

Fiscal Decentralization in Nepal:

A Case Study of Achham, Darchula and Kailali Districts in Far-Western
Development Region

Submitted to

The Central Department of Rural Development

In Partial Fulfillment of the Requirements for Degree of Master of Arts

in

Rural Development

Submitted By

Krishna Prasad Jaishi

Central Department of Rural Development

Faculty of Humanities and Social sciences, Tribhuvan University,

Kirtipur, Kathmandu, Nepal

May, 2010

Fiscal Decentralization in Nepal:

**A Case Study of Achham, Darchula and Kailali Districts in Far-Western
Development Region**

Submitted to

The Central Department of Rural Development

In Partial Fulfillment of the Requirements for Degree of Master of Arts

in

Rural Development

Submitted By

Krishna Prasad Jaishi

Exam Roll No. 3728

T.U. Reg. No. 6-3-28-74-2004

Central Department of Rural Development

Faculty of Humanities and Social sciences, Tribhuvan University,

Kirtipur, Kathmandu, Nepal

May, 2010

TRIBHUVAN UNIVERSITY
CENTRAL DEPARTMENT OF RURAL DEVELOPMENT
Office of the Head of Department
Kirtipur, Kathmandu, Nepal

Ref. No.

Date: 2067-02-14

RECOMMENDATION LETTER

It is with great pleasure that I recommend the approval of the thesis entitled FISCAL DECENTRALIZATION IN NEPAL: A Case study of Achham, Darchula and Kailali districts in Far-Western Development Region completed by Krishna Prasad Jaishi under my supervision for his fulfillment of the requirements for Master of Arts in Rural Development. Therefore, I recommend for its final evaluation.

Date : 2067-02-14

Dr. Pradeep Kumar Khadka
Supervisor
Head of the Central Department (RD)
Tribhuvan University
Kirtipur, Kathmandu

TRIBHUVAN UNIVERSITY
CENTRAL DEPARTMENT OF RURAL DEVELOPMENT
Office of the Head of Department
Kirtipur, Kathmandu, Nepal

Ref. No.

Date: 2067-02-16

APPROVAL SHEET

This is to certify that the Thesis submitted by Krishna Prasad Jaishi entitled FISCAL DECENTRALIZATION IN NEPAL: A Case Study in Three Deitricts (Darchula, Achham and Kailali) in Far-Western Region has been approved by this department in the prescribed format of the Faculty of Humanities and Social Sciences. The Thesis is forwarded for the evaluation.

EVLUATION COMMITTEE

.....

Dr. Pradeep Kumar Khadka

Head of the Department

.....

Dr. Prem Sharma

Supervisor

.....

Dr. Mahendra Singh

External

ACKNOWLEDGEMENTS

The thesis is for the fulfillment of the requirements for Masters Degree of Rural development of the Faculty of Humanities and Social Sciences. To complete this thesis various suggestions, guidance and forwarding stages granted by my teachers and other specialist who are the sources of my inspiration.

I am grateful to Dr. Pradeep Kumar Khadka Professor head of the Central Department of Rural Development, Tribhuvan University, Kirtipur Kathmandu for his excellent guidance to complete the thesis. His excellent and memorable suggestions enlighten to improve myself in research activities and procedures. Similarly, Associate Professor Dr. Prem Sharma and Prof. Dr. Pradeep Kumar Khadka, Head of the Department, are the sources of inspiration who kindly added best solution for well conduct of this project work.

I express my sincere gratitude to Krishna Prasad Sapkota, the former chairperson of Association of District Development Committees of Nepal and K. P. Sharma Oli, Central Committee member of CPN(UML) and Angelika Schrettenbrunner from Germany, then team leader of Health Sector Support Programme, Ministry of Health of government of Nepal for their moral support. I would like to thank my wife Jumuna Devi Jaishi for her kind co-operation to support my study. Similarly, I would like to thank my friend Khem Lohani, senior student of Rural Development and chairperson of Dhading DDC in 2054-59 BS for his information and suggestions to study the degree of Rural Development.

Date : 14 Jeshtha, 2067

Krishna Prasad Jaishi

Abstract

This study aims to assess the present status of fiscal decentralization in Nepal by using descriptive analytical method. For analyze of policy, primary data has been drawn from questionnaire survey by selecting purposive sampling and secondary data from literature review. For the fulfillment of the objectives, some research questions: resource bases of Local Bodies (LBs), resource generation and mobilization capability, transfer of grants, resource allocation/revenue sharing, resource utilization and sustainability of fiscal decentralization policy were developed. Problems are identified, discussed and suggestions are made.

People are sovereign in the democratic system. So, they should be pivotal in every sphere of development and hence, all development endeavors should indeed be people centric (UNDP, HDI Report, 1997). Development is multi-dimensional phenomena this consists into the beneficiaries' maximum interest. Decentralization is an effective medium to achieve it, which is also the process to strengthen democracy (High Level Decentralization Commission Report, 1995). In order to realize the practice of democracy as the bottom where vast majorities of the people live, structures of local government are created and necessary powers and authorities are devolved to them. Fiscal decentralization denotes the financial autonomy and responsibility given to the LBs (Bird Richard, 2001, Kandel Pushpa, 2003).

Main themes of fiscal decentralization are: developing effectiveness and efficiency of fiscal administration, delegating the authority of decision making on collection and expend the sources, developing the leadership for maximum mobilization of local resources and means and solving the local problems locally (LBFC Report, 2001). For sound fiscal decentralization, it should be designed the revenue criteria apt with country specific. In designing revenue criteria independently, the policy and administrative structure should be based on the ground of the revenue potentiality, economic efficiency, equity, administrative feasibility and political acceptability (Bahl Roy, 1998).

Nepal has been exercising delegated authority model of decentralization. Two tiers of LBs i.e. DDC as a higher level and VDC and municipality as lower level are functioning for the concept of local self-governance. LBs have easy access over the natural resources within their jurisdiction. They have the greater potentialities having local resources, which needs to mobilize fir overall national development. For successful implementation of fiscal decentralization, it is essential to formulate pragmatic policy, which can identify and assign

the functions to LBs that can be easily adopted (LBFC Report, 2001). Local Self- government Act 1999 has developed some fiscal powers, but they are still facing grave challenges related to financing their services to the people.

Fiscal decentralization is in initial stage in Nepal. On policy implementation various hindrances have appeared. In the study, major financial problems, increment of internal income and grants and its impact on the goods and services including infrastructures as well as hurdles of implementation have been defined both in policy and implementation. Accordingly, increment of internal resources and grant by the central government and mobilization of external resources, mainly of donors and its impact in development activities are also studied.

Achham, Darchula and kailali districts were also studied regarding policies of fiscal decentralization and implementation status during the research work. The major problems were identified like unskilled human resource, insufficiency of resource, centralized fiscal policy, poor fiscal management and information system, over politicization, indistinct revenue collection criteria and no transparent and grant allocation system etc.

Due to greater variance in geology, politics and culture, single and similar rule regarding resource provision could not exploit into practice (Khadka RB 1997). The fragmentation of political division is not scientific, neither have they had equal population nor have equal resource. Moreover, neither have basic infrastructure nor have geographic feasibility. Each segment must be self-competent and with sufficient resource base (Bahl Roy, 1998). It should focus on making LGs as the strong pillar of development with national vision. But investment in the sector of education, health, rural roads, suspended bridges and production of electricity by micro-hydropower stations is increased manifold in all districts. Among them Darchula district was the one where road from Baitadi was not connected and people had to use Indian transportation and vehicles. After restoration of democracy, due to increment of grant to VDCs and DDCs, road is constructed from both side i.e. Gokule and Marpha (DDC Darchula, Progress Report, 2008). Accordingly, production of electricity is more by different micro-hydro schemes in different VDCs than Kailash Khola small hydro power station in Achham (DDC Achham, Progress report, 2005). Achham, Darchula and Kailali districts have constructed road joining different clusters which would not be possible only by the central government. There has been increment of quantity of schools from primary to higher secondary level, campus and facilities in sub/health posts including birthing centers (MoH Progress Report, 2008). Investment in the sector of awareness raising and social

mobilization as well as income generation including diverse farming i.e. fruit, vegetable and herbal and seed production is also increased with collaboration of I/NGOs and donors. Although investment is increased, quality assurance, monitoring and evaluation are inevitable to fulfill the expectation of the people (LBFC Report, 2006).

The research has found that the capable human resource is essential for effective fiscal decentralization. Due to adequate facilities in rural areas, attraction towards urban and Terai (southern part of Nepal) area brought the heavy problem of migration. Brain drain psychology will never die due to unemployment and unpractical education in Nepal, along with skilled manpower apt our local need never been fulfilled (Subedi Somlal, 2008). The ways and wherefores became thrusts of urban facility and such kind of imported technology. Capability of formulating and implementation of local plans was found very insignificant in general.

The resource allocation system among LBs in Nepal has hardly been found practicable except some cases. Resource equalization aspect is much emphasized on social and national perspective. The central government has played the dominant role in virtually all expenditures and revenue decisions. The central government collects and spends an estimated above 95 percent of total government revenues and expenditures, while local governments spend about 5 percent only (ADDCN Analysis Report, 2008). The efficiency of resource allocation cannot be found in Nepal. Most development grants are decided on discretionary basis as part of the annual budget process. All the practices are necessary to replace by making rational grant allocation formula for certain period. This research has found that the existing policy on grant of the DDCs should revisit, municipalities should ensure to foster new resource and develop self-revenue-raising mechanism and VDCs' should utilize. Legal provision to fulfill the minimum condition and performance measures (MCPM) of DDCS, municipalities and VDCs (MC only) and allocation of grant by formula has been started recently by Local Body Fiscal Commission in Ministry of Local Development (LBFC Annual Report, 2004). The study on efficiency of resource allocation has also been found premature.

Beyond doubt there have been appearing some of financial problems for smooth operation of the fiscal decentralization policies and implementation situation in Nepal. Responsibility and accountability has been found in decreasing pattern due to lack of elected representatives and without amendment of contradictory laws with the LSGA 1999. Association OF District Development Committees of Nepal (ADDCN) has proposed to amend 23 Acts which

contradicts with LSGA 1999 (Sthaniya Prajatantra, ADDCN; Vol 5 2001). There is the managerial efficiency in the tuff task. Management is the skill to perform any task towards finding out desired production. Fiscal decentralization seeks such kind of fiscal management to translate policy into action skillfully (Bahl Roy, 1998). Another solution of lacking of resources is either developing more resources or providing grants to recurrent cost for the certain period. For success of fiscal decentralization, capacity to increase revenue collection through local mechanism as well as resource mobilization capacity of LBs should be strengthened. Accountability and autonomy can be achieved through transparent and efficient resource utilization (LBFC Report, 2006). Balance development can be achieved making equal resource bases of LBs, which can be achieved through restructuring of LBs as local government in new constitution in the process of restructuring of the federal state in republic of Nepal (NPC, Three Year Plan, 2007).

Any Act does not create miracles overnight. Neither does it work as a panacea for all the problems of the society in which it is to be implemented. It is only, at best, a legal framework within which a system or institution(s) could operate effectively under certain conditions. Thus one should review an act as a catalyst in the process of development of a system or institution.

CONTENTS

	<u>Page</u>
RECOMMENDATION LETTER	II
APPROVAL SHEET	III
ACKNOWLEDGEMENTS	IV
ABSTRACT	V
ABBREVIATIONS	IX
LIST OF TABLES	XIV
CHAPTER ONE: INTRODUCTION	1-7
1.1 Background of the study	1
1.2 Statement of the problem	4
1.3 Rationale of the study	5
1.4 Objective of the study	6
1.5 Organization of the study	7
CHAPTER TWO: REVIEW OF LITERATURE	8-14
2.1 Introduction	8
2.2 Evolution and concept of Fiscal decentralization	8
2.3 Finding and Conclusion of relevant Studies	12
CHAPTER THREE: RESEARCH METHODOLOGY	15-19
3.1 Introduction	15
3.2 Selection of the study area	15
3.3 Rationale for selecting the study area	15
3.4 Natures and sources of data	16
3.5 Sampling procedure	16
3.6 Data collection, tools and techniques	17
3.6.1 Interview survey	18
3.6.2 Key informant interview	18
3.6.3 Observation	18
3.6.4 Focus group discussion	18
3.7 Method of data analysis	18

3.8	Limitations of the study	19
CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION		20-47
4.1	Introduction	20
4.2	Introduction of the study area	20
4.3	Internal Resources of DDCs	21
4.4	Composition of Expenditure of DDCs	21
4.5	Review of the Fiscal Status of the DDCs	22
4.6	Fiscal Status of Municipalities	23
4.7	Fiscal Status of VDCs	23
4.8	Expenditure	24
4.9	Revenue Income of Municipalities	25
4.10	Revenue of DDC Achham	26
4.11	Expenditure Pattern of DDC Achham	27
4.12	Contribution of Grant and Other Sector in Expenditure	28
4.13	Revenue of DDC Kailali	28
4.14	Expenditure Pattern of Kailali DDC	29
4.15	Contribution of Expenditure from Central Government and own Source Revenue of Kailali DDC in Fy 2063/64	30
4.16	Revenue of Darchula DDC	31
4.17	Expenditure of Darchula DDC	32
4.18	Contribution of Expenditure from GoN and OSR of DDC Darchula	33
4.19	Comparison of Local Revenue vs Recurrent Expenditure	34
4.20	Comparison of Internal Revenue vs Recurrent Expenditure	35
4.21	Analysis of Internal Revenue vs Capital Investment Expenditure	36
4.22	Analysis of Internal Revenue Per-capita (in NRs)	36
4.23	Block Grant to DDC Per-Capita Income and Expenditure	37
4.24	Meetings and Time as Scheduled	38
4.25	Public Audit and Hearings	38
4.26	Empowerment of Women, Dalits, Janajaties and other Minorities	39
4.27	Participation of Women, Janajaties, Dalits and other Minorities in Decision Making Bodies of LGs and User Committees.	41
4.28	Increment in the Construction of Infrastructures	42
4.29	Participation of People in Decision Making Process	43
4.30	Implication of Monitoring and Evaluation at Local Level	44

4.31	Adequacy of Grant to Local Bodies	45
4.32	Resource Generating Capability of Local Governments	45
4.33	Restructuring of the LGs	46
4.34	Availability of Human Resource	46
4.35	Development of Grant Allocation Formula	47
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS		48-59
5.1	Summary	48
5.2	Conclusion	49
5.3	Recommendations	53
5.4	Specific Recommendations	54
REFERENCES		60
ANNEX-1 Request Letter		62
ANNEX-2 Questionnaire		63-66
ANNEX-3 Revenue of Achham DDC		67
ANNEX-4 Revenue of Darchula DDC		70
ANNEX-5 Revenue of Kailali DDC		72

List of Tables

		Page
2:1	Governance Structure -20 th Versus 21 st Century	9
4:1	Composition of Internal Resources of DDCs (In Rs. 000)	21
4:2	Summary of the Expenditure of DDCs In Rs. '000	22
4:3	Internal Resources of DDCs by Ecological Regions	22
4:4	Sources of Income of Municipalities	23
4:5	Sources of Income of VDCs	24
4:6	Expenditure Details of VDCs	25
4:7	Analysis of Local Resources of Municipalities (in percent)	26
4:8	Revenue of ACHHAM DDC	26
4:9	Expenditure Patterns of Achham DDC	27
4:10	Expenditure Contribution from GoN Grant and DDC's OSR (Achham DDC FY 2007/08)	28
4:11	Revenue of KAILALI DDC	29
4:12	Expenditure Patterns of Kailali DDC	30
4:13	Expenditure Contribution from GoN Grant and DDC's OSR	31
4:14	Revenue of DARCHULA DDC	32
4:15	Expenditure Patterns of Darchula DDC	33
4:16	Expenditure Contribution from GoN Grant and DDC's OSR	34
4:17	Local Revenue (Tax, fees etc) Vs Recurrent Expenditure	35
4:18	Internal Revenue (Local Revenue + Revenue Sharing) Vs Recurrent Expenditure	35
4:19	Internal Revenue (Local Revenue + Revenue Sharing) Vs Capital Investment Exp	36
4:20	Internal Revenue Per-Capita (in NRs)	37
4:21	GoN Development Block Grant (DDC) Per Capita Income and Expenditure (in NRS)	37
4:22	Analysis of Meetings and Time as Scheduled	38
4:23	Number of Times of Public Audit and Hearings Conducted	39
4:24	Number of Trainings for Empowerment	40
4:25	Increasing Situation of Participation in Decision Making Process in Percent	41
4:26	Construction of Infrastructure after Fiscal Decentralization	42

4:27	Participation of Women Dalit, Scheduled and Minority Caste in Decision Making Unit	43
4:28	Status of Monitoring and Evaluation	44
4:29	Adequacy of Grant to Local Bodies	45
4:30	Views of Resource Generating Capability of LGs	45
4:31	Views on Necessity of Restructuring of LGs	46
4:32	Views on Availability of Proper Human Resource	46
4:33	Views on Developing Grant Allocation Formula	47

Abbreviations

ADB	-	Agricultural Development Bank
ADDCN	-	Association of DDCs in Nepal
CBS	-	Central Bureau of Statistics
CBO	-	Community Based Organization
CPN(UML)	-	Communist Party of Nepal (Unified Marxist Leninist)
DDC	-	District Development Committee
DFDP	-	Decentralized Finance for Development Programme
DFID	-	Department for International Development
DIP	-	Decentralization Implementation Plan
DMC	-	District Management Committee
DRCC	-	District Road Coordination Committee
DoLIDAR	-	Department of Local Infrastructure Development and Agriculture Roads
FfW	-	Food for Work
FAO	-	Food and Agricultural Organization
FY	-	Fiscal Year
GTZ	-	German Technical Cooperation
GO	-	Governmental Organization
GoN	-	Government of Nepal
HSSP	-	Health Sector Support Program
IGA	-	Income Generating Activities
INGO	-	International Non-Governmental Organization
LB	-	Local Body
LG	-	Local Government
LGCDP	-	Local Governance and Community development Programme
LBFC	-	Local Body Fiscal Commission
LSGA	-	Local self governance Act
LSGR	-	Local Self Governance Rules
MC	-	Management Committee
MCPM	-	Minimum Conditions and Performance Measures
MoF	-	Ministry of Finance

MoH	-	Ministry of Health
MoLD	-	Ministry of Local Development
MuAN	-	Municipal Association of Nepal
NAVIN	-	National Association of VDCs in Nepal
NGO	-	Non-Governmental Organization
NPC	-	Participatory Learning Appraisal
OSR	-	Own Source Revenue
PCRW	-	Productive Credit for Rural women
PDLT	-	Panchayat Development and Land Tax
SFDP	-	Small Farmer Development Programme
SHG	-	Self Help Group
SG	-	Saving Group
UC	-	Users' Committee
UCPN(M)	-	Unified Communist Party of Nepal (Maoist)
UNDP	-	United Nations Development Programme
UN	-	United Nations
VDC	-	Village Development Committee
WB	-	World Bank
WFO	-	World Food Organization
WFP	-	World Food Programme