroeconomic stabilization, income redistribution and resource allocation (Vazquez et al, 2006). Macroeconomic stabilization can be obtained through high employment and price stability, which is possible, only by central government. It is because sub-national governments have no power to print money and often have limited power to borrow money and there is no much effect on microeconomic stability by sub-national governments due to their limited jurisdictions. Moreover, the distribution system means the equitable distribution of income. These functions are also theoretically assigned to the central government, because it is difficult to manage by sub-national governments and are likely to distort the geographical allocation of economic resources.

2.3.2 Revenue assignments

Revenue assignment is the second but very important feature of fiscal decentralization. The sub-national governments have the authority and responsibility to own-finance local services at the margin. There is no ideal assignment of revenue sources between central and lower levels of government. Nevertheless, the three major functions need to be determined as revenue assignment (Musgrave, 1959). The functions relating to the macroeconomic stabilization (maintenance of high employment and price stability) and income redistribution (maintenance of equitable geographical allocation of economic resources) should be assigned to the central government and the function of allocation of resources is better to assign to the sub-national government. Moreover, a set of ‘tax-assignment rules’ has been developed in the traditional fiscal federalism theory (Oates, 1972). Furthermore, in developing countries the administrative capabilities of local government in revenue design (that is, deciding on revenue bases and setting rates) must be taken into consideration (Bird, 1990). Moreover, in large and diverse countries the issue of revenue harmonization between jurisdictions is important when assigning taxing powers.

On the other hand, the traditional theory of fiscal federalism argues that taxes which are easily administered at local level should be given to sub-national The service provided by the sub-national governments can be financed through benefit taxes such as user charges, other local fees like taxes to be levied on motor vehicles, fuels and construction fees etc (Ebel and Serdar 1999). These principles relate to the respective responsibilities of central and lower tiers of government in macroeconomic stabilization, income redistribution, and resource allocation (Boadway et al, 2000). There should be a control over own resource of sub national government to promote fiscal decentralization. Independent source of revenue is necessary for the effective and pragmatic fiscal autonomy. Otherwise, sub-national governments are- under the financial thumb of the central government (Martinez, 2006).

It is important to understand the five core issues with respect to intergovernmental finance (Neumann and Robinson, 2006). The first issue is about **e**xpenditure assignments **(Who should do what?)**. The second is about revenue assignment (**Who should levy what taxes?).** The third is in relation to fiscal transfer to address the imbalance between revenue and expenditure (**How should any imbalance between revenue and expenditure of sub-national governments be addressed?). Similarly,** The fourth concern is regarding the horizontal fiscal imbalance that occurs when different units of the same order of government, with similar expenditure responsibilities, have significantly differing fiscal capacities (**How are any horizontal imbalances**

addressed?) Finally, the issue is about the legal provision of borrowing of sub-national governments **(How to address the issue of sub national borrowing?).**

Principle of revenue assignment

In other word, revenue assignment is also known as revenue sharing among the level of governments. The major principles of revenue assignment are as follows (Kandel, 2009):

1. Taxes on mobile factors and tradable goods should be assigned to central government.
2. According to national equity consideration point of view, progressive or redistributive taxes should be assigned to central government.
3. The taxes should be assigned to the jurisdiction with the best ability to monitor relevant assessment. It helps to reduce the administrative cost and potential tax evasion. Local governments are the appropriate authorities to collect property and land taxes.
4. To ensure accountability revenue means should be matched as closely as possible to expenditure needs.

Tax is one of the major sources of internal revenue of government (Singh, 1991). Decentralization of responsibilities without an allocation of the sufficient financial resources would not allow the full realization of the benefits of decentralization (Quebec, 2002). Taxes are the most important component of government revenue. User charges and borrowing can't provide all that is needed. Federal aid is unlikely to fill the gap. Taxes must produce enough revenue to fund necessary services. The principles of taxation are specific tax measures up in terms of simplicity, horizontal equity, vertical equity, and distortion of economic decisions, volatility and revenue adequacy (John, 2002).

The relationship between different levels of government, and their interactions on the financial side, has been the subject of considerable scrutiny in recent years. There are broadly two strands to this literature. The optimal assignment of public service provision and it is financing between different levels of government; this is the classic literature on fiscal federalism (Julia, 2004). High incidences of tax evasion are the high tax rate, low probability of detection and low penalty of tax evasion. It is associated with undervalued and officially unrecorded transactions. It is so called underground economy, informal, shadow, second economy, subterranean or hidden economy (Suliman, 2005).

Tax assignment principle

Regarding the tax assignment among different tiers of government, international experience suggests that some taxes are better suited for local government than others. International lessons provide a number of economic rationales of taxation in a federal setting (McLure 1983). Maintaining efficiency is often emphasized for the assignment of local taxes. This is because decentralizing tax systems can often interfere with the efficiency of nationwide economic integration. The detail information about the international practice of revenue assignment/tax assignment is presented in appendix-3. However, commonly emphasized criteria of tax assignment are as follows:

(1) Local taxes should be independent from national policy goals such as income redistribution objectives and economic stability.
(2) The local tax base should exhibit low mobility between jurisdictions.
(3) Benefit taxes and user charges are appropriate to local taxes.

In addition to the aforementioned efficiency criteria, economic principles, such as national equity, administrative costs, and fiscal needs are important for developing countries (Boadway, Roberts, and Shah 1994). Thus,

(1) Sub-national engagement in perverse redistributive policies, using both taxes and transfers, should be restrained.
(2) Rules to allocate tax revenue among jurisdictions, restricting tax evasion and avoidance, will be required.
(3) Revenue means should be matched as closely as possible to revenue needs.

Revenue instruments for local government

In addition to raising revenues, local revenue mobilization has the potential to foster political and administrative accountability by empowering communities (Oates 1999). However, prescriptions deriving from the theory and from good international practice impose huge constraints on the choice of revenue instruments for local government. Although, there is no ideal assignment of revenue sources between central and lower government, a sound revenue system is an essential pre-condition for the success of fiscal decentralization (Olowu & Wunsch 2003). In general, there are two main categories of current revenue for local authorities in Africa: (i) 'own revenue', which includes taxes, user fees, and various licenses, and (ii) transfers from the central or regional levels, usually in the form of grants and revenue sharing (Bahl, Smoke and Solomon, 2003). In some countries, municipalities are also allowed to borrow money for capital investments in infrastructure.

Revenue sources of local government

Local governments are the closest people representative institution that delivers and provides timely services to the people at their own door. It is assumed that the services provided by the local government would be more participatory, transparent, and efficient. The financial resource is necessary in order to expedite the assigned role and responsibilities for local government. The resources of local government can be generally grouped under the following four broad heads (McLure, 1999).

1. ***Own Resources:*** The very important source of income of local governments is their own revenue. However, own revenues are a necessary but not a sufficient condition for fiscal decentralization. The local government can collect revenue from the various resources locally. Basically own tax comprises property/house tax, professional tax, vehicle tax, tax on agricultural land, pilgrim tax, tax on animal, fees and other non-tax revenue etc.
2. ***Assigned/Shared Revenue:*** The collected revenue can be shared in both ways such as vertical sharing from central to sub-national and vice versa. Likewise, there can be horizontal revenue sharing between one state and another and one local government and another. However, the taxes levied and collected are shared to the local governments by the state and the central government.
3. ***Grants:*** The central government provides fund to the local government to implement the activities assigned to them at the local level. The grants are given either as incentive for tax efforts or for matching the efforts in maintenance of services. It may be both conditional and un-conditional. Unconditional grant means the money that is given or transferred to the local government to run decentralized services from central

government. It is generally given to the provinces and local government based on a formula set at the national level. Similarly, the conditional grant is money given to the local government to finance programmes agreed between central and local government. Both conditional and unconditional grants are to be provided to the poorer provinces and local government based on equalization process. Equalization means the amount of money to be paid to local government for giving subsidies or making special provisions for the least developed governance units.

4. ***Other revenues:*** Non-tax revenue consists of the taxes charged on properties like shops, bus stands guest house etc. as prescribed by local law and regulation.

In addition to above transfer and borrowing are other very important source of revenue of local government to implement the assigned expenditure. Almost without exception, governments across the world assign more expenditure functions to local authorities than can be financed from their own revenue sources. The result of this mismatching of functions and finances–often referred to as 'vertical imbalances'– is that local government are generally dependent on transfers from higher levels of government. There are a number of methods to close the fiscal imbalances of sub-national governments, some of which also reduce imbalances between jurisdictions (Ahmad, 1997).

There are several reasons that can justify the fiscal transfers from central to sub-national and between sub-national governments for the vertical equalization which helps to improve the revenue adequacy of sub-national government (Schroeder and Smoke, 2002; Schroeder, 2007). It is also necessary for horizontal balance of the resources which leads to promote inter jurisdictional redistribution of resources. However, the horizontal transfer system is usually considered more controversial as compared to vertical transfer (Smart, 2007). In practice, generally transfers may be in the form of surcharges or revenue sharing whereby a local government receives a share of the revenues from particular taxes collected by the central government within its jurisdiction (McLure, 1999). The main mechanism for intergovernmental transfers in Africa, however, is conditional and/or unconditional grants from central to local government. On the other hand, in some countries, for instance in South Africa, municipalities are also given the right to borrow to finance investments in local capital infrastructure (Bahl & Smoke 2003).

In order to improve the financial base of local government, it is required increase revenue which includes both taxes and innovative ways to mobilize local assets and community resources. It requires strengthened financial management and accountability systems in local government. This includes robust, independent regulatory bodies, and strengthening of *‘downward accountability* which will promote transparency and combat corruption (CLGF, 2009). Moreover, the vertical fiscal gap and vertical fiscal imbalance is arisen if there are inappropriate assignment of responsibilities, centralization of taxing powers, pursuit of beggar-thy-neighbor (wasteful tax competition), and lack of tax room at sub-national levels due to heavier tax burdens imposed by the central government (Shah, 2007). Broadly speaking, intergovernmental transfer or grant is generally classified into two categories such as general purpose transfers (unconditional) and specific purpose transfers (conditional or earmarked) transferred which are transferred from central to sub-national governments (Shah, 2007). Generally unconditional transfers are mandatory by law but sometimes central governments may provide these types of transfers in ad hoc and discretionary (flexible) manner. The objective of these transfers is to safeguard local autonomy and improve inter-jurisdictional equity.

2.3.3 Inter-governmental fiscal transfers (IGFT)

Inter-governmental fiscal transfer is the third pillar of the fiscal decentralization. It has many names such as grants, subsidies, subventions etc. The intergovernmental fiscal transfers are important tool of public sector finance in both industrial and developing countries in three major reasons (Shrivastave, 2002). First, the central government will have opportunity to raise more revenue and maintain good relationship with the sub-national governments and on the other hand, sub-national governments will have advantages to deliver quality services as required by the people in transparent and efficient manner.

Second, in most cases, there are considerable differences in revenue-raising capacity between sub-national governments. If they were fully autonomous to mobilize revenue and solely depend on their own revenue, richer jurisdictions would be capable to spend more on public service as compare to the lower income jurisdictions. This kind of situation has both equity and efficiency implications in service delivery process of sub-national government. Therefore, in order to support lower income jurisdictions, central government makes fiscal transfer to bridge the gap of resources to support local economic development. Third, resource transferred from central to sub-national level helps to address the national priorities areas such as health, education, sanitation, drinking water etc. through the initiation of sub-national government. It is more helpful to promote equity and efficiency of sub-national governments and be supportive for poverty reduction agendas at grass root level.

The "piggybacking" approach may be appropriate to the tax sharing to sub-national governments. From the theoretical point of view, the asymmetric decentralization relates to a transfer of different "dosages" of fiscal powers, authority and responsibility in different local governments taking into consideration the conditions and requirements for each particular country and local development. There are inherent tradeoff between central government control and local flexibility (Fernando, 2010). Moreover, there are several kinds of centre-local fiscal instruments. The major purposes are to shut the vertical gap, to minimize the horizontal gap by equalizing across SNGs, to compensate for spillovers and externalities, to encourage SNG expenditure in national priority areas, to build SNG capacity and encourage SNG performance and to help remove political discretion, patronage and corruption (Shotton, 2010). The main types of IGFT instrument are share of a national tax (share may be distributed to SNGs by area of derivation or a formula base system), unconditional block grants based on formula for general SNG expenditure like administrative and development, specific (conditional) grants which is more or less tied on specific service, cost reimbursement for delegated functions, targeted transfers for national priority programmes and so on (Shotton, 2010).

2.3.4 Sub-national borrowing

Sub-national borrowing is the fourth and final pillar of fiscal decentralization. Sub-national governments are entitled to receive borrow/debt from the finance company in the development activities of the jurisdiction. However, this provision is applied or not applied in practice depending upon the state law of the respective countries. Generally, there are two schools of thought about the borrowing of sun-national government. The first view is in favor of the borrowing of sub-national government. According to the first view, if the own revenue of sub-national government doesn't meet the public expenditure, they should have right to borrow to meet the expenditure assignment. Further, borrowing is one of the most important and preferred option to meet the gap between expenditure and revenue. So the sub-national governments should have authority to meet the development expenditure through borrowing (Mica, 2000).

The two data sets such as (1) state and local government in the U.S. and (2) international sample of 43 countries to test the decentralization hypothesis "the size of public sector should be inversely with the extent of fiscal decentralization were surveyed (Oates, 1985). Firstly, the cross-sectional data of 48 states in the U.S was analyzed by using dependent variable the size of public sector measured by aggregate state-local tax receipts in each state as a fraction of personal income. At the same time, the independent variables used in the analysis were (1) state share of state-local general revenues, (2) state share of state-local total expenditure, and (3) absolute number of local government units in a state.

In order to make consistent with decentralization hypothesis, the size of public sector and state revenue share and state expenditure share measures are assumed to be positive and the relationship between the dependent variable and number of local government is anticipated to be negative. First, according to the simple correlation analysis he found that the correlation coefficients of three pairs of variables are all negative. It indicates that a more centralized state-local sector in terms of revenue and expenditure tends to be associated with a smaller state-local sector that is not consistent with decentralization hypothesis. Similarly, in terms of number of local government, a more centralized state-local sector tends to be linked with a larger state-local sector. However, in all cases, there was no statistical significant relationship.

Correspondingly, he carried out regression analysis of the dependent variable and each measures of the independent variable by both ways with and without control variable. The control variables used by him were (1) per capita income (2) population size (3) urbanization, and (4) the percentage of state-local general revenues that comes from intergovernmental grants. The result of analysis shows that there is no statistically significant relationship between dependent and independent variables with and without control variables.[3] In this way, he concluded that multiple-regression analysis did not support for either the view of decentralization constraints the size of the public sector or it results in a more expansive government sector. From the analysis of cross-sectional data of 43 countries, he finally concluded that the decentralization is not a factor that affects the public sector size at all. Second, Oates (1985) measured competition among jurisdictions as absolute number of local government units in a state.

The institutional setting and capacity of local authorities of Nepal and the governmental and quasi-governmental relations in terms of service delivery and coordination; and proposed some fundamental proposals with regard to the decentralization strategies for strengthening local authorizes in a democratic framework have been reviewed and assessed (Martinussen, 1993). Moreover, the author has assessed the legal framework of local authorities enacted immediately after the restoration of multi-party democracy in Nepal. The legal provision of inter-governmental fiscal transfer has also been reviewed but not analyzed by using statistical database at all.

[3] In fact, the finding was negative relationship between the dependent and independent variable and expenditure measure of independent variable in the equation without control variable. However, R-square is low (.10).

B. National Context

2.4 Historical perspective of local governance and decentralization in Nepal

The ***Democratic*** era started after the enactment of Interim Constitution in 2007 BS. The article five of the constitution had made the provision of village *Panchayat* as units of local government. 791 panchayats were set up by 1956 AD compared to 171 in 1950 AD. A new village panchayat act also came into force in 1956 AD, which replaced the panchayat act, 1949. The first elected government in 1959 had recommended 7 provinces, 32 districts, 76 sub-districts, 165 blocks and 6500 gram panchayats to share the central power to the lower level. In the same year, 33 Panchayat officers and 109 supervisors were recruited to impart momentum to the initiative. But, the removal of elected government and collapse of democratic practice hindered the progress (Khanal, 2006).

During the ***Panchayat*** era (1962-90), the local authorities namely Village, Town and District Panchayat were functional at local level. However, they had been used extensively as an extended arm of the central government. Therefore, local authorities were hence became centrally driven and non-effective. Later, based on the recommendations from different committees and commissions the Decentralization Act, 1982 and regulation, 1984 were enforced. This had initiated a significant process of decentralization, putting all district level line agencies under the umbrella of respective District Panchyats; but in practice, it gave less emphasis on fiscal decentralization and less orientation on local governance. A high commission under the chairpersonship of Bishwa Bandhu Thapa recommended dividing country to 75 districts and 14 zones. He also recommended delegation of power to the panchayat without decreasing its efficiency and effectiveness and abolish the post of Bada hakim.

After the restoration of ***Democracy*** in 1990, decentralization and local governance took the pace in Nepal. The constitution of 1990 had clearly mentioned that *"the chief responsibility of the state is to maintain conditions suitable for the employment of the fruits of democracy through wider participation of the people in the governance of the country and by way of decentralization"* (Khanal, 2006). Local Self Governance Act, 1999 has explicitly stated the two levels of local government viz. Village Development

Committees in rural areas and Municipalities in urban areas and District Development Committees (DDCs) in district level. As there are many implications in implementation of LSGA, it is considered as the milestone in favor of decentralization in the history of Nepal. It has explicitly provisioned the role, responsibility, accountability and limitation of elected representatives and local government institutions in line with the inclusive and participatory planning process to address the aspirations and needs of the people at local level (HMG, 1999). However, after the expiry of the five years tenure of the elected representatives in local government from July 2002, there is no existence of representation of elected representatives in local government institutions.

The article 139 (1) of Interim Constitution of Nepal, 2007 has explicitly made provision of holding the local election or making according to article 139 (2) to make special political arrangement in the local government bodies in the all party consensus in order to promote decentralization and local governance system (GoN, 2007). But, unfortunately both provisions have not come into action yet. This vacant situation in local level has hampered the effective and efficient service delivery to the people (ADDCN, 2010). Some important information about the events in the process of decentralization in Nepal is presented in Appendix-4.

2.5 Legal provisions of local government finance in Nepal

The following aspects are reviewed as legal provisions of local government finance in Nepal.

2.5.1 Functions, duties and powers of local government in Nepal

In addition to the executing or causing to be executed decisions and directions of the respective councils, according to the provisions of LSGA, VDCs, municipalities and DDCs shall be responsible to perform assigned functions as prescribed in LSGA. The functions of VDCs, municipalities and DDCs (local government bodies of Nepal) are presented in Appendix-5.

2.5.2 Revenue sharing between central and local government in Nepal

After the restoration of democracy in 1990, Local Self Governance Act (LSGA) was promulgated in Nepal in 1999. The experts and authorities of the local democracy and decentralization in Nepal use to say that this act is the milestone in promoting decentralization in Nepalese history. The District Development Committee is entitled to receive the certain percentage amounts as a revenue sharing collected by the central government. The details of the vertical sharing (from central to local) and horizontal sharing (from DDC to VDC and Municipality) and vice versa are as follows (LSGA, 1999).

1. DDC shall receive the following percent share from registration fee to be obtained by government of Nepal for the purchase and sale of house and land.

1.1 Up-to 5 million	- 90%
1.2 From 5-10 million	- 60%
1.3 From 10-20 million	- 30%
1.4 From 20-30 million	- 20%
1.5 From 30-50 million	- 15%
1.6 From 50-100 million	- 10%
1.7 More than 100 million	- 5%

2. DDC shall receive 50% out of the amount to be obtained by the government of Nepal for royalty of mines,
3. DDC shall obtain 10% out of the amount to be obtained by the government of Nepal from forests,
4. DDC shall get 50% out of the amount to be obtained by government of Nepal from hydropower production and sale. Out of 50%, 12% shall be obtained by the DDC where hydro power plant is installed and remaining 38% for the DDCs of the respective development region at the proportional rate[4].
5. DDC shall get 30% out of the amount of entrance fee to be obtained by government of Nepal for entry of tourists into the district development area[5], royalty of mountain climbing[6], entry of tourists into national park, and pad yatra/trekking.[7]

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[4] Amended by the second amendment of LSGR on 2061/09/26
[5] Added by the second amendment of LSGR on 2061/09/26
[6] Added by the second amendment of LSGR on 2061/09/26
[7] The amount to be obtained from the revenue sharing shall not be used in the administrative expenses by the DDCs.

2.5.3 Fund of the district development committees in Nepal

The District Development Committee shall have a fund of its own. The fund shall consist of the following amounts (LSGA, 1999, section, 221),:

- Amounts received from government of Nepal,
- Amounts received from taxes, fees, duties, and tariff,
- Twenty five percent the land revenue collected by the VDC and Municipality
- Amounts obtained from sales, rent, fare, interest of movable and immovable properties, or other goods of DDC
- Donation, gifts, grants, or assistance obtained from any person or organization
- Amounts obtained from any foreign government or international organization[8]
- Amounts received from revenue allocation and fines and penalties
- Amounts obtained from income generating programme operated by DDC
- Amounts of loans and borrowings taken by the DDC from any bank or any other organization
- Amount obtained from other sources.

2.5.4 Performance based grant system to local government in Nepal

The local government bodies receive administrative/recurrent, capital and other expenditure grants annually from the government of Nepal. The government of Nepal provides two-types of capital expenditure grants viz. minimum capital expenditure grant and formula based capital expenditure grant which is known as performance based grant system (PBGS). Minimum capital expenditure grant is provided based on the proximity and remoteness which wouldn't be more than 30% of total capital expenditure grant for municipalities and DDCs. Moreover, Ministry of Local Development provides formula based capital expenditure grant to local government bodies based on the result of assessment of Minimum Conditions and Performance Measures (MCPM). The aim of PBGS is to improve service delivery, accountability and transparency of local bodies through an incentive and penalty mechanism (MoLD, 2010). The basis of formula based expenditure grant to local government bodies are explained in table 2-1 below.

[8] DDC shall have to obtain approval of government of Nepal before to receive amounts from foreign government of international organization.

Table 2-1: Basis of formula based grant of local bodies in Nepal

VDCs (Weight-age in %)	Municipalities (Weight-age in %)	DDCs (Weight-age in %)
Population - 60 %	Population - 50 %	Population - 40 %
Cost - 30 %	Poverty - 25 %	Poverty - 25 %
Geographic Area - 10%	Geographic Area - 10%	Geographic Area - 10%
	Efforts of Internal revenue - 15%	Cost - 25%

Source: GoN/MLD (2010), DDC, VDC and Municipality Grant Operation Procedures, 2010

2.5.5 Source of income of local government in Nepal

Internal sources of income of local government (bodies) viz. VDCs, municipalities and DDCs are explicitly explained in LSGA in order to cover their recurrent and capital expenditure at local level by the respective authorities. For more detail, the sources of internal income of local government of Nepal are presented in Appendix-6.

2.6 Empirical Studies

The policy and institutional arrangements of local level planned development, the procedures involved in designing the District Development Plan (DPP) and analyzed the capacity of the local level development mechanism to achieve broader goals such as participatory and sustainable development at the local level has been examined (Paudyal, 1994). Moreover, the author has tried to review the achievements of the decentralization Act, 1982 and the decentralization By-laws, 1984 as to institutional development for effective planning process at local level. However, the author has not focused the financial part such as expenditure and revenue assignment and its efficiency in order to deliver services at local level.

The implementation of the decentralization scheme in order to ascertain its real implementation status and distill lessons from the experience of the implementation of decentralization scheme in order to facilitate the effective implementation of decentralization programme in the years to come has been reviewed and assessed (Shrestha, 1999). The study has only reviewed the functions and powers local government, the legal framework of decentralization scheme and level of local level planning process. Moreover, it has also been tried to overview the resource mobilization activities of local government institutions specially gaps between prescribed and practiced revenue sources. The revenue gap is not properly analyzed. It is just mentioned the lists of legally prescribed and practically used revenue sources in annexes.

Moreover, he has clearly mentioned that the fundamental factors hampering the adequate mobilization of the financial resources at local level are the narrow and fragile revenue base of the local government institution because of poor economy of the country and the politically motivated institutional proliferation of the non-viable. He has also argued that villages and districts are technically weak in the fields such as conducting surveys, developing revenue records, billing techniques, and account maintenance. On the other hand, local people do not have proper taxpaying habit and the lack of transparency in public financial accountability.

The trends in resource gap and analyze of the role of internal and external sources in financing the planned development process in Nepal has been examined (Singh, 1999). He concludes that the process of economic development in Nepal has been heavily dependent on external sources from the early stage of the inception of the planned development. The increase of revenue deficit is due to the rapid increase in both development (capital) and recurrent (consumption) expenditure of the government. But he has not differentiated the income and expenditure pattern of both central and local government. The overview of intergovernmental fiscal relations highlights the issues and direction of reform for the effective fiscal decentralization in Nepal (Shrestha, 2002). This analysis is based on sub-national fiscal data. This study has overviewed the local government structure, expenditure responsibilities and revenue assignment, intergovernmental fiscal transfer, local government borrowing and local government budgeting in Nepal.

The various facets of expenditure assignments and sectoral devolution in local government have been reviewed and assessed (Ligal et al, 2004a) in Nepal. It has focused on the review of the status of sectoral devolution, existing fund flow mechanism and identify the problems and challenges in the expenditure assignment across the level of government in Nepal. It has also recommended the clear delineation and definition of the specific tasks and responsibilities of all tiers of local bodies and central government and clear linkage between them.

The issues associated with fiscal decentralization namely expenditure assignment, revenue assignment, and estimation of expenditure needs, fiscal gap, and intergovernmental fiscal transfers have been analyzed (Ligal et al, 2004b). The study has broadly focused on revenue assignment, assessed resource gaps, and suggested some measures for minimizing the fiscal gaps of the local bodies in the country. The overall objective of the study is to design revenue assignment to local bodies namely VDCs, Municipalities and DDCs, identify potential tax and non tax areas of local bodies, estimate total revenue along with expenditure needs quantify resource gaps in relation to expenditure requirement and suggest modalities of intergovernmental transfer to address the resource gaps among local bodies.

The service delivery and its effectiveness and revenue mobilization pattern of the local government in Nepal have been reviewed and analyzed (Adhikari et al, 2004) . This study has just shown total approved budget, total expenditure and gap between two annual aggregate of two fiscal years 2001/2002 and 2002/2003. At the same time, internal revenue mobilization pattern of Jhapa, Parbat, Sindhuli and Surkhet districts of the same fiscal year has been revealed. Besides, he has also depicted internal income and recurrent expenditure of some municipalities such as Khadbari, Biratnagar, Bhimeshor, Kamalamai, Butawal, Hetauda, Narayan, Nepalgunj, Dasarathchanda, and Mahendranagar. Moreover, he has also presented the figure of internal income of some VDCs of Morang and Kaski districts in the same fiscal year (2001/02 and 2002/03). The total conditional and unconditional grants transferred by the central government to DDCs, Municipalities and VDCs of the same two fiscal years are analyzed. It is also mentioned the support received by Tanahu, Rupandehi, Kailali and Surkhet DDCs from Development partners (various donor communities). However, the study report could not analyze the correlation between internal and central grant of local government properly. It has just presented the reflection of the financial position of local government in general of two fiscal years.

According to the LSGA, local government (VDC, Municipality and DDC) have some revenue raising powers, but the local revenue base is limited and stagnant. Due to the lack of sufficient fund to meet the assigned expenditure, there is a high degree of dependency of DDCs and VDCs upon central government transfers (representing 75% of total LG revenues) is very high. On the other hand, the local government expenditures are small in scale as compare to central government. It is accounted that only four % of total public expenditures is mobilized by local government in Nepal. Central transfers to DDCs have been mainly channeled down through sector ministries to their deconcentrated departments. The fiscal decentralization policy is now to switch to "devolved" funding through a mix of conditional and unconditional grants to the DDCs themselves – but implementation is stalled because of the current suspension of local elected bodies (UNCDF, 2004).

The highlights of the political variables of pro-panchayat or anti-panchayat policies have been analyzed (Kumar, 2006). This study tries to answer the questions such as in what circumstances panchayats were set up and how their survival was ensured, what were the reasons of not being held periodic local election, and what were the motivation factors that political leaders to create panchayats and further the logical course of decentralization. In order to seek the answer the author purposively selects four districts such as Puna from Maharastra, Birbhum from West Bengal, Mandya from Karnataka and Vidisha from Madhya Pradesh.

The study entitled *"Towards Local Democracy in Nepal"* has mainly focused the district planning in the context of decentralization and decentralization in the context of district planning (Adhikary, 2006). He has captured the theoretical framework of decentralization and planning process. It has just touched the revenue and expenditure assignment of local government in general and district development committees in specific. The study has highlighted the role of local government associations such as ADDCN, NAVIN and MuAN[9] in the decentralization process in Nepal. Furthermore, the study has explored and analyzed determinant factors of successful planning, participating, decentralization and development management of the district level.

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[9] Association of District Development Committees of Nepal (ADDCN), National Association of VDCs in Nepal (NAVIN) and Municipal Association of Nepal (MuAN) are the representative institution of local government in Nepal. They all were established under the National Directive Act, 1961. They have been working in favor of respective members in two outputs such as advocacy and lobby in policy issues regarding decentralization and local governance and capacity development of respective members since their establishment.

The study on expenditure pattern of local government submitted to Asian Development Bank of Nepal has focused on expenditure patterns of local governance in the context of rural poverty alleviation (Kandel, 2006). The study has reviewed the various aspects of the responsibility given to the local bodies (LBs); present status of LBs expenditure in Nepal; the present status of poverty in the rural sector of Nepal; and the rural poverty reduction strategy adopted in Nepal. He has also tried to identify the role of LBs in poverty reduction strategy of Nepal, and the central government's responsibility that can be transferred to local bodies in the context of rural poverty alleviation. Besides, the policy improvements needed to strengthen local bodies to reduce rural poverty in Nepal also has been analyzed.

The scope of the study is limited to the expenditure pattern of VDCs and DDCs on sample basis. It does not cover the resource mobilization by 58 municipalities, NGOs and CG in rural area. The study has not been able to make microanalysis of the district and village level expenditure pattern. The state e of fiscal decentralization in Nepal has also been reviewed in the dissertation of M.Phil (Nepal, 2007). He has evaluated the revenue and expenditure assignment of municipalities in general and tried to analyze the prominent sources of financing of municipal services in Nepal. Furthermore, it has emphasized on the revenue administration of municipalities in Nepal. The impact of fiscal decentralization on government size in terms of fiscal decentralization indicators, indicators of local government collusions (vertical imbalance) and control variable such as population, age, council, sex, adult literacy, and personnel size in municipalities have been analyzed. However, the pattern of fiscal decentralization in general and revenue and expenditure assignment of DDCs have not analyzed specifically.

The study on assessment of Village Development Committee Governance and the use of blocal grants have principally focused on how the large amount of money transferred to VDCs from central government as block grants are spent on reducing poverty and achieving the millennium development goals (Inlogos, 2009).

The study on the Assessment of Fiduciary Risk in Local Bodies, (LBs) Public Expenditure Financial Accountability in Nepal has identified the key areas and the degree of fiduciary risks in managing public finance by LBs in Nepal (NAREC, 2009). The has analyzed the existing status of fiduciary risks by all sampled local bodies- DDCs, VDCs and Municipalities, to overview the final audit process in LBs how far the process has become able to explore financial irregularities and LBs response on those aspects, and to provide recommendations on various aspects (policies, systems and procedures and capacity) of local bodies to improve public expenditure management capacity and to reduce fiduciary risks on the basis of analysis.

Both qualitative and quantitative methods and approaches have been adopted during the course of the research. High emphasis has been given to qualitative work. The data and information are collected from both the secondary as well as primary sources covering the existing policy, acts, rules and regulations and concern stakeholders and persons. In the process of study, the literatures and documents review, filed visits, focus group discussion, and workshop and seminar were conducted as per need.

The study report entitled "Nepal's Choices in Fiscal Federalism" submitted to ADB, Nepal and Ministry of Local Development has aimed an endeavor to contribute to the ongoing discussion on fiscal federalism in Nepal. It has presented a strategic evaluation of options for setting up a decentralized state structure in Nepal in the context of concepts and international practices of fiscal federalism. The study has recommended for considering only certain elements of the fiscal federal scheme not all the matters to be reflected in the constitution (Cyan et al, 2009).

Fiscal federalism is one of the important components of federal state and only fiscal decentralization can only ensure devolution of fiscal power to local government bodies. Similarly, expenditure assignment needs to be preceded revenue assignment. Equalization fund should be transferred to the local government bodies on the formula based grant system (Pyakuryal et all, 2009). There are tremendous causes against the borrowing of sub-national government. According to this school of thought, there may be high chance of misuse of loan amount politically. It is hard to repay the loan and create the burden for future generation and it may put the potential revenue resources in future (Kandel, 2009).

CHAPTER – III

3 RESEARCH METHODOLOGY

3.1 Introduction

This is the fundamental type of research rather applied research. It is both descriptive as well as analytical study, which simply portrays an accurate profile of fiscal decentralization in Nepal. Simple analytical tools such as multiple regression and correlation have been analyzed in the study. The situation of fiscal decentralization in Nepal has been reviewed based on the 16 observations which is also the population of the study.

3.2 Sources of data

The basic objective of the study is to review the resource allocation between central to local government in general and share on revenue of District Development Committees in specific. In order to seek the information regarding revenue and expenditure of the both central and local government, the relevant materials were reviewed and gathered the necessary information from the various secondary sources. The sources of data were Ministry of Finance, Ministry of Local Development, Local Body Fiscal Commission, National Planning Commission (NPC), Central Bureau of Statistics (CBS), Financial Comptroller General Office (FCGO), Office of Auditor General (OAG), UDLE/GTZ, Human development report of UNDP, World Bank, Asian Development Bank, Central Library of TU Kirtipur, secretariat of Association of District Development Committees of Nepal (ADDCN), and various web pages including google.com, libraries as per need.

3.3 Methods of data collection

National annual budget allocation between central and local government of 16 years from fiscal year 1996/97 to 2011/12 has been collected from published documents to compute multiple regressions. Besides, key informant interview was also carried out as individual discussion and interaction with few ex-secretaries of Government of Nepal, selected senior decentralization and local governance experts with a view to get input and the perception on the research topic. Similarly, a set of questionnaire was developed to obtain opinion of former elected President and present LDOs of selected DDCs. LDOs of Banke, Chitwan, Gulmi, Lamjung, Kaski and project coordinator of Western Upper-Hill Poverty Alleviation Project-WUPAP have responded the questions. Basically the present practice of internal resource mobilization by DDCs, role of central and district government in effective resource mobilization, major problems and challenged in resource utilization, role of MoLD and LBFC for improving fiscal decentralization in Nepal are some issues which were asked to the respondents. The intensive desk study to review of related literatures was carried out in order to internalize the concept of subject matter and to get more knowledge of previous empirical studies on the same subjects and areas which helped to shape this study in this form. The questionnaires which were used to collect opinion from key informants are presented in appendix-7.

3.4 Methods of data analysis

The information collected from the secondary sources was processed to analyze the regression by using PHStat 2. Since it is time series data the Durbin-Watson Statistic was computed to review multicolliarinity among the variables. The R square value was computed to view the strength of linear model and its associated variables.

The simple average method is used to calculate the average income and expenditure of local government bodies in Nepal. The total sum is divided by the total number of observations.

District-wise GDP (UNDP, 2004, table 10, pp. 173-175), internal revenue of DDCs and total expenditure of devolved sectors (agriculture, livestock, education, and health) of 75 Districts of fiscal year 2006/07 collected for analyzing the biviriate pearson's correlation among the three variables. The recurrent and capital expenditure of 16 years from fiscal year 1996/97 to 2011/12 also reviewed and calculated the ratio between recurrent and development expenditure for the period in table 6-11. This analysis has shown the detail status of income and expenditure pattern of the local bodies of the same fiscal year. Moreover, aggregate income and expenditure of local bodies has also been reviewed to see the ratio of total income and expenditure among the VDCs, DDCs and municipalities (table 6-13).

Besides, 16 years data from 1996/97 to 2011/12 about actual tax and non-tax revenue and GDP are analyzed with a view to see the average ratio between GDP and Tax and non-tax revenue of Nepal which is explained in table 6-15. Total income and expenditure of fiscal year 2006/07 of all VDCs, DDCs and municipality based on the data from LBFC publication has also been analyzed.

Likewise, total estimated verses actual expenditure of center government and district level of the fiscal year from 1996/97 to 2008/09 also been reviewed for the analysis of expenditure capacity of the central government and district level. Similarly, district-wise expenditure of all 75 district of the fiscal year 2011/12 has also been examined to observe the district wise budget allocation, capacity of internal revenue mobilization and the expenditure patter such as recurrent and development expenditure etc. All the descriptive analyses are presented in table, pie chart and figure in the chapter-six of the study.

In order to show the real picture of fiscal decentralization in Nepal, the following three indicators of signs of fiscal decentralization has been analyzed (Prud'homme, 1990). However, due to the lack of data availability the following second and third criterions have been analyzed based on the available data with regard to DDCs.

1. The share of local taxes in total tax revenue is one of the important sign of fiscal decentralization. However due to data constraint this indicator is not analyzed in the study.
2. The share of local government expenditure as compare to central government expenditure has been presented in chapter-six.
3. The self-reliant rate of DDCs of Nepal has been calculated through the ratio of own source revenue to the central government grant.

Moreover, the sharing of development expenditure between district and central level of 14 years has been examined. Likewise the share of local government expenditure out of total national budget also analyzed separately. The local government grant also compared with GDP, tax and non-tax revenue of central government.

3.5 The model specification

The following model is estimated. The basis equation of the model to be estimated is as follow. The local government expenditure is assumed as the dependent variable and the total national revenue, foreign grant, foreign loan and domestic loan are independent variables.

The significance level (α) of testing multiple regressions is at 5% level.

$Y=\alpha+\beta_1X_{1+}\ \beta_2X_{2+}\ \beta_3X_{3+}\ \beta_4X_{4+}\ \varepsilon$ ……………………………..(i)

Where,

Y= Local government expenditure

α = Intercept

X_1=Total national revenue

X_2=Foreign grant

X_3= Foreign loan

X_4= Domestic loan

ε = Error term

3.6 Perceptions of the Stakeholders: An Opinion Survey

In order to generate and collect opinions for supporting the objectives open-end structured questionnaires were used. The questionnaire was used to collect information from selected LDOs, high level civil servants, experts and former president of DDCs in Nepal. The detail perception of the stakeholders is explained in chapter-7.

3.7 Basis of selection of sampled countries

With a view to review the fiscal decentralization practice in the world, the nine different countries are selected purposively but based on the certain criterion. India is selected because it is the neighboring country of Nepal and it is known as having economically sound countries in the world. Moreover, India has been experiencing democratic practice since long and known as largest democratic countries in the globe and local democracy has been strengthened after the 73rd and 74th amendment of Constitution of India. China is also the neighboring county of Nepal having unitary system of governance. It is well known as "Tiger" of Asia in terms of economic boom. The South Africa is selected because this country is well-known as the good model of decentralization in the world after 1990s. Although Uganda is one the poorest African countries in the World, the central government of Uganda has started to transfer new tasks and responsibilities to the local government in the late 1990s. So it is selected to understand the good practice for promoting fiscal decentralization in Uganda. Similarly, Brazil is selected because it is also a biggest country in terms of population and territory having federal structure of political governance. The next countries are Switzerland and Germany represent European continent are very renowned as the example of good federal countries. Although Denmark is one of the OECD countries, it is selected because it is renowned as having good democratic practice, prosperous, well-off and affluent country in the world even under the unitary system of governance.

CHAPTER-IV

4 GLOBAL PRACTICES OF FISCAL DECENTRALIZATION

4.1 Background

This chapter deals, in general, with the introduction of governance system, revenue and expenditure assignment, and inter-governmental fiscal transfer across the levels of governments in the selected countries having federal and unitary system of political governance in the world. More specifically, the purpose is to review the practice of management of local government finance and recommend best options of resource sharing in various layers of government in the new framework of restructuring of state in Nepal.

The sample countries are selected from highly developed, emerging and developing countries in terms of economic development and having long history of democracy and recently decentralized federal and unitary countries in Asia, Africa, Latin America and Europe. The selected countries are India, South Africa, Uganda, Brazil, Switzerland, Germany, Denmark, China and Nepal. This chapter focuses only the revenue and expenditure of local government and tries to compare the financial authorities and autonomy between national and sub-national level of government of the selected countries.

The main source of revenue of local government in developing countries is the property tax, but in some countries like Brazil, other taxes are also more important (Nickson, 1995). The property tax is the provincial tax in the Latin American county Argentina but in El Salvador it is central government tax. On the other hand, in South Africa, local government raises more property tax revenue than provinces (Bagchi and Chakraborty, 2006). Local governments rely heavily on property taxes for revenue, while state government is responsible on sales and income taxes and the source of revenue of central government is income (payroll) tax. The services provided by local government always rely, in part and sometimes very heavily, on the transfers from upper-level governments (Bird, 1986). The country wise study with regard to local governance system and revenue and expenditure assignments across the level of governments are as follows:

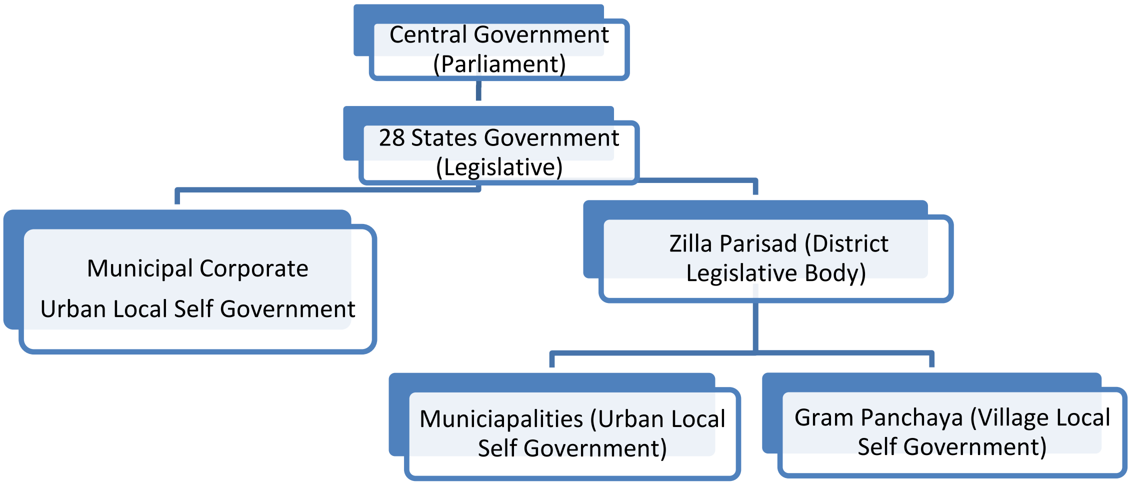
4.2 India

India is the largest democratic country in the world. It is the neighboring country of Nepal. It is the second largest in Asia and seventh largest and second most populous country in the earth. It has made enormous economic and political paces since it achieved independence more than sixty years ago. The statutory recognition to local governments was accorded with the 73rd constitutional amendment in 1992 for rural decentralization. The 74th constitutional amendment in 1992 was for urban decentralization. The purpose of the amendments of the constitution was to transfer of administrative, fiscal and political responsibilities to locally elected bodies namely panchayat raj institutions such as districts, intermediate (between the village and district), village and urban local bodies (Fraschini, 2006).

There are three tiers of local government, with different names in different states. They are village (Gram Panchayat), block (Panchayat Samitis) and district (Zilla Parishads). The panchayat gives the common term "Panchayati Raj" to India's system of rural local government (Singh, 1997). There are 28 states, seven union territories and 3,694 municipalities in urban areas. At the same time, there are altogether 246,977 rural councils that include 459 zilla panchayat (districts-third tier), 5,930 panchayat samitis (blocks-second tier) and 240,588 gram panchayat (village-first tier) (UCLG, 2008). The Panchayats are a linked-system of local bodies among village panchayats), panchayat samities at the intermediate level, and district panchayats. According to Mathur (2006), the urban local bodies are divided into three categories such as municipal corporation (larger urban area), municipal council (small urban area) and nagar panchayat (transition from rural to urban). There are altogether 242,328 villages, 6,097 intermediate governments and 543 district government in India. The average rural population per village panchayat is 3,278 (Alok, 2006).

Likewise, there are 236,350 gram (village) pachayats, 6,795 pachayat samities, 531 zilla panchayats and 9 autonomous district councils as rural local bodies; and 109 municipal corporates, 1,432 municipalities and 2,182 nagar pachayat as urban local bodies in India (Fraschine, 2006). The number of rural and urban local bodies varies in literatures.

Figure 4-1: Political governance structure in India



Prior to the amendment of constitution, the sources of income earmarked for local government, were only for providing civic services and welfare functions, but not for development functions. But after the constitutional amendments and enactment of conformity acts in the State in 1994, significant portion of development functions of the State were devolved to local governments. In 1996, the State government earmarked one-third of its development plan size as devolved funds for bottom-up planning in development sectors transferred to local government.

Indian experience shows that attempt to decentralize below the state level has come about more from the center than the states. Many states did not find it necessary to decentralize below their level until the constitution was amended. Of course, there are cases of some states such as Karnataka takes a proactive approach to decentralization. Such initiative is an exception rather than a rule. Thus, sub-state decentralization in India is mostly a 'top-down' process (Rao, 2000).

However, the push to decentralize below the state level has been stronger on the center side than on the states side. So the process of local government reform is still under way and the local governments play a very limited role both in raising revenues and in spending (Rao, 2002).

A very few revenue productive tax powers have been devolved to local government in India. Urban local government can collect local revenue from property tax. Moreover, the tax on entry of good into local areas can obtain a significant amount of revenue in some cities like Mumbai in India. Tax powers are mostly restricted to powers of property tax and a few land based taxes (Shah, 2007). The 80th amendment of the constitution after the recommendation of the 10th Finance Commission (1995-2000), certain percent of all union tax has been devolved to states (Alok, 2006).

According to the table 4-1, the revenue share of local government is very poor (3%) compare to 67% of central government and 30% of state government in India. However the share of expenditure of local government is comparatively in better position (30%) of the total expenditure. Conversely the share of expenditures of federal and state government is 37% and 33 % respectively.

Table 4-1: Share of total tax revenue and public expenditure in India

Level of government	Revenue (%)	Expenditure (%)
Central/Federal government	67	37
State government	30	33
Local government	3	30
Total	**100**	**100**

Note: Fiscal year of tax revenue and public expenditure is not mentioned in the report.

Source: UCLG (2010). Local government finance challenging of the 21st century, second global report of decentralization and local democracy, Gold 2010

The important indicator of fiscal autonomy is the share of revenue expenditure to be covered with own sources and the percentage of own sources on the total revenue. The table 4-2 below shows that percentage share of own sources of revenue panchayati raj institutions and urban local bodies in India. The total revenue of rural local bodies was only 6.85%. It means that more than 93% of their total revenue comes from external sources in 2002/03. On the other hand, urban local bodies raised 58.44% revenue from their own sources in 2002/03.

Similarly the percentage of revenue expenditure by own resources vary in rural and urban bodies covering only 9.26 % and 68.97% respectively. Also, percentage of revenue received from own tax is much more lowering 3.87% for rural and 39.23% for urban in

2002/03. The gram pachanyats are comparatively in a better position for service delivery because they have some taxing power of their own while other two (district and intermediate panchayats) are dependent only on tolls, fees and non-tax revenue for internal revenue (Fraschini, 2006).

Table 4-2: Revenue and expenditure of local bodies in India, 2002/03

Source of revenue and expenditure	Pachayati Raj Institution (PRI) All tiers (%)	Urban local bodies (all levels) (%)
Revenue		
Own Tax	3.87	39.23
Own-non tax	2.98	19.21
Assignment + devolution	27.69	17.69
Grants-in-aid	58.95	16.48
Others	6.51	7.39
Total revenue	100	100
Expenditure		
Revenue expenditure	73.05	76.24
Capital expenditure	26.95	23.76
Total expenditure	100	100
Own revenue as percentage of revenue expenditure	9.26	68.97

Source: Fraschini, 2006, table no. 5 A and B

The constitution of India has explicitly mentioned the principle of separation of tax responsibility across the level of governments. For example, the taxes assigned to the central government are not again assigned to the states and vice versa (Rao, 2007). On the contrary, the central government has right to levy excise duties on manufactured products. Similarly, states can levy taxes on the sale and purchase of goods. Till now, most states levy sales taxes at the point of manufacture or on imports from one state to another. Therefore, there is substantial overlap and duplication in the consumption tax system in India. However, the weights of revenue sharing formula by individual states are population (25%), distance from the state with the highest per capita GDP (50%), area (10%), tax efforts (7.5%) and fiscal discipline (7.5%) (Rao, 2007)

Finance Commission (FC) and Planning Commission (PC) oversee the fiscal transfer in India. The development sectors are carefully looked after by PC, which covers both current and capital parts whereas FC take cares the recurrent expenditure (Shrivastava, 2002). By the year 2000, the revenue sharing principle was based on a tax-by-tax basis from central to states. The very important central taxes such as income tax and union excise taxes were shared to states. Nevertheless, the other taxes like the corporate taxes and custom duties were not shared to states. However, after the 80th amendment to the constitution, except central sales and consignment taxes other taxes are distributable between central and states. The vertical dimension of revenue sharing between centre to states ranges from 23.66 % to 44.06 % which stands at around 35% in recent years (Shrivastava, 2002).

The thirteenth finance commission has made very positive recommendation in favor of local government in India that 7.42% of the eligible allocations for panchayati raj institutions (PRIs) and 10.57% of urban local bodies (ULBs) should be ensured. The state governments should delegate funds, functions and functionaries to the local bodies and expenditure of PRIs should be increased to at least 5% of GDP. Local bodies should be given authority to levy tax on properties of the central government. Each panchayat should be given a minimum grant of Rs. 10 lakh (one million) irrespective of population or any other criteria and there should be provision of a special grant of Rs. 5 crore (50 millions) to each zilla (district) to meet local needs. Similarly, the finance commission should directly devolve funds to autonomous district councils instead of routing it through State government (Finance Commission, 2009).

In the same way, according to the provision of constitution, each state government has to specify the responsibility and resource assignment of local bodies such as urban and rural. To ensure the resource allocation to the local bodies, each state has to appoint a state level FC with five years tenure. The major responsibility of state is to strengthen the finances of their local bodies for effective service delivery.

4.3 South Africa

South Africa is one of the most diverse countries in the world. There are three tiers of governance system namely central, provincial and local. The local governments are focused on growing local economies and providing infrastructure and services. In accordance with the constitution and the organized local government act, 1997 (act 52 of 1997), a local government association has formally been recognized.

According to the provision of the constitution provides, there are three categories of municipalities. As directed by the constitution, the local government: municipal structures Act, 1998, (Act 117 of 1998), contains criteria for determining when an area must be a category-A municipality (metropolitan municipalities) and when municipalities fall into categories B (local municipalities) or C (district municipalities). The Act also determines that category-A municipalities can only be established in metropolitan areas.

The constitution of South Africa, 1997 has focused on three important natures of inter governmental relationships. It has recognized three "spheres", rather than tiers of government. It means that national, provincial and local governments are equal, separate, and autonomous in terms of decision-making and service delivery in accordance with the constitution. It is also envisaged that the relationship between the spheres would be cooperative rather than hierarchical. It focuses on establishing harmony between all spheres of governments to cooperate and negotiate political and budgetary issues. Based on the principle of subsidiary, the functions have ideally been performed by the lowest possible sphere of the government (Heymans, 2006).

National and provincial governments are concurrently responsible for school education, health, welfare and housing. National government determines the policies and provincial governments are responsible for implementing a few exclusive functions. Basically, local governments engage in user fee services such as electricity, water, and sanitation; the remaining involve in the provision of public goods like municipal and household infrastructure, streets, streets lights, and refuse collection.

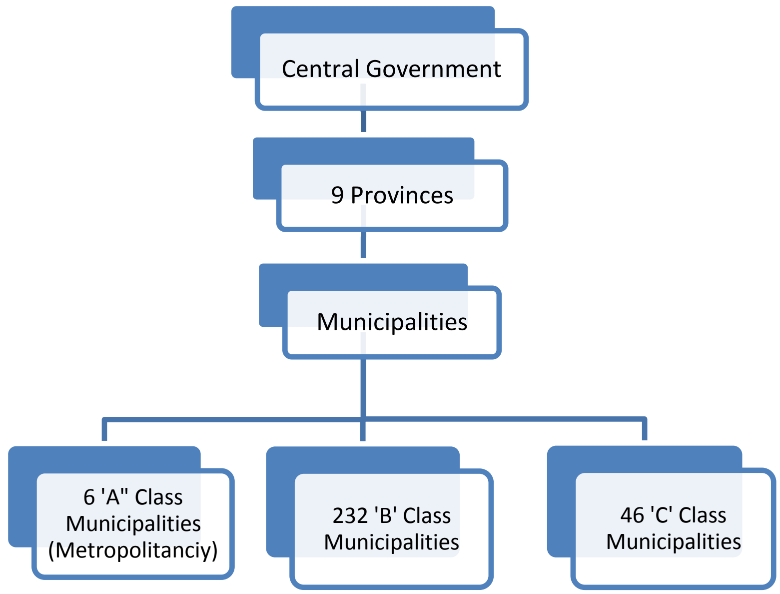
There are altogether nine provinces and 284 municipalities. Category 'A' municipalities are known as metropolitan cities. There are only six metropolitan cities. There are total 232 category 'B' municipalities which are very weak in administration and fiscal capacity especially in rural areas. Likewise, category 'C' municipalities are of district level. There are 46 such structures. According to Heymans (2006), District municipalities do not have authority to control local municipalities but have been created on the basis of following three logical points.

a. Certain services are presumably better provided at larger scale because of scale economies.

b. There is a need of coordination of planning at a district scale.

c. It is believed to provide opportunities for redistribution on the district scale.

Figure 4-2: Political governance structure in South Africa



Districts have certain responsibilities for municipalities roads (district roads), although there is considerable uncertainty regarding roads function (Palmer Development Group, 2004). Mostly local governments generate revenue in urban South Africa through property taxes and the delivery of services to residents and business. This suited white municipalities that had small populations to serve and large concentrations of economic resources to tax. For black areas, financial shortfalls were built into the approach to local government. In this way, municipalities in black areas were deprived of the means to meet the needs of local residents (Joseph and Rensburg, 2002)

Fiscal decentralization provides sub-national government with lower fiscal autonomy as compare to national government, which levies broad-based taxes such as income and corporate tax, value-added tax (VAT), customs and excise, and fuel levies. Local governments have extensive powers to raise their own revenues through property and business taxes. They are also authorized to impose fees for services such as electricity, water, and sewerage. They also receive substantial grants and subsidies from provincial and national government to carry out the function at local level (Yemek, 2005).

The table 4-3 shows the division of revenue of 2007/08 and 2009/10 and consolidated expenditure of 2009/10 of government of South Africa. In 2007/08, central, provincial and local government received share about 36.9, 58.1 and 5% respectively. In 2009/10, the share of revenue of central government has increased to 50.1% from 36.9% but share of provincial government has decreased to 42.6% from 58.1%. On the contrary, the share of revenue of local government has gone up to 7.3% from 5%. Moreover, it is explicit that provinces were stronger to mobilize revenue as compared to central and local government in 2007/08 but the share of revenue of central and local government has increased as compared to provinces in 2009/10. Municipalities have very low power to mobilize the revenue. However, the expenditure part is completely reverse against revenue.

Table 4-3: Consolidated revenue and expenditure of South Africa

Level of government	2007/08 Revenue (%)	2009/10 Revenue (%)	2009/10 Expenditure (%)
Central Government	36.9%	50.1	40.4
Provinces of 2009/10 (100%) - Equitable share (80%) - Conditional grants (20%)	58.1%	42.6	37.2
Municipalities of 2009/10 (100%) - Equitable share (48%) - Conditional grants (38%) - General fuel levy sharing with metro municipalities (12%)	5.0%	7.3	22.4
Total	**100%**	**100%**	**100%**

Sources:

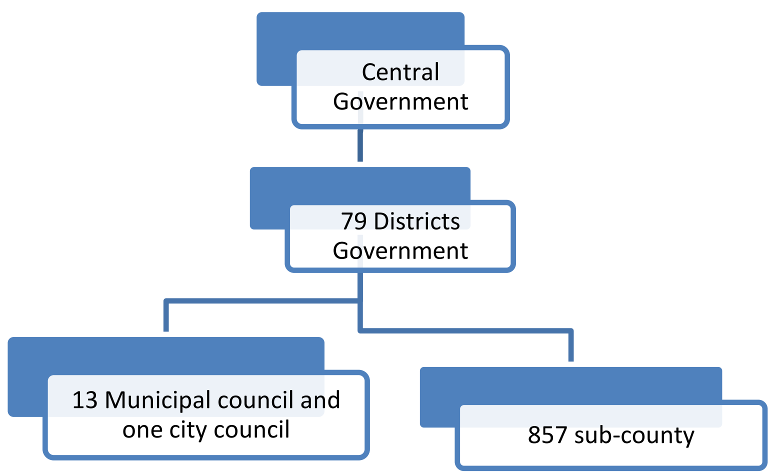
1. Yemek, 2005, Revenue of fiscal year 2007/08
2. National treasury (2009). Medium term budget policy statement, national treasury, republic of South Africa, table 4.2, 4.5, A.1 and A.2 for fiscal year 2009/10

4.4 Uganda

Uganda is one of the poorest countries and a landlocked East African country. Agriculture is the most important sector of the economy, accounting for 44% of GDP and employing over 80% of the workforce. Coffee is the major export crop, accounting for over half of export earnings. Industry and services make up 18% and 38% of GDP respectively (UNDP, 2003).

With a view to promote decentralization process sub-spatial powers have been devolved to LGs under a clear legal framework. The system in Uganda is still relatively devolved and many aspects of the LG system including financial management procedures, planning procedures and capacity building modalities have over the years been fine-tuned. However, several challenges are now emerging to the decentralization reforms.
There are upper and lower layers of local government in Uganda. Under upper layer of local government, there are 79 districts, 13 municipal councils and 1 city council. Similarly, under lower level of government, there are 857 sub-county (rural districts), five-city division and 34 municipal divisions (DEGE, 2007)

Figure 4-3: Political governance structure in Uganda



There is a constitutional status of local government in Uganda. The principle of decentralized local governance system is explicitly provisioned in constitution. There is multitier system of local government in Uganda. District councils, city councils, municipals, sub-county councils and town councils are lower level local government as corporate bodies. On the other hand, county council, parish, ward, village and cell or zones are administrative units (Steffensen, 2006).

According to the Uganda's constitution 1995, local government are autonomous which have two layers of local governments; the revenue sharing system is such where locally collected revenues are shared between the higher level governments (HLGs) and the lower level governments (LLGs). In total 65% of the locally collected revenues are retained by the LLGs. Some part of this is shared with the villages, counties and parishes. The major source of local government' revenue is central government transfer (Steffensen et al, 2004).

The system of local government is based on the principles of *subsidiairty* and integration without subordination (ibid.) However, the share of owns revenue of local government is very nominal as compare to the central government grant. This decline indicates that there are a lot of serious concerns about the sustainability and viability of autonomous local government, ownership and incentive to deliver services and accountability and transparency of the resource utilization (Steffensen et al, 2004). The central government has transferred new tasks to the local governments and responsibilities in the late 1990s, the local government share of the total public sector expenditure has been increased significantly. The local government expenditure has increased about threefold from 1997/98 to 2002/03 (Steffensen, 2006).

The table 4-4 shows the pattern of contribution on own sources of local government revenue in Uganda. The G-tax (graduated tax) played significant contribution in revenue generation of local government that accounts (52%). Similarly, the share of property tax in internal revenue was (13.6%). The user fee and charge also played important role to collect own revenue that accounted (18.5%). In the same way, licenses contributed (3.6%) and from other sources (12.3%).

Table 4-4: Own source of revenue of local government in Uganda, 2001/02

Source of Revenue	G-Tax (%)	Property Tax (%)	User Fee and Charge (%)	Licenses (%)	Others (%)	Total (%)
Contribution (%)	52	13.6	18.5	3.6	12.3	100

Source: (Steffensen, 2006)

Own source of local government has gradually decreased and the central government grant has substantially increased. It means that the local governments heavily rely on the central government grant. Own source of local government contributes only 13% to 15% of all local government revenue and the remaining 85% was contributed by the conditional grant in 2000/01 (Steffensen, 2006). Also, of the total revenue of municipalities in Uganda, the total local revenue was declined to 22 % in 2007/08 from 26% in 2006/07. It is due to abolition of graduated tax in 2006 (Management system and economic consultants limited, 2006).

The table 4-5 summarizes the expenditure trend of local government. The local governments are mostly responsible for primary education, health, roads, agriculture extension, water and sanitation. The share of local government expenditure in 2002/03 can be calculated as in education (40%), administration (25%), health (16%), roads (14%) and agriculture (5%).

Table 4-5: Share of local government expenditure in Uganda, 2002/03

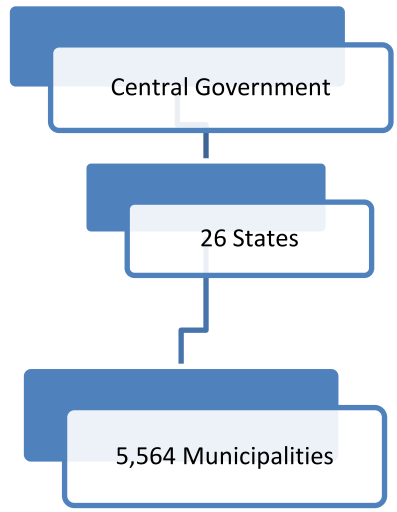
Sectors of Expenditure	Administration (%)	Education (%)	Health (%)	Roads (%)	Agriculture (%)	Total (%)
Share (%)	25	40	16	14	5	100

Source: (Steffensen, 2006)

4.5 Brazil

Brazil has the fifth largest territory and the sixth biggest population on the planet. It became an independent nation in 1822 AD from the rule of Portugal and republic in 1889 AD. Each of Brazil's states has its own constitution and popularly elected legislature and governor. The federation is of the sum of three tiers-central government (federal government), the intermediate governments (state governments) consisting of 26 states and one federal district (Brasilia), and local government (municipalities consisting of 5,564 units) (Afonso and Araujo, 2006).

Figure 4-4: Political governance structure in Brazil



Municipals are responsible for the construction and maintenance of roads, the creation and upkeep of public parks and museums, and the program of primary education. As districts have increment in population, they, in turn, become municipalities. The large municipalities are important political units and may rival the state in political power. The largest city in each municipality serves as the capital, and usually the largest city in the largest municipality serves as the state capital. Municipal governments are also responsible for water, sewerage, and garbage services. State tax revenues are concentrated in sales taxes. State governments are allowed to operate state financial institutions.

State governments are responsible for maintaining state highway systems, low-cost housing programs, public infrastructure, telephone companies, and transit police. Both state and municipal governments are responsible for public primary and secondary schools and public hospitals.

Value Added Tax (VAT) is levied in both central and state levels. Specifically, federal government levies tax on industrial products (is known as IPI-imposto sobre products industrialization) and VAT on manufacturing sectors. IPI is considered as complex tax system levied from 4% to 333%. States levy VAT up to retail level. Besides, 9% to 11% tax is levied as central tax on the interstate sale of goods (Rao, 2007).

According to Vigneault (2007), Brazil has exercised relatively high degree of decentralization. Federal government provides high proportion of shared revenue to states and local government. However, there is significant overlap of responsibilities of service delivery across the level of government.

The tax revenue and expenditure pattern of Brazil is explained in table 4-6. The share of tax revenue of central government is 54% of the total national tax revenue where as the tax revenue of state government and local government (municipalities) are 28 and 18% respectively. This indicates that the tax revenue is highly captured by central government rather than state and local government. Similarly, the expenditure of local government (26%) is relatively higher as compared to the own source of tax (18%). It means that local government receives more fund from inter governmental fiscal transfer especially from central government.

Table 4-6: Consolidated revenue and expenditure of government in Brazil, 2007

Level of governments	Tax revenue (%)	Expenditure (%)
Central government	54.0	45.0
State government	28.0	29.0
Local government (Municipalities)	18.0	26.0
Total	**100**	**100**

Source: UCLG (2010), GOLD II, Annex 6.3, pp248

The federal and states taxes are shared to other tier of government but the municipal taxes are shared as federal and states. The sources of internal revenue of municipalities are tax on services, urban property tax, social security contributions, fees, charges and others (Afonso and Araujo, 2006).

Fundamentally, municipalities levy taxes on personal and professional services, property tax on urban buildings and urban land, and tax on the transfer of real property. However, the figure left shows detail sources and percentage contribution of tax collection by municipalities. Table 4-7 below shows that the municipalities in Brazil receive about 34% revenue from service tax. The second important sector of revenue collection is urban property tax, which accounts about 24%. Similarly, social security contribution, public service fee, income tax withheld at source, contribution for public illumination, tax on transfer of real estate and other taxes accounts 8.3%, 6.8 %, 6 %,4.7 %,4.7 % and 11.6% respectively.

Table 4-7: Share of internal revenue of municipalities in Brazil, 2005

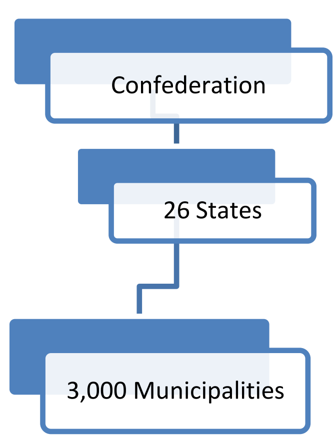
SN	Sources of Revenue	Share (%)
1	Service tax	33.7
2	Urban property tax	24.2
3	Social security	8.3
4	Public service Fee	6.8
5	Income tax	6.0
6	Public illumination	4.7
7	Tax on transfer of real state	4.7
8	Other taxes	11.6
	Total	**100**

Source: Afonso and Araujo (2006), pp391, table 11.5

4.6 Switzerland

Switzerland is a federal republic country having three hierarchical government layers- federal government (the Confederation), sovereign states (26 cantons) and municipalities. There are 3000 municipalities at local level (Feld et al, n.d.[10]). The largest municipality has over 400,000 inhabitants, whereas 45% municipalities have less than 500 inhabitants, and 240 municipalities have less than 100 inhabitants (Bulliard, 2005).

Figure 4-5: Political governance structure in Switzerland



[10] n.d. = date not mentioned in the publication.

The cantons have their own constitutions and laws, and are responsible for their own public works, education, care of the poor, justice, and police forces. Although the forms of local governments vary each canton has a legislative council, which appoints a chief executive. Communes are the basic units of local government. For the most part, Swiss districts (Bezirke), constituting a middle level of organization between the cantons and communes, are little more than judicial circuits.

The municipalities share almost the same amount of revenues and expenditures as the federal government. All the three different levels primarily finance their needs with their own taxes and user charges. The cantons as well as the municipalities rely heavily on direct taxes (around 95% of total tax revenue) whereas the federal government relies much more on indirect taxes (around 60% of total federal tax revenue) such as VAT. The cantons and the municipalities levy the main part of the direct income taxes, although the federal government also raises its own (very progressive) income tax (Schelker, 2005). Municipalities collected 96.4 % revenue from tax and only 3.6% from investment collection in 2001. Municipalities can determine the rate to levy taxes. As a fiscal equalization policy, state takes measures in order to diminish the effects of differences between municipalities (Bulliard, 2005).

The expenditure of municipalities per functions are education (23.3%), health (18.6%), hospital (17.6%), general administration (8.8%), environment (8.6%), traffic (7.2%), local roads (5.8%), culture and leisure (5.3%), police and fire brigades (4.5%), public economy (2.0%) national defense (0.6%) (ibid.)

The special advantage of the Swiss case is that the cantons decide autonomously on their tax scheme. They set the rate of progression as well as the ‘level’ of cantonal income taxes. In contrast, the municipalities can only levy a surcharge (tax shifter) on the cantonal income taxes.

The table 4-8 portrays that over the time sharing of revenue and expenditure pattern across the tires of government has changed. The share of central government in total revenue and expenditure has increased 17% and 6% in 1950 and 2009 within the fifty nine years period. On the contrary, the share of revenue and expenditure of cantons and municipalities has decreased gradually. The central government transfers certain revenue to fill up the gap of the revenue of cantons and local government. Moreover, the share of revenue and expenditure of central government gradually increased as compared to cantons and municipalities in 2009.

Table 4-8: Revenue and expenditure in the Swiss Federalism, 1950-2009

	1950	1960	1970	1980	1990	2000	2009
	%	%	%	%	%	%	%
Central government							
Revenue	42	40	34	30	31	33.1	59.0
Expenditure	38	35	32	31	31	32.4	44.0
Cantons							
Revenue	32	33	39	39	39	40	25.0
Expenditure	34	38	40	39	40	40.4	37.0
Municipalities							
Revenue	26	27	27	31	30	26.8	16.0
Expenditure	28	27	28	30	29	27.2	19.0
Total*							
Revenue	100	100	100	100	100	100	100
Expenditure	100	100	100	100	100	100	100

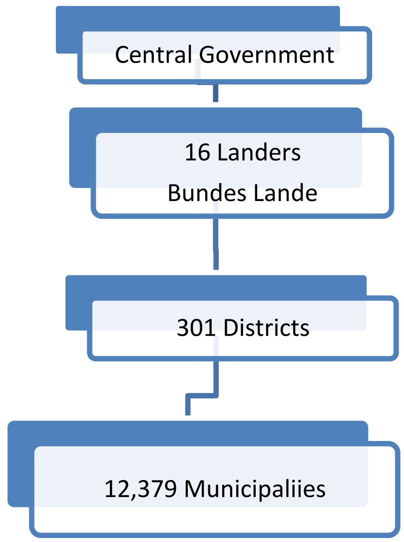
* Without double counting,

Sources:
1. Feld, Lars P. et al (nd). Fiscal federalism and economic performance: evidence from Swiss Cantons (for the period from 1950-1990)
2. Feld, Lars P.; Kirchgassner, Gebhard; Schaltegger, Christoph (July 1, 2010) "Decentralized taxation and the size of government: evidence from Swiss state and local government" (for the period of 2000-2007)
3. http://www.oecd.org/document/32/0,3746,en_2649_37427_47467040_1_1_1_37427,00.html#section_b

4.7 Germany

Germany is a federal state with three tiers of governments' structure such as federal, federal states (16 Länder) and local government. The local government comprises two types of entity like 301 districts known as Kreiser and 12,379 municipalities known as Gemeinden (Oireachtas, 2010).

Figure 4-6: Political governance structure in Germany



Source: (Oireachtas, 2010).

There are three types of local governments in Germany such as council of cities and towns (Stadtetag); a league of towns and municipalities (Stadte-und Gemeindebund); and the council for districts (Kreistag). These are voluntary associations without statutory authority. Municipalities are free to join any of these, and in practice, most do (Kramer, 2005).

There is high degree of fiscal imbalance between federal and states. States have very low discretionary power in order to collect own source-revenue. Sub-national governments receive shared taxes from the federal government where both base and rate are determined by the federal government (Vigneault, 2007). In the same way, local governments rely on shared taxes from federal and state government. Moreover, local governments have discretionary power to fix tax rates of property tax and trade, but they have to follow the legislation of either federal or states for other taxes (ibid.). Local self-government is the most important branch of self- government. The communes need revenues in order to fulfill their tasks. The revenues are contributed from following three sources of revenues (Tilkorn, n.d.).

1. Tax revenues (trade taxes and land taxes),
2. Financial transfers from the State and the Federation,

3. Payments, such as fees and contributions for the services they furnish.

4. Share in personal income tax; share in the tax on Economic affairs; share in VAT.

The consolidated revenue and expenditure as percentage of the total general government expenditure in Germany is depicted in table 4-9. The central government reserves the strong authority to handle the revenue as compare to regional and local government. The share of central, regional and local government is allocated by 70%, 22% and 8% respectively. The local government has limited power to mobilize resources in their own discretion. Local governments have to depend on the central government grant to perform the assign tasks and responsibility at local level. Similarly, the table 4-9 also shows that there is high percent (68%) of expenditure share of local government against 8% revenue sharing. The share of public expenditure in centre and state government accounts only 29% and 3% respectively. It indicates that local governments in Germany heavily rely on the central and state governments grant to perform their assigned functions.

Table 4-9: Consolidated revenue and expenditure in Germany, 2009

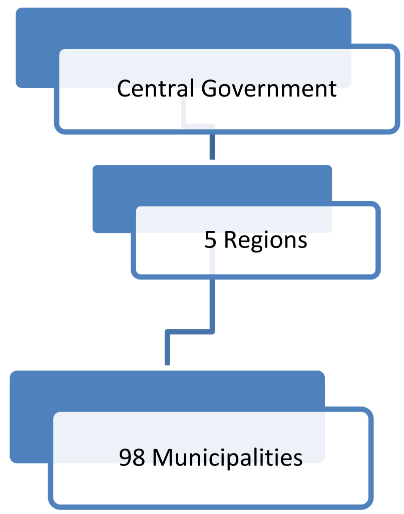
Level of governments	% share of revenue	% share of expenditure
Central government	70.0	29.0
State government	22.0	3.0
Local government	8.0	68.0
Total	100.0	100.0

Source:http://www.oecd.org/document/32/0,3746,en_2649_37427_47467040_1_1_1_37427,00.html#section_b

4.8 Denmark

Denmark is one of the OECD countries having a unitary system of governance. Human Development Index (HDI) shows that Denmark is categorized at 16th rank (UNDP, 2009b) out of 182 UN member states. It is categorized under a very high HDI country. Until 1970, there were more than 1300 urban and rural municipalities. In 1970 a reform was implemented and only one type of municipality emerged. The large numbers of municipalities were merged into 275 and the 24 counties into 14. Moreover, in 2007, the Danish Government passed another reform and the counties were abolished and replaced by five regions. The number of municipalities is now 98 (LGDK, 2009).

Figure 4-7: Political governance structure in Denmark



The consolidated revenue and expenditure as percentage of total government expenditure in Denmark of 2009 is shown in table 4-10.The share of tax revenue between central and local government in Denmark stands 74% and 26 % whereas the public expenditure is exactly inverse 26% and 74% respectively These figures indicate that there is less revenue decentralization but higher expenditure decentralization in Denmark.

Table 4-10: Consolidated revenue and expenditure in Denmark, 2009

Level of governments	**% share of revenue**	**% share of expenditure**
Central government	74.0	26.0
Local government	26.0	74.0
Total	**100.0**	**100.0**

Source:http://www.oecd.org/document/32/0,3746,en_2649_37427_47467040_1_1_1_37427,00.html#section_b

However, the total public expenditures of regions and municipalities are responsible for 51% of all public expenditures. The share of the total public expenditures to the GDP is 52% and the share of the local governments' expenditures to the GDP is 26.5% (LGDK, 2009).

Municipalities receive revenues from income and company taxes, land and property taxation, the central government grants and fees paid by the citizens for specific services. The share of income tax is very important that covers about 70% of the total municipal revenues, while user fee and property taxes (land and buildings) amount 10% and 8% respectively. Similarly reimbursement and grant occupies 7% share whereas company tax, loans and interest covers only 2%, 2%, and 1% share of the total revenue of local government in Denmark (Table 4-11). The municipal councils themselves decide the tax rates within some limitations set by regulation and by the result of the yearly negotiation between MoF and LGDK (LGDK, 2009).

Likewise, most welfare tasks have been devolved to local government in Denmark. The distribution of expenditure in local government budgets is presented in table 4-11. Most local government functions are carried out with full discretion, except for a handful of social security benefits (old age pensions, in particular), where central government covers a share of the costs. Road management is now mostly a municipal responsibility covering 90% of the Danish roads (LGDK, 2009). The table 4-11 shows that local governments spend about 23% of revenue in primary education. Likewise, local governments use revenue in care for elderly (18%), day care institutions (16%) around the clock services (14%), other social services (10%), roads and environment (3%) and in administration (16%).

Table 4-11: Revenue and expenditure of local government in Denmark, 2007

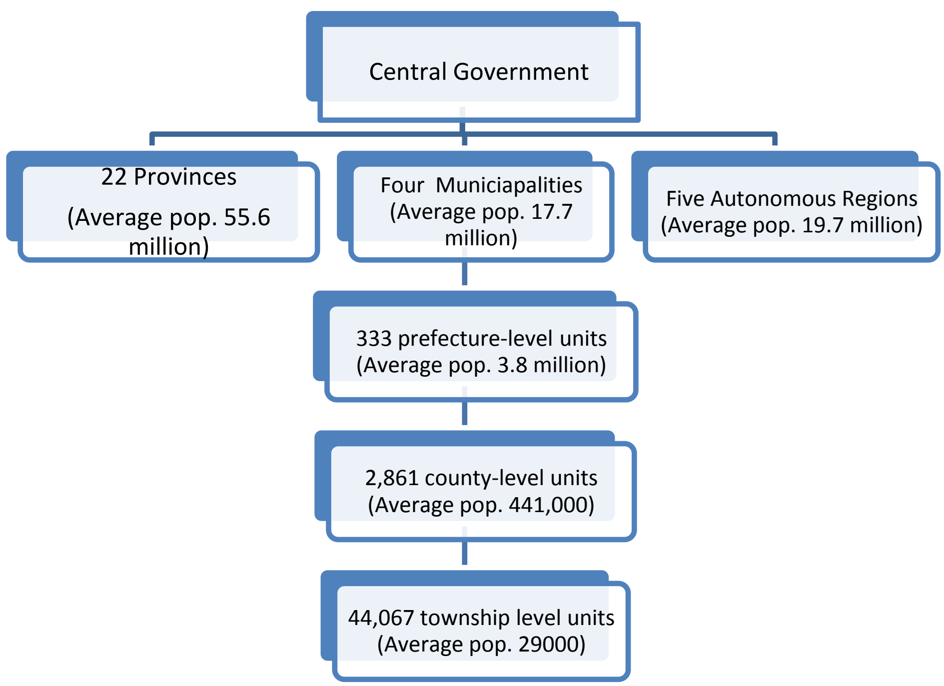
SN	Revenue		Expenditure	
	Source of revenue	**% Share**	**Areas of expenditure**	**% Share**
1	Income tax	70	Primary education	23
2	User payment and fee	10	Care for the elderly	18
3	Land and property tax	8	Day care institution	16
4	Reimbursement and grant	7	Around the clock service	14
5	Company tax	2	Other social services	10
6	Loan	2	Roads and environment	3
7	Interest	1	Administration	16
	Total	**100**	**Total**	**100**

Source: LGDK, 2009

4.9 China

The People's Republic of China is one of the biggest countries in the world in terms of territory and population and it ranks third in geographic area. The base of government system of China is unitary. China is divided into three regions (East Coast, Middle, and West). The government of China has a five-tier hierarchical structure such as central government, provinces (31), autonomous prefecture (333), county level units (2,861), and township level units (44,067). There are 22 provinces, 4 municipalities and 5 autonomous regions. There are two special administrative regions like Macao and Hong Kong in China, (Qiao and Shah, 2006). The Constitution of China provides for three levels of sub-national administration-the province, the county and the township- and in actual implementation, there are two more levels: the prefecture under the province and village under the township (Zhang and Zou 1998). The hierarchical organigram of the government structure of China is as follow.

Figure 4-8: Political governance structure in China



Source: Qiao and Shah (2006)

The taxes concerning national interests and macroeconomic adjustment were assigned to the centre and the taxes relevant to provincial economic development and microeconomic adjustment were assigned to the provinces. Under the first category came tariffs and custom, consumption taxes, income taxes from state-owned-enterprises (SOEs), taxes on banks, insurance companies and financial institutions, taxes on rail roads and business taxes. Other revenues assigned to the centre included the profits from SOEs. Under the provincial category came business taxes (excluding banks and financial institutions), company income taxes, personal income tax, urban maintenance and development tax, house property tax, agricultural related taxes, tax on contracts and animal slaughter. There are two other tax revenues that are shared by the centre and the provinces. The value added taxes (VAT) are shared by 75% and 25 % respectively. Taxes on security exchanges are shared equally or fifty-fifty (Zhang and Zou 1998).

Local government does not have authority to decide tax base and rate. However, based on the decision made by the central government, local government collect revenue from urban maintenance and construction, vehicle purchasing, agriculture and animal husbandry, special products, contracts, housing property, urban and township land use, farmland occupation, resources, land appreciation, vehicle and vessel use, fixed asset investments, slaughter, and banquets. Moreover local government levy taxes on educational surcharge, stamp tax, and population charge (Qiao and Shah, 2006).

Local governments are based on a hierarchical system with a characteristic of leadership at different levels in China. The lower levels of governments are being subordinate to higher level, and this feature is recognized in the constitution. Local governments are not recognized as independent authority and power on fund raising under the existing centralized fiscal system (Fraschni, 2006).

1. ***Local taxes:*** Income tax of collective enterprises, agricultural tax, contract tax License plate tax of using vehicles and ships, real estate tax of cities, tax on slaughtering animals, tax on animals trade, tax on country fair trade, tax on urban maintenance and construction, income tax of local state-owned enterprises, adjustment tax of local state-owned enterprises;

2. **Shared taxes:** Product tax, business tax, increment tax, resource tax, building tax, salt tax Income tax of individuals, bonus tax, Tax on industrial and commercial integration, Income tax of joint-venture enterprises, and Income tax of foreign enterprises
3. **Non-tax revenues**: Revenue from monopoly, Revenue from benefit fee from projectsRevenue from penalty and compensation, revenue from a set quota, revenue from trust and management, revenue from assets, revenue from contribution, revenue from assistance revenue from bonds and credits and revenue from allowance.

The central government collects more revenue and transfers to provincial and sub-provincial government as the intergovernmental fiscal transfer in order to carry out the assigned activities at the lower level (Dollar and Hofman, 2008).

According to the table 4-12, the pattern of expenditure sharing across the various levels of governments in China is 30%, 19% and 51% by central, provincial and sub-provincial government respectively. At the same time, the revenue share of the various orders of government in 2003 is 55%, 12% and 33% by central, provincial and sub-provincial government respectively.

Table 4-12: Consolidated revenue and expenditure in China, 2003

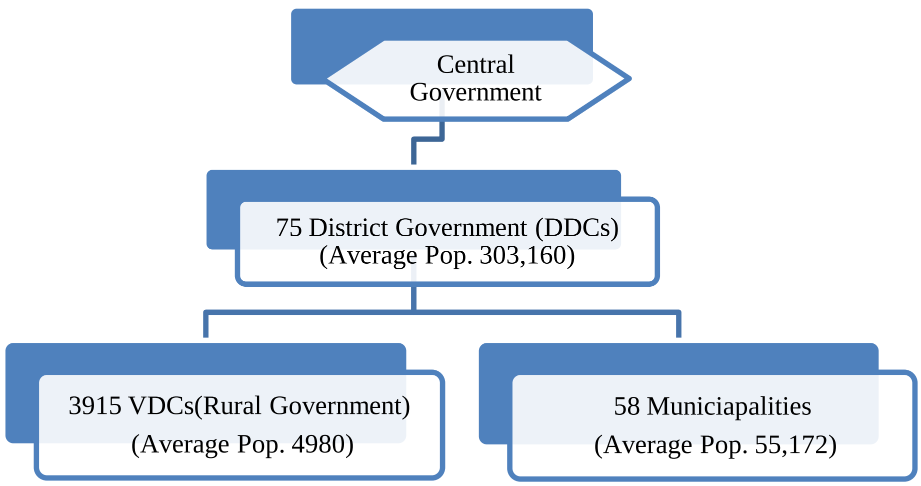
Level of government	Revenue (%)	Expenditure (%)	Resource Gap (%)
Central	55	30	25
Provincial	12	19	(7)
Sub-provincial (Local government)	33	51	(18)
Total	**100**	**100**	

Source: Dollar and Hofman (2008)

4.10 Nepal

The Interim Constitution (First amendment in 2007) has provided the space to adopt a federal structure by abandoning its longstanding unitary and centralized state structure sooner (UNDP and GTZ, 2008), it is in transition from unitary to federal state. Currently, Nepal has been exercising two tiered governance system namely central and local government. Further, local government are characterized into two tiers namely Village Development Committees (VDCs) in rural and municipality in urban areas as lower level of local government units and District Development Committees (DDCs) as intermediate level of government unit at district level. There are altogether 3915 VDCs in rural and 58 municipalities (among them, one metropolitan city and four sub-metropolitan cities) in urban at grass root level, whereas 75 District Development Committees in district level as local government[11]. The political governance in Nepal is as follow.

Figure 4-9: Political governance structure in Nepal



The elected local representatives practiced the local governance for two full terms after 1990 until their terms expired in July 2002. The first local election for the five years tenure was held in 1992 and subsequently the second election was carried out in 1997. However, after the expiry of the tenure of the second term elected representatives in July 2002, the government of Nepal has neither held local election nor made any de jure political arrangement to run local government until now. Still there is absence of elected representatives in local government. Financial data are analyzed in chapter-six (VI) in detail.

[11] According to population census of 2001, the total population is accounted to 22.73 million. Of the total, rural population is 19.50 million and urban population is 3.23 million (CBS, 2009). District level average population is calculated dividing total population by the total number of DDCs where as average population of VDCs and municipalities are calculated dividing rural and urban population by the total number of VDCs and municipalities respectively.

4.11 Summary of chapter

The table 4-13 below shows that the GDP per capita income of Nepal is very low out of selected total nine countries. On the other hand, human development indication of Nepal is ranked at 144 which are just above compared to Uganda.

Table 4-13: Basic indicators of the selected countries

SN	Country	Total Area** (Sq.km.)	Population, 2007 (Millions)*	Population Density	GDP per capita (USD)*	Gini-index*	HDI*
1	Nepal	147181	28.3	192.28	367	47.3	144
2	India	3201446	1164.7	363.80	1046	36.8	134
3	South Africa	1221037	49.2	40.29	5914	57.8	129
4	Uganda	241038	30.6	126.95	381	42.6	157
5	Brazil	8514877	190.1	22.33	6855	55.0	75
6	Switzerland	41284	7.5	181.67	56207	33.7	9
7	Germany	357114	82.2	230.18	40324	28.3	22
8	Denmark	43094	5.4	125.31	36130	24.7	16
9	China	9596961	1329.1	138.50	2432	41.5	92

Sources:

* UNDP (2009b). Human Development Report, Overcoming Barriers: Human Mobility and Development, UN Plaza New York, NY 10017, USA

**http://en.wikipedia.org/wiki/List_of_countries_and_outlying_territories_by_total_area, March 20, 2010

The table 4-14 gives detail information about the political structure of selected countries in the world. It is clear that the role of local government is very vital whether the country adopts federal or unitary system of governance. In federal countries India and South Africa and unitary nature of countries like Uganda and China there are three spheres/layers of local governments namely as rural, urban and district. But in federal countries like Brazil, Switzerland and German and unitary country Denmark, there are only urban level local government. Nepal, which is in transition from unitary to federal, now there are two-levels of local government namely VDCs and municipalities at lower level and DDCs in intermediate level.

It can be said that only system of governance (federal or unitary) is not solely responsible to promote fiscal decentralization. It depends upon the commitment of political parties and central government to give more responsibilities with adequate financial authorities to the local governments for providing basic services from the lower level government units.

Table 4-14: Governance structure of selected countries

SN	Countries	Governance system	Continents	Central or Federal	States or Province	Local government		
						Rural	Urban	District
1	Nepal[12]	Transitional	S.A.	1	-	3915	57	75
2	India	Federal	S.A	1	28	246977	3697	459
3	South Africa[13]	Federal	Africa	1	9	232	6	46
4	Uganda[14]	Unitary	Africa	1	-	857[15]	131[16]	93[17]
5	Brazil	F.R.	L.A.	1	26	-	5564	1 FD
6	Switzerland	Confederation	Europe	1	26	-	3000	-
7	Germany	F.R	Europe	1	16	-	13829	323
8	Denmark	Unitary	Europe	1	5	-	98	-
9	China	Unitary	S.A	1	22[18]	44,067[19]	2,861[20]	333[21]

Note: S.A=South Asia, L.A.=Latin America, F.R. = Federal Republic, FD=Federal District,
– = figures are not available

Sources: Collected from various publications by author/researcher

The comparative details about the sources of internal revenue of local government of the selected countries are explained in table 4-15. This information would be very useful while assigning the fiscal authorities to the different level of government while restructuring the state in new Nepal.

[12] There are 3915 VDCs, 58 municipalities (includes one metropolitan city, four sub-metropolitan city and 53 municipalities) and 75 DDCs.

[13] As directed by the Constitution, the Local Government: Municipal Structures Act, 1998, (Act 117 of 1998), contains criteria for determining when an area must have a category-A municipality (metropolitan municipalities) and when municipalities fall into categories B (local municipalities) or C (district municipalities).

[14] Local Level Service Delivery, Decentralization and Governance, A comparative study of Uganda, Kenya and Tanzania, Education, Health and Agriculture Sector for JICA by DEGE Consult, February 2007 (Source).

[15] Sub-county is known as rural district.

[16] There are 92 town cities, five city divisions and 34 municipal divisions as lower layer of local government.

[17] There are 79 districts, 13 municipal councils and 1 city council as upper layer of local government.

[18] There are 22 provinces, four municipalities and five autonomous regions

[19] This is the township level unit which is very lower level of government unit

20 This is the county level government units below the prefecture level unit

21 This is the prefecture level government units below the provincial unit

Table 4-15: Sources of internal revenue of local government in selected countries

SN	Countries	Sources of revenue of local government
1	India	**Own Tax on :** Octroi, Real Estate, and others **Own non-tax on:** Water and sewerage, Building Licenses, Vehicles & animals Investment income, fine **Shared tax :** Stamp duty, Electricity, Motor Vehicle tax **Grant** (State Government and other agencies)
2	South Africa	Property tax, service charges for water, electricity, sanitation, traffic fines, late library book fines and penalties for overdue payment of service charges .The equitable share is an amount of money that a municipality receives from the national government each year. The constitution has provision that all revenue collected nationally must be divided fairly among national, provincial and local spheres of government. The local government equitable share is meant to ensure that municipalities can provide basic service and develop their areas. The amount a municipality gets depends mainly on the number of low-income people in the area; rural municipalities usually get more. Most municipalities only get a small part of their operating budget from the equitable share (Joseph and Rensburg, 2002).
3	Uganda	The LG tax base is now extremely narrow, and the revenue autonomy has been significantly decreased. The abolished tax sources and the insufficient and late compensation have impacted negatively on most of the LG core operations, and on the good governance performance, particularly in the LLGs, which were entirely rely on G-Tax. LGs now finance less than 5 % of their expenditures from own source (DEGE, 2008).
4	Brazil	Service tax, Urban Property tax, Frontage Tax, Property Tax, Federal and States transfers (Steffensen, 2006).
5	Switzerland	Income and wealth tax, tax on profits and capita, household tax, Immovable property, gains tax, real estate tax, transfer tax, lottery tax, dog tax, entertainment tax, trade tax, miscellaneous tax (Schelker, 2005)
6	Germany	Tax revenues (trade taxes and land taxes), financial transfers from the

SN	Countries	Sources of revenue of local government
		state and the federation, payments, such as fees and contributions for the services they furnish, Share in personal income tax; share in the tax on Economic affairs; share in VAT (Bosch and Espasa, n.d.)
7	Denmark	Major sources of tax are local personal income, company taxes, land and property taxation; user fee and central government grant such as equalization, general and specific grants (Bosch and Espasa, n.d.)
8	China	Urban maintenance and construction, vehicle purchasing, agriculture and animal husbandry, special products, contracts, housing property, urban and township land use, farmland occupation, resources, land appreciation, vehicle and vessel use, fixed asset investments, slaughter, and banquets. Moreover local government levy taxes on educational surcharge, stamp tax, and population charge (Qiao and Shah (2006).
9	Nepal	**Own Tax and non-tax Revenue** (For more detail, see appendix-6) **Shared Tax** (Forest, Water Resources, Tourism and Land Registration) **Central Government Grant (**Conditional and un-conditional)

Notes:
CG= Central Government; LGs =Local government, LLGs=Lower Level of Government, ULGs=Upper Level of Governments

Source: Collected from various publications by author

The share of total revenue of central government is found higher in both unitary and federal countries such as 94.5% in Nepal, 86.4% in Uganda, 63.4% in Denmark, 55% in China, 58.3% in Brazil and 67.2% in Germany. However, the share of revenue of provinces is higher in South Africa (37.2%7) and Switzerland (25%) as compared to (40.4%) and (59%) share of central government in 2009 respectively. In the same way, the share of revenue of local government is higher in Denmark (34.6%). The revenue share of local government is also comparatively very higher percentage in China (33%), and in Switzerland (30%). Unlike these, the share of revenue is lower in India (2.84%) in local government. Similarly, the revenue sharing of local government in Nepal is only 5.5 % of total national revenue. Although South Africa is known as the exemplary of the federal country in the world, only 4.7% of the total revenue is utilized by the local government (table 4-16).

Table 4-16: Revenue sharing among the level of government in selected countries

SN	Countries	% Share of revenue of CG	% Share of revenue of Provinces	% Share of revenue of LGs	Total revenue % of GDP (2007)[22]
1	Nepal (2009)	94.55	-	5.45	11.9
2	India, 1995[23]	63.80	33.40	2.84[24]	14.7
3	South Africa,2006[25]	37.60	57.70	4.7	30.0
4	Uganda,2004	86.4	-	13.6[26]	12.9
5	Brazil,2001	58.3	26.2	15.5	23.8
6	Switzerland, 2009	59.0	25.0	16.0	18.3
7	Germany, 2009	70.0	22.0	8.0	28.5
8	Denmark, 2009	74.0	-	26.0	40.6
9	China, 2003 [27]	55.0	12.0	33.0	10.3

Note: – = figures are not available

CG=Central Government, LGs=Local Goverments

Sources**:** http://data.worldbank.org/indicator/GC.REV.XGRT.GD.ZS, on July 19, 2010, Bagchi, (2007), Yemek, (2005) DEGE, (2007), and Dollar (2008).

[22] http://data.worldbank.org/indicator/GC.REV.XGRT.GD.ZS, on July 19, 2010
[23] Bagchi, (2007)
[24] Includes revenue from municipalities only; revenue raised at the village level is not significant.
[25] Yemek, (2005)
[26] DEGE, (2007)
[27] Dollar (2008)

CHAPTER-V

5 FISCAL DECENTRALIZATION ON THE SIZE OF BUDGET

One of the important rules of fiscal decentralization is "Finance follows the Functions". It is very important that expenditure assignment of local governments should be followed by the revenue responsibilities. The very necessary conditions of fiscal decentralization are the assignments of expenditure and revenue responsibilities, budget autonomy and hard budget constraint of the local governments (Bahl, 1999). Although the classical economists opine that *'every tax is an evil'* and *'every public expenditure is unproductive*, modern states should be considered as welfare states whose responsibility is to ensure maximum social welfare for the people and public expenditure is good for welfare state. So it is compulsory contribution of citizen to the state and also the personal obligation to pay tax by any individual. Therefore, a government collects the revenue through taxation and makes public expenditure (Lekhi, 2001).

The fiscal decentralization deals with the aspects how public goods and services are provided by regional and local government in a devolved government system. Although there is no single best measure of decentralization, a quantitative indicator of decentralization is necessary for empirical analysis. The following two measures are mostly used to calculate ratios for government revenues and expenditures (Boex et al., 2005).

1. The expenditure decentralization is measured as a ratio of sub-national government (regional and local) spending to general government (central, regional, and local) spending. This ratio measures the responsibility of local government bodies for administering and delivering services.
2. The revenue decentralization is calculated as a ratio of sub-national government revenue to general government revenue. This ratio measures the power of local government to finance their services.

The sub-national governments should have sufficient discretion on “own-source” taxes. If the sub-national governments rely on sharing national revenues, there is less incentive to develop their own tax resources and more incentive to overspend with money other than their own. This discretion should be broad enough to allow local officials to develop their own source taxes (including some discretion on rates) to fund discretionary local expenditures. For stabilization and fiscal equalization/redistribution purposes, the central government should collect 50 % or more of total taxes, and those taxes should be from a broad-based elastic tax bases such as income or value added (Kee, nd).The fiscal decentralization is in favor of sufficient local taxing power to local government bodies. However, the central government must be able to monitor and evaluate the process and practice of decentralization. It is generally believed that no fiscal decentralization or devolution is meaningful unless around 25% of overall expenditure is allocated to the sub-national fiscal expenditure (Fernando, 2010).

Revenue mobilization, foreign grants and loans, domestic borrowing and use of cash balance have been used as fiscal instruments to fund government expenditure in Nepal (GoN/MoF, 2008). The sources of revenue to be collected by central government of Nepal are customs, tax on consumption and production of goods and services, land revenue and registration, tax on property, tax on profit and income such as tax from public enterprises, semi-public enterprises, private corporate bodies, individuals, remuneration, urban house and land tax, vehicle tax, tax on interest and others (GoN/MoF, 2009).

The budget allocation between central government and local government bodies of the various fiscal years of Nepal is analytically presented in the chapter. The correlation among district level Gross Domestic Product (GDP), internal revenue of DDCs and total expenditure of devolved sectors of all 75 districts based on the date of fiscal year 2006/07 has been analyzed. Moreover, this regression analysis of the model has been carried out and the result is presented accordingly. Similarly, the income and expenditure of central and local government bodies of Nepal is presented below.

5.1 Correlation of variables

The number of observation for pearson's correlation is 75 districts. Data analyzed for pearson's correlation is presented in Appendix-8. According to the table 5-1 below, the mean value of GDP is calculated as 5473.21 and standard deviation is 6445.93. Likewise the mean and standard deviation of internal revenue are calculated as 21.55 and 22.62 respectively. Similarly the mean and standard deviation of total expenditure of devolved sectors is calculated as 400.96 and 123.59 respectively.

Table 5-1: Descriptive statistics of variables used in correlation analysis

Variables	Mean	Std. Deviation	N
GDP	5473.21	6445.93	75
Internal Revenue (IntRev)	21.55	22.62	75
Total expenditure of devolved sectors (TexDevo)	400.96	123.59	75

Source: Result of correlation analysis from the data of Appendix-8

The table 5-2 shows that the correlation between GDP and internal revenue of DDCs are about 80% where as the correlation between GDP and total expenditure of devolved sector is only 67 %. Likewise, the correlation between internal revenue of DDCs and total expenditure of devolved sectors is about 60% whereas the correlation between total expenditure of devolved sector and GDP is nearly 67%. All the correlations are found to be significance at one percent (1%) alpha level.

Table 5-2: Pearson's correlations between variables

Variables	GDP	Internal Revenue	Total expenditure of devolved sectors
GDP	1	.801(**)	.667(**)
Internal Revenue	.801(**)	1	.606(**)
Total expenditure of devolved sectors	.667(**)	.606(**)	1

** Correlation is significant at the 0.01 level (2-tailed).

Source: Result of correlation analysis from the data of Appendix-8

5.2 Multiple regression analysis

Multiple regressions is closer to reality and hence generally used in practice rather simple regression. The regression model is supposed to support the assumptions of the hypothesis. Therefore in this study, multiple regression is used to test the hypothesis. The analyzed data is presented in Appendix-9. The hypothesis of the regression model is that local government expenditure depends on total national tax revenue and foreign aid to be received by government of Nepal. If R square is 1, the fitted regression line explains cent % of the variation in Y. On the other hand if R square is 0, the model doesn't explain any of the variation of Y. However, R square always lies between these two extreme values. The fit of the model is said to be "better" the closer is R square to 1.

5.3 Multiple regression of model

Local government expenditure depends on total national revenue, foreign grant, foreign loan and domestic loan.

The calculated value of regression is as follow. The detail statistical analysis is presented in appendix-12.

$Y=\alpha+\beta_1X_1+\beta_2X_2+\beta_3X_3+\beta_4X_4+\varepsilon$ …………………………….. (i)

Putting the value;

$Y=-1400.557 + 0.090\ X_1 - 0.090\ X_2 + 0.132X_3 - 0.095\ X_4$

ρ= (0.120) (0.001) (0.225) (0.070) (0.251)

Adjusted R^2 = 0.96, DW =1.3805251, Significance F = 6.28577E-09

Table 5-3: Analysis of variance (ANOVA) of the estimated model

	df	*SS*	*MS*	*F*	*Significance F*
Regression	4	213425941.6	53356485.39	116.5905111	6.28577E-09
Residual	11	5034040.365	457640.0332		
Total	15	218459981.9			

Local government expenditure = -1400.557 + 0.090 total national revenue - 0.090 foreign grant +0.132 foreign loan - 0.095 domestic loan.

The regression coefficients show that both total national revenue and foreign loan have positive impact on local government expenditure. However, the foreign grant and domestic loan do not have any contribution in local government expenditure. The model shows that one rupee increase in total national revenue leads to 9 paisa increase in local government expenditure. Similarly, if the foreign loan goes up by 1%, on average, local government expenditure increases by about 0.13%.

The calculated value of adjusted R Square is 0.96. It means that the independent variables explain 96% of variation in dependent variable. Or, 96% of variation in dependent variable is explained by the variation in independent variables. It can readily be verified that the slope coefficient is statistically significant.

The coefficient table of the multiple regression shows that the coefficient of total national revenue is only found significant. The ρ value of total national revenue is 0.001. So, total national revenue is found very powerful factor for local government expenditure. It can be said that if the national revenue increases the local government expenditure will also be increased and vice versa. Moreover, it (X_1) is statistically significant but other variables are not significant at 5% alpha level (Annex-12).

The ANOVA table (5-3) shows that the overall test of the model is significant at 5% alpha level which represents by F value 6.28577E-09.

The rule of thumb of Durbin-Watson calculation (DW) is that if d is found to be 2 in an application, are may assume that there is no first order autocorrelation either positive or negative in the residual. But if d=0, it means that the greater the evidence of positive correlation. The value of Durbin-Watson calculation (DW) is 1.380, it means that there is no first order autocorrelation in the residual.

The above analysis shows that the tested model is very significant to explain the local government expenditure. It means that the null hypothesis is rejected against the alternative hypothesis that the local government expenditure depends on the total national revenue, foreign grant, foreign loan and domestic loan is accepted. There is no statistical evidence to reject the model. Therefore, it can be concluded with more confident that the total national revenue, foreign grant, foreign loan and domestic loan do have strong effect on the local government expenditure.

CHAPTER-VI

6 REVENUE AND EXPENDITURE ASSIGNMENT IN NEPAL

To review and analyze the revenue and expenditure assignment between central and local government is very crucial while studying the fiscal decentralization. The fiscal arrangement in terms of total income and expenditure of central and local government in Nepal is presented in this chapter.

6.1 Sources of income of government of Nepal

The major sources of income of government of Nepal are tax and non-tax revenue. Table 6.1 shows the trend of tax and non tax revenue collection by the central government of 15 years from fiscal year 1996/97 to 2010/11 and the gross domestic product (GDP) of the same period. The ratio of tax revenue ranks from 75.74% in 2002/03 and 86.86% in 2009/10. The average contribution of tax revenue to total national revenue is 79.74%. Likewise, the ratio of non-tax revenue ranks from 13.14% 2009/10 and 22.84% in 2004/05. In average, the role of non-tax revenue in total revenue is only 20.26%.

Similarly, the ratio of total revenue (tax and non-tax revenue) to GDP is between 10.09% and 15.35% in 1996/97 and 2009/10 respectively while the average ratio of 15 years of total revenue to GDP is only 13.01% (Table 6-1).

Table 6-1: Tax and non-tax revenue and GDP in Nepal

(Figure in Million NRs.)

S. N.	Fiscal Years	Tax Revenue	Non-tax Revenue	Total Revenue	GDP (at (current price)	% of Tax Revenue to total Revenue	% of Non-Tax Revenue to Total Revenue	% of Total Revenue to GDP
1	1996/97	24,424.30	5,949.20	30,373.50	301,140.00	80.41	19.59	10.09
2	1997/98	25,939.80	6,998.10	32,937.90	322,968.00	78.75	21.25	10.20
3	1998/99	28,752.90	8,498.40	37,251.30	367,188.00	77.19	22.81	10.15
4	1999/00	33,152.10	9,741.60	42,893.70	407,394.00	77.29	22.71	10.53
5	2000/01	38,865.10	10,028.80	48,893.90	441,519.00	79.49	20.51	11.07
6	2001/02	39,330.60	11,115.00	50,445.60	459,443.00	77.97	22.03	10.98
7	2002/03	42,587.00	13,642.70	56,229.70	492,231.00	75.74	24.26	11.42
8	2003/04	48,173.00	14,158.00	62,331.00	536,749.00	77.29	22.71	11.61
9	2004/05	54,104.70	16,018.00	70,122.70	589,412.00	77.16	22.84	11.90
10	2005/06	57,430.40	14,851.70	72,282.10	654,084.00	79.45	20.55	11.05
11	2006/07	71,126.70	16,585.50	87,712.20	727,827.00	81.09	18.91	12.05
12	2007/08	85,155.00	22,467.00	107,622.00	815,658.00	79.12	20.88	13.19
13	2008/09	117,051.00	26,422.00	143,473.00	988,053.00	81.58	18.42	14.52
14	2009/10	156,294.00	23,650.00	179,944.00	1,171,905.00	86.86	13.14	15.35
15	2010/11	176,909.00	27,007.00	203,916.00	1,346,816.00	86.76	13.24	15.14
					Total	**1,196.14**	**303.86**	**179.26**
					Average	**79.74**	**20.26**	**11.95**

Notes:
1.The figure of FY 2009/10 is revised, FY 2010/11 is just preliminary and remaining is actual.
2. Receipt of Principal return is not included in non-tax revenue in FY 2009/10 and 2010/11

Source: Economic Survey of various fiscal years, Government of Nepal, Ministry of Finance

6.1.1 Recurrent and development expenditure

The table 6-2 shows the trend of recurrent and development expenditure at both central and district level for the last 15 years from 1996/97 to 2010/11. Moreover, the first six fiscal years from 1996/97 to 2001/02, the development expenditure is higher than the recurrent expenditure. But after 2002/03, the recurrent expenditure is higher than the development expenditure. In 2004/05, the recurrent expenditure has reached up to 68% where as development expenditure is accounted only 32% of the total estimated expenditure. In average, 56% of national budget is allocated for recurrent expenditure whereas remaining 44% budget is allocated for development expenditure in Nepal during the corresponding years.

Table 6-2: Recurrent and development expenditure in Nepal

(Figure in Million NRs.)

SN	FY	Recur. exp.	Development Expenditure			Total (recur. + dev.)	Ratio of recur. to total exp. (%)	Ratio of dev. exp. to total exp. (%)
			Central	District	Total of capital exp.			
1	1996/97	24984	26027	6554	32581	57565	43	57
2	1997/98	27983	27409	6629	34039	62022	45	55
3	1998/99	31952	31050	6692	37741	69693	46	54
4	1999/00	35386	34453	7399	41852	77238	46	54
5	2000/01	43512	39027	9082	48109	91621	47	53
6	2001/02	49321	39590	10881	50470	99791	49	51
7	2002/03	57445	29252	9427	38680	96125	60	40
8	2003/04	60555	31685	10160	41845	102400	59	41
9	2004/05	67608	25529	6049	31578	99186	68	32
10	2005/06	75850	29673	7561	37234	113084	67	33
11	2006/07	83767	34138	10838	44976	128743	65	35
12	2007/08	98172	41043	14219	55262	153434	64	36
13	2008/09	128516	68942	22368	91310	219826	58	42
14	2009/10	160632	77410	28875	106285	266917	60	40
15	2010/11	190319	94498	35039	129537	319856	60	40
						Total	**838**	**662**
						Average	**56**	**44**

Notes:

1. *Principal repayment is not included in the total annual budget*

2. *Figure of 2010/11 is revised.*

Recur= Recurrent, dev.= development, exp.=expenditure, FY=Fiscal year

Source: Estimates of Expenditure of various fiscal years, Government of Nepal, Ministry of Finance

6.2 *Income and expenditure of VDCs*

The LSGA and Local Self Governance (Financial Regulation, 2000), has explicitly provisioned the sources of income and areas of expenditure of Village Development Committees (VDCs). The income and expenditure pattern of VDCs has been analyzed below in table 6.3 based on the information of fiscal year 2006/07. Due to lack of sufficient information of VDC level income and expenditure, multi year's data about income and expenditure of VDCs have not be examined in this section.

The table 6.3 clearly depicts the total revenue and expenditure of VDCs in Nepal. It has also explicitly explained the breakdown of recurrent (administrative) and development (capital) expenditure. Of the total expenditure, 77.68% is spent as development expenditure and remaining 22.32% is spent as an administrative or recurrent expenditure. Likewise, the overall ratio of expenditure to revenue is about 93.59% whereas the ratio of expenditure under grant is accounted 99.09 and ratio of expenditure under internal revenue is accounted only 88.10%.

The major source of revenue of VDCs is external grant, which is received from central government, DDCs and other sources. Moreover, VDCs are highly dependent on the central government grant, which covers about 85% of the total external revenues. Likewise, VDCs receive some portion of income from revenue sharing which is made available by DDCs that covers nearly 8%. Moreover, VDCs receive about 4% revenue from other sources.

Table 6-3: Total income and expenditure of VDCs in 2006/07

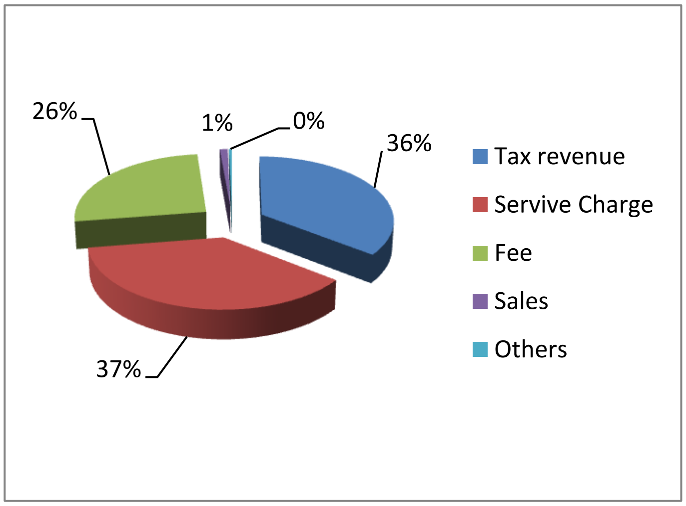
(Figure in Million NRs.)

Sources of Revenue	Revenue[28]	Expenditure[29]			% Share of Expenditure	% of Total Expenditure to Revenue
		Recurrent (a)	Development (b)	Total (a+b)=c		
Grant	4,166.66 (85.42)	845.95 (80.02)	3,263.08 (88.70)	4109.03 (86.76)	77.68[30]	99.09
Internal	711.10 (14.58)	211.12 (19.98)	415.83 (11.30)	626.96 (13.24)	22.32[31]	88.10
Total	4,877.76 (100)	1,057.07 (100)	3,678.91 (100)	4735.99 (100)	100.00	93.59

Note: The figures in parenthesis are %age to recurrent and development expenditure from grant and internal revenue

Source: LBFC (2009)

Figure 6-1: Sources of internal revenue of VDCs in 2006/07



At the same time, VDCs collect their internal revenue from the various sources such as tax revenue, service charges, fee, sales and others. Of the total revenue, there is the highest share of service charges (37%) in the internal revenue of VDCs. Similarly, tax revenue occupies 36%, fee covers 26%, and sales occupy only one %. Unlike others, there is no significant role of other sources in internal revenue collection of VDCs in Nepal (Figure 6-1).

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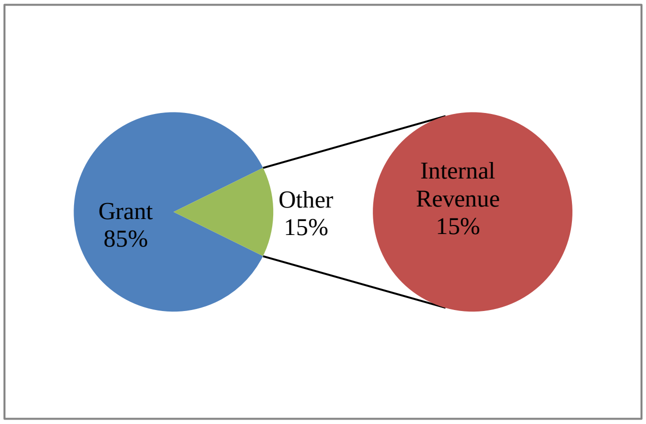
[28] LBFC (2009). p.15, table 6, total income of VDCs
[29] LBFC (2009). p.29, table 12, total expenditure of VDCs
[30] %age share of development expenditure of VDCs
[31] %age share of recurrent expenditure of the total expenditure of VDCs

Figure 6-2: Share of grant and internal revenue of VDCs in 2006/07



The figure 6-2 shows the relationship between internal revenue and external revenue of VDCs. According to the figure, the share of internal revenue (grant and revenue sharing) plays vital role which is accounted about 85% whereas the share of internal revenue from various sources accounts only 15% out of the total revenue. It is clear that very limited power and authorities are devolved to the VDCs in order to mobilize internal revenue to meet the local expenditure at village level.

6.3 Income and expenditure of municipalities

A. Source of income

The income and expenditure of a single fiscal year 2006/07 is presented below in table 6.4 in order to show the glimpse of income and expenditure pattern of municipalities of Nepal. The major sources of income of municipalities are conditional and unconditional grant to be received from central government, revenue sharing from DDCs and internal revenue to be collected through the various sources such as local development fee, integrated property tax, property rent, fee and fines, other taxes and other revenues (Table 6-4). The percentage share of government grant (65.54%) is higher as compared to the revenue sharing from DDCs (34.46%). Of the total income, the share of local development fee covers about 29%. Local Development Fee (LDF) is being collected in the custom point by the central government at the rate of 1% in some selected goods instead of 'Octroi' (Chungikar) from the fiscal year 2004/05 (LBFC, 2009 p.71). Likewise the share of government grant occupies only 21% of the total income of municipalities. There is also practice of getting loan and borrowings by the municipalities that covers about 1.43% of the total income (Table 6-4).

Table 6-4: Sources of income of municipalities in Nepal, 2006/07

(Figure in Million NRs)

SN	*Sources of income*	Amount NRs.	% of grant and revenue sharing	% of all sources
1	***Central government grant and revenue sharing***			
1.1	Government of Nepal (Admin.)	53.96	4.90	1.61
1.2	Government of Nepal (Development)	643.43	58.50	19.20
1.3	Revenue Sharing by DDCs	378.85	34.50	11.31
1.4	Urban Development Fund (UDF)	23.12	2.10	0.68
	Sub-total	**1099.36**	**100.00**	**32.80**
2	***Internal revenue***			
2.1	Local Development Fee (LDF)	986.37	50.68	29.42
2.2	Integrated Property Tax	266.61	13.70	7.95
2.3	Property Rent	86.29	4.43	2.57
2.4	Fee and Fines	444.62	22.84	13.27
2.5	Others Tax	118.55	6.09	3.53
2.6	Others Revenue	43.88	2.25	1.30
	Sub-total	**1946.32**	**100.00**	**58.04**
3	**Miscellaneous income**	**259.08**		7.73
4	**Loans**	**47.77**		1.43
5	Total income of municipalities	**3352.85**		**100.00**

Source: LBFC (2009), p. 61, table 31

B. Expenditure pattern

The table 6-5 shows the percentage share of expenditure in the different budget heads of municipalities. Of the total annual budget, about 27% budget has been spent in recurrent expenditure whereas 51.65% budget has been invested in development sector. The next third important priority area of municipality is social service that covers about 18% of the total expenditure annually.

Table 6-5: Expenditure of municipalities in Nepal, 2006/07

(Figure in Million NRs.)

SN	Particulars	Amount NRs.	% Share
1	Administrative Expenses	845.75	27.01
2	Loan Repayment	68.71	2.19
3	Social Activities	576.86	18.42
4	Fixed Assets Investment	22.34	0.71
5	Capital Investment	1617.24	51.65
	Total Expenditure	**3130.90**	**100.00**

Source: LBFC (2009, p.68, table, 38

6.4 Income and expenditure of DDCs

A. Sources of income

The DDCs have the different sources of revenue. The major sources are central government grant, revenue sharing and internal revenue from the verities of sources at local level. The breakdown of revenue collected by DDCs in 2006/07 fiscal year is presented below. In average, per district is receiving NRs. 85.56 million grants annually from the central government along with revenue sharing. But the share of internal revenue is accounted NRs. 12.12 million. Similarly the total per district revenue is NRs. 97.68 million of the total income. About 73% share of revenue of DDCs comes from central government grant. The remaining 27% revenue comes from revenue sharing (15%) and internal income (12%). The detail income of DDCs in presented in table 6-6.

The share of central government grant to DDCs is about 83% while remaining 17% comes from the revenue sharing by the various sources such as forest, water resources, tourism and registration. Internal revenue of DDCs plays vital role to mobilize resources at district level. The internal revenue is collected from the various sources such as infrastructure use tax; sources use tax, service charges, fees, land tax, sales and other sources. The source use tax plays major role in mobilizing internal revenue of DDCs which contributes about 54% of total internal revenue whereas other taxes contributes only 36% . The remaining sources such as service charge, land tax, sales, fee and infrastructure use taxes plays very low role in internal revenue mobilization in DDCs. The major source of revenue of DDCs is the central government grant along with revenue sharing which covers about 88%. The internal revenue from tax and non-tax source plays very insignificant role in the revenue mobilization of DDCs which is accounted only 12% of the total revenue of DDCs (Table 6-6).

Table 6-6: Sources of income of DDCs[32], 2006/07

(Figure in Million NRs.)

SN	*Source of revenue*	Amount NRs.	% share of grant and revenue sharing	% share in total revenue
A	***Grant***			
1	Government of Nepal	5325.21	82.99	72.69
2	Revenue Sharing	1091.85	17.01	14.90
	Sub-total	**6417.06**	**100.00**	87.59
	Per DDC Grant	**85.56**		
B	***Internal revenue***			
1	Infrastructure use tax	5.68	0.63	
2	Source use tax	494.43	54.39	
3	Service Charge	23.73	2.61	
4	Fee	22.72	2.50	
5	Land tax	17.61	1.94	
6	Sales	13.56	1.49	
7	Others	331.36	36.45	
	Sub-total	**909.11**	**100.00**	12.41
	Per DDC internal income	**12.12**		
	Total income of DDCs	**7326.17**		
	Per DDC total income	**97.68**		**100.00**

Source: LBFC (2009)

B. Expenditure pattern

Principally DDCs spend their income in two sectors viz. administrative expenditure and capital expenditure. The table 6-7 shows the total expenditure of DDCs which covers administrative and capital expenses. Of the total expenditure incurred by DDCs, 18.51 %

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budget is spent as administrative expenses. But if we see only for the internal revenue mobilization in both administrative and capital expenses, about 26% budget is spent for administrative expenses by the DDCs which in line with the provision of LSGA. According to the provision, DDCs have to cover their administrative cost by 25% of the internal revenue. About 19 % grant is used up for administrative expenses. This trend of use of DDCs fund in administrative expenses is nearly closer to the provision of LSGA. This is the good practice of financial discipline at district level.

Table 6-7: Total expenditure of DDCs, 2006/07

(Figure in Million NRs.)

Expenditure areas	Source of expenditure		
	Internal	Grant	Total
Administrative	257.00 (26)	774.06 (17)	1,031.06 (19)
Capital expenditure	732.60 (74)	3,806.72 (83)	4,539.32 (81)
Total	**989.60 (100)**	**4,580.78 (100)**	**5,870.38 (100)**

Note: The figures in parenthesis are %age to expenditure under administrative and capital heads from internal and grant.

Source: LBFC (2009)

6.5 Aggregated income and expenditure of local government in Nepal

The table 6.8 gives the comprehensive picture of the local governments' income and expenditure. Total income includes the central government grant and internal revenue of the respective local government. The share of internal revenue in total income of municipality is very significant compare to VDCs and DDCs. The share of internal revenue in total income is 14.57%, 54.10% and 12.40% of VDCs, municipalities and DDCs respectively.

The ratio of expenditure to revenue of VDCs, municipalities and DCCs is 97.09 %, 93.38% and 80.12% respectively. The ratio of expenditure to revenue of VDCs is the highest and the lowest of DDCs whereas it is moderate ratio of municipalities. However, in average, the ratio of local governments' expenditure (total expenditure of VDCs, municipalities and DDCs) to revenue is 90.20%. Additionally the share of internal revenue to total revenue of local government is about 31.40% only.

Table 6-8: Aggregated income and expenditure of local bodies in Nepal 2006/07

(Figure in Million NRs.)

Name of local government bodies	Income			Expen. NRs.	% share of income	% share of Expenditure	% of expen. to income	% of internal revenue to total income
	Grant[33]	Internal	Total					
VDCs	4,166.66	711.10	4,877.76	4,735.99	31.35	34.22	97.09	14.57
Municipal	1,099.36	2,253.17[34]	3,352.53	3,130.90	21.55	22.62	93.38	67.21
DDCs	6,417.06[35]	909.11	7,326.17	5,870.38	47.10	41.45	80.12	12.40
Total	11,683.09	3,873.38	15,556.47	13,837.27	100.00	100.00	90.20	31.40

Source: Calculated from the tables 6.3, 6.4 and 6.6

6.6 Total estimated vs. actual expenditure of central government

The expenditure capacity of central government can be measured by the ratio of estimated and actual development expenditure of the various fiscal years. The table 6-9 shows the budget allocation and actual expenditure of the government of Nepal for the period from 1996/97 to 2008/09. The budget estimation has slowly been increasing from 1996/97 to 2000/01. But onward 2000/01, again the estimated budged has been gradually decreased. Once more, after 2003/04, the volume of estimated budget had been rising till 2008/09. The simple reason of decreasing development expenditure at central level is the rapid increase of recurrent expenditure. The expenditure capacity of government of Nepal was very low in 2001/02 where only 62.09% allocated budget was spent. However, 99.88% budget was expended in 2007/08. On an average, of the total estimated development expenditure, central government has been able to spend about 76.47% budget as actual expenditure.

[33] Conditional and unconditional grant provided by central government and the amount received by local government through central government of revenue sharing from registration, forest royalty, tourism, electrification, mine royalty etc. includes under the income heading of grant.

[34] Borrowing and miscellaneous income also included

[35] Income of revenue sharing also included

Table 6-9: Estimated vs. actual expenditure of central government

(Figure in Million NRs.)

SN	FY	Estimated capital expenditure	Actual expenditure	% of actual expenditure
1	1996/97	26027	20478	78.68
2	1997/98	27409	23344	85.17
3	1998/99	31050	22485	72.42
4	1999/00	34453	25173	73.07
5	2000/01	39027	29271	75.00
6	2001/02	39590	24580	62.09
7	2002/03	29252	18336	62.68
8	2003/04	31685	18512	58.43
9	2004/05	25529	22157	86.79
10	2005/06	29673	23455	79.05
11	2006/07	34138	29612	86.74
12	2007/08	41043	40993	99.88
13	2008/09	68941	51060	74.06
	Total	457816	349457	994.05
	Average	**35217**	**26881**	**76.47**

Source: Expenditure details of various years, GoN/GoF

6.7 Total estimated vs. actual expenditure at district level

The district level expenditure capacity is determined by the ratio of estimated and actual development expenditure of the various fiscal years at district level. Year wise district level estimated versus actual expenditure is presented in table 6.10 below. There is more or less same pattern of development expenditure at district level. It is clearly depicted in the figure that there is a gradual increase of estimated and actual expenditure from 1996/97 to 2008/09 at district level.

However, it is again slowly declining the estimated expenditure at district level between 2001/02 and 2004/05. During these periods, the ratio of actual expenditure is lower than the estimated expenditure. The reason behind declining estimated budget was the absence of elected representatives at local government (VDCs, Municipalities and DDCs) and political instability in the country while the poor actual expenditure pattern is directly related to the less accountable and responsible local government due to above mentioned causes. The expenditure capacity of government of Nepal was very low in 2002/03 where only 42.64% allocated budget was spent. However, 99.48% budget was expended in 2008/09. On an average, of the total estimated capital expenditure at district level, about 80% has been spent as actual expenditure (Table 6-10).

Table 6-10: District level estimated vs. actual expenditure

(Figure in Million NRs.)

SN	FY	Estimated capital expenditure	Actual expenditure	% of actual expenditure
1	1996/97	6554	6065	92.54
2	1997/98	6629	5600	84.48
3	1998/99	6692	6047	90.36
4	1999/00	7399	6576	88.88
5	2000/01	9082	7795	85.83
6	2001/02	10881	6903	63.44
7	2002/03	9427	4020	42.64
8	2003/04	10160	4583	45.11
9	2004/05	6049	5184	85.70
10	2005/06	7561	6151	81.35
11	2006/07	10838	10118	93.36
12	2007/08	14219	12523	88.07
13	2008/09	22368	22028	98.48
	Total	***127859***	***103591***	**1040.22**
	Average	***9835***	***7969***	***80.02***

Source: Expenditure details of various fiscal years, GoN/GoF

6.8 District-wise total expenditure in Nepal, 2006/07

The district wise expenditure patters are calculated in terms of three broad expenditure headings such as regular or administrative expenditure, development or capital expenditure and miscellaneous expenditure of all 75 districts of the country. Furthermore, the expenditure pattern can be read in each development regions like eastern, central, western, mid-western and far-western development region. The Kathmandu district has occupied the highest percentage shares of expenditure (2.48%) amongst the 75 districts whereas the lowest percentage share of the total expenditure (0.45%) has been utilized by Rasuwa district. Of the total expenditure about 22 %, 28%, 23%, 16% and 11% are spent in the eastern, central, western, mid-western and far-western development region respectively (Appendix-10).

Likewise, of the total expenditure, about 48.44% goes as regular expenditure, whereas 50.44% and 1.24% as development and miscellaneous expenditure correspondingly. District wise average expenditure is 1.32% in Nepal. In eastern development region, out of 16 districts, nine districts are below the national average. Likewise, in central region six out of 19 districts, in western region four out of 16 districts, in mid-western region 13 out of 15 districts and in far-western development region five out of nine districts are below of the national average. In total, 37 districts are below the average.

The average share of expenditure in eastern development region is 1.38% and 10 districts are below the regional average. Similarly, the regional average expenditure in central development region is 1.47 whereas 9 districts out of 19 are ranked below average. In western development region the regional average is 1.44 where six districts are below out of 16 districts. In the same way, the regional average of mid and far western development region are 1.06 and 1.32 respectively. Eight and two districts are ranked below the average from mid and far western development region correspondingly (Appendix-10).

6.9 Revenue mobilization at central and local level

The differentiation of capital and regular expenditure is more formal and high technical. In general, funds used by government of Nepal, local government bodies and line agencies at districts to upgrade physical assets such as property, industrial buildings or equipment is considered as development/capital expenditure. Basically it is known as program budget of general public service, social service and economic services. On the contrary, administrative expenses like salary of staffs, utility cost such as house rent, electricity, water, telephone and social security cost are considered as current expenditure that is also known as un-investment expenditure from the government side.

The table 6-11 depicts the allocation development budget between central and district level. The district level allocation includes the expenditure of local bodies and the line agencies working at district level. The share of district level development budget is very low as compared to central level capital expenditure. The share of district level capital expenditure is between 18% and 27% while the share of central government capital expenditure places between 73% and 82% of the total capital expenditure. On an average, of the total capital expenditure, 78% is spent by central government whereas only 22% is spent at district level.

Table 6-11: Share of development expenditure between central and district level

(Figure in Million NRs.)

SN	FY	Development expenditure		Total capital exp.	Central Level Share	District Level Share
		Central Level	District Level			
1	1996/97	26027	6554	32581	80	20
2	1997/98	27409	6629	34039	81	19
3	1998/99	31050	6692	37741	82	18
4	1999/00	34453	7399	41852	82	18
5	2000/01	39027	9082	48109	81	19
6	2001/02	39590	10881	50470	78	22
7	2002/03	29252	9427	38680	76	24
8	2003/04	31685	10160	41845	76	24
9	2004/05	25529	6049	31578	81	19
10	2005/06	29673	7561	37234	80	20
11	2006/07	34138	10838	44976	76	24
12	2007/08	41043	14219	55262	74	26
13	2008/09	68942	22368	91310	76	24
14	2009/10	77410	28875	106285	73	27
15	2010/11	94498	35039	129537	73	27
	Total	**629725**	**191773**	**821498**	**1168**	**332**
	Average	**41982**	**12785**	**54767**	**78**	**22**

Note: exp.= expenditure; Gov.=Government
Source: Estimates of expenditures of various fiscal years, government of Nepal, Ministry of Finance

6.9.1 Share of local government budget to total budget

The table 6-12 represents the share of budge allocation of village development committees, district development committees and municipalities of the total national budget from the fiscal year 1996/97 to 2011/12. Firstly, the share of local government bodies of the total national budget is very nominal and ranges from 2.48% to 4.71% in 2005/06 and 1996/97. The grant of government of Nepal to local government bodies is unevenly distributed among VDCs, municipalities and municipalities. Comparatively the share of grant to VDCs is higher as compared to municipalities and DDCs. The share of central grant to municipality is lowest among three local government bodies. In 1996/97, the share of central grant to local government bodies was about 4.71% of the total national budget which has fallen down to 2.86 % in 2011/12. In average, from 1996/97 to 2011/12, the shares of total central government grant to VDCs, municipalities and DDCs are 2.77%, 0.90% and 0.20% respectively (Table 6-12).

Table 6-12: Share of local government budget to total budget

(Figure in Million NRs.)

SN	Fiscal Years	Total Budget	VDCs Grant	DDCs Grant	Municipal Grant	Total LGs Grant	Share of VDCs Grant (%)	Share of DDCs Grant (%)	Share of Municipalities Grant (%)	Share of LGs Grant (%)
1	1996/97	57566	2010	620	84	2714	3.49	1.08	0.15	4.71
2	1997/98	62022	1957	650	140	2747	3.16	1.05	0.23	4.43
3	1998/99	69693	1960	650	145	2755	2.81	0.93	0.21	3.95
4	1999/00	77238	1960	700	150	2810	2.54	0.91	0.19	3.64
5	2000/01	91621	1966	700	150	2816	2.15	0.76	0.16	3.07
6	2001/02	99792	1957	700	290	2947	1.96	0.70	0.29	2.95
7	2002/03	96125	1957	810	200	2967	2.04	0.84	0.21	3.09
8	2003/04	102400	1957	843	160	2959	1.91	0.82	0.16	2.89
9	2004/05	111690	1957	810	200	2967	1.75	0.73	0.18	2.66
10	2005/06	126885	1957	1010	176	3143	1.54	0.80	0.14	2.48
11	2006/07	143912	3915	1055	176	5146	2.72	0.73	0.12	3.58
12	2007/08	168996	3915	1134	300	5349	2.32	0.67	0.18	3.17
13	2008/09	236016	7830	1300	324	9454	3.32	0.55	0.14	4.01
14	2009/10	285930	7830	2080	350	10260	2.74	0.73	0.12	3.59
15	2010/11	337900	7830	2434	700	10964	2.32	0.72	0.21	3.24
16	2011/12	384899	7832	2461	710	11003	2.03	0.64	0.18	2.86
	Total	***2452686***	***58787***	***17956***	***4255***	***80998***	***38.79***	***12.66***	***2.86***	***54.31***
	Average	***175192***	***4199***	***1283***	***304***	***5786***	***2.77***	***0.90***	***0.20***	***3.88***

Notes:

1. Figure of FY 2010/11 is revised and FY 2011/12 is preliminary.

2. LGCDP topping up block grant is not included in LGs grant

Source: Estimates of Expenditures of various fiscal years, government of Nepal, Ministry of Finance

6.9.2 Share of central government grant among local government

The government of Nepal provides high segment of conditional and un-conditional annual grant to the local government bodies in Nepal. The share of central government grant is presented in table 6.13 below. It depicts that out of total grant of central government to the local government bodies, about 71 % grant goes to the VDCs whereas out of remaining, DDCs receive 24 % grant and municipalities obtain only 5 %. It means that the share of central government grant to municipalities is very low as compared to DDCs and VDCs. This presentation explains that municipalities have been exercising more fiscal autonomy as compared to DDCs and VDCs in Nepal. On the other hand, VDCs are more dependent on the central government grant.

Out of total central government grant to local government bodies, the share of grant to VDCs was 62.26 % in 2005/06 and it increased up to 82.82% in 2008/09. Similarly, the share of grant to DDCs was 13.75% in 2008/09 and it increased up to 32.14% in 2005/06. The share of grant to municipalities was 3.10% in 1996/97 and it increased up to 9.84% in 2001/02. The central government grant to VDCs was increased by two folds in 2006/07 as compared to 2005/06. Similarly, the grant to VDCs was again increased by same degree (two folds) in 2008/09 as compared to 2007/08 (Table 6-13).

Table 6-13: Share of government grant to local government bodies in Nepal

(Figure in Million NRs.)

SN	Fiscal Years	VDCs Grant	DDCs Grant	Municipalities Grant	Total LGs Grant	Share of VDCs Grant (%)	Share of DDCs Grant (%)	Share of Municipalities Grant (%)	Share of LGs Grant (%)
1	1996/97	2010	620	84	2714	74.06	22.84	3.10	100.00
2	1997/98	1957	650	140	2747	71.24	23.66	5.10	100.00
3	1998/99	1960	650	145	2755	71.14	23.59	5.26	100.00
4	1999/00	1960	700	150	2810	69.75	24.91	5.34	100.00
5	2000/01	1966	700	150	2816	69.81	24.86	5.33	100.00
6	2001/02	1957	700	290	2947	66.40	23.76	9.84	100.00
7	2002/03	1957	810	200	2967	65.95	27.30	6.74	100.00
8	2003/04	1957	843	160	2959	66.12	28.47	5.41	100.00
9	2004/05	1957	810	200	2967	65.95	27.30	6.74	100.00
10	2005/06	1957	1010	176	3143	62.26	32.14	5.60	100.00
11	2006/07	3915	1055	176	5146	76.08	20.50	3.42	100.00
12	2007/08	3915	1134	300	5349	73.19	21.20	5.61	100.00
13	2008/09	7830	1300	324	9454	82.83	13.75	3.43	100.00
14	2009/10	7830	2080	350	10260	76.32	20.27	3.41	100.00
15	2010/11	7830	2434	700	10964	71.42	22.20	6.38	100.00
16	2011/12	7832	2461	710	11003	71.18	22.37	6.45	100.00
	Total	***58787***	***17956***	***4255***	***80998***	***1133.71***	***379.14***	***87.16***	***1600.00***
	Average	***4199***	***1283***	***304***	***5786***	***70.86***	***23.70***	***5.45***	***100.00***

Notes:
1. Figure of FY 2010/11 is revised and FY 2011/12 is preliminary.
2. LGCDP topping up block grant is not included in LGs grant

Source: *Estimates of Expenditures of various fiscal years, government of Nepal, ministry of finance*

6.9.3 Self-reliant rate of DDCs in Nepal

The self-reliant rate has been calculated by the percentage of own source to the total revenue and the %age of own source to the total income of the local government. On an average, the share of own source of DDCs of the total income is about 23% whereas the share of central government grant is nearly 55%. Similarly, the contribution of revenue sharing in income of DDCs is about 22% (Table 6-14).

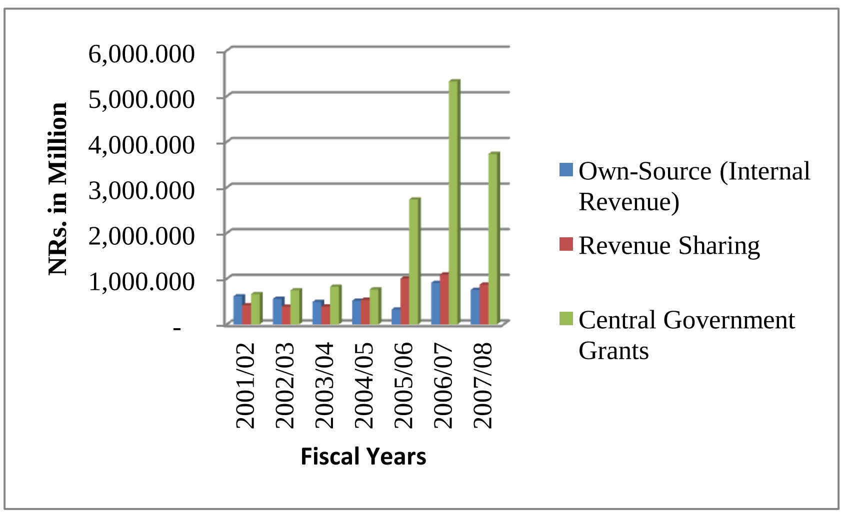
Table 6-14: Self-reliant rate of DDCs in Nepal

(Figure in Million NRs.)[36]

SN	Fiscal Years	Internal Revenue	Revenue Sharing	Grants from GoN	Total Income	% of Internal Revenue to Total Income	% of Revenue Sharing to Total Income	% of Grants to Total Income
1	2001/02	614.471	417.749	663.376	1695.596	36.24	24.64	39.12
2	2002/03	560.880	388.342	747.037	1696.259	33.07	22.89	44.04
3	2003/04	492.627	390.350	826.539	1709.516	28.82	22.83	48.35
4	2004/05	518.061	539.043	765.922	1823.026	28.42	29.57	42.01
5	2005/06	325.770	1005.908	2736.332	4068.010	8.01	24.73	67.26
6	2006/07	909.108	1091.859	5325.208	7326.175	12.41	14.90	72.69
7	2007/08	758.137	870.027	3734.781	5362.945	14.14	16.22	69.64
	Total	**4179.054**	**4703.278**	**14799.195**	**23681.527**	**161.09**	**155.79**	**383.12**
	Average	**597.008**	**671.897**	**2114.171**	**3383.075**	**23.01**	**22.26**	**54.73**

Sources:
1. Analysis of Financial Situation of Local Bodies in Nepal, LBFC, July 2009
2. Analysis of Financial Situation of Local Bodies in Nepal, LBFC, July 2010 (Asadh 2067 BS)

Figure 6-3: Sources of revenue of DDCs in Nepal



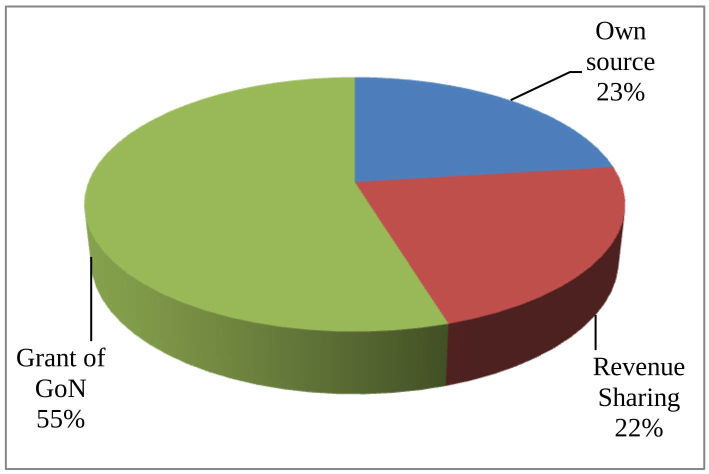
The total annual income of DDCs comprises internal revenue collected by DDCs and income from revenue sharing (registration, forest, tourism, water resource) as per provision of LSGA and LSGFAR. Moreover, central government regular grant and additional topping up block grant and unconditional grant. However, only the regular grant of central government is taken into consideration while comparing the self reliance

36 The self-reliant rate of DDCs is measured comparing between internal revenue of DDCs and grant of Government of Nepal based on the seven years' data. The researcher could not get the internal revenue of DDCs before FY 2001/02 and after 2007/08 to compare with the grant of Government of Nepal.

of local government (DDCs) in Nepal due to the non-availability of detail information about topping up block grant and wind fall conditional grant to be transferred by central government to the DDCs (Figure 6-3).

It is said that as fiscal decentralization proceeds, the size of the central budget decreases while the size of local budget increases. The share of own source revenue of local government in Nepal is extremely low as compared to central government grant. The average income of seven fiscal years from 2001/02 to 2007/08 shows that the contribution of own sources, revenue sharing and grant represents 23%, 22% and 55% respectively (Figure 6-4). This percentage sharing indicates that the self reliance of DDCs is very low. It means that the tax collection authority is not appropriately devolved to the local government especially to DDCs in Nepal. Therefore it can be concluded that the dependency of DDC on central government grant is substantially higher.

Figure 6-4: Share of revenue source of DDCs in



6.9.4 Share of local government grant to total tax and GDP

The table 6-15 shows the comparison of the grant to local government bodies with GDP and total revenue. Moreover, the average share of total tax as central government grant to VDCs, DDCs and municipalities is 4.2%, 1.48% and 0.33% respectively. Likewise, correspondingly the share of local government grant to GDP stands 0.52%, 0.18% and 0.04% of VDCs, DDCs and municipalities. The share of local government grant was about 8.94% of total tax revenue of central government in 1996/97 whereas it decreased nearly 4.32% in 2007/08. It indicates that central government is reluctant to provide grant to local government in comparison of increasing total tax revenue. The average share of revenue to local government is about 6.02%. At the same time, the share of local government grant to GDP is also decreasing from 0.78% in 1996/97 to 0.62% in 2004/05.

However, the share of local government grant to GDP has increased by 1 % in 2006/07 and again started to decline to 0.87% in 2007/08. In average, from 1996/97 to 2010/11, the share of grant to local government bodies is only 0.71% of GDP.

Table 6-15: Share of local government grant to total revenue and GDP

(Figure in Million NRs)

SN	Fiscal Years	GDP (at Current Price)	Total Tax (Tax & Non-Tax)	% of VDCs grant to Total Tax	% VDCs grant to GDP	% of DDCs grant to Total Tax	% of DDCs grant to GDP	% of Municipalities grant to Total Tax	% of Municipalities grant to GDP	% of LGs grant to Total Tax	% of LGs grant to GDP
1	1996/97	301140	30374	6.62	0.67	2.04	0.21	0.28	0.03	8.94	0.90
2	1997/98	322968	32938	5.94	0.61	1.97	0.20	0.43	0.04	8.34	0.85
3	1998/99	367188	37251	5.26	0.53	1.74	0.18	0.39	0.04	7.40	0.75
4	1999/00	407394	42894	4.57	0.48	1.63	0.17	0.35	0.04	6.55	0.69
5	2000/01	441519	48894	4.02	0.45	1.43	0.16	0.31	0.03	5.76	0.64
6	2001/02	459443	50446	3.88	0.43	1.39	0.15	0.57	0.06	5.84	0.64
7	2002/03	492231	56230	3.48	0.40	1.44	0.16	0.36	0.04	5.28	0.60
8	2003/04	536749	62331	3.14	0.36	1.35	0.16	0.26	0.03	4.75	0.55
9	2004/05	589412	70123	2.79	0.33	1.16	0.14	0.29	0.03	4.23	0.50
10	2005/06	654084	72282	2.71	0.30	1.40	0.15	0.24	0.03	4.35	0.48
11	2006/07	727827	87712	4.46	0.54	1.20	0.14	0.20	0.02	5.87	0.71
12	2007/08	815658	107623	3.64	0.48	1.05	0.14	0.28	0.04	4.97	0.66
13	2008/09	988053	143473	5.46	0.79	0.91	0.13	0.23	0.03	6.59	0.96
14	2009/10	1171905	177990	4.40	0.67	1.17	0.18	0.20	0.03	5.76	0.88
15	2010/11	1346816	203916	3.84	0.58	1.19	0.18	0.34	0.05	5.38	0.81
			Total	**64.20**	**7.61**	**21.08**	**2.45**	**4.71**	**0.55**	**89.99**	**10.62**
			Average	**4.28**	**0.51**	**1.41**	**0.16**	**0.31**	**0.04**	**6.00**	**0.71**

Note: The ratio of VDCs, municipalities and DDCs grant to GDP and total revenue is calculated from the figure of Table 6-12

Source: Economic Surveys of various years, Government of Nepal, Ministry of Finance.

6.9.5 Support of LGCDP and LDF grant in local development

The grant system to LGs is based on certain criteria such as population, poverty, cost, geographic area, per capita income. The grant of government of Nepal to LGs has been increased annually. The grant to VDCs was doubled from Rs. 5 lakh (0.5 million) to 10 lakh (one million) in 2006/07. It was further doubled to two millions in 2008/09.However, in addition to the regular grant, topping up block grant is also provided to the VDCs, municipalities and DDCs on the basis of result of the assessment of minimum condition and performance measure (MCs and PMs) that is known as performance based grant system (PBGS). This system was implemented from 2008/09 in municipalities and DDCs but in VDCs it was implemented from 2009/10. Only the indicators of minimum condition are applied but not applied the indicators of performance measure for VDCs.

The table 6-16 shows the detail information of resources allocation to the local government in four fiscal years 2008/09, 2009/10, 2010/11 and 2011/12. The total central government grant to VDCs comes from various sources.

Of the total 80% comes from regular grant and remaining 20% comes from LGCDP topping up block grant to VDCs. Similarly, of the total grant of DDCs, 42% covers from LGCDP grant and 58% from regular grant. The role of LGCDP additional grant plays pivotal role in local development through DDCs in Nepal as compared to VDCs.

Moreover, of the total grant of municipalities local development fee covers 65% share while regular and LGCDP grant covers only 16% and 19% respectively. It shows that the contribution of LDF is exemplary in municipal level for infrastructure development at urban areas of Nepal.

The grant of LGCDP has played vital role in DDCs activities while LDF grant has a substantial contribution in municipalities' activities. The conclusion is that LGCDP and LDF grant is very important for local development in Nepal. On an average, local government mobilizes about 4.84% budget of total national budget in Nepal.

Table 6-16: Budget allocation to local government in Nepal, 2008/09 to 2011/12
(Figure in Million NRs.)

Fiscal Years	Total National Budget	VDCs Grant		DDCs Grant		Municipalities Grant			Total LGs Grant	% of LGs grant to Total Budget
		Reg.	LGCDP	Reg.	LGCDP	Reg.	LGCDP	LDF		
2008/09	236016	7830	0	1300	635	324	0	2000	12089	5.12
2009/10	285930	6244	1586	2080	2539	350	469	2000	15268	5.34
2010/11	337900	4180	3650	2434	1840	700	1020	2160	15984	4.73
2011/12	384899	7833	1425	2461	1150	710	989	2300	16868	4.38
Total	1244745	26087	6661	8275	6164	2084	2478	8460	60209	4.84
Average	**311186**	**6521 (80)**	**1665 (20)**	**2068 (58)**	**1541 (42)**	**521 (16)**	**619 (19)**	**2115 (65)**	**15052**	**4.84**

Notes:

1. LGCDP was started from 2008/09 and was implemented in 47 DDCs only in the first year. Onward 2009/10, it has been implemented in VDCs, municipalities and DDCs.
2. Figures in parenthesis are %age of share of regular grant, LGCDP grant and LDF grant
3. VDCs are receiving certain fixed amount of grant annually. From FY 1995/96 each VDC received 0.3 million. From 1997/98, government provided grant at the rate of 0.5 million to each VDC. In 2006/07, government increased the grant amount to one million for each VDC. Similarly, in 2008/09, this amount again was gone up from 1.5 to 3.0 million for each VDC.
4. The figures in parenthesis are %age of regular and LGCDP grant to VDCs, DDCs and Municipalities of Nepal
5. LGs= Local government bodies/local authorities which includes VDCs, DDCs and Municipalities of Nepal
5. Reg.=Regular

Sources:

1. Detail Estimation of Expenditure, GoN, MoF of various years
2. LGCDP Website: www.lgcdp.gov.np, October 2011

CHAPTER-VII

7 PERCEPTIONS OF THE STAKEHOLDERS: AN OPINION SURVEY

In order to seek the opinion and perception of the key stakeholders (respondents), a set of questionnaire was developed and provided to the selected DDCs for the individual opinion of the Local Development Officers who are the chief administrative officers of the respective DDCs. Moreover, the researcher also met and discussed with the some Executive Board Members (former elected President of DDCs), former secretaries of government of Nepal and decentralization and local governance experts of Nepal to gather the information to justify the study. The final questionnaire used to collect opinion and perception of the major stakeholders is in appendix-7.

7.1 Corrective measures in resource mobilization at local level

Under this area, the respondents have shared very constructive and useful experience with the researcher. Based on the opinion of key respondents, the researcher has presented here some important information. Although, there is resource gap in local level to meet the aspiration and demand of people, Local Body Fiscal Commission has been able to carry out the study on revenue potentiality at local level and identified some new areas of sources of revenue for the local government bodies. Similarly, the concern of accountability, transparency and responsibility of local government bodies has got high priority for the quality and timely service delivery to the people even though there is absence of elected representatives since about nine years back in Nepal. It is said the pattern of local resource mobilization is in the learning stage but it is necessary to reach to the earning stage so that the resource gap will be minimized.

The new areas of local resource mobilization need to be identified because DDCs and VDCs are highly dependent to the grant of government of Nepal as compared to the Municipalities. The provisions of Local Self Governance Act and the policies related to local governance and decentralization must be respected by all. The government of Nepal should not intervene time and again in the areas of mobilizing local revenue as provisioned by LSGA. It is pre-condition that there should be elected representatives in local government bodies to respect democratic norms and value and for effective service delivery, resource mobilization. Further, it is necessary to maintain transparency and inclusive participation in resource mobilization and decision making process.

7.2 Role of GoN and DDCs for effective resource mobilization at district level

The Government of Nepal should carry out study and research to identify the potential new sources of resource mobilization at district level. In order to properly implement the fiscal decentralization process, the fiscal autonomy needs to be devolved to local level. New laws regarding revenue collection, sharing and mobilization need to be promulgated as and when needed. The Government of Nepal has to transfer certain authority to collect local tax at district level. The mega projects that create employment and generate local tax need to be implemented by the Government of Nepal. There should be cordial relationship between Ministry of Local Development and Ministry of Forest and Soil Conservation for the mobilization and utilization of natural resources for the economic development of the country. The relevant acts which are contradicted with the LSGA need to be amended or new act should be promulgated to supplement LSGA.

The local government bodies themselves be proactive to identify the new sources of revenue at the local level. The participation of socially, economically and politically excluded people in planning process, decision making process, resource mobilization and utilization need to be ensured by the local government bodies.

7.3 Problems in resource mobilization at district level

The situation is that the local government bodies are not autonomous to utilize own internal revenue in their discretion. There is no proper coordination and support from the local administration to local government bodies for resource mobilization. The role of political parties in resource mobilization should be positive and constructive. It is difficult to prepare actual annual program and budget due to the un-certainty of amount to be received by DDCs by the revenue sharing from forest, tourism, electrification and registration. DDCs have not prepared clear policy of resource mobilization at district level. The increment of illegal import and expert of local productions has hampered to generate new sources of income at local level. There is no mutual understanding about resource mobilization among NGOs, CBOs and local bodies.

7.4 Problems in receiving the fund of revenue sharing by DDCs

The DDCs receive certain amount of revenue from forest, tourism, electrification and land registration. Of the total four sectors, major source of income of DDCs is the revenue received from the land registration by the Government of Nepal. However, there is un-certainty and delay in receiving amount by the DDCs from concerned agencies of forest, tourism, electrification and registration. The concerned agencies are reluctant to make the fixed amount of revenues sharing available to DDCs easily. It is not good practice to receive junk amount of money in the last month of the fiscal year from center in the name of capital expenditure. It has created a serious problem to use the money in proper way and in right place. As a result, it has played a crucial role to make big volume of advance amount of DDCs. The legal provision to use the amount received by DDCs from the revenue sharing heading is not much pragmatic. The compulsion is that DDCs have to utilize certain percentage of the amount in the same area from where revenue is received by DDCs. For example DDCs have to spend all the money in the tourism promotion activities which was received from tourism sector.

Current provision to send back of 5% amount to district land revenue office out of the total amount received by DDCs through registration fee needs to be discouraged or cancelled. The reality is that the DDCs have been receiving the fixed revenue from forest and registration regularly but there is still problem with DDCs in receiving revenue from tourism and electrification sectors.

7.5 Focused areas for the effective resource mobilization by DDCs

For effective use of legal provisions, institutional capacity needs to be strengthened. In order to mobilize effectively the local resources in development activities, the capacity of DDCs needs to be enhanced. The capacity of DDCs means the full fledged DDCs including elected representatives, equipped and trained human resources. Although there is provision of forecasting of the local revenue by the local government bodies, the provision is not properly followed at the local level. It is more specifically argued that the fiscal autonomy of fixing rate and base of local taxes should be given to the local government by constitution. The role of NGOs should be positive for effective role of LBs in resource mobilization. LG Associations should play vital role to make political party more accountable.

7.6 Problems of fund transfer system of Government of Nepal

Center grant transfer system emphasizes process rather than output of the service delivered by the local government. The Government of Nepal does not provide grant in line with the approved annual program and budget by the respective local government council. Formula based grant system of Government of Nepal should be effective. It is necessary to discourage the process of formulating plans based on access and power of certain groups of the society. There should be special treatment for the DDCs having very low internal revenue. For example, the ceiling of using internal revenue in administrative purpose is same for all DDCs. It is not practical for the DDCs having low income from internal revenue. Although the sources of local bodies are being increasing year by year, there still exist some core problems such as weak institutional capacity of DDC to collect and use the resources. Moreover, there is no good monitoring and motivation mechanism of the programs and projects implemented at the local level. There is no scientific and practical forecasting system of revenue for coming fiscal year at district level.

7.7 Areas of improvement in fund transfer of Government of Nepal

Still there is a lack of clear policy and legislation about the fund transfer system of Government of Nepal. Although the performance based grant system is good initiative, its evaluation procedure needs to be implemented impartially and measurement indicators must be more pragmatic so that each local government body will have equal chances to show their performance. It is important to have a very strong and effective monitoring system at center to carry out monitoring in quarterly basis that contribute to correct procedural weaknesses of the local government bodies in time. Moreover, the reporting system is also very vital for policy makers. It is realized that neither there is uniformity in report format nor the report is prepared in the stipulated time frame by the local government bodies in Nepal.

7.8 Capacity development areas of DDCs in resource mobilization

Although there is a Revenue Section in each DDC to look after all the activities related to the revenue forecasting, collection and its utilization, it is not functional properly due to the lack of sufficient capacity responsible of person. Moreover, due to the absence of elected representatives, local government bodies have neither seriously taken their ownership nor given leadership. It is urgent that there should be strong inter sections coordination between Revenue section, account section, internal audit section, and planning section for effective functioning of each section with in DDCs. Furthermore, necessary training and orientation program must be conducted focusing DDCs personnel, representatives of all party mechanism and user group etc. In fact, DDCs staffs are not mentally prepared to work independently to identify the new sources of revenue at the district level because of the political instability in the country since long ago. So, time has come to increase support for the human resource and physical infrastructure development for the quality of service from the local government bodies. The public private partnership would be a good instrument to mobilize more resources in the district level.

7.9 Role of MoLD and LBFC for effective fiscal decentralization

Ministry of Local Development (MoLD) is a leading ministry to coordinate and facilitate whole devolution and decentralization process in Nepal. This ministry is also the guard to protest and protect any kind of interference to effectively implement the provisions of LSGA. The role of MoLD in capacity development, infrastructure development, coordination and effective monitoring and evaluation should be more proactive and effective. Already established source of revenue should not be withheld by center such as 'octroi', local development fee, land registration. Similarly, LBFC should carry out the series of studies and facilitate all DDCs to prepare vision and policy of revenue potentiality. Moreover, LBFC should formulate appropriate fiscal policy and implement at local level efficiently. LBFC should be autonomous and play the role of facilitating and coordinating for proper implementation of fiscal decentralization in Nepal.

7.10 Role of LGAs for effective fiscal decentralization

As ADDCN, NAVIN and MuAN are the representative organizations of all 75 DDCs, 3915 VDCs and 58 municipalities in Nepal, they should work as a facilitator to empower local bodies in planning, implementation and service delivery at district level. They should also conduct various activities about policy advocacy and lobby with Government of Nepal and the development partners with regard to local autonomy and promoting fiscal decentralization at the local level. Now the practice is that all are trying in pulling resources and pushing the responsibility. But this needs to be translated into the stage of resource sharing and responsibility bearing by all sectors.

7.11 Implementation status of LSGA provision of borrowing and loan

The LSGA has envisaged a very good provisioning of receiving borrowing and loan by the local government bodies in Nepal. However, this provision is not implemented properly. The local government bodies would be more benefited by utilizing the facility of borrowing and loan in income generating activities and infrastructure development program. But this facility should not be used to incur administrative expenses of the local government bodies. Current practice is that the process of getting loan is not easy task for local government bodies. Although this provision is important for local government bodies, it is recommended that this provision should not be implemented until the elected representatives will be placed in the local government bodies. Moreover, it is said that there should be easy process to get borrowing from the banking system and it is better to establish local bodies development bank.

CHAPTER – VIII

8 MAJOR FINDINGS, CONCLUSION AND RECOMMENDATIONS

8.1 Major findings

Although fiscal federalism and decentralization is not a new phenomenon, the practices of expenditure and revenue assignment across the levels of governments are varied from countries to countries in the world. For example, in some countries, central government collects more tax and transfers to sub-national governments as equalization grant. In some other countries, sub-national governments collect more revenue and share to central government. Similarly, in some countries, local government collects very few revenues but makes expenditure more than revenue (India, South Africa, Brazil, Germany, Denmark, China and Nepal). It indicates that there is less revenue decentralization but very high expenditure decentralization. On the other hand the expenditure and revenue sharing in Switzerland among various levels of governments is more or less equal.

In order to resolve the vertical fiscal gap and imbalance, national policies related to reassign the functions, decentralize tax power to the sub-national governments, tax-base sharing (give autonomy to sub-national governments to levy complementary rates on a national tax-base) etc need to be revised and changed time to time. Moreover, national government should adopt revenue sharing policy and provide formula based unconditional grant to the lower level of governments. The tax and revenue sharing are normally used to tackle the fiscal gap between national and sub-national governments.

Revenue sharing from the central government to regional and local governments is necessary for minimizing the vertical imbalances and horizontal inequities. Vertical imbalances arise when regional and local governments have more expenditure responsibilities than the revenues assignments. Horizontal inequities happen due to the different fiscal capacities of regions and local governments. Both of these issues must be dealt at the central government level; although regional governments could play a mediating role with local governments. In order to address the vertical imbalances and promote the fiscal decentralization, revenues collected from VAT, certain natural resources, and Personal Income Tax and certain minor taxes by the central government should have been shared to the sub-national governments by designing an effective tax sharing system. The "piggybacking" approach would be appropriate for the tax sharing to sub-national governments.

There are only urban local governments in Switzerland, Germany, Denmark and Brazil but not rural local governments. The property tax, service charges, revenue sharing and grant are the major sources of local governments. Generally, revenue of selected natural sources is shared to local government. But there is also practice of sharing revenue collected from VAT. South Africa has assigned significant non-property taxing power to sub-national governments including a payroll and turnover tax. The sub-national governments are granted some borrowing powers as well. However, hard budget constraint has not been put in place for local governments to force efficient use of the instruments. Fiscal reform of China in 1994 has changed national revenue sharing system and has given power of mobilization of local taxes to local governments. In China, The value added taxes (VAT) are shared by 75% and 25% by centre and provinces respectively. Taxes on security exchanges are shared equally between centre and provinces in fifty-fifty ration. But, in Nepal, the certain percentage of the revenue collected by central government from natural resources like forest, water, registration and tourism is shared to local government bodies as revenue sharing.

The share of local expenditure in Nepal is much lower (about 4.84%) as compared to total national expenditure (95.16%). Therefore, local governments cannot deliver sufficient services to the people as demanded in the local level. On the contrary, due to the political instability in the country, and the absence of elected representatives in local government bodies, the allocated budget at local level have not been used properly or has remained unspent. The pattern of local government expenditure is, to some extent, not oriented towards poverty alleviation in terms of coverage, scale, design, spending method and transparency. Therefore, in order to engage local bodies in alleviating poverty, it should be reoriented in future. As a result, local bodies can be helpful in poverty reduction. All the functions relating to poverty reduction should be devolved to local bodies and the expenditures should be designed considering the poverty status in the district.

The correlation between GDP and internal revenue of DDCs and GDP and total expenditure of devolved sectors found significant at 1% alpha level. Moreover the tested model shows that only total national revenue and foreign loan have positive impact but foreign grant and domestic loan have negative impact on local government expenditure in Nepal.

Out of the total national revenue of Nepal, 80% comes from tax and remaining 20% comes from non-tax sources. The ratio of total tax and non-tax revenue of government of Nepal to total GDP is only 12%. In average, of the total expenditure, 56% goes for capital and 34% goes for current expenditure in Nepal.

In 2006/07, of the total income of VDCs, 87% came from central government as grant and 13 % was collected internally. The case of municipalities, only 33% was received as grant from government of Nepal including revenue sharing, 58% was collected locally and 9% from other sources in the same year.

Similarly, out of total income of DDCs, 72% as grant, 15% from revenue sharing and 13% collected from own sources. Of the total expenditure of DDCs, only 19 % budget was spent as administrative expenses and remaining 81% was spent as development and capital budget expenditure in the same year. Out of total estimated development budget, about 76% budget was actually spent through central government.

However, at the district level, in the same fiscal year, about 80% estimated budget was expended. Of the total development expenditure by government of Nepal, 78% was spent from central level and 22% was spent from district and village level agencies in the same year. In 2006/07, the Kathmandu district received the highest %age shares of expenditure (2.48%) amongst the 75 districts whereas the lowest %age share of the total expenditure (0.45%) has been utilized by Rasuwa district. Of the total expenditure, about 22%, 28%, 23%, 16% and 11% were spent in the eastern, central, western, mid-western and far-western development region respectively.

Of the total grant of government of Nepal, VDCs receive about 71%, DDCs 24% and municipalities only 5%. Of the total national budget, VDCs, municipalities and DDCs receive only 2.77%, 0.20% and 0.90% respectively as annual grant. In total, only 3.88% of the total national budget goes to local government bodies as grant by the central government. But the central government grants including LGCDP and LDF to local government bodies, it is about 4.84% of the total national budget. The income of DDCs comes from government grant (55%), revenue sharing (22%) and internal source (23%) (Table 6-14). Similarly, the grant of government of Nepal to local government bodies is about 6% of the total tax and non-tax revenue which is accounted only 0.71% of GDP at current price (Table 6-15).

Out of the total revenue, the minimum regular grant of government of Nepal to VDCs is about 80% and remaining 20% comes from LGCDP as topping up block grant. In DDCs, 42% is covered by LGCDP grant and 58% by regular grant. Moreover, of the total grant of municipalities, local development fee covers 65% share while regular and LGCDP grant covers only 16% and 19% respectively. It indicates that the contribution of LGCDP and LDF have played vital role in local development (Table 6-16).

8.2 Conclusion

The concept of fiscal decentralization is being adopted and implemented globally after 1990's whether the political system of governance is federal or unitary. Necessarily, expenditure decentralization is given more priority rather than revenue decentralization in many countries of the world. For effective implementation of fiscal decentralization, authorities on fixing the bases and rates of taxes should be devolved to sub-national governments. The financial dependency of local government bodies in Nepal on central government has increased year by year. For stabilization and fiscal equalization/redistribution purposes, general practice is that the central government should collect 50% or more of total taxes, and those taxes should be from a broad-based elastic tax bases (such as income or value added).

For horizontal equity (among regions and local governments) and vertical balance (matching revenues and expenditures), the national government should have at least one tax that is shared with sub-national governments on a formula basis which takes into account fiscal capacity and tax effort. Although the degree of fiscal equalization is a political question, it is not probably desirable and possible to attempt for 100% equalization. It is better to provide certain incentive for regional and local governments to develop their own-source revenues because it simply results in less revenue sharing from the national government. The lack of any equalization program often regards as one of the defects in the federal system. Some combination of tax sharing and rate sharing (or piggybacking) could deal with the equity issues while not crippling national stabilization functions.

Regional or state governments could play a positive intermediately role by allowing the national government to deal with national disparities and inequalities whereas the regional governments will deal with local disparities and individual allocational needs. Regional oversight over local taxes may be important to ensure integrity and uniformity, especially if the local tax base is used in a formula determining fiscal capacity (e.g., assessed real property values).

It can be said that the VAT might be a good shared tax that could be collected at either the national or regional level. The VAT is more stable than the income tax and thus provides a more assured revenue stream for regions and/or local governments. Sharing natural resource taxes is appropriate because in one sense oil, gas and coal reserves are a national resource; yet, in another sense, the exploitation of those resources imposes costs on local governments. The property tax is a good local tax in developing countries. Business taxes, charges and fees are often closely related to specific services provided by state or local government and thus are good from a standpoint of allocational efficiency. Regional governments might rely on a piggybacked source of revenue, such as on a national income tax or VAT, or on excise taxes.

Although there is provision of carrying out the study on revenue potentiality by local government bodies in Nepal, no effective and practical efforts are made so far. The legal provision of horizontal revenue sharing and revenue transfer from one local government to another is not appropriately practiced in Nepal. The total national revenue is found very powerful factor to determine the local government expenditure in Nepal. It is clear that very limited power and authorities are devolved to the VDCs in order to mobilize internal revenue to meet the local expenditure at rural area (Figure 6-2). There is practice to obtain loan and borrowings by the municipalities that covers about 1.43% of the total income (Table 6-4). The share of tax and non-tax revenue (internal revenue) plays very insignificant role in total revenue mobilization by DDCs (Table 6-6). However, the share of internal revenue to total revenue of local governments is about 31.40% (Table 6-8).

On an average, of the total expenditure, about 78% is directly spent by central government whereas 22% is spent by local government bodies, district and village level line agencies at strict level (Table 6-11). The total share of grant to local government unevenly distributed among VDCs, DDCs and municipalities. Comparatively the share of grant to VDCs is higher as compared to DDCs and municipalities. Of the total national budget, 2.77% goes to VDCs whereas only 0.90% and 0.20% go to DDCs and municipalities respectively (Table 6-12). It gives an idea about the share of total grant to three types of local government bodies of Nepal. The share of central government grant to municipalities is very low as compared to DDCs and VDCs. This point explains that municipalities have been exercising more fiscal autonomy as compared to DDCs and

VDCs in Nepal. On the other hand, VDCs are more dependent to the central government grant among the three local bodies in Nepal. Although municipalities are relatively more autonomous than VDCs and DDCs in resource mobilization, in totality, local government in Nepal deeply rely on the central government grant to deliver services at local level. The tax collection authority is not devolved appropriately to the local government especially to DDCs in Nepal. Therefore it can be said that the dependency of DDCs on central government revenue is substantially high. It is the fact that of the total revenue, the share of grant and revenue sharing is about 75% of DDCs revenue.

8.3 Recommendations

On the basis of review of literature, data analysis and perception of stakeholders, the following recommendations have been made for the further enhancement of the fiscal decentralization effort in Nepal.

1. The major four pillars of fiscal decentralization viz. expenditure responsibility, revenue assignment, inter-governmental fiscal transfer and borrowing need to be clearly defined and provisioned in the constitution so that local governance system would be ensured and promoted.
2. In order to increase the self reliant rate of sub-national governments and enhance the service delivery mechanisms, fiscal decentralization needs to be ensured by devolving more fiscal autonomy to sub-national governments.
3. The share of revenue by the local government bodies are found much less as compared to their expenditure responsibilities. So, to address this problem, the theory of ***'finance follows functions'*** should be followed strongly.
4. The Government of Nepal has to increase the volume of local development expenditure and district expenditure for positive impact on local government expenditure
5. The participatory planning and inclusive decision making processes should be followed while preparing annual and periodic plan of local government bodies.
6. More autonomy to fix tax base and rate at local level needs to be devolved to local governments for effective mobilization of resources.

7. The local government is the vehicle to implement the activities relating to poverty reduction at local level. Therefore, the expenditure assignment should be designed accordingly.
8. The performance based grant system has promoted the participatory planning process and encouraged local government bodies to perform works more effectively and transparently. It has also supported them to make more responsible and accountable for service delivering. So, this system is highly recommended to be continued and promoted.
9. The role of Ministry of Local Development and Local Body Fiscal commission needs to be clearly defined and directed towards the facilitation and monitoring of the activities to be carried out by the local bodies. Moreover, urgent need is that the information system including financial database of DDCs needs to be updated timely. Likewise, their role should be focused on capacity development, infrastructure development, and coordination to the local government' activities.
10. The placement of elected representatives in the local government bodies is the very important precondition in promoting and strengthening the governance system including fiscal decentralization for effective, transparent and accountable service deliver at the local level.
11. As Association of District Development Committees of Nepal (ADDCN), National Association of VDCs in Nepal (NAVIN) and Municipal Association of Nepal (MuAN) have been playing a vital role in strengthening local democracy and promoting decentralization process in Nepal, it is necessary to enhance their capacity to achieve result based outputs in governance sector.
12. It is recommended to establish local government development bank so that they can borrow and get loan for the betterment of the people if local governments feel necessary.
13. Finally, the self reliant rate of municipalities and VDCs has not analyzed in this study. Moreover, time series data (income and expenditure) of VDCs, municipalities and DDCs has not been reviewed independently. Therefore, I strongly recommend choosing these areas for further study to the new researchers who are interested.

To end, the strong political commitment in principle (policy) and encouraging environment to implement the policies at both central and sub-national level are the preconditions to effectively execute the fiscal decentralization. People's representation through periodic election is extremely important to translate the policies into real practice for enhancing the fiscal decentralization. Moreover, the expenditure assignments among the levels of governments should be based on the *principle of subsidiary* so that inclusive participation and ownership of local people in decision making process can be ensured.

«The-End»

9. Appendices

Appendix-1: Role of local government under new vision

20th Century: Old view	21st Century: New view
is based on residuality and local government as wards of the state	is based on subsidiarity and home rule
is based on principle of ultra vires	is based on community governance
is focused on government	is focused on citizen-centered local governance
is agent of the central government	is the primary agent for the citizens and leaders and gatekeeper for shared rule
is responsive and accountable to higher-level government	is responsible and accountable to local voters; assumes leadership role in improving local governance
is direct provider of local services	is purchaser of local services
is focused on in-house provision	is facilitator of network mechanisms of local governance, coordinator of government providers and entities beyond government, mediator of conflicts, and developer of social capital
is focused on secrecy	is focused on letting the sunshine in, practices transparent governance
has input controls	recognizes that results matter
is internally dependent	is externally focused and competitive , is ardent practitioner of alternative service delivery framework
is closed and slow	is open, quick and flexible
has intolerance for risk	is innovative; is risk taker within limits
depends on central directives	is autonomous in taxing; spending, regulatory, and administrative decision
is rules driven	has managerial flexibility and accountability for results
is bureaucratic and technocratic	is participatory, works to strengthen citizen voice and exit options through direct democracy provision, citizen's charters, and performance budgeting
is coercive	is focused on earning trust, creating space for civic dialogue, serving the citizens, and improving social outcomes

20th Century: Old view	21st Century: New view
is fiscally irresponsive	is fiscally prudent, works better and costs less
is exclusive with elite capture	is inclusive and participatory
overcomes market failures	overcomes market and government failures
is boxed in a centralized system	is connected in a globalized and localization world

Source: Shah Anwar and Sana Shah (2006), "The New Vision of Local Governance and the Evolving Roles of Local Government". In *Public Sector Governance and Accountability Series: Local Governance in Developing Countries*, ed. Shah Anwar, The World Bank, Washington DC, pp 1 and 46

Appendix-2: Possible expenditure assignment across the level of governments

Expenditure Categories	Policy, standards, and oversight	Provision and administration	Comments
Defense	F	F	Benefit and costs national in scope
Foreign Affairs	F	F	Benefit and costs national in scope
International Trade	F	F	Benefit and costs national in scope
Monitoring Policy, Currency, Banking	F	F	Benefit and costs national in scope
Interstate Commerce	F	F	Benefit and costs national in scope
Transfer Payments to Individual	F	F	Redistribution
Subsidy to business and industry	F	F	Regional development, industrial policy
Immigration	F	F	Benefit and costs national in scope
Unemployment Insurance	F	F	Benefit and costs national in scope
Airlines and railway	F	F	Benefit and costs national in scope
Fiscal Policy	F,S	F,S,L	Coordination possible
Regulation	F	F,S,L	Internal Common Market
Natural Resources	F	F,S,L	Promotes a common market
Environment	F,S,L	S,L	Benefit and costs national, regional, or local in scope
Industry and Agriculture	F,S,L	S,L	Significant Inter-jurisdictional spillovers
Education	F,S,L	S,L	Transfers in kind
Health	F,S,L	S,L	Transfers in kind
Social welfare	F,S,L	S,L	Transfers in kind
Police	F,S,L	S,L	Primarily local benefits
Water, sewerage, refuse collection	L	L	Primarily local benefits
Parks and recreations	F,S,L	F,S,L	Primarily local responsibility, but national and provincial governments may establish own parks

Expenditure Categories	Policy, standards, and oversight	Provision and administration	Comments
Highway			
Interstate	F	S,L	Internal common market
Provincial	S	S,L	Provincial benefits and costs
Interregional	S	S,L	Inter-regional benefits and costs
Local	L	L	Local benefits and costs
Spending Power	F,S	F,S	Fiscal transfers to advance own objectives

Note: F=Federal Responsibility, S=State Responsibility, and L=Local Responsibility

Source: Martinez-Vazquez, et.al.(2006). , "Revenue and Expenditures in an Intergovernmental Framework" In, *Perspectives on Fiscal Federalism, ed. Bird, R. Richard and Vaillancourt Francois the World Bank Institute, Washington, DC, table 2.1, p.p.20*

Appendix-3: Possible tax assignment across the level of governments

Type of Tax	Determination of		Collection and administration	Comments
	Base	Rate		
Customs	F	F	F	International Trade taxes
Corporate Income	F	F	F	Mobile factor, stabilization tool
Resource taxes				
Resource rent (profits, income) tax	F	F	F	Highly unequally distributed tax bases
Royalties, fees, charges, severance taxes (production, output, and property taxes)	S,L	S,L	S,L	Benefit taxes/charges for state and/ or local services
Conservation charge	S,L	S,L	S,L	to reserve the local environment
Personal Income	F	F,S,L	F	Redistributive, mobile factor; stabilization tool
Wealth taxes (taxes on capital wealth, wealth transfers, inheritances and bequests)	F	F,S	F,S	Benefit charge, for example, social security coverage
Payroll taxes	F,S	F,S	F,S	Benefit charge, for example, social security coverage
Multistage sales taxes (VAT)	F	F	F	Boarder tax adjustments possible under federal assignments; potential stabilization tools
Signal stage sales taxes (Manufacture, wholesale, retail)				
Less centralized choice	S	S,L	S,L	Higher compliance cost
More centralized choice	F	S	F	Harmonized, lower compliance cost
"Sin" taxes				
Excises on alcohol and tobacco	F	F	F	Health care shared responsibility
Betting, gambling	S,L	S,L	S,L	State and local responsibility

Type of Tax	Determination of		Collection and administration	Comments
	Base	Rate		
Lotteries	S,L	S,L	S,L	State and local responsibility
Race tracks	S,L	S,L	S,L	State and local responsibility
Taxation of "bads" (negative externalities)				
Carbon	F	F	F	To combat global and national pollution
Motor fuels	F,S,L	F,S,L	F,S,L	Tolls on federal, provincial and local roads
Effluent charges	F,S,L	F,S,L	F,S,L	To deal with interstate, inter municipal or local pollution issues
Congestion tolls	F,S,L	F,S,L	F,S,L	Tolls on federal, provincial and local roads
Parking fee	L	L	L	to control local congestion
Motor vehicles				
Registration, transfer taxes, and annual fees	S	S	S	State responsibility
Drivers licenses and fees	S	S	S	State responsibility
Others				
Business taxes	S	S	S	Benefit tax
Excises	S,L	S,L	S,L	Residence based taxes
Property	S	L	L	Completely immobile factor, benefit tax
Land	S	L	L	Completely immobile factor, benefit tax
Frontage, betterment	S,L	L	L	Cost recovery
Poll tax	F,S,L	F,S,L	F,S,L	Payment for services
User charges	F,S,L	F,S,L	F,S,L	Payment for services

Note: F=Federal Responsibility, S=State Responsibility, and L=Local Responsibility

Source: Martinez-Vazquez, Jorge et.al.(2006). , "Revenue and Expenditures in an Intergovernmental Framework" In, *Perspectives on Fiscal Federalism, ed. Bird, R. Richard and Vaillancourt Francois the World Bank Institute, Washington, DCtable 2.1, p.p.29*

Appendix-4: A summary of events in decentralization process in Nepal

Year	Events	Impact
1951	End of the Rana rule and advent of Democracy	Ushered new ideas for development and welfare of the people
1956	Tribhuwan Village Development Programme introduced by US and Indian Aid	Village Development Centers established and Block Development Officer appointed to co-ordinate rural development
1961	Introduction of Panchayat System of Polity	Establishment of local institutions called as the Panchayats at village and district levels
1962	Promulgation of Constitution of Nepal 2019 BS	This is the first constitution after the collapse of democracy in Nepal in 1960
1963	Viswabandhu Thapa Commission on Decentralization of Administration	Major recommendations: a. Provision of district and village level cabinets b. Delegation of law and order responsibility to villages c. Enactment of local administration act
1966	Promulgation local administration act	Establishment of 75 districts in the plaace of already existing 35 districts
1967	Bhojraj Ghimire Committee to lool into the implementation of decentralization	Major recommendations: a. Decentralization of power to local level institutions b. Appointment of Chief District Officer as District Panchayat Secretary c. Provision of government financial grants to local panchayats
1968	Vedananda Jha Commission on Administration Reform	Recommendation of administrative reforms and reorganization
1969	Jaya Prakash Committee to examine effectiveness of decentralization scheme	Major recommendations: a. Co-ordination among various central level ministries b. Formulation of District level plans by district panchayat and its implementation by CDO
1970	Decentralization Committee	Recommendation made for the strengthening of decentralization
1970	Implementation of fourth plan (1970-75)	Regional planning was introduced during the fourth five year plan. A growth pole development

Year	Events	Impact
		strategy was conceptualized under which the country was divided into 4 development regions each with a growth pole
1974	Implementation of District Administration Plan	All district line agencies of development ministries put under the authority of CDO and were made responsible for the formulation of district development plan
1975	Implementation of small area development programme	Concepts of growth centers and growth corridors introduced in ten areas
1976	Bekh Bahadur Thapa Administrative Reform Commission	Administrative reform was recommended both at central and local levels
1978	Implementation of Integrated Panchayat Development Decision	The authority for formulating and approving plans was given to the village and district assemblies and Panchayats; service centers recommended
1980	Creation fo Ministry of Panchayat and local Development	The responsibility of coordinating all rural development projects and programmes was assigned to the Ministry
1981	Formation of decentralization sub-committee	It worked out Decentralization Act 1982
1982	Decentralization Act 1982	Devolution of decision making power to local level panchayat for their development
1984	Decentralization bylaw	The act was to be implemented all over the country up to 1991 on a phase wise basis
1992	Holding of First Local Bodies' Election DDCs, VDCs, and Municipalities	Elected local representatives for local development
1995	Establishment of Local Government Associations such and ADDCN, MuAN a and NAVIN	Worked as watch dog for promotion of decentralization and local autonomy in the country. Facilitated in capacity development sector of local government
1996	Report on Decentralization and Local Self Governance submitted by the high level decentralization coordination committee chaired by Sher Bahadur Deuwa	Major recommendations: a. Provision of decentralization b. Authorities and functions of local self governance unit c. Provision of planning, implementation,

Year	Events	Impact
		monitoring and evaluation d. Establishment of Local Body Fiscal Commission e. Establishment of local service act f. Functional relationship between central and local government and local government and NGOs/INGOs g. Capacity development of local government h. Promulgation of Decentralization implementation strategy
1997	Holding of Second Local Bodies' Election DDCs, VDCs, and Municipalities	Elected local representatives for local development
1999	Promulgation of Local Self Governance Act, 1999	The act and rules have set an unprecedented policy shift by legally endorsing the concept of self-governance and devolution of authorities to local bodies. They clearly defined the objectives, principles, duties, and responsibilities, inter-agency relationship for local governance in the country
2000	Promulgation of Local Self Governance (Financial Administration) Regulation, 2000	This is the milestone in the history of decentralization process in Nepal.
2000	Implementation of Decentralization Implementation Plan (DIP)	According to the decision made by DIMC, role, responsibility and timeframe was fixed to implement the decentralization policy at grass root level
2002	Establishment of Local Body Fiscal Commission	According to the provision of LSGA, this commission has been established under MoLD jurisdiction
2002	Initiation of Sectoral Devolution Process	Three sectors were devolved to local government such as primary education, health, agriculture/livestock
2004	Study on Expenditure Assignment and Revenue Assignment	Role of all tire of government and the resources have been recommended in order to institutionalize the decentralization and

Year	Events	Impact
		devolution process
2008	Implementation of Local Governance and Community Development Programme (LGCDP)	This program is jointly being implemented by GoN and Development partners working in Nepal. The main purpose of the programme is to promote local governance through community development and enhance the capacity of local bodies such as VDC, Municipalities and DDCs.

Source: UNDP(2009a), "Nepal Human Development Report", State Transformation and Human Development, Kathmandu, Nepal, table 15 p.p.165, updated by author.

Appendix-5: Functions of local government in Nepal

VDCs (LSGA, Article 28)	Municipalities (LSGA, Article 96)	DDCs (LSGA, Article 189)
1. Agriculture	1. Finance	1. Agriculture
2. Rural Water Supply	2. Water Resource, Environment and Sanitation	2. Rural Water Supply and Habitation Development
3. Works and Transport	3. Works and Transport	3. Works and Transport
4. Education and Sports	4. Education and Sports	4. Education and Sports
5. Physical Development	5. Physical Development	5. Hydropower
6. Health Service	6. Health Service	6. Health Services
7. Irrigation, Soil Erosion and River Control	7. Social Welfare	7. Irrigation, Soil Erosion and River Control
8. Forest and Environment	8. Culture	8. Forest and Environment
9. Language and Culture	9. Industry and tourism	9. Language and Culture
10. Tourism and Cottage Industry	10. Approval of Building Design	10.Tourism
11. Miscellaneous	11. Miscellaneous	11.Cottage Industry
		12.Land Reform and Land Management
		13.Development of Women and Helpless People
		14. Information and communication
		15. Wages for Lab
		16. Miscellaneous

Source: Government of Nepal, LSGA, 1999

Appendix-6: Sources of internal revenue of local government in Nepal

Source Revenue	VDCs (Article 55-59 of LSGA)	Municipalities (Article 136-148 of LSGA)	DDCs (Article 215-219 of LSGA)
Tax	▪ House and land tax ▪ Land revenue and tax ▪ Haat Bazaar Pasal tax ▪ Rent tax ▪ Vehicle tax ▪ Entertainment tax ▪ Professional tax ▪ Advertisement tax ▪ Natural resource utilization tax ▪ Commercial video tax ▪ Other tax	▪ House and land tax ▪ Vehicle tax ▪ Entertainment tax ▪ Rent tax ▪ Advertisement tax ▪ Professional tax ▪ Property tax ▪ Commercial video tax	▪ DDC may impose tax on infrastructure such as road, paths, bridges, irrigation, ditches, ponds etc. built by or transferred to it. Likewise, Wool, turpentine, herbs, worn and torn goods[37], stones, slates, sand and bone, horn, wing, feather etc[38].
Service Charge	▪ Sanitation - use of drainage ▪ Tourist Site Entrance fee ▪ Park, garden, view tower ▪ Fee for entertainment like magic, circus etc. ▪ For recovering dues for others	▪ Parking fee ▪ Water supply, electricity, tap, public telephone fee ▪ Solid waste, sanitation, sewerage fee ▪ Public lavatories, park, bath room, swimming pool, gymnasium, guest house, tourist site, hostel, haat bazaar, slaughter house, crematorium, use of washing space, street light, road, drainage maintenance.	▪ DDC may impose the service charge at the rate approved by district council not exceeding the rate as prescribed in its area. Such as guest house, library, clinic, hermitage, city hall, ditch, small ditch, embankment etc. built by it or under its custody. ▪ Local Development Fee[39]

[37] From the fiscal year 2009/2010, this tax authority has been abolished from the jurisdiction of DDC

[38] Up-to 35-50 % of the amount obtained from the tax shall have to be provided to the concerned VDC and Municipality.

[39] *From the fiscal year 2009/2010, this tax authority is abolished from the jurisdiction of DDC*

Source Revenue	VDCs (Article 55-59 of LSGA)	Municipalities (Article 136-148 of LSGA)	DDCs (Article 215-219 of LSGA)
		▪ Valuation of real estate (fixed assets)	
Fees	▪ Television, video and other equipment license fee ▪ Approval fee ▪ Recommendation fee	▪ Approval and recommendation fee ▪ Approval of building design fee ▪ Attestation of maps fee	▪ DDC may impose fees at the rate approved by district council not exceeding the rate as prescribed in its area such as river rafting, boat, tunings, fishing permission and renewal, registration and renewal fee for water bank, recommendation fee and others as prescribed.
Sales	▪ Soil from fallow govt. land ▪ Product from public pond - orchard ▪ VDC property ▪ Dry wood, fire wood, branches, roots ▪ Grass (Khar)		▪ DDC may sell, as prescribed the sand in the river, and canals, roda, stones, soil, wood swept by river etc. lying in the area.[40]
Loan	▪ Loans from bank or other institution with approval from Council, with or without collateral and on government guarantee	▪ Loans from bank or other institution, with approval from Council, with or without collateral and on government guarantee	▪ DDC may raise loans, or receive borrowings with or without pledging any of its movable and immovable property owned and possessed by it or under guarantee given by GoN from bank or any other organization, according to the policy adopted by the district council.

Sources: Government of Nepal, LSGA, 1999 and LSGR, 2000

[40] Up-to 35-50 % of the amount obtained from such sales shall have to be provided to the concerned VDC and Municipality.

Appendix-7: Questionnaires asked for key informants

1. Does the present practice of internal resource mobilization by DDCs is satisfactory?
2. What kinds of role need to be played by center and district government for proper management and effective resource mobilization at district level?
3. What are the problems/challenges faced at district level in course of mobilization of internal revenue?
4. What are problems and challenges to receive and utilization of the revenue from forest, tourism, electrification, and registration?
5. What are areas need to be focused for the effective mobilization of resources by DDCs?
6. What are the problems in the center government transfer system in Nepal?
7. What is your opinion to improve the center government transfer system?
8. What are the areas of Capacity Development of DDCs for resource mobilization at district level?
9. What are the roles of MoLD and LBFC for improving the fiscal decentralization process and system in Nepal?
10. What kinds of role need to be played by ADDCN for improving fiscal dimension of DDCs?
11. What is the present status of implementation of LSGA provision of borrowing and loan to be received from Bank and other institutions by DDCs?

Appendix-8: Data used for correlation analysis

(Figure in Million NRs.)

S.N.	Districts	GDP at market price (2001)	Internal revenue of DDCs (2006/07)	Total expenditure of devolved sectors (2006/07)
1	Taplejung	2130.00	3.723	341.310
2	Panchathar	2931.00	6.035	328.850
3	Ilam	4649.00	11.423	411.960
4	Jhapa	12123.00	34.290	636.640
5	Sankhuwasava	2706.00	7.148	303.630
6	Terathum	1907.00	2.469	271.840
7	Bhojapur	2752.00	3.975	359.920
8	Dhankuta	2481.00	7.710	297.930
9	Sunsari	11688.00	48.262	469.640
10	Morang	18442.00	68.084	682.420
11	Solukhumbu	2119.00	30.637	278.220
12	Khotang	2986.00	3.857	408.120
13	Udayapur	3796.00	18.510	379.040
14	Okhaldhunga	2018.00	4.143	362.460
15	Saptari	7244.00	19.519	564.230
16	Siraha	6812.00	22.274	538.460
17	Dhanusa	9029.00	17.578	530.840
18	Mahottari	5908.00	25.478	442.250
19	Sarlahi	6897.00	26.070	497.120
20	Sindhuli	4083.00	16.470	394.920
21	Ramechhap	2899.00	10.394	393.680
22	Dolakha	2666.00	10.585	354.060
23	Sindhupalchok	4939.00	16.516	453.020
24	Rasuwa	1019.00	11.338	136.120
25	Dhading	4924.00	55.155	500.570
26	Nuwakot	4827.00	26.041	439.870
27	Kathmandu	50318.00	109.603	746.090
28	Lalitpur	9410.00	76.240	382.090
29	Bhaktapur	5679.00	60.190	266.510
30	Kavrepalanchowk	8200.00	41.183	588.930
31	Makawanpur	9754.00	46.825	430.380
32	Rautahat	6420.00	24.656	472.050
33	Bara	16306.00	67.384	470.790
34	Parsa	9458.00	27.055	412.980
35	Chitawan	10953.00	40.680	492.970
36	Nawalparasi	9974.00	40.419	544.260
37	Rupandehi	13015.00	97.393	606.330
38	Kapilbastu	7312.00	45.152	442.370

S.N.	Districts	GDP at market price (2001)	Internal revenue of DDCs (2006/07)	Total expenditure of devolved sectors (2006/07)
39	Arghakhachi	3185.00	13.952	394.010
40	Palpa	4241.00	16.954	505.750
41	Gulmi	3049.00	12.599	521.210
42	Syanja	5724.00	15.728	579.630
43	Tanahu	5066.00	26.412	503.950
44	Gorakha	4750.00	21.678	495.610
45	Manang	356.00	6.147	105.100
46	Lamjung	3077.00	13.287	402.410
47	Kaski	8786.00	52.791	571.560
48	Parbat	2605.00	12.764	412.690
49	Baglung	4164.00	14.610	459.000
50	Myagdi	1873.00	10.309	270.710
51	Mustang	500.00	15.775	132.830
52	Mugu	657.00	0.767	260.600
53	Dolpa	511.00	1.994	245.110
54	Humla	557.00	3.821	299.990
55	Jumla	1336.00	4.216	243.910
56	Kalikot	1108.00	1.027	216.580
57	Rukum	2554.00	3.786	312.630
58	Rolpa	2491.00	5.346	302.880
59	Pyuthan	2168.00	4.615	385.900
60	Dang	6645.00	31.257	438.070
61	Salyan	2283.00	7.586	317.500
62	Banke	7152.00	25.758	364.500
63	Bardiya	5019.00	10.253	349.580
64	Surkhet	4247.00	12.445	419.360
65	Jajarkot	1531.00	1.948	254.190
66	Dailekha	2070.00	3.422	359.030
67	Kailali	9879.00	35.812	483.150
68	Doti	2646.00	4.491	368.440
69	Achham	2410.00	2.433	447.460
70	Bajura	1335.00	0.654	272.930
71	Bajhang	1865.00	4.371	406.810
72	Darchula	1940.00	2.808	337.260
73	Baitadi	2824.00	3.525	417.340
74	Dadeldhura	2255.00	3.069	256.280
75	Kanchanpur	6858.00	24.058	325.260

Source: UNDP, 2004, Nepal Human Development Report, Kathmandu, Nepal.

Appendix-9: Data used for multiple regression analysis

(Figure in Million NRs.)

SN	Fiscal year	Total LGs grant	Total national revenue	Foreign grant	Foreign loan	Domestic loan
1	1996/97	2714	30374	5988	9043	3000
2	1997/98	2747	32938	5403	11054	3400
3	1998/99	2755	37251	4337	11852	4710
4	1999/00	2810	42894	5712	11812	5500
5	2000/01	2816	48894	6753	12044	7000
6	2001/02	2947	50447	6686	7698	8000
7	2002/03	2967	56230	11339	4546	8880
8	2003/04	2960	62331	11283	7629	5607
9	2004/05	2967	70123	14391	9266	8938
10	2005/06	3143	72282	13827	8214	11834
11	2006/07	5146	87712	15800	10053	17892
12	2007/08	5349	107622	20321	8979	20496
13	2008/09	9454	143473	26383	9968	18417
14	2009/10	10260	179944	38545	11223	29914
15	2010/11	10964	203916	49327	14859	33680
16	2011/12	14568	241774	70132	29654	37410

Notes:

1. Local Government grant is estimated figure whereas total revenue and foreign grant is actual figure. However the total revenue and foreign grant of fiscal year 2010/11 is revised and figure of fiscal year 2011/12 is estimated.

2. Principal receipt is not included in central level total revenue.

Source: Economic Survey of Expenditure Details of various year's publication of MoF

Appendix-10: District-wise total expenditure in Nepal, 2006/07

(Figure *in NRs.)*

SN	District	Regular or Administrative Expenditure	Development or Capital Expenditure	Miscellaneous Expenditure	Total Expenditure	% of Regular Expenditure to Total	% of Development Expenditure to Total	% of Miscel. Expenses to Total	Total % Share
	Eastern Development Region								
1	Taplejung	169,662,209.78	168,070,450.82	3,580,936.91	341,313,597.51	49.71	49.24	1.05	1.13
2	Panchathar	173,912,176.64	149,614,559.53	5,332,049.57	328,858,785.74	52.88	45.50	1.62	1.09
3	Ilam	227,240,280.32	177,404,784.95	7,320,536.42	411,965,601.69	55.16	43.06	1.78	1.37
4	Jhapa	390,508,184.10	233,807,354.49	12,330,645.13	636,646,183.72	61.34	36.72	1.94	2.12
5	Sankhuwasava	172,021,997.71	128,133,566.64	3,482,560.00	303,638,124.35	56.65	42.20	1.15	1.01
6	Terathum	142,881,742.52	123,842,913.71	5,117,049.84	271,841,706.07	52.56	45.56	1.88	0.90
7	Bhojapur	193,697,868.19	164,116,979.65	2,107,052.00	359,921,899.84	53.82	45.60	0.59	1.20
8	Dhankuta	155,432,014.08	138,599,249.56	3,899,667.15	297,930,930.79	52.17	46.52	1.31	0.99
9	Sunsari	278,358,943.26	184,197,702.73	7,087,124.60	469,643,770.59	59.27	39.22	1.51	1.56
10	Morang	401,621,784.17	269,400,079.53	11,404,729.15	682,426,592.85	58.85	39.48	1.67	2.27
11	Solukhumbu	127,103,381.93	150,024,087.74	1,096,851.85	278,224,321.52	45.68	53.92	0.39	0.93
12	Khotang	206,791,366.54	195,882,788.11	5,447,947.20	408,122,101.85	50.67	48.00	1.33	1.36
13	Udayapur	177,000,975.37	195,756,008.15	6,287,678.29	379,044,661.81	46.70	51.64	1.66	1.26
14	Okhaldhunga	150,524,868.13	206,476,476.18	5,462,741.00	362,464,085.31	41.53	56.96	1.51	1.21
15	Saptari	270,083,652.27	284,143,063.79	10,008,304.57	564,235,020.63	47.87	50.36	1.77	1.88
16	Siraha	254,425,550.37	277,502,615.61	6,535,930.41	538,464,096.39	47.25	51.54	1.21	1.79
	Total	**3,491,266,995.38**	**3,046,972,681.19**	**96,501,804.09**	**6,634,741,480.66**	**832.11**	**745.52**	**22.37**	**22.07**
	Average	**218,204,187.21**	**190,435,792.57**	**6,031,362.76**	**414,671,342.54**	**52.01**	**46.59**	**1.40**	**1.38**
	Central Development Region								
1	Dhanusa	283,904,453.69	243,819,437.07	3,118,992.62	530,842,883.38	53.48	45.93	0.59	1.77
2	Mahotari	220,911,646.09	217,711,269.94	3,631,622.00	442,254,538.03	49.95	49.23	0.82	1.47

SN	District	Regular or Administrative Expenditure	Development or Capital Expenditure	Miscellaneous Expenditure	Total Expenditure	% of Regular Expenditure to Total	% of Development Expenditure to Total	% of Miscel. Expenses to Total	Total % Share
3	Sarlahi	248,299,423.79	244,333,639.89	4,489,595.58	497,122,659.26	49.95	49.15	0.90	1.65
4	Sindhuli	187,638,750.69	203,317,351.26	3,967,809.90	394,923,911.85	47.51	51.48	1.00	1.31
5	Ramechhap	161,993,991.86	219,447,389.33	12,248,414.80	393,689,795.99	41.15	55.74	3.11	1.31
6	Dolakha	167,881,753.57	181,321,156.16	4,860,885.61	354,063,795.34	47.42	51.21	1.37	1.18
7	Sindhupalchok	213,207,522.18	227,643,238.74	12,173,062.36	453,023,823.28	47.06	50.25	2.69	1.51
8	Rasuwa	58,513,180.18	75,443,190.46	2,167,223.06	136,123,593.70	42.99	55.42	1.59	0.45
9	Dhading	222,852,133.26	253,670,092.93	24,055,012.30	500,577,238.49	44.52	50.68	4.81	1.66
10	Nuwakot	208,037,685.23	217,375,325.38	14,463,133.68	439,876,144.29	47.29	49.42	3.29	1.46
11	Kathmandu	463,191,521.04	263,654,477.34	19,245,909.51	746,091,907.89	62.08	35.34	2.58	2.48
12	Lalitpur	213,333,724.44	162,336,341.01	6,428,311.22	382,098,376.67	55.83	42.49	1.68	1.27
13	Bhaktapur	162,096,022.60	99,471,832.98	4,945,870.59	266,513,726.17	60.82	37.32	1.86	0.89
14	Kavrepalanchow k	298,791,709.03	281,596,695.41	8,549,691.39	588,938,095.83	50.73	47.81	1.45	1.96
15	Makawanpur	221,319,793.36	200,358,435.15	8,708,928.98	430,387,157.49	51.42	46.55	2.02	1.43
16	Rautahat	226,784,701.82	238,139,624.64	7,125,786.98	472,050,113.44	48.04	50.45	1.51	1.57
17	Bara	239,013,922.98	226,930,996.51	4,851,945.40	470,796,864.89	50.77	48.20	1.03	1.57
18	Parsa	207,728,112.03	199,706,785.08	5,553,443.28	412,988,340.39	50.30	48.36	1.34	1.37
19	Chitawan	302,635,089.96	184,980,957.74	5,356,221.87	492,972,269.57	61.39	37.52	1.09	1.64
	Total	**4,308,135,137.80**	**3,941,258,237.02**	**155,941,861.13**	**8,405,335,235.95**	**962.71**	**902.55**	**34.74**	**27.95**
	Average	**226,743,954.62**	**207,434,644.05**	**8,207,466.38**	**442,386,065.05**	**50.67**	**47.50**	**1.83**	**1.47**
	Western Development Region								
1	Nawalparasi	286,682,497.00	247,429,473.13	10,152,771.26	544,264,741.39	52.67	45.46	1.87	1.81
2	Rupandehi	295,455,647.36	296,360,227.41	14,518,689.26	606,334,564.03	48.73	48.88	2.39	2.02
3	Kapilbastu	192,617,603.86	247,237,194.62	2,520,905.85	442,375,704.33	43.54	55.89	0.57	1.47
4	Arghakhachi	202,998,966.13	185,256,704.73	5,756,959.17	394,012,630.03	51.52	47.02	1.46	1.31
5	Palpa	277,284,221.56	218,365,787.86	10,100,914.75	505,750,924.17	54.83	43.18	2.00	1.68

SN	District	Regular or Administrative Expenditure	Development or Capital Expenditure	Miscellaneous Expenditure	Total Expenditure	% of Regular Expenditure to Total	% of Development Expenditure to Total	% of Miscel. Expenses to Total	Total % Share
6	Gulmi	271,547,604.07	240,274,410.56	9,396,762.50	521,218,777.13	52.10	46.10	1.80	1.73
7	Syanja	326,556,108.45	246,606,950.52	6,469,014.79	579,632,073.76	56.34	42.55	1.12	1.93
8	Tanahu	306,012,955.20	191,951,646.36	5,986,193.65	503,950,795.21	60.72	38.09	1.19	1.68
9	Gorakha	271,619,651.34	215,368,891.18	8,623,313.47	495,611,855.99	54.80	43.46	1.74	1.65
10	Manang	38,218,380.97	65,740,598.43	1,144,866.43	105,103,845.83	36.36	62.55	1.09	0.35
11	Lamjung	214,224,425.77	183,284,360.63	4,904,738.72	402,413,525.12	53.23	45.55	1.22	1.34
12	Kaski	306,491,321.96	251,653,779.21	13,422,690.85	571,567,792.02	53.62	44.03	2.35	1.9
13	Parbat	219,760,599.44	186,116,304.16	6,822,415.74	412,699,319.34	53.25	45.10	1.65	1.37
14	Baglung	250,152,372.21	199,971,109.08	8,882,041.71	459,005,523.00	54.50	43.57	1.94	1.53
15	Myagdi	130,354,151.26	137,215,221.41	3,150,047.40	270,719,420.07	48.15	50.69	1.16	0.90
16	Mustang	55,585,208.49	77,008,607.77	244,853.80	132,838,670.06	41.84	57.97	0.18	0.44
	Total	**3,645,561,715.07**	**3,189,841,267.06**	**112,097,179.35**	**6,947,500,161.48**	**816.22**	**760.05**	**23.73**	**23.1**
	Average	**227,847,607.19**	**199,365,079.19**	**7,006,073.71**	**434,218,760.09**	**51.02**	**47.50**	**1.48**	**1.44**
	Mid-Western Development Region								
1	Mugu	79,000,308.37	180,795,870.80	812,287.22	260,608,466.39	30.31	69.37	0.31	0.87
2	Dolpa	80,526,918.07	164,034,614.78	551,795.56	245,113,328.41	32.85	66.92	0.23	0.82
3	Humla	74,780,326.18	224,601,345.47	611,652.00	299,993,323.65	24.93	74.87	0.20	1.00
4	Jumla	95,134,742.43	146,889,689.98	1,890,477.80	243,914,910.21	39.00	60.22	0.78	0.81
5	Kalikot	110,780,497.03	104,627,016.25	1,174,385.64	216,581,898.92	51.15	48.31	0.54	0.72
6	Rukum	134,152,680.17	176,749,293.94	1,730,771.09	312,632,745.20	42.91	56.54	0.55	1.04
7	Rolpa	128,378,432.79	169,325,771.19	5,177,418.04	302,881,622.02	42.39	55.90	1.71	1.01
8	Pyuthan	156,866,953.13	226,371,676.12	2,665,820.00	385,904,449.25	40.65	58.66	0.69	1.28
9	Dang	231,277,619.11	202,733,951.89	4,061,594.22	438,073,165.22	52.79	46.28	0.93	1.46
10	Salyan	143,490,399.05	169,916,791.75	4,097,440.93	317,504,631.73	45.19	53.52	1.29	1.06
11	Banke	170,319,582.42	190,153,268.95	4,035,193.91	364,508,045.28	46.73	52.17	1.11	1.21
12	Bardiya	172,480,464.45	172,957,397.26	4,145,890.06	349,583,751.77	49.34	49.48	1.19	1.16

SN	District	Regular or Administrative Expenditure	Development or Capital Expenditure	Miscellaneous Expenditure	Total Expenditure	% of Regular Expenditure to Total	% of Development Expenditure to Total	% of Miscel. Expenses to Total	Total % Share
13	Surkhet	203,120,729.61	212,454,629.73	3,791,837.92	419,367,197.26	48.44	50.66	0.90	1.39
14	Jajarkot	103,122,808.65	150,640,363.83	436,110.35	254,199,282.83	40.57	59.26	0.17	0.85
15	Dailekha	154,855,792.19	201,264,529.72	2,915,866.51	359,036,188.42	43.13	56.06	0.81	1.19
	Total	**2,038,288,253.65**	**2,693,516,211.66**	**38,098,541.25**	**4,769,903,006.56**	**630.38**	**858.21**	**11.41**	**15.86**
	Average	**135,885,883.58**	**179,567,747.44**	**2,539,902.75**	**317,993,533.77**	**42.03**	**57.21**	**0.76**	**1.06**

Far-Western Development Region

1	Kailali	213,989,573.78	267,947,186.65	1,215,536.89	483,152,297.32	44.29	55.46	0.25	1.61
2	Doti	140,276,400.68	225,568,184.03	2,602,670.80	368,447,255.51	38.07	61.22	0.71	1.23
3	Achham	165,032,335.41	278,181,634.91	4,248,385.00	447,462,355.32	36.88	62.17	0.95	1.49
4	Bajura	129,880,688.24	141,323,366.22	1,735,738.82	272,939,793.28	47.59	51.78	0.64	0.91
5	Bajhang	190,252,251.81	214,702,583.03	1,857,834.00	406,812,668.84	46.77	52.78	0.46	1.35
6	Darchula	175,705,383.74	158,684,848.08	2,870,254.40	337,260,486.22	52.10	47.05	0.85	1.12
7	Baitadi	193,693,923.21	219,952,851.72	3,695,011.80	417,341,786.73	46.41	52.70	0.89	1.39
8	Dadeldhura	125,015,063.79	129,700,583.58	1,568,067.82	256,283,715.19	48.78	50.61	0.61	0.85
9	Kanchanpur	170,277,848.64	151,301,498.98	3,685,864.79	325,265,212.41	52.35	46.52	1.13	1.08
	Total	**1,504,123,469.30**	**1,787,362,737.20**	**23,479,364.32**	**3,314,965,570.82**	**413.24**	**480.28**	**6.48**	**11.02**
	Average	**167,124,829.92**	**198,595,859.69**	**2,608,818.26**	**368,329,507.87**	**45.92**	**53.36**	**0.72**	**1.22**
	Grand Total	**14,987,375,571.20**	**14,658,951,134.13**	**426,118,750.14**	**30,072,445,455.47**	**241.64**	**252.18**	**6.19**	**6.58**
	Average of the average	**199,831,674.28**	**195,452,681.79**	**5,681,583.34**	**400,965,939.41**	**48.32**	**50.44**	**1.24**	**1.32**

Source: Financial Comptroller General Office, Government of Nepal, available from ADDCN.

Appendix-11: District-wise budget allocation in Nepal, 2011/12

(Figure in Thousand NRs)

SN	Districts	Total allocation for LBs	Total of Local Development	District-wise total allocation
1	Taplejung	123,364	330,485	787,693
2	Panchthar	148,212	420,043	848,657
3	Ilam	213,342	544,107	1,235,409
4	Jhapa	369,287	835,422	1,977,342
5	Sangkhuwasaba	216,264	329,715	848,844
6	Terhathum	125,590	271,911	655,844
7	Bhojpur	184,190	456,591	904,161
8	Dhankuta	145,971	407,838	839,050
9	Morang	420,068	888,833	2,291,086
10	Sunsari	360,332	739,135	1,599,732
11	Solukhumbu	126,045	310,473	728,779
12	Khotang	245,453	622,488	1,136,266
13	Okhaldhunga	203,978	514,200	1,036,066
14	Udayapur	246,153	446,203	1,071,592
15	Saptari	274,142	523,534	1,168,580
16	Siraha	277,850	549,855	1,380,555
17	Dolakha	215,664	503,615	1,059,156
18	Ramechhap	154,015	466,864	1,052,068
19	Sindhuli	217,867	516,278	1,156,108
20	Dhanusa	361,719	607,394	1,769,547
21	Mahottari	236,281	479,926	1,239,463
22	Sarlahi	294,294	528,089	1,798,413
23	Rasuwa	62,616	143,487	446,556
24	Dhading	192,591	412,367	1,028,124
25	Nuwakot	235,630	420,940	1,030,051

SN	Districts	Total allocation for LBs	Total of Local Development	District-wise total allocation
26	Kathmandu	543,278	952,048	2,389,937
27	Bhaktapur	237,872	479,876	961,526
28	Lalitpur	294,882	584,607	1,370,119
29	Kavre	355,289	701,880	1,380,851
30	Sindhupalchok	259,434	583,668	1,335,287
31	Makawanpur	276,716	458,663	1,149,587
32	Rautahat	284,757	566,861	1,276,363
33	Bara	267,456	443,531	1,259,514
34	Parsa	460,809	688,657	1,560,883
35	Chitwan	267,965	637,255	1,511,980
36	Gorkha	73,605	221,244	419,819
37	Lamjung	196,607	431,437	953,570
38	Manang	73,605	221,244	419,819
39	Kaski	345,990	535,692	1,284,355
40	Tanuha	192,735	441,795	1,068,997
41	Syangja	248,447	542,162	1,166,946
42	Gulmi	231,177	447,922	1,150,069
43	Palpa	233,635	413,365	1,035,236
44	Arghakhachai	141,416	333,590	792,139
45	Nawalparasi	272,524	537,532	1,364,894
46	Rupendehi	396,204	674,117	1,833,581
47	Kapilvastu	279,283	482,435	1,167,072
48	Mustang	59,802	260,108	471,972
49	Myagdi	146,951	323,548	690,724
50	Baglung	205,277	525,367	1,190,337
51	Parbat	167,858	496,768	952,012
52	Rukum	175,333	468,769	1,048,696

SN	Districts	Total allocation for LBs	Total of Local Development	District-wise total allocation
53	Rolpa	196,916	500,431	1,024,414
54	Pyuthan	172,886	461,297	867,467
55	Salyan	176,817	317,565	755,313
56	Dang	256,007	438,321	1,268,216
57	Dolpa	113,972	488,178	992,539
58	Mugu	129,824	407,120	899,875
59	Jumla	140,419	531,000	1,016,282
60	Kalikot	141,715	606,960	1,138,687
61	Humla	116,420	428,206	954,942
62	Jajarkot	124,608	367,921	854,616
63	Deilekh	217,808	563,341	1,110,892
64	Surkhet	223,029	405,995	1,184,905
65	Banke	215,639	428,456	2,191,849
66	Bardia	176,550	329,215	1,471,958
67	Achham	224,251	563,423	1,199,373
68	Bajhang	171,299	448,929	956,228
69	Kailali	305,414	608,246	2,547,515
70	Bajura	115,485	374,401	827,680
71	Doti	190,495	509,029	1,034,126
72	Darchula	130,750	352,403	800,966
73	Baitadi	203,480	518,259	1,078,250
74	Dadeldhura	134,180	446,537	838,467
75	Kanchanpur	131,042	321,724	1,248,163

Source: Government of Nepal, National Planning Commission, 2011, district-wise budget allocation Red Book.

Appendix-12: Statistical result of regression analysis

Regression Statistics	
Multiple R	0.988411196
R Square	0.976956693
Adjusted R Square	0.968577309
Standard Error	676.4909705
Observations	16

Analysis of variance (ANOVA)

	df	*SS*	*MS*	*F*	*Significance F*
Regression	4	213425941.6	53356485.39	116.5905111	6.28577E-09
Residual	11	5034040.365	457640.0332		
Total	15	218459981.9			

Coefficients Table of third Model

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	-1400.557133	831.116082	-1.685152246	0.120084583	-3229.831294	428.7170291
Total national revenue	0.090204285	0.022183608	4.066258429	0.001863249	0.041378492	0.139030078
Foreign grant	-0.090012471	0.070174885	-1.282687834	0.225970687	-0.244466352	0.064441409
Foreign loan	0.132552149	0.06622308	2.001600499	0.070610048	-0.013203866	0.278308164
Domestic loan	-0.09559659	0.078986475	-1.210290625	0.251532385	-0.269444649	0.078251469

Residual output

Observation	*Predicted Y*	*Residuals*
1	1712.192447	1001.807553
2	2224.457264	522.542736
3	2690.006721	64.99327942
4	2994.438959	-184.4389591
5	3329.318898	-513.3188982
6	2803.768758	143.2312416
7	2404.662734	562.3372655
8	3681.585689	-721.5856894
9	4003.254341	-1036.254341
10	3832.47984	-689.4798396
11	4711.376606	434.6233941
12	5709.103003	-360.1030034
13	8727.200601	726.7993986
14	9989.588343	270.4116575
15	11303.39384	-339.3938446
16	14450.17195	117.8280491

Durbin-Watson Calculations

Sum of Squared Difference of Residuals	6949619.08
Sum of Squared Residuals	5034040.365
Durbin-Watson Statistic	**1.3805251**

Appendix-13: Name of intellectuals and key respondents of questionnaire

A. Name of Intellectuals met by Researcher during the study

1. Professor Dr. Yagya Prasad Adhikari, Executive Director, CNAS
2. Dr. Tulsi Naryan Shrestha, Decentralization Expert
3. Dr. Dwarika Nath Dungel, former Secretary of GoN
4. Dr. Rabindra K Shakya, former Secretary of GoN
5. Mr. Khem Raj Nepal, former Secretary of GoN
6. Dr. Prem Sharma, Associate Professor, TU
7. Dr. Bishnu Shanker Paudel, Associate Professor, TU
8. Dr. Neil Webster, Governance and Decentralization Expert, UNDP/Nepal
9. Dr. Roy Kelly, Professor, Duke University, USA
10. Mr. Jesper Steffensen, International Expert of Local Governance Finance, Danish Nationality
11. Mr. Khim Lal Devkota, Local Governance Finance Expert, LGCDP

B. The Key Respondents/Informants

1. Mr. Krishna Prasad Jaishi, Spokesperson of ADDCN and former elected President of Achham DDC
2. Mr. Bharat Bahadur Khadka, Member of ADDCN and former elected President of Doti DDC
3. Mr. Jiwan Bahadur Shahi, Member of ADDCN and former elected President of Humla DDC
4. Mr. Madhav Paudel, Ex-Chairperson, ADDCN and former elected President of Lalitpur DDC
5. Mr. Ramesh Sharma, Member of ADDCN and former elected President of Kapilbastu DDC
6. Mr. JN Thapaliya, Member of ADDCN and former elected Vice-President of Chitwan DDC
7. Mr. Udav Prasad Timilsena, Local Development Officer of Chitwan DDC
8. Mr. Guru Prasad Subedi, Local Development Officer of Kaski DDC

9. Mr. Ramesh Kumar Adhikary, Under Secretary, MoLD
10. Mr. Purusottam Nepal, Under Secretary, MoLD
11. Mr. Shambhu Prasad Luitel , LDO of Banke DDC
12. Mr. Krishna Chandra Gyawali, LDO of Gulmi DDC

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