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**Decentralization in Nepal**

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# Nepal Case Study

In Asia, as in many other regions of the world, decentralization occurs in countries of all sizes and in highly diverse contexts. A few countries are large and have substantial and heterogeneous populations, while others are much smaller in area and have populations lower in number and less varied in composition. Some countries have attained middle income status, while others remain poor. A number of countries have some history of decentralization and democratization, while others have had little previous experience.

Despite the great variety, many Asian countries have chosen to pursue some form of decentralization. The way decentralization is structured and functions, however, is as diverse as the countries themselves, and not always in systematic ways. This variety results from considerable differences in country characteristics, histories and various political economy drivers that shape the dynamics underlying how public governance is managed.

In order to better understand decentralization in Asia, EC DEVCO B2 prepared a set of short case studies--on Bangladesh, Bhutan, Cambodia, Indonesia, Nepal, Pakistan, Philippines, Sri Lanka, Vietnam and Yemen. This note presents the case of Nepal.

Subnational governments have existed in Nepal since the 1960s, and the foundation for decentralization as it looks today has been in place since the 1990s. Nepal has made moderate progress in improving local service delivery, empowering local governments (although the exact future of local governments depends on ongoing negotiations over a new constitution) and increasing local participation. There are still centralizing tendencies and the central government retains considerable political, administrative and fiscal control. Nepal has also been marred by ethnic conflict, which has resulted in a commitment to transform Nepal into a federal republic. Debates around how to federalize have not been resolved and may be further delayed by the significant 2015 earthquake, but the impact on local governments once the change takes place is likely to be significant.

## Underlying political economy context/drivers of decentralization

Subnational governments have existed in Nepal since the 1960s. The Nepalese government adopted decentralization reforms during the 3rd Plan Period (1965-1970) to establish local bodies at the village level. The pivotal moment in the empowerment of local bodies was the *Decentralization Act of 1982*, which made provisions for elected district and village level councils called panchayats. The main stated driver for decentralization reforms was to increase local civic participation and not necessarily to improve service delivery at the local level.

In 1990, Nepal became a multi-party democracy and developed a new constitution. Multiparty local government elections were held in 1992 and 1998 for five-year terms.

Much of the motivation, legislation and institutional infrastructure required to create and sustain local governments was undermined during the decade-long armed conflict between the Maoist groups and the Nepalese governments, which took place from 1998 to 2006.

Elected local government bodies were disbanded in 2002, and even with the return of national elections in 2006, there have been no local government elections since 2002. Today, local government bodies are run by central government appointed staff and staff from line agencies. In 2009, the central government made an attempt to strengthen local government accountability by inviting political parties into the local government decision-making process. This occurred under the "All Party Mechanism," was repealed in 2012 after reports of corruption.

In 2007, the Nepal government made a commitment to transform itself from a constitutional monarchy to a federal republic. The purpose of the creation of the federal state is to mitigate ethnic conflict and as a mechanism to promote regional interests. The Constituent Assembly was commissioned to write a new constitution by January 2015, but it has reached a stalemate on what is the best approach to federalism; current debates center on whether federal state borders should be drawn around ethnic boundaries or what is most viable for efficient public administration, governance structures and electoral reform. No constitution has been promulgated to date and the role of local governments in the new federal state has also not been confirmed (Phuyal, 2015). Current debates around federalism seem to consider local government bodies as channels for local participation and as institutions that execute small development projects as opposed to institutionalizing them as elected governments with significant autonomous responsibilities for service delivery at the local level (Boex, 2012).

## Decentralization policy

Until the new constitution is in place, the eventual role of local governments will be unclear. At present, decentralization policy is a mixture of status quo arrangements and ad hoc adjustment. Various previous local government acts were combined into the *Local Self Governance Act* (LGSA)in 1999. In the same year, the country adopted *Local Government Self Governance Regulations*, which laid out many of the details on how the local governments were to operate (more detail is provided below.

In 2002, there was another positive step towards enhancing decentralization with the devolution of three sectoral ministries- primary education, primary health care and agriculture and livestock. This was followed by the devolution of certain local infrastructure functions in 2004. In practice, however, these sectoral devolutions appear to be relatively nominal because these services continue to be administered by central government staff. The most recent steps included the issue of the *Local Body Financial Administration Regulations* in 2007, as well as the development of a number of other standards and operations manuals developed by sectoral ministries (Dhungel et al 2011).

## Basic structures, actors and mechanisms

There are three forms of local government in Nepal; at the lower level are the Village Development Committee (VDCs) and municipalities. Above these lower councils are the District Development Committees (DDCs). There are 75 DDCs, 58 municipalities (133 additional municipalities were created in 2014, but the extent to which they are functioning is not clear) and 3915 VDCs.

The LSGA is the framework that lays out the institutional structure, functional responsibilities and powers of local government bodies. These governments work as executive committees made up of officials who are elected from an electoral college. VDCs are managed by an elected chairperson and municipalities are managed by an elected mayor, both of whom represent their constituencies in the DDC executive committee. The LSGA mandates that there should be a women representative at each level of subnational government. DDCs, VDCs and municipalities are classified into three categories, A, B and C depending on their population size, geographical topography and location (Dhungel et al 2011).

In practice, since there have been no local elections since 2002, local government bodies have been managed by civil servants, local political leaders and leaders from other stakeholder groups like NGOs and civil societies. These committees continue to execute local government functions as prescribed in the LSGA. They include formulating annual plans and budgets, preparing five-year plans, overseeing local development projects and ratifying key decisions. The five years plans have to be developed in a participatory way. Implementation of projects is usually carried out by appointed user committees. In 2009, 70% of VDC projects were carried out by a user committee. Regulations around the formation of user committees can be found in the LSGA. These include a mandate that 33% of the user committees be formed by women representatives (World Bank 2014).

At the national level, the Decentralization Implementation and Monitoring Committee (DIMC) and a Local Body Financial Commission (LBFC) were set up in 2007 to improve implementation of the LSGA (Dhungel et al 2011). There seems to be a growing perception in Nepal that local bodies are a branch of the Ministry of Federal Affairs and Local Development (MoFALD). The MoFALD is responsible for executing all policies and functions related to decentralization and local development, including local infrastructure. Their mandate in municipal governments overlaps with the Ministry of Urban Development (World Bank 2014).

Functional responsibilities for local government bodies are also proscribed in the LSGR. The framework assigns a broad range of services to be carried out by the local government bodies, but the actual responsibilities are unclear. There is an absence of mandatory assignments to local government bodies in the LSGA, with the exception of municipalities. The Local Body Resource Mobilization and Operation Management Guidelines (RMOMG) were issued by the MoFALD in 2013. These provide greater definition of the functional categories that local government can finance. However, there is still significant overlap in the responsibilities of the DDCs and the municipalities. Functional assignments are usually better defined mostly when local government bodies are working with conditional funds. The range of services that local government bodies are involved with, to different extents, include water and sanitation, roads, primary health and education, hydropower and electricity and miscellaneous activities. Other major local services are undertaken by deconcentrated central government units.

The primary source of revenue for local bodies is transfers from the central government. These transfers have increased six fold in the last 6 years amounting to 9-12% of total public expenditure in fiscal years 2011-2013. The core transfer is an unconditional block grant. Block grants consist of a minimum grant that varies by the size of the local government body and a formula based grant, which is an additional provisional grant based on achieving certain performance requirements. Nepal is among the first developing countries to link performance outcomes to conditional funding (UNCDF 2010). Unconditional transfers make up approximately 34 percent of total local revenue, conditional transfers are 30 percent of local revenue, and own source revenue is approximately 11 percent. Local bodies also have access to user fees but these revenues had been shrinking from 2006-2012 (World Bank, 2014).

In the absence of local elections, there are few robust downward accountability mechanisms in place. Local accountability mechanism can be interpreted as two broad categories: mechanisms to hold public officials accountable to carry out specific functions and those functions need to be executed to specific standards. The former is mandated by the Right to Information Act in 2007. The public is entitled to demand relevant information from local public officials (World Bank 2014). Local government officials have to take an oath before taking office, and every local government body has to appoint an Information Officer. Local government bodies are also mandated to publish project plans and any other relevant documents (Dhungel et al 2011).

Accountability around service delivery standards is undertaken through frequent audits of local government bodies’ project budgets and expenditure. The World Bank also initiated a Citizen Report Card in 2012 in certain VDCs (Prasai 2013). There are emerging debates about how to streamline and introduce greater transparency mechanisms in the project procurement process at all levels of government (World Bank 2014). Due to the appointment of civil servants at the local level, upward accountability to sectoral ministries and other central government agencies is already established.

## Decentralization outcomes

Service delivery in Nepal experiences considerable challenges due to unclear functional responsibilities of local government bodies and overlap between sectoral line agencies and local government body functions and overlap in functional responsibilities between DDCS and Municipalities. Local government bodies tend to supplement the work of the line ministries, rather than take more primary responsibility for local functions as expected in a decentralized system (World Bank 2014).

Available evidence indicates that there is considerable regional variation in service delivery due to geographical location of the local government, the topography of the land and the economic base; hilly areas have dispersed populations and have greater difficulty in providing services due to the impenetrable terrain. Areas in the plains have greater agricultural productivity, and border areas, such as Terai on the Indian border, engage in cross-border trade and therefore have a more vibrant tax base. Overall, the location of the local government has an impact on its fiscal capability and economic opportunities and generally on service delivery. Seven of the 58 municipalities (prior to the creation of new municipalities in 2014) account for half of all the recurrent expenditure and five of 58 municipalities make up more than a third of capital spending (World Bank 2014).

There is some evidence on particular services, but it is limited and mixed. A 2008 assessment of the primary health care sector, for example, showed that decentralization had resulted in some positive outcomes, such as increased ownership, greater participation in planning and monitoring, greater transparency and even better resource management in certain DDCs. These positive factors, however, did not always improve the poor quality of health care, and local governments suffer from lack of managerial resources and central government constraints on finances and staffing (Regmi et al 2009).

There have been other positive decentralization outcomes in the form of increased fiscal resource availability and autonomy. The large increase in transfers to local bodies overshadows the significant gains in revenue raising capacity by local governments, but the latter is significant. The Ministry of Finance reports that internal revenue in municipalities more than doubled from FY 2009/10 to FY 2012/13. DDCs have not experienced similar growth rates--their internal revenue levels have mostly declined. The composition of own source revenues remains balanced between taxes and user charges in municipalities. Taxes constitute 41 percent of own source revenues, service fees constitute 42 percent and other income constitutes 17 percent. Revenue patterns in DDCs differ significantly from municipalities. In DDCs, the bulk of revenues (over 50%) come from taxes, while service fees contribute only three percent. Among all local bodies, own source revenue as a portion of total local government revenue expanded from 6 to 16 percent over the period 2006 to 2012.

While there is variation in the revenue raising capacity of local governments, the improvements in the revenues of municipalities registered over the past five years were widespread. Though there is not readily accessible revenue data organized by jurisdiction size, given that per capita levels of grant transfers are higher for smaller local bodies, it is reasonable to assume that smaller local governments have made legitimate progress in expanding their revenue capacity.

A related issue is discretion over the use of funds. A recent study found that VDCs and municipalities have greater discretion (over 50% of their revenues) in how they spend their revenues than DDCs. Many local governments tend to use discretionary funding on small local infrastructure projects, and fiscal accountability is focused more on what the money is allocated for as opposed to service delivery performance (World Bank 2014).

Public participation is mandated as a part of the planning and budgeting processes. The planning process, however, does not appear to be undertaken in full. Local government bodies are not provided with much guidance from the central government or the DDCs on budget ceilings--they can increase the budget up to 10% over the previous year, but there is no systematic approach to budgeting. Ward meetings, which are currently the only place for public participation in the annual budgeting process, appear to take place, and there has been growing representation of grassroots organizations in these ward meetings, which is a positive sign. There is also anecdotal evidence that local political parties participate in local government body planning. The actual influence or impact of civic society groups or local parties is difficult to assess. Mandatory representation of women is required in local government bodies, but since there have been no local elections since 2002, there is little evidence on whether this has been enforced (World Bank 2014).

Local governments in Nepal do not operate within robust systems of oversight to hold the various actors responsible for the manner in which they carry out their responsibilities. Forms of local accountability can be divided into two broad categories: mechanisms for holding officials accountable for carrying out assigned functions and mechanisms for holding officials accountable for carrying out assigned functions up to specific standards. Regarding the former, Nepal adopted a Right to Information Act in 2007 that allows access to “public information of importance.” The Act places a number of obligations on local government bodies including appointing Information Officers and to proactively publish relevant information for the public. However, it is unclear how much these obligations actually incentivize changes in the behavior of local government officials as well as how much of a burden is placed on common citizens interested in submitting requests.

Regarding accountability for the standard of service delivery, the World Bank funded a pilot for a Citizen Report Card in the water sector in 2012, but it is unclear how the findings were used and whether or not this horizontal feedback mechanism is in the process of being institutionalized at the subnational level. The Public Expenditure and Financial Accountability and Fiduciary Risk Reduction Action Plan implementation timetable is coming to an end and improvement of public procurement guidelines has been a major priority.

A system of public auditing of projects among all local bodies was brought online in July of 2013. However, few if any mechanisms exist for sanctioning poor performance. The lack of sanctioning mechanisms has hindered any progress towards improving project performance. For example, large development projects require significant subcontracting but shortfalls in technical capacity and poor institutional development related to administrative procedures effectively prevent municipalities from being able to expedite approval of subcontractors and their plans.

There is no solid empirical analysis of how well current accountability mechanisms work. While the Right to Information Act is an important step towards increasing local government transparency and downward accountability, there is not much information as to whether local governments proactively publish information for the public or whether the public have filed claims to local government bodies for information. There is currently limited oversight of the appointment of user committees and there is some evidence that the appointments are influenced by local party politics and that appointees often do not have the necessary technical qualifications to carry out the assigned work.

Local government audits of service delivery budgets and project expenditures are being conducted but there is not a robust framework for sanctioning poor performance. There is also no clear evidence as to whether feedback from the World Bank funded Citizen Report card project for the water sector is being considered in local decision making much less being institutionalized at the local government level (World Bank 2014).

## Evolution of decentralization and local government performance

Decentralization reforms in Nepal have made some progress over the years, but there are concerns that they have tended to focus on increasing local participation rather than improving development outcomes through enhanced service delivery at the local level. There have been substantial increases in local revenues and formal increases in transparency through the Right to Information Act. There are, however, major weaknesses--ambiguities exist about service roles at various levels, and it is not clear how well oversight mechanisms are being used. At the same time, it is important to recognize that Nepal has had a complex recent political history, which has resulted in an institutional climate that is not particularly conducive for pursuing effective decentralization reforms. Nepal clearly has a long way to go before it can achieve more effective local governance and development outcomes through subnational governments.

The overarching issue impacting the future of decentralization is the core controversy over the shape of the state. Ongoing debates on federalism have been robust, but they may not have fully considered the impact that federalism might have on local service delivery and local development, despite the likelihood that weak public services are one factor underlying conflict. There are concerns that the current approach to restructuring Nepal’s government has been focusing on the state level structures rather than considering appropriate empowerment the local level and “building up” a local government structure that can most effectively deliver on functional assignments.

The federalism debates are considering the removal of the district-level governments in a new federal state system and only having local governments at the municipal and village level. This may be in some respects politically strategic, but perhaps it is not developmentally strategic--district level governments should be more efficient in delivery of services to scale compared to individual village development councils (Boex, 2012). Nepal has always has centralizing tendencies. One key issue is whether the transfer of central power to federal states will result in another form of monopolization of power. Will this be effective, or might another way of sharing power that includes strong roles for multiple tiered local government do a better job of assuaging ethnic tensions and delivering more efficient public services and better development?

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