

Policy Note for the **Federalism Transition in Nepal**

AUGUST 2019



THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP



*Empowered lives.
Resilient nations.*

Abbreviations and Acronyms

CIP	Capital Investment Plan
FCNA	Federalism Capacity Needs Assessment
HEZ	Himalayan Ecological Zone
GDP	Gross Domestic Product
GRB	Gender Responsive Budgeting
GESI	Gender Equality and Social Inclusion
GoN	Government of Nepal
IPC	Inter-Provincial Council
LDTA	Local Development Training Academy
LGCDP	Local Governance and Community Development Program
LMBIS	Line Ministry Budget Information System
MOFAGA	Ministry of Federal Affairs and General Administration
NPSAS	National Public Sector Accounting Standards
NNRFC	National Natural Resource and Fiscal Commission
O&M	Organization and Management
OPMCM	Office of the Prime Minister and Council of Ministers
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PIFIP	Physical Infrastructure and Facility Improvement Plan
PPSC	Provincial Public Service Commission
PLGs	Provincial and Local Governments
SUTRA	Sub-National Treasury Regulatory Application
TEZ	Terai Ecological Zone

Table of Contents

Abbreviations and Acronyms	i
Table of Contents.....	ii
Foreword	iv
Executive Summary	v
Managing the Transition to Federalism	v
Capacity for Implementation of Federalism	vi
Legal Framework for Federalism	vii
Monitoring and Evaluation for Federalism	vii
Institutional Framework of Federalism.....	viii
Implementation Plan/Roadmap	viii
Section I: Introduction	1
Section II: Discussions on Federal Government Capacity Needs Assessment	2
Federalism Implementation Progress and Issues since 2017	2
Devolution of Government Employment.....	3
Provision of Legal Framework for Federalism	6
Institutional and Organizational Arrangements	7
Capacity Building and Training.....	8
Public Financial Management.....	9
Gender Equality and Social Inclusion.....	9
Fiscal Capacity	10
Discussions on Provincial Governments Capacity Needs Assessment	13
Physical Infrastructure	13
Human Resource Management	14
Public Financial Management.....	14
Gender Equality and Social Inclusion.....	15
Accountability and Transparency	15
Discussions on Local Governments Capacity Needs Assessment	15
Physical Infrastructure and Connectivity.....	15
Human Resource Management	17
Planning and Public Financial Management.....	20
Political Governance and Administration	22

Sector Administrative Capacity	22
Gender Equality and Social Inclusion.....	26
Accountability & Transparency	26
SECTION III: Recommendations—Blueprints for a Roadmap	28
Annex: Significant and Recent Achievements in the implementation of Federalism	37
Legal Framework for Federalism.....	37
Institutional Framework of Federalism.....	38
Public Financial Management, Accountability & Transparency	39
Political Governance and Administration	40
Gender Equality and Social Inclusion (GESI)	43
Fiscal Capacity and Local Government Revenues Mobilization	44
Monitoring and Evaluation	44
Institutional Capacity Building	45
List of Best Practices in the Implementation of Federalism in Nepal	46

Foreword

This policy note is based on the findings and report of the Federalism Capacity Needs Assessment (FCNA) carried out by the Georgia State University for the Government of Nepal. The assessment was conducted between September 2018 and July 2019. It aimed at identifying the gaps between the needs and the capacity of all three levels of government to implement fiscal federalism in Nepal. The Government of Nepal is rolling out federalism, by quickly and effectively setting up the basic structures and processes to support the operation of both the federal as well as provincial and local governments (PLGs). Nonetheless, the Government acknowledges that the reform is nothing short of a long-drawn out process, requiring strong capacity to manage new functions at all levels of government. The Government has asked the World Bank for assistance to assess capacity needs for effective implementation of federalism. The World Bank has facilitated the production of the FCNA in coordination with government counterparts and development partners (DPs), particularly with the United Nation Development Programme (UNDP). The FCNA was jointly implemented by the World Bank and UNDP, with technical inputs from the United Kingdom's Department for International Development (DFID), Embassy of Norway and Swiss Agency for Development Cooperation (SDC). The study's methodology, selection of samples, and technical reviews of the final output were coordinated with the Ministry of Finance (MOF), Ministry of Federal Affairs and General Administration (MoFAGA), the National Natural Resources and Fiscal Commission (NNRFC) and the Financial Comptroller General Office (FCGO). The Steering Committee consisting of the MOF, MoFAGA and NNRFC provided overall guidance and oversight in carrying out the FCNA on behalf of the Government of Nepal. Saurav Shamsher J.B. Rana, Hubert Nii-Aponsah, Gabriel Dedu, Syed Khaled Ahsan and Serdar Yilmaz have prepared the policy note under the guidance of Faris H. Hadad-Zervos (Country Manager, SACNP), Ayshanie Medagangoda-Labé (Resident Representative, UNDP) and George A. Larbi (Practice Manager, ESAG2). The team has also benefited from inputs from the United Nations Development Programme (UNDP) team, Yam Nath Sharma and Anil Chandrika.

Executive Summary

1. **With the adoption of federalism through the 2015 Constitution, seven newly created provincial and 753 local governments are now placed at the frontline, tasked to manage substantial amount of public resources and deliver critical services to citizens.** As result, Nepal is now in the middle of the transition to federalism, and it is understandable that the process will be a drawn-out one, which could take decades. As envisioned in the Constitution, PLGs have accounted for about 34% of national expenditure in the fiscal years 2018 and 2019, significantly boosting the fiscal resources available to the PLGs. Albeit, Nepal faces longer term hurdles in managing the transition to federalism and consolidating its operationalization. While progress has been achieved in terms of, setting up of key institutional structures, and strengthening the regulatory environment for federalism, to some extent staff deployment, significant gaps still exist between the needs and existing capacity at all levels of government. The immediate issue is that capacity deficits exist at all levels of Government to manage new functions, with adverse implications for efficient management of assignments and public finances, coupled with challenges posed to the provision of public services. Moreover, setting up functioning regulatory and institutional arrangements for fiscal federalism represents a monumental challenge, which may impact the reform process. The challenge is exacerbated by lack of experience and clarity on division of powers for governance and responsibilities between subnational and federal governments in Nepal. The PLGs are awaiting actions by the federal government to expedite implementation of federalism to augment service delivery to citizens.

2. **This Policy Note has been prepared based on the findings, analyses and recommendations of the Federalism Capacity Needs Assessment (FCNA) study.** The FCNA was conducted by the Georgia State University in 2018-19 for the Government of Nepal (GoN) with the joint support of the World Bank and UNDP. It has identified the gaps between the needs and the capacity in different levels of government. The study used a broad definition of capacity, including organizational (physical and human) and institutional (laws and regulations) elements. The FCNA covered the federal government, all seven provincial governments, and 115 (out of the 753) local governments in Nepal. This note provides a synthesis of the FCNA findings as well as its forward-looking recommendations in terms of actions the Government could take in the immediate, medium and long-terms towards a full realization of the benefits of federalism implementation in Nepal.

Key Recommendations of the FCNA

Managing the Transition to Federalism

3. **Roadmap for implementation of federalism.** Global experience has shown that the transition to federalism is a profound transformation that requires years, decades and sometimes longer to unfold. Nepal has begun its transformation, with important initial gains. Moving forward, yet, the complexity of the country's transition to federalism, coupled with the relatively slow progress in delivering the required regulatory and institutional framework remains a source of concern among PLGs. The general expectation is that full transition to federalism could be cumbersome and may take a reasonable amount of time. To deliver on common objectives and improve coherence and coordination among the three levels of

Government, a federalism roadmap is necessary. This would also be beneficial to the GoN and development partners in harmonizing their contributions to the process. The roadmap will articulate reform priorities and sequencing of actions, and ultimately help to improve implementation of the reform process. It will also enhance the confidence of citizens in the implementation of federalism. Finalization of the roadmap and its implementation plan has to follow a participatory process with different stakeholders both within the federal level (among key ministries and institutions) and across the three tiers of Government, to ensure ownership and commitments to its implementation. The preparation of roadmap could be anchored in the Office of the Prime Minister and Council of Ministers, and coordinated jointly with MoFAGA and the National Planning Commission. These institutions have mandates relating to implementation of federalism across all levels of government and are currently collaborating to develop an M&E system for federalism.

4. ***Development of a Communications strategy for the implementation of federalism.*** Nepal is new to federalism: provincial governments did not previously exist, and local governments existed in a very different form. Within the federalism context, the responsibility for issues that affect various aspects of federalism is not only shared among government actors at all levels, but also shared by citizens, the ultimate beneficiaries of the reform outcomes. Development of a communications strategy is critical for the implementation of federalism. The effectiveness of the reform process could be ensured through improved coordination, by engaging key beneficiaries and stakeholders at all levels of Government. The communications strategy, developed using appropriate approaches and instruments, would support dissemination of information to: (i) promote shared understanding of the reform process, its purposes and benefits; (ii) provide opportunities for citizens to appreciate the benefits of the reform, as well as its implementation challenges; and (iii) meet the growing need for transparency in the implementation of the federalism.

Capacity for Implementation of Federalism

5. ***Development of a capacity improvement strategy to support long-term capacity enhancement and training for elected officials and civil servants.*** This would focus on: (i) deepening the understanding of the elected officials on the principles and mechanisms of federalisms; (ii) ensuring that PLGs have necessary staff with the required skills in areas such as public financial management, procurement, public investment management, and citizen engagement; (ii) supporting national training institutes to provide formal training for public officials on federalism; and (iii) developing mechanisms and processes to boost coordination between and/or among PLGs and the federal government.

6. ***Development of Physical Infrastructure and Facility Improvement Plan (PIFIP) to boost capacity of PLGs.*** A major challenge most PLGs continue to face during the transition to federalism relates to limited physical administrative facilities, including office buildings and assembly halls, as well as administrative equipment. The severity of infrastructural deficits varies according to PLGs. The issue pertains also to limited funding for the purchase of adequate quality facilities. The PIFIP would identify government priorities for improving the infrastructure capacities of PLGs, aimed at ensuring that PLGs have adequate funding to secure administrative facilities with required quality and quantity in a timely manner. Since this will require both a long-term strategy and large-scale investment, a well thought out and phased PIFIP plan would address this gap in a more systematic and realistic manner.

7. ***Strengthening capacity for effective transition to federalism to manage the implementation of federalism with devolution of authority to Nepal's seven provincial and 753 local governments.*** A comprehensive capacity building program would help the implementation process, by enhancing knowledge and delivery capacity of the core teams of government officials and technocrats managing the transition to federalism. The program will help build shared understanding of: (i) the design and implementation experiences of various models and aspects of the federalism; (ii) the political, economic, social, and cultural considerations underpinning choices pertaining to federalism; (iii) real and potential impacts of fiscal decentralization on development outcomes; (v) success factors of fiscal decentralization in the target countries; (vi) instruments and value addition of citizen engagement and participation, as well as mechanisms for transparency and downward accountability in the federalism context.

Legal Framework for Federalism

8. **The Constitution underscores the importance of compatible framework legislations upon which the federal system is to be made operational.** A significant amount of framework legislation is required to complete the transition process to federalism. It is appreciated that the federal government has started the process of formulating framework legislations. The framework legislations would enable the PLGs to develop legislations at their levels to adequately deliver and manage public services. Considering the efforts made so far by the federal government, this note further endorses and recommends prioritized enactment of the following primary and secondary legislations as well as guidelines, to create the enabling environment for effective roll-out of federalism at different levels of the government:

- Passing the enabling legislation for provincial public service commissions (PPSC) to operate;
- Passing the sectoral laws required to enable subnational government service delivery programs, by clarifying the division of responsibilities among these levels of government and defining service delivery norms and standards for the PLGs;
- Issuing sectoral guidelines based on the standards of the laws to be followed by the PLGs, and providing support to them on how to integrate these guidelines into their plans and policies;
- Clarifying the objectives of each of the intergovernmental transfers, and advising on their use;
- Passing of laws related to the concurrent responsibilities (Schedules 7 and 9) and clarifying the responsibilities of each level of government following the principle of subsidiary and the intergovernmental coordination mechanism (Art. 235);
- Identifying regulations, ordinances and laws that are necessary to implement various provisions in the Constitution and to provide for smooth operations of the PLGs.

Monitoring and Evaluation for Federalism

9. **While the Constitution seems to call for the federal, provincial, and local governments to operate mostly as spheres of governance, with defined powers and responsibilities, federal government's overall oversight over implementation of federalism remains paramount.** Such a federal oversight role is necessary to ensure the proper transition to federalism and should/does not come at the expense of subnational authority. The diversity of Nepal's local governments in terms of size, as well as fiscal, physical and human resource capacity, requires coordinated and sustained federal oversight. The Constitution calls for monitoring the implementation of the directive principles, policies and

responsibilities by all levels of governments. A solid and modernized Monitoring and Evaluation (M&E) system is needed to support systematic assessment of the performance of federalism against targets. This needs to include the establishment of a federalization cell and development of a system to evaluate the fiscal performance of PLGs. A restructuring of the overall system for data collection and dissemination is needed to support decision making at all levels of government. Ultimately, a means must be created to actively engage citizens. Experience from other contexts suggests that implementation of feedback tracking system could be helpful to systematically gauge citizens' perceptions about implementation of federalism. It is a tool that will offer opportunity for continuous federal, provincial and local governments oversight, based on the principles of cooperative federalism, while promoting citizen engagement and helping to close the feedback loop. The ensuing report from the proposed M&E system should be jointly reviewed at the Intergovernmental coordination meetings held at both the federal and provincial levels.

Institutional Framework of Federalism

10. **The roll-out of federalism must be supported by the existence of an adequate institutional framework to attain optimal results.** Setting up the required institutional structures for federalism has proven difficult, partly because of delays in enacting the relevant laws, and partly due to political economy constraints. The Inter-Provincial Council and Inter-Governmental Fiscal Council are the only two institutional coordination mechanisms established so far. To address this critical issue, the Government's roadmap for federalism needs to include a plan on how key institutional frameworks envisioned in the constitution would be implemented (See Annex 1). The FCNA recommends setting-up a federalization cell to support implementation of the federalism reform. The cell could also be mandated to do continuous evaluation of the intergovernmental system for the Government in strong coordination with subnational governments. The Office of the Prime Minister and Council of Ministers (OPMCM) could be the institutional home for this with direct involvement of subnational governments.

Implementation Plan/Roadmap

11. An implementation plan or roadmap is proposed to be developed through a consultative process with all stakeholders under the leadership of the government. The table below could help consultations on a roadmap for the implementation of the federalism in Nepal.

Issue	Description	Method in Implementation Plan	Mitigating Measure
Functions			
Concurrent responsibilities	Clarify concurrent expenditure assignments	Review unbundling exercise for concurrent assignments	Capacity of PLGs to assume service delivery responsibilities is essential
Recommendations: <ul style="list-style-type: none"> Review all the relevant sectoral legislations to make sure that functional assignment is clear Design a capacity improvement plan for PLGs in these areas 			
Devolution of service delivery responsibility	How exactly will devolved functions and functionaries be handed off from line ministries? What flow of resources will take place?	Plan for a slower phased in transition Clarify the shift of management	Will the establishment of a contingency fund be necessary? An assessment of provincial capacity and

	<p>Will there be a breakdown in service delivery for essential functions?</p> <p>What budget and management autonomy will be given to local governments?</p>	<p>responsibility and reporting lines</p> <p>Design capacity building interventions</p>	<p>needs to assume service delivery from line ministry must be undertaken before services are devolved</p> <p>Clarity on assignment of responsibility for management of health and education personnel must be put in place before devolution</p>
<p>Recommendations:</p> <ul style="list-style-type: none"> Establish systems and tools to implement the Local Government Operations Act of 2017 (Act 2704) Establish communication channels between sector ministries and PLGs to address service delivery issues Review all the relevant sectoral legislations to make sure that functional complies with the constitutional mandate, for example: <ul style="list-style-type: none"> Review Town Development Act of 1988 Revise Public Procurement Act Review the Forestry Act Review Water Resource Act 1992 Transfer five regional emergency centers to provincial governments 			
Monitoring and evaluation (M&E)	Where will responsibility for M&E of service delivery and local government performance in general be placed?	<p>Design development interventions for M&E</p> <p>Clarify lines of responsibility and reporting</p> <p>Allocate adequate funding for M&E function</p>	<p>Systems for monitoring and evaluation are not yet in place</p> <p>Database adequate to support M&E not in place</p> <p>Training programs for M&E not yet established</p>
<p>Recommendations:</p> <ul style="list-style-type: none"> Establish a federalization cell to do continuous evaluation of the intergovernmental systems Design a capacity building program for federal ministries on M&E Design self-assessment evaluation tools for PLGs 			
Institutionalization of self-assessment for service delivery	Identification of institutional and organizational weaknesses for service delivery at the local level	There are existing tools, such as LISA, to identify service delivery weakness, which can be deployed immediately	Make sure LISA assessment is available to all local governments
Recommendation: Make sure that local governments' reports of LISA assessments are uniform			
Funds			
NNRFC and inter-governmental fiscal transfers	Dispute over how the duties and responsibilities of NNRFC will be interpreted	<p>Clarity on the binding nature of recommendations</p> <p>Technical training of the secretariat staff</p>	<p>Commission is not fully staffed</p> <p>Initial review of the intergovernmental transfer system has not yet been done</p> <p>Need for stronger oversight of the NNRFC by the Parliament</p>
<p>Recommendations:</p> <ul style="list-style-type: none"> Appointment of commissioners 			

<ul style="list-style-type: none"> • Staffing the NNRFC secretariat • Design study tours to other federal countries to improve the technical capacity of the NNRFC • Begin to develop an adequate data base to support the work of the NNRFC • Establish an ongoing training program for NNRFC secretariat 			
Sub-federal government revenue mobilization	PLGs adopt distortive taxes PLGs need to be encouraged to adopt new taxes PLGs need to improve local tax and revenue administration	Capacity building and training Build incentives into grant programs Technical assistance in drafting new legislation including model laws	Capacity building and training program not yet in place Strong incentives in the legislation to promote increased local revenue mobilization are not in place No monitoring in place
Recommendations: <ul style="list-style-type: none"> • Review the use of intergovernmental transfers to incentivize own source revenue collection • Improve the capacities of subnational governments to administer tax bases, establish databases, and collect taxes • Establish monitoring system for revenue collection • Clarify tax assignment for shared taxes • Establish divisible fund to share the natural resource royalties 			
Funds for investments	Underdeveloped domestic capital market limits subnational governments' ability to raise financing for investments.	Capitalization of domestic intermediaries (such as Town Development Fund)	Improve financial management capacities of subnational governments before promoting access to capital markets
Recommendations: <ul style="list-style-type: none"> • Improve the capacity of subnational governments across public investment management cycle • Improve transparency of subnational finances • Strengthen the legal and institutional framework for PPPs • Review Town Development Act (1988) and update it based on the provisions of the Constitution 			
Public Financial Management	Time delays in extending PFM programs to the subnational sector Limited capacity to absorb PFM improvements	Design technical assistance, capacity building and training programs for PLGs	Capacity building and training plan not yet in place
Recommendations: <ul style="list-style-type: none"> • Strengthen the PFM capacity of subnational governments • Identify projects and programs to be transferred to PLGs • Prepare a plan to transfer them • Preparation and implementation of an expenditure reporting system for PLGs by OAG 			
Accounting and reporting	Ensure comparability and accuracy in financial reporting Periodicity of external audits	Design capacity building and training programs for PLGs Provide incentives for compliance	Capacity building and training program not in place
Recommendation: Strengthen the capacity of subnational governments			
Alignment of plans	The linkages between various planning instruments are very weak.	Annual plans prepared by subnational governments are not aligned with medium term plans	Medium-term plans prepared with the involvement of subnational first, then,

		prepared by sector ministries.	annual plans prepared by PLGs.
Recommendations: <ul style="list-style-type: none"> Promote citizen engagement and participation in medium term plans Involve subnational governments in the preparation of medium-term plans 			
Standardization of PFM software	Proliferation of PFM software (SUTRA, EazyTech, Shangrila); Proliferation of PFM software at the provincial level (NPSAS, LMBIS)	Identification of the best software in terms of coverage (planning, budgeting, accounting etc.) and user-friendliness to roll out across local governments	Familiarization of local governments with the selected software
Recommendations: <ul style="list-style-type: none"> Training of local government finance officials on the selected software Ensure the Budgeting and Accounting Software used by all governments are interlinked between budgeting and reporting and across all three tiers 			
Procurement	Current system promotes fragmentation of large contracts; most projects procured by user committees without a formal tendering process	The quality of public works is low as projects less than \$100K are managed by user committees	The informal nature of procurement coupled with the absence of monitoring system undermines transparency and accountability across the procurement cycle.
Recommendations: <ul style="list-style-type: none"> Establish standard procurement documents (contract, tender documents, etc.) Make sure that user committees comply with procurement guidelines and use official procurement documents Revise Public Procurement Act Prepare sample Public Procurement Rules for PLGs 			
Functionaries			
Devolution of functionaries	Needs at each level not properly estimated Unfilled gap at PLG levels	Understand incentives structures for readjustment Design a program for redeploying federal staff at subnational levels by addressing incentives Create enabling environment for provincial governments to recruit through Provincial Public Service Commissions	Provincial Civil Service Commission legislation is not complete
Recommendations: <ul style="list-style-type: none"> Finalize current staff profile assessments and development of model organizational structures for local governments as mandated by the Local Government Operations Act of 2017 (Act 2704) Establish an institutional framework for making deputed staff (federal staff adjusted to subnational levels) accountable to subnational governments Review the financing system for recurrent expenditures: there is a need for a financing plan for the sustainability of subnational wage bill 			

<ul style="list-style-type: none"> • Draft the Civil Service Act that sets the basis for the formation of the Province Civil Service • Provide provinces with a model Province Civil Service Law • Draft laws that set the criteria for the formation and terms of service for Local Service 			
Identification of human capacity needs at the subnational level	The PLGs have the legal authority to carry out their own O&M surveys to determine their staffing needs. However, they don't have the capacity to do so.	Work with subnational governments to design an O&M survey similar to the one conducted by MOFAGA	Finalization of organizational structures for subnational governments
Recommendations: <ul style="list-style-type: none"> • Help PLGs to carry out their own O&M surveys • Draft law for that forms the basis of establishing the Provincial Public Service Commission • Draft the Federal Civil Service Act that sets the basis for the formation of the Provincial Civil Service • Provide provinces with a model Province Civil Service Law • Draft laws that set the criteria for the formation and terms of service for Local Service 			
Misalignment employment profile at the federal level	Sector ministries' institutional inheritance is out-of-sync with their new federal mandate.	Sector ministries are under-capacitated with respect to their federal mandate (policy-setting & monitoring and evaluation) and over-capacitated with respect to implementation functions for which they are no longer responsible.	Improve the capacity of sector ministries vis-à-vis their new federal mandates
Recommendation: Equip sector ministries to undertake their new federal mandates on policy-setting & monitoring and evaluation			
Organizational and Institutional			
Gender Equality and Social Inclusion (GESI)	Many PLGs do not have a GESI plan M&E on progress is not adequate Training and monitoring of GESI budget practices is limited Clarify GESI extensions to new hiring	Improve GESI budget practices Establish Provincial Civil Service Commission and hiring/management rules	PCSCs management rules and authorization for hiring is not in place External monitoring of GESI outcomes not yet in place
Recommendations: <ul style="list-style-type: none"> • Promote local civil society for the engagement with socially excluded groups and to disseminate information on rights • Establish a monitoring system with local civil society on GESI plan • Put in place legislation to enable PCSC hiring and management practices 			
Investment accountability	Capital expenditures are too heavily biased in favor of small projects with neighborhood benefits Borrowing practices not yet established	Conditional grants to stimulate investments with areawide benefits Adopt local government revenue mobilization improvements	Structure of intergovernmental transfers to stimulate capital spending Incentives to increase user charges Institute formal borrowing practices
Recommendations: <ul style="list-style-type: none"> • Promote local associations 			

<ul style="list-style-type: none"> • Use social mobilizers (drawing from Local Governance and Community Development Programme LGCDP experience) • Use Citizen Awareness Centers effectively • Amend domestic debt law to allow PLGs to raise domestic debt 			
Institutional framework for inter-governmental coordination	Confusion over roles and responsibilities of federal, provincial, and local governments in certain areas Monitoring of subnational governments' performance	Need clarity in responsibility for certain services Consider a more phased-in assumption of responsibilities for PLGs	No arrangement for a phased in responsibility and autonomy is in place No provision for monitoring performance is in place
Recommendation: Inter-Provincial Council (mandated by the Constitution) and Inter-Governmental Fiscal Council (mandated by the Intergovernmental Fiscal Arrangement Act) are the only two institutional coordination mechanisms established so far. There is a need for inter-ministerial coordination mechanisms with respect to the development of policy and the administration of the subnational systems. In the absence of intergovernmental coordination mechanisms, different administration tools and systems (in case of PFM, for example, SUTRA and MARS systems) are being promoted. There is a bill in the Parliament on intergovernmental coordination (Bill on Inter-governmental Coordination 2019) which is subject to discussions and criticism. It needs to be enacted as soon as possible after reaching a consensus among all stakeholders to ensure cooperation and coexistence in concurrent power-sharing among the federal, provincial and local levels.			
User committees and civil society involvement	Confused continued role for user committees Who will represent the interests of municipal governments?	Redefine capital investment planning	The role of civil society has not been addressed in detail
Recommendation: Use local civil society effectively as a stakeholder.			
Database	Inadequate accurate data to track fiscal performance of PLGs Inadequate data to populate and evaluate intergovernmental transfer programs	Develop a data base that integrates fiscal and socioeconomic data Produce the data on a timely basis	A plan to do this at the national level does not appear to be developing quickly
Recommendation: Appoint a Committee of experts to prepare a proposal for the content of a data base that could serve the goals of monitoring the performance and entitlements of PLGs.			
Local government preparedness	FCNA survey produced a significant list of needs for PLGs to effectively implement federalism	Action plan for follow up on these	No mechanism for follow up is in place
Recommendations: <ul style="list-style-type: none"> • Empower a task force to put an action plan in place • Consider a more phased in implementation of federalism, based on readiness 			
Legislative Actions	Important pieces of legislation for implementing federalism are not in place	Enact all required legislation for implementing Federalism	Key issues are PPSC legislation, bill of rights, some sectoral laws; others

Recommendations: Review Parliament's priorities and timeline for new legislation regarding:

- Draft a new law for private firm registration and commercial enterprise regulations
- Prepare a sample inter-provincial trade management law for the provinces
- Prepare a sample law for consumer protection and market monitoring for PLGs
- Draft a new law for the operation of stone, sand collection & crusher industries
- Draft new laws for land use and management
- Review the Land Acquisition Act 2034 (1977) and Immoveable Property Requisition Act 2013 (1956) in the context of federalism
- Draft a new law relating to management of squatters and unmanaged settlers
- Draft laws relating to Nepal police - their functions, supervision and coordination with provincial police
- Draft the province police integration law
- Draft a new law setting criteria for recruitment, training, uniform and security of provincial police
- Draft a domestic security law that also defines the CDO's roles at the federal and province levels
- Review acts relating to prisons
- Review laws regulating license issuance for FM radio and TV stations
- Review the Forestry Act
- Review Water Resources Act

Section I: Introduction

1. **Federalism is taking roots in Nepal.** Since the adoption of the federal constitution in 2015, coupled with the sharing of power and functions among Nepal's federal government, seven provinces and 753 local governments, the GoN has adopted legislations and put in place institutional structures, intended to roll-out federalism. Within the first two years of their operation, PLGs have accounted for about 34% of national budget, significantly boosting their fiscal capacity. However, Nepal faces longer term challenges in managing the transition to federalism. Despite the increased flow of transfers to PLGs, budget execution by PLGs remains low, averaging 61% in 2018, with adverse consequences for delivery of public services and quality of spending. In addition, while progress was achieved in terms of the deployment of staff, setting up of key institutional structures, and strengthening of the regulatory environment for federalism, significant gaps still exist between the needs and existing capacity at all levels of government. The legal and regulatory frameworks envisioned in the constitution are yet to be fully implemented. More importantly, like all new federal governments, Nepal is confronted by capacity deficits to manage new functions. There are also confusions related to the delegation of functions, where more clarity is required on the exact roles of the functional assignments devolved to PLGs.

2. **Building on the core study; that is, Federalism Capacity Needs Assessment (FCNA), carried out by Georgia State University for the Government of Nepal (GoN), this policy note offers a succinct and strategic guidance to help GoN to develop strategies and programs for accelerated and effective implementation of fiscal federalism.** The FCNA, conducted in 2019, was intended to, "...identify the gap between the needs and the capacity..." of all levels of government to manage their assigned service responsibilities under the new system. The FCNA assessed the capacity of the federal government to regulate and manage the way the federalism transition is rolled out, and its capacity to manage the intergovernmental system thereafter. The study used a broad definition of capacity, including organizational (physical and human) and institutional (laws and regulations) elements. The FCNA generated a wealth of relevant information on the capacity needs of federalism. The FCNA surveyed PLGs, targeting 115 of the 753 municipalities and all seven provincial governments in Nepal. It also conducted desk review and informant interviews of public officers.

3. **This Policy Note is prepared as an abridged version of the FCNA.** It provides a synthesis of the FCNA findings as well as forward looking recommendations in terms of actions Government could take in the immediate, medium and long-terms towards a full realization of the benefits of federalism implementation in Nepal. The note outlines measures and opportunities for consideration, which are outlined in the executive summary and discussed in detail in section two while the annotated roadmap of federalism is documented in section three of the note. Therefore, the note offers critical inputs for the Government's potential roadmap for the implementation of the federalism.

Outline of the Policy Note

4. **This Policy Note is structured as follows:** Following the executive summary, which outlines immediate-to short-and long-term measures for transition to federalism, Section 1 introduces the background and purposes of the policy note. Section 2 discusses the findings of the FCNA while highlighting progress and main constraints, including existing gaps between the needs and capacity at all levels of government. The note concludes with Section 3, which details out relevant recommendations to smoothen Nepal's transition to federalism.

Section II: Discussions on Federal Government Capacity Needs Assessment

Federalism Implementation Progress and Issues since 2017

5. **Nepal has achieved noteworthy progress so far on the transition to federalism.** Elections in 2017 have essentially established Nepal's seven provinces and 753 local governments. Municipal assemblies are meeting regularly, laws and regulations are being developed, budgets are being passed, and financials continue to be audited. There seems to be a feeling in the general population that things are moving in the right direction. In addition, much of the important framework for transition to federalism is in place. A basic system of intergovernmental transfers has been set up, expenditure assignments (defined by the Constitution) are being elaborated, and the transfer of staff from the federal to PLGs levels is almost complete.

6. **While the progress is commendable, slow actions on measures necessary to effectively empower PLGs have contributed to limited performance of PLGs.** Service delivery and local government management have been slower to develop than some had hoped, in part because PLGs have not yet received their full quota of relocated federal employees, important civil service legislation has not yet been passed, and the capacity of local governments to manage functions is still at a low level. In addition, there is some confusion about the powers and functions of levels of government. The result is that many PLGs officials, and many in the political leadership of federal government, are either not in place or not very far along in performing their new jobs.

7. **It is also probably fair to say that the difficulties that might arise from putting a new federal structure in place were underestimated.** Provincial governments did not previously exist, municipal governments existed in a very different form, and neither level had adequate capacity to manage the delivery of local services. Nor did the federal government have experience with guiding the implementation of a fiscal decentralization or with monitoring the performance of the PLGs. The expectations on the part of some PLGs officials and some citizen groups were likely high, especially given the weak capacity of local governments to deliver services or manage their responsibilities. Three sets of short-term measures would be needed to advance the transition to federalism.

8. **First, the Federal Government would have to develop a federalism implementation roadmap, to address the obstacles associated with confusion about sequencing of reform activities.** While political commitment to federalism is strong, Nepal's lack of a roadmap for the roll-out has exacerbated the complexity of the reform process and contributed to slow transition to federalism. The roadmap could help control expectations and clarify sequencing of policies and administrative procedures that are needed to be put in place.

9. **Second, the federal government would need to develop and implement a communication strategy, to support effective change-management and to tackle the growing burden of political economy issues.** The FCNA and the policy note have not assessed political economy factors of the reform. However, like all types of reforms, the transition to federalism in Nepal is not extricated from producing "winners" and "losers". The explanation for the much slower progress of devolution of powers to subnational governments goes beyond technical factors. There is a potential that reformers are proceeding cautiously, given the enormous and complex nature of the reforms process, but clearly, there has been some foot-dragging because not all actors (elected leaders and bureaucrats) interpret the required devolution in

the same way, or agree with it. Consequently, the transition process has required time-consuming manoeuvring at different stages.

10. **Third, the Federal Government would need to develop a capacity improvement program to support effective transition to federalism.** Managing a “big bang” reform, such as the dramatic transformation from unitary to federal government, involving devolution of authority to seven provincial and 753 local governments, needs to be supported by a well-thought out capacity support plan for the transition. Limited knowledge about the risks and unintended consequences of reform choices are among factors contributing to the slow pace of the transition. To improve knowledge and capacity of the drivers of the reforms (government officials and technocrats managing the transition to federalism), a capacity building program would need to be developed as a short-to-medium terms reform measure. The short term capacity building program would be instrumental in establishing shared understanding of: (i) the design and implementation experiences of various models and aspects of the federalism; (ii) the political, economic, social, and cultural considerations underpinning choices pertaining to federalism; (iii) real and potential impacts of fiscal decentralization on development outcomes; (v) success factors of fiscal decentralization in the target countries; (vi) instruments and valued addition of citizen engagement and participation, as well as mechanisms for transparency and downward accountability in the federalism context. In the medium term, capacity development programs would need to include support to public training institutions to develop curriculum, programs, improved facilities and staffing to deliver both short term, continuous professional development courses and tailored courses for different staffing needed at all three levels of government for federalism implementation

Devolution of Government Employment

11. **The Constitution of Nepal specifies a new and more decentralized assignment of expenditure responsibilities to each sphere of government, which in turn requires a significant redistribution of government employment from the federal to the PLGs levels.** This is a major and difficult task that only a few middle- and lower-income countries have even attempted (see Box 1 on Indonesia’s experience).

Box 1: Indonesia’s Big Bang Decentralization Reform

In 2001, Indonesia implemented a major fiscal decentralization program that led to an increase in the expenditure share of subnational governments, from a pre-reform level of 15 percent of total government expenditures to a post-reform level of about 40 percent. This was accomplished by transferring over two million central government civil servants (almost two thirds of the central government workforce) to the regional governments. In addition, provincial and local level offices of the central government and more than 16,000 schools, hospitals, health centers, etc. were transferred to the regions. Most functions of government were decentralized, with the exception of national defense, international relations, justice, police, national development planning, religion, and finance, which remained with the central government. Local governments were not given any significant tax-levying powers but were financed mostly by unconditional grants from a 26 percent share of domestic tax revenue collections.

The transition to a decentralized system in Indonesia was not perfectly smooth. The assignment of expenditure responsibilities in the new Constitution was murky, with the role of provinces being especially unclear, and there was significant dissention coming from the natural-resource-rich regions. However, the transition was somewhat easier in Indonesia than in Nepal because: (a) provincial and local governments already existed: so, local government service delivery was handed over more easily; and (b) significant deconcentration of national government employment was already in place, which meant that there was less reliance on forced relocation of central employees from the national capital.

Sources: Hofman and Kaiser (2004); Directorate of Fiscal Balance (2012)

12. **Currently, the Government of Nepal’s civil service employs 89,825¹ individuals, 25 percent of whom are female.** However, total government employment is much broader, including for example, teachers, police, and permanent employees of local governments; but they are not classified as civil service employees. So, when all employees (excluding teachers) are considered, it is estimated that total government employment is 126,852 (about one government worker for every 230 population in Nepal).

13. **The transition to the new federal system requires the “adjustment” of these 89,825 civil service employees.** Some of these employees are being physically relocated to become employees of either provincial governments or local governments while some will remain with the federal government. The wages and salaries of those assigned to the subnational level will be paid by their respective PLGs, but their benefits will continue to be paid by the federal government.

14. **The number of employees to be devolved from the federal level has been determined in two steps.** The first, which follows the new assignments of expenditure responsibility, was for the federal government to wind up certain offices and transfer all employees in those departments to the PLGs. Most of these are service delivery workers, many of whom are already working at the PLGs level on a secondment basis. This is the largest component of “adjusted” employees. The second step was to reduce the number of the remaining federal civil service employees to address weaknesses in the management structures of PLGs. To do this, the Ministry of Federal Affairs and General Administration (MOFAGA) conducted an organization and management (O&M) survey of each federal government ministry to establish federal employment needs.² The difference between the number “needed” by the federal ministry and the number of present employees is the redundant employees who needed to be “adjusted” to the PLGs level. Those employees were the special concern in the FCNA.

15. **These two approaches to employment devolution have led to a proposed reduction in civil servant employment of the federal government by 41,335 or about 46 percent of total civil service employment.** For those departments to be retained by the federal government, the O&M survey for civil servants led to a proposal for the retention of 48,490 civil service positions. As compared to the 51,420 existing positions in the departments to be retained by the federal government, this was a decrease of 2,930 positions.³ In other words, 2,930 public administration/public management employees could be potentially reallocated to PLGs posts in addition to those that were already serving in a seconded capacity at various subnational government offices and service centers.

16. **There is no objective way of judging whether a total reduction of 46 percent of the federal civil servants (or one third of the total government workforce, excluding teachers) is ideal, too much or too little.** A possible yardstick or international comparison is not very helpful in this regard because the assignment of expenditure responsibilities and the classification of employees differ across countries.

¹ This civil service number is as of February 5, 2019 and includes health personnel but excludes teachers.

² The O&M survey method used for the federal government relied on a request for needed employment from each Ministry, accompanied by “expert judgement” by MOFAGA officials. At the subnational level, the approach was similar but relied more heavily on expert judgement by MOFAGA officials.

³ It is equivalent to a 6-percent reduction in the number of civil service positions that the federal government will retain in their ministries.

17. **Interim O&M surveys were conducted by the federal government for the PLGs.**⁴ The proposal based on these surveys is for 21,399 employees across the seven provincial governments.⁵ For rural local governments, O&M surveys were carried out on the basis of local government size classifications (rural, municipality, metropolitan, etc.) rather than individual O&Ms, as were carried out for each provincial government. The total employment needs of all local governments were calculated by multiplying the needs for each local government category by the number of local governments in that category. Across the 753 local (municipal and rural) governments, 33,262 civil servants are proposed, based on these interim O&M analyses. This number includes positions at the municipal offices (local government headquarters) and all associated ward offices. However, it does not include sectoral delivery units in agriculture, livestock and health positions etc. With these, the total proposed positions for local governments (including for sectoral service delivery) are 66,750.⁶

18. **To fill these positions and assist with the adjustment of civil service across the three levels of government, the GoN fielded a questionnaire asking civil servants to identify and rank their preferred level of service.** Based on the response to this questionnaire, staff were assigned to either the federal, province or local government, considering the individual's experiences, skills and the needs at vacant positions.⁷ One level of adjustment exercise across the three levels of government was completed on March 28, 2019.

19. **Individual employees have been assigned their new posts, and their physical relocation is now underway.** Based on the survey, a total of 39,960 individuals have been assigned to the federal government, 13,821 have been assigned to provincial governments, and 31,710 to the local governments.⁸ In the case of local governments, 12,097 legacy staff⁹ have also been assigned to new positions. Thus, the total adjusted staff at the local government level is 43,807. An additional 2,443 civil service employees have been in a reserve pool¹⁰ and have not yet been assigned positions. Thus, the unfilled employment gap as of March 2019 is 39,051 (Table 1). If the reserve pool is assigned to PLGs, the net employment deficit across the three levels of government would be 36,608, and it is largest at the provincial level when measured relative to the total number of proposed positions. This gap includes both service delivery personnel and public administration/public management personnel.

⁴ The PLGs also have the authority to carry out their own O&M surveys to determine their staffing needs. However, without provincial public service commissions in place, they would have to rely on the federal civil service commission to carry out recruitment.

⁵ The MOFAGA O&M for Province Governments is as of July 17th, 2018. At the subnational level, the approach used was based on expert judgement by MOFAGA officials.

⁶ Teachers are excluded.

⁷ MOFAGA requested civil servants to submit their preferred level of government service. Of the approximately 77,000 civil servants who responded, 46 percent chose federal, 18 percent province, and 36 percent local.

⁸ The federal and subnational governments also hire workers on a contractual basis to perform operational tasks. Such individuals are hired directly by ministries at the federal level, and they are not a part of the civil service. MOFAGA estimates that there are about 10,000 contractual workers on the federal government payroll, and about 10,000 at the PLGs level. (The FCNA survey estimates are that there are about 20,000 positions filled with contractual employees at the local level). However, these employees are unlikely to meet the qualifications to fill civil service management positions since many (most) are drivers, messengers, cleaners, computer operator etc.

⁹ Legacy staff at the local governments are permanent employees hired directly by previous Village Development Committees and nagar palikas but have been retained by and adjusted to successor local governments.

¹⁰ The reserve pool of civil service employees is those who have not been assigned to any position during the adjustment process. They will also be assigned positions to fill the remaining gaps taking into account their skills, expertise, and other non-professional attributes.

Table 1: Interim Post Adjustment Human Resource Gap at Three Levels of Government

	Proposed	Adjustment	Post-Adjustment Gap	Reserve Pool	Final Gap
Local	66,750	43,807	-22,943		
Province	21,399	13,821	-7,578		
Federal	48,490	39,960	-8,530		
Total	136,639	97,588	-39,051	2,443	-36,608

Source: Compiled from the data provided by MOFAGA, Government of Nepal, and team calculations.

20. **Even with the employee adjustment underway, there are issues that still need to be resolved.** How will the subnational governments fill the estimated gap of 36,000 in public administration/public management positions and service delivery position? Although PLGs can carry out their own O&M surveys and recruit additional employees through the provincial public service commissions, these commissions have not been established yet. The PLGs are waiting for the federal government to enact a framework legislation for the establishment of provincial public service commission. Therefore, it is urgent for the framework legislation to be enacted and province civil service/local service legislations to be passed to enable the PLGs to hire new employees.

21. **Secondly, will the skills of the relocated federal bureaucrats and the legacy employees of the local governments fit the needs of the subnational governments?** It is not clear what recourse the PLGs have to address skill mismatches. According to federal government officials, the expectation is that local governments will do their own O&M survey after the initial round of relocations are in place.¹¹ But it is not clear whether PLGs will have funds and proper institutional set up to attract new employees with the right skill sets.

22. **Thirdly, it is not clear whether there is a financing plan in place to ensure that the budget supports these employment increases.** Funding for the adjusted federal bureaucrats and any new hires will primarily come from federal grants, with vertical shares that are mostly decided as part of the annual budget process. A financing plan would require analysis of the match between revenues from the present formula-based conditional and unconditional grant allocations (and locally-raised revenues) and the cost requirements for all new employees.

23. **Finally, since the new civil service legislations at all levels are not in place, it is not yet clear how gender balance and representation of disadvantaged groups will be addressed in the new employment structure at the subnational government level.** To the extent that women and minorities will be given special consideration, this will likely come from the hiring rules that accompany the new Federal Civil Service Act hiring rules, and from the Provincial Civil Service Commission hiring rules.

Provision of Legal Framework for Federalism

24. **For federalism to be implemented successfully and governed by the rule of law in Nepal, a significant amount of framework legislation is required.** This includes laws to assign expenditure, revenue, and public administration responsibilities to the three spheres of government and to enable the issuance of necessary laws at the PLGs. These laws will give clarity on the division of responsibilities and operating procedures between the different levels of government. While the GoN is in the process of

¹¹ Meetings of World Bank team and MOFAGA officials on December 7, 2018, and during the January-March period of 2019.

preparing some of these legislations, there is a need to map out and sequence these legislations based on priorities.

25. **The government has a challenging task ahead with about 200 laws that require amendments or redrafting.** Nevertheless, it should be noted there is some progress and the key pieces of legislation have already been enacted, including the: (i) Local Government Operations Act, 2017 (Act 2704); (ii) Intergovernmental Fiscal Arrangement Act, 2017; (iii) National Natural Resources and Fiscal Commission Act, 2017; and (iv) Staff Adjustment Act 2019. These provide the legal basis for establishing the needed management infrastructure for PLGs. The Ministry of Law, Justice and Parliamentary Affairs is also working with the Office of the Prime Minister and Council of Ministers (OPMCM) to draft a law on coordination among the three-tiers of government.¹² The draft law also has a provision to establish a secretariat of the Inter-Provincial Council at the OPMCM.

26. **However, there are several other key legislations that are yet to be enacted.** Among the most important is the Federal Civil Service Bill which is under consideration in the House of Representatives at the time of this report. This bill has completed a significant amount of the parliamentary processes, and the deadline for proposals for revisions and modification has passed. Besides, the Provincial Public Service Commission Bill is under discussion in the Parliament. It is a framework law for the provincial governments to draft Provincial Public Service Commission Act for the respective provinces, not merely a model or sample law for the provinces. The Parliament, by making this framework law, will determine the basis and criteria to guide the provincial governments on issues such as meritocracy, fairness, and impartiality in human resource (HR) management.

27. **Potentially of great importance to the full implementation of federalism are 16 laws that form a kind of Bill of Rights for Nepalis.**¹³ They include, for example, rights to environmental protection, safe motherhood, health care, and housing, as well as rights of children and disabled people, social security, employment, and more. The Constitution guarantees these rights, which means that all three levels of government are accountable for protecting these rights. However, in some cases there may not be proper mechanisms or resources to guarantee these rights. For example, all Nepalis have a right to health care, with eligible services defined by law. The law explicitly states that the cost burdens will be borne by the governments involved. In the case of primary health care services, the burden will fall heavily on municipal and rural local governments. The responsibilities of inspection and regulation of health care institutions also fall on the governments providing the service, but there is no mention made of an additional compensating federal grant for these expenditures.

28. **The Justice system will adjudicate the practice of federalism in Nepal to ensure that it stays the course set by the Constitution.** While the Constitution of Nepal frames the new responsibilities of provincial and local governments, it provides significant autonomy to PLGs in deciding how they will govern themselves, subject to agreement with the Constitution. In cases of dispute over Constitutional interpretation, the exact channel for settlement is unclear although this is a role that can be played in some cases by the Constitutional Bench of the Supreme Court.¹⁴

Institutional and Organizational Arrangements

29. **The Constitution calls on the federal government to establish some new institutions and organizations.** These institutions are to ensure that federalism functions efficiently. They also provide

¹² It has already been drafted by the OPMCM and is now being reviewed by the concerned Parliamentary Standing Committee.

¹³ Art. 18-48, Constitution of Nepal

¹⁴ Art. 137 Constitution of Nepal

additional check on the powers of government to ensure the adoption of policies intended to deliver services that are in line with the goals expressed in the Constitution. These institutions include:

- ✓ **Inter-Provincial Council (IPC)**: As specified by Article 234 of the Constitution, an Inter-Provincial Council is to settle disputes of political nature between the federal government and provincial governments, and among the provincial governments. Its members include the Prime Minister, the Ministers of Home Affairs, and Finance, and the Chief Ministers of respective Provinces. At its first formal meeting, the Council agreed to 29 actions that the federal government needed to take to allow for a smooth transition to the federal governance structure.¹⁵
- ✓ **Provincial Public Service Commissions**: Article 244 of the Constitution calls for the formation of a Public Service Commission in each province. The degree of autonomy is vested in provincial governments to hire, fire and promote its employees. Once the fiscal federal system is fully implemented, the employee compensation share at the subnational government level will likely be larger. If hiring, firing, promoting, and the wage bill are not within the control of the PLGs, their budget autonomy will be greatly limited.
- ✓ **National Natural Resources and Fiscal Commission (NNRFC)**: The NNRFC is charged with recommending/determining the distribution of revenues to subnational governments from the federal consolidated fund (Art. 251 and NNRFC Act, 2017). The NNRFC is a key actor of the intergovernmental fiscal system in Nepal. Its formation is meant to give GoN a permanent and objective body for managing the distribution of intergovernmental transfers, guiding local revenue mobilization, and generally tracking the performance of the intergovernmental fiscal system. If NNRFC chooses to mandate the level and distribution of intergovernmental transfers to subnational governments, it dramatically limits the authority of Parliament to make decisions about the level at which local governments will be financed and about the degree of equalization among PLGs. It also limits the overall ability of the Ministry of Finance to shape the national budget envelope. On the other hand, if the NNRFC chooses to view its mandate as one of making recommendations about vertical and horizontal sharing, then the federal government and the Parliament will have a more direct voice, but the final outcomes could be more politicized.

30. **The Constitution also mandates the federal government to establish other commissions to facilitate inter-governmental coordination and to enhance equity and social inclusion.**¹⁶ The Commission for the Abuse of Authority has broad powers to investigate corruption by public officials. Other commissions are: Inclusive Commission, (Art. 258), the Madheshi Commission (Art. 262), the Tharu Commission (Art. 263), the Muslim Commission (Art. 264), the Women's Commission (Art., 252), the National Dalit Commission (Art. 255), and the Adibasi Janajati/Indigenous Commission (Art. 261). At the provincial level, Provincial Policy and Planning Commissions have been set up. It is critical that all commissions become operational soon.

Capacity Building and Training

31. **The transition to a federal structure significantly increases the need to provide training for government officials and civil servants at all levels.** It would require a suitable institutional arrangement to deliver the necessary capacity building and training to PLGs. The PLGs in the new federal system have

¹⁵ There was a meeting between the Prime Minister and Chief Ministers in May 2019, but it was not a formal IPC meeting.

¹⁶ Article 232 (1) of the Constitution of Nepal stipulates that the interrelations among the local, provincial and federal units would be based on the principle of co-existence, coordination and collaboration. There are deliberations in the Parliament on the 'Bill on Inter-governmental Coordination 2019'. This will be Inter-governmental Coordination Act after enactment.

significant control over how they deliver their services and manage their systems. The responsibility for capacity development has been placed at the provincial level. The Local Development Training Academy (LDTA) Act has been amended to allow the federal government to transfer LDTA assets and properties to the provincial governments to establish the provincial-level training centers.

32. **Aside the absence of a capacity development plan, there is also no estimate of how much such a plan would cost.** Given the scale of capacity development needs across Nepal, the overall cost may be high, should federalism be appropriately implemented with full capacity and adequate training to employees and elected officials. However, these costs may pale against the gains from getting governance close to the people.

33. **Another important area of capacity and institutional enhancement is the need for a comprehensive database for tracking the fiscal and service delivery performance of PLGs in Nepal.** A good database on subnational government finance and the economic-population structure can be used to track the fiscal performance of PLGs, measure disparities, and provide guidance for adjusting the system of intergovernmental fiscal transfers. The database will be necessary for the subnational governments to manage their borrowing from financial markets and assess their respective creditworthiness. This will also help evaluate formulae developed by the NNRFC. While designing a comprehensive database, the government needs to be mindful of two needs. The first important aspect is to ensure uniformity in gathering and reporting data and the second is the need for a local government census. This census would record and update the fiscal statistics of all 760 subnational governments.

Public Financial Management

34. **Nepal has made significant strides in modernizing its national PFM system.** It has established a PFM steering committee, set up a Public Expenditure and Financial Accountability (PEFA) Secretariat and carried out a PEFA assessment. There has been a successful implementation of the treasury single account, a transparent expenditure reporting system, a revenue management information system and an upgraded audit system.

35. **However, the extension of PFM practices to subnational governments is a high priority now.** The PLGs are responsible for one-third of all government expenditures and have borrowing and tax-levying powers. Yet, the PLGs lack capacity to implement a PFM system strong enough to provide confidence in the use of public resources. The federal government with assistance from development partners, is continuing a process of developing a financial management system to modernize practices related to budget formulation and control, budget execution and financial reporting. However, this modernization and extension of PFM practices to PLGs will take time and require significant capacity building and training.

Gender Equality and Social Inclusion

36. **The commitment to Gender Equality and Social Inclusion (GESI) is enshrined in the Constitution.** The modalities to address the GESI issues through policies and their implementation may vary in different contexts. The success of the implementation is conditional on local preferences and availability of resources.

37. **The Constitution calls for legislation to achieve the goal of inclusion in governance system by earmarking some legislative seats by gender and ethnicity.** The spirit of the Constitution was carried forward by the Election Commission in administering elections in 2017, based on the Constitution and Local Level Election Act. Some have argued that this representation of minorities is fair because it has given women and minorities a formal participation in the governance, but others argued that it may not yet

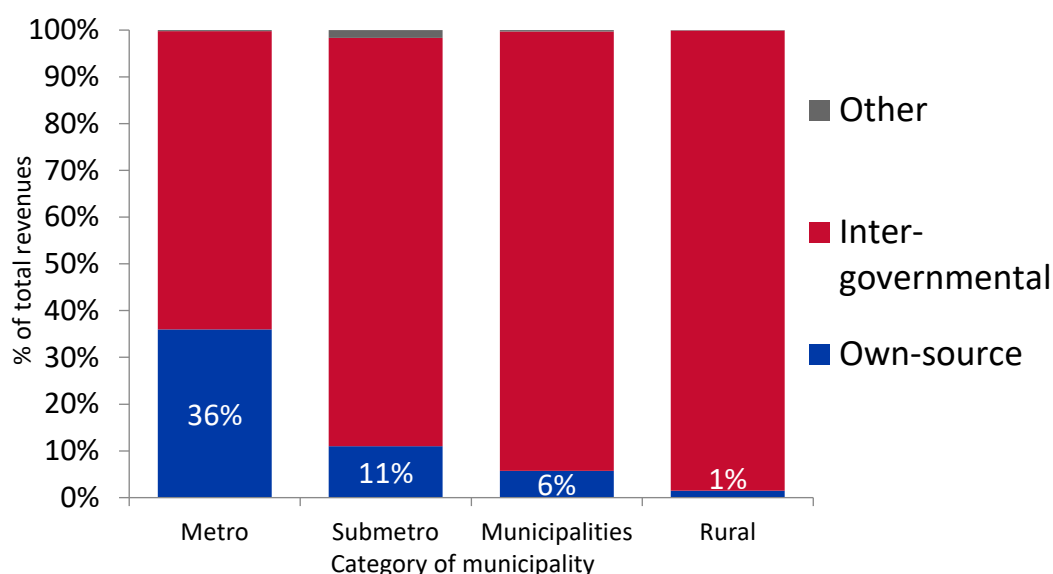
be a meaningful involvement. Post-election analyses suggest that few would have won offices had there not been the mandate about a representation.¹⁷ The women or ethnic minorities should have a larger participation in the civil service. At present, the women are only 25 percent of total civil service, and 12 percent are in gazetted positions.

38. **Gender Responsive Budgeting (GRB) has been active in Nepal since 2007, but there is little evidence of significant positive results.** The weightage of factors for gender-responsive programs is subjective and may reflect the extent to which officials want to present a good picture, as well as their understanding of gender.¹⁸ The international experience shows that gender budgeting is a step towards increasing awareness of budgetary effects on gender equality. However, the effectiveness of gender budgets in achieving desired outcomes in low income countries is limited and remains a challenge.¹⁹ To achieve its objective, implementation of GRB should be supported by expenditure-tracking to ensure that allocated budgets are spent accordingly.

Fiscal Capacity

39. **Fiscal capacity is an important component of PLGs' delivery capacity.** To meet their constitutionally mandated responsibilities, PLGs require adequate discretion to shape expenditure budgets to fit local preferences. The Constitution makes room for locally raised revenues as well as borrowing. However, for the foreseeable future, the bulk of financing of PLGs expenditures is most likely to come from intergovernmental transfers (Figure 1).

Figure 1: Composition of Revenue of Local Governments by Category of Municipality (2018)



Source : FCNA report

40. **In FY2019, the federal government budgeted for an amount equivalent to 53 percent of all national tax collections to PLGs as transfers through the grant system and tax sharing.** By

¹⁷ Democracy Resource Center. (2017, November). Nepal's local elections, 2017: Final observation report. Kathmandu

¹⁸ Budlender, D. (2008). Integrating gender-responsive budgeting into the aid effectiveness agenda: Ten Country Overview Report. Capetown: UM Development Fund for Women.

¹⁹ Chakraborty, L. (2016). Asia: A survey of gender budgeting efforts. IMF Working paper, Strategy, Policy, and Review and Research Departments. Washington DC: International Monetary Fund.

international standards, this is a large share. Revenue mobilization has been buoyant, deficits have been manageable, and GDP has been rising, so the level of transfers in the first two years of federalism was affordable. However, the fiscal space will be constrained as costs rise from the following:

- a. **Wage bill of PLGs.** This will arise from PLGs hiring more staff to complement federal staff transferred to the PLGs, which appear to be less than the MOFAGA's estimates. The civil servants who have been adjusted and relocated to PLGs would be paid a premium.
- b. **Training budget of PLGs.** There are about 80,000 employees and about 37,550 elected officials at the PLGs levels. Training and capacity development for PLGs employees and elected leadership will require significant resources. The FCNA survey responses indicated that over 8,000 local staff have not attended any relevant training since the local level elections. This represents one fifth of all staff currently present in public administration positions at local governments.
- c. **Cost of service delivery.** The continued pressure to improve the quality and coverage of services and to initiate public works projects will require more funds. For example, one study has estimated that the national government is providing local governments with only between 30 to 50 percent of the funds needed to provide elementary/secondary education according to the quality standards that the government has in place, thereby creating a large liability.²⁰

41. **Ultimately, unless effectively managed, PLGs could be pressured into hard budget constraints, limiting the fiscal space, with adverse implications for development and capital investments.** As a result, the Federal Government could prioritize policies on PLGs-own resource mobilization, including borrowing, as an instrument for development financing. As part of fostering fiscal discipline by PLGs, the federal government can promote development of improved public investment management, including development of Capital Investment Plans (CAPs) by PLGs.

42. **The Intergovernmental Fiscal Arrangement Act in Nepal provides for 30 percent of the federal government tax collection from excise tax and Value Added Tax (VAT) on domestic goods is to be shared 50:50 with the relevant PLG.**²¹ In addition, the federal government allocates additional funds for financing the intergovernmental grants; namely, equalization grant, conditional grant, special grant and complementary grant. Table 2 provides the total amount of grant resources—vertical shares—going to subnational governments for FY2018 and FY2019.

Table 2: Intergovernmental Transfers: Vertical Shares

		Amount (in NPR mn) ^a	Percent Distribution	Percent of GDP
2018 (estimates)	Local	245,556	98.2	6.8
	Provincial	4,412	1.8	4.1
	Total	249,968	100	10.9
2019 (budget)	Local	262,173	59.2	7.6
	Provincial	180,554	40.8	5.3
	Total	442,727	100	12.9

a. Includes tax sharing grants of Rs114 240 million for 2019, distributed in equal amounts to provinces and local governments.

²⁰ Louis Berger (2018). Grant systems for subnational governments – some basics and issues for Nepal. Preliminary estimates presented to the NNRFC during a workshop conducted by Ron Hackett, PFMSP PFM Advisor, Dec. 13, Kathmandu.

²¹ This tax sharing entitlement was allocated for the first time in FY 2018/2019. As used in Nepal, it is a direct claim against national tax collections rather than a transfer from the consolidated fund. It is not explicitly provided for in the Constitution. Note also that because of this feature, the national budget does not classify the tax sharing grant as an intergovernmental transfer to subnational governments.

Source: Government of Nepal, Budget Speech FY 2018/2019

43. **The distribution arrangements vary by grant type.** Tax sharing and equalization grants are distributed by two different formulae, but both are based on indicators of expenditure needs and are unconditional transfers. The formulae were developed by the NNRFC.²²

44. **Conditional grants, on the other hand, are more in the form of cost reimbursement grants because they are used mostly to guarantee the cost of salaries of transferred central government employees (mostly education and health) and to cover the costs of legacy projects from the former centralized regime.** Less important in the present system are special and matching grants that are distributed to defray part of the cost of local implementation of special projects of the federal government. Table 3 provides the shares of each transfer type for FY2018 and FY2019.

Table 3: Intergovernmental Transfers, 2018 and 2019, by Percent Distribution

	Description	FY 2018 (estimates) ²³	FY 2019 (budget) ^a
Local Governments	Equalization Grants	61.3	32.5
	Conditional grants	38.7	41.9
	Complimentary Grants		1.9
	Special Grants		1.9
	Tax Sharing Grants		21.8
	Total	100	100
Provincial Governments	Equalization grants	100	27.9
	Conditional grants		35.0
	Complimentary grants		2.8
	Special Grants		2.8
	Tax Sharing grants		31.6
	Total	100	100
All Governments	Equalization grants	61.9	30.6
	Conditional grants	38.1	39.1
	Complimentary grants		2.3
	Special grants		2.3
	Tax Sharing Grants		25.8
	Total	100	100
Exhibit: Total Grants to PLG as A Percent of GDP		10.9	12.9
a. Includes tax sharing grants of Rs114 240 million for 2019, distributed in equal amounts to provinces and local governments.			

Source: Government of Nepal, Budget Speech FY 2018/2019

45. **There is no such thing as a “best” intergovernmental transfer system.** It all depends on what a country is trying to accomplish with its transfer system. Therefore, a fundamental question is what goals the intergovernmental transfer system is meant to achieve. In Nepal, a key question for the NNRFC to ask and answer is whether the intergovernmental transfer system is in line with the provisions of the Constitution that urge fiscal autonomy for subnational governments. Among the issues to be investigated

²² Since the NNRFC Committee members are not appointed yet, so far it was only the NNRFC Secretariat who decided on the formulae. But after the appointment of the Committee member, the formulas need to be approved by the Committee.

²³ The first fiscal year for the provincial governments.

are: (i) the extent to which local government expenditures are mandated; (ii) how much discretion subnational governments have under the current system;²⁴ (iii) what kind of fiscal disparities have emerged in the first two years of operation; (iv) whether the present formula-based system is unduly complicated and whether it gives biased results with regards to its objectives; and (v) what implicit incentives are imbedded in the present system.

46. **To maintain or expand the fiscal space, there is a place for local government taxation in Nepal, particularly for urban local governments as well as the provincial governments.** It is estimated that urban areas account for about 62 percent of Gross Domestic Product (GDP). Urban economies are growing faster than rural ones, and the incidence of poverty in urban areas has decreased significantly during the last decade.²⁵ As GDP and economic activity increases, so too will the potential tax bases.

47. **The Constitution and the Intergovernmental Fiscal Arrangement Act provide the legal basis and define the exclusive and concurrent lists of revenue instruments available to PLGs.** It is not unusual for PLGs in low-income countries to be given only limited taxing powers and for the right to tax more broad-based consumption, income and international trade taxes to be reserved for the central governments, as is the case in Nepal. However, unlike many other low-income countries, in Nepal, PLGs have some powers to pass their own tax laws and have some rate-setting discretion.²⁶ Further, some of the local tax sources that have been assigned to PLGs have good revenue potential. These include taxes on real property and real property transfers, taxes on motor vehicles, and certain user charges.

48. **Under the present intergovernmental fiscal structure, there are no significant incentives to induce PLGs' revenue collection efforts.** In fact, there are notable disincentives, including the hesitance of elected local officials to impose taxes on their constituents. Therefore, it might be a good idea to introduce incentives for increased use of local taxing and user charge powers. The intergovernmental transfers formula could include allocation of certain types of grants based on the fiscal efforts of PLGs. Capacity development of PLGs could prioritize improvement in revenue administration.

Discussions on Provincial Governments Capacity Needs Assessment

Physical Infrastructure

49. **Most provincial governments are in the process of selecting the location of their capitals.** As such, the adequacy of existing infrastructure was assessed in terms of the provincial governments' ability to discharge their functions from their temporary offices.

50. **With a few exceptions, most provincial governments do not own their office space.** In most cases, they can use existing federal (or in some cases municipal) buildings without having to pay rent. Given the current vacancy levels (which range between one quarter and one half of approved positions), the existing office space is generally adequate for the existing staff. On average, there are less than two employees per room. However, in Provinces 5 and 6, half of the ministries have office space below the required size or quality. The availability or size of meeting rooms is an issue in some ministries in Provinces

²⁴ For example, local government fiscal autonomy can be limited by conditional grants, civil service rules that limit discretion of subnational governments to hire and fire their employees, and central government-determined compensation rates and work rules for local government employees.

²⁵ Muzzini and Aparicio, 2013 as reported in World Bank, 2018, Managing the federal transfer to support sustainable urbanization.

²⁶ Subnational governments can pass tax laws as long as their laws do not conflict with tax jurisdiction provisions, exclusive and concurrent list as defined in the Constitution and the Intergovernmental Fiscal Arrangement Act.

2, 3 and 5. More importantly, more than half of the provinces do not have adequate space to accommodate meetings of provincial assemblies or cabinets.

51. **Each province has between 30-50 four-wheel vehicles (sedans, vans, jeeps) and 50-90 two-wheel vehicles (motorcycles and scooters), with (Karnali) Province 6 having the least and Province 5 having the most.** This translates into roughly one car and two motorcycles/scooters per seven existing employees. Generally, ministerial offices in all provinces have access to electricity, telephone and internet. Gandaki (Province 4) experiences frequent blackouts though. The provincial governments have supply of computers for their essential staff, while they are not connected through a network that would allow staff to access and manage integrated data systems.

52. **At present, provincial governments do not practice a long-term (life-cycle) approach on management, maintenance, renewal, and development of assets.** They do not have ownership titles for the buildings that they are currently occupying. They have only a paper-based asset inventory system. There are no procedures in place to collect data on operating and maintenance costs for major asset items. There is no system in place for monitoring and recording maintenance work performed and needed.

Human Resource Management

53. **Provincial administrations were introduced in 2017, and they have been following a uniform interim organizational structure developed by the federal administration.** No province has yet conducted its own Organization and Management (O&M) survey to develop its organizational structure. Even with a uniform interim organisation structure in the provinces, there are differences in vacancy rates, ranging from a quarter of approved positions in Gandaki (Province 4) to half in Sudur-Pashchim (Province 7). For all provinces, this adds up to about 1,000 vacant positions in public administration (that is, excluding service centers, such as veterinary clinics). On average, 15 percent of existing staff are contracted, primarily for support functions, such as office assistants and drivers. But a few are more skilled employees, such as computer operators.

54. **The HR policies and guidelines have not been developed for managing approval of leave, performance appraisal etc. in the provincial administrations.** All provincial administrations are now staffed with civil servants seconded from the federal government, and the federal policies are being followed in managing them. Some provinces have developed their own policies for managing contractual staff (e.g., Province 5). Only Province 1 has developed job descriptions for all positions in all provincial ministries. Most provinces have descriptions of roles and responsibilities for various sections within provincial ministries but not by positions. However, many provinces are planning or are in the process of developing job descriptions for individual positions and already have it done for at least one ministry in each province, except Gandaki (Province 4).

Public Financial Management

55. **No province had a multi-year development plan at the time of the FCNA survey.** However, most provinces had begun the process to develop a plan by forming a dedicated commission. There were some public consultations at the district level. In all cases, the planning horizon is for five years. Except for Province 3, provinces do not have any sector-specific plans either. All provinces have annual investment plans, which are broken down by ministry. While Sub-National Treasury Regulatory Application (SUTRA) was used by most local governments to prepare the 2018/19 budget, at the time of the interviews, provinces were uncertain as to which software and budget format to use for FY 2019/20. Province 1 was transitioning to the Nepal Public Sector Accounting Standards (NPSAS) software. Province 3 was planning to use Line

Ministry Budget Information System (LMBIS). Provinces 5 and 6 were waiting for guidelines from the federal government.

56. **While most provinces have a section dedicated to revenue collection, it is often understaffed and busy dealing with other tasks.** Furthermore, district land revenue offices collect the land transfer fee, and there appears to be dual subordination of these offices to both federal and provincial authorities. Most provinces do not have their own arrangements (regulations, manuals, guidelines) in place for internal audits, and they rely on federal legislation and guidelines. All provinces adopted their own procurement guidelines and standards. However, some seconded civil servants are more comfortable with the federal procedures. Half of the provinces acknowledge having limited capacity for procurement. Most provinces lack mechanisms to assess suppliers and their performance. There are no mechanisms for appeals against decisions made in relation to procurement other than the general grievance redress systems.

Gender Equality and Social Inclusion

57. **No province has a comprehensive Gender Equality and Social Inclusion (GESI) policy.** No province has a GESI strategy either. They don't have a framework for promoting women's leadership in provincial governments. No GESI audit has been conducted yet by any provincial government. However, some provinces have programs that target specific social groups, such as children, senior citizens, and differently-abled individuals.

Accountability and Transparency

58. **To share the decisions of provincial assemblies with the citizens, provinces use a variety of methods.** The websites and press releases are the most commonly used methods. There are also designated information officers in each of the ministries. No province has prepared a Provincial Government Citizens' Charter to inform citizens on how to access provincial services. While expenditure statements are published on the provincial government websites at least quarterly, not all provinces report revenues. No province publicizes its budget in a layman version (i.e., provincial government citizens' budget). The officials who were interviewed do not appear to be familiar with this concept. Most provinces have some mechanism for responding to citizen grievances, while its utilizations and response rates vary.

Discussions on Local Governments Capacity Needs Assessment

Physical Infrastructure and Connectivity

59. **More than half (54 percent) of the local governments owned at least some of their buildings.** Among those local governments that owned their own buildings, 17 percent also rented additional space and 4 percent were also temporarily using other public buildings. Out of the 46 percent who did not own any buildings, over 80 percent had to rent at least some of the office space and the remaining local governments temporarily using other public buildings only. Differences in ownership are most evident by type of municipality, with all cities owning buildings, while only 38 percent of rural municipalities owned buildings (Table 4).

60. **Construction of office building is underway for almost half; that is, 47 percent of the local governments.** This is a proportion that is approximated across most comparisons, except in the Himalayan ecological zone (HEZ) where only 24 percent of local governments had construction projects and Province 6, which has only 10 percent of local governments reporting construction. Surprisingly, construction takes

place in less than one half of the local governments without any building but in more than half of those that already own some building(s).

Table 4: Owned vs Rented Local Government Buildings & Average Rooms

	Buildings Owned	Buildings Rented	Average Number of Rooms
Metro	100%	18%	63
Urban	61%	56%	17
Rural	38%	64%	14
All	54%	54%	22

Source: Estimated by the study team based on a representative survey of local governments.

61. **Some 82 percent of local governments are connected to the national grid, but in Province 6 this figure is only 20 percent.**²⁷ In the HEZ, there is a greater reliance on solar power, with 82 percent of HEZ local governments utilizing it, and a lower national grid connectivity, with only 35 percent connected to the national grid. Nationally, 89 percent of all local governments have a back-up electrical system.

62. **Local governments averaged 44 desktop computers and 17 laptops, with metropolitan municipalities, Terai Ecological Zones (TEZ) and Province 2 having more than their counterparts.** Metro municipalities averaged 47 laptops and 199 desktops, compared to 14 and 24 respectively in urban local governments, as well as 11 and 12 respectively in rural local governments. Substantial differences were noted by ecological zone as well: TEZ local governments averaged 16 laptops and 68 desktops, compared to 14 and 13 for HEZ, and 20 and 31 for the Hilly zone. Thus, unlike office space, the number of computers seems to be more aligned with the staff count, at least when compared across different types of municipalities in terms of urbanization. Province 2 local governments averaged 103 desktops, about twice the next highest province's number.

63. **Internet connectivity was high across Provinces 1 through 5, with at least 75 percent of local governments reporting a “functioning internet connection” (Table 5).** However, only half of the local governments in Provinces 6 and 7 were connected to internet, and only 41 percent of HEZ local governments, compared to 80 percent for Hilly and 90 percent for Terai regions. Nearly all (98 percent) local governments have access to cellular telephone networks, with 68 percent calling it reliable and another 25 percent calling it “somewhat reliable.” Only 10 percent of Province 6 local governments called their cellular connection reliable, while HEZ had 24 percent with reliable cellular connections and 51 percent of rural local governments. Most local governments (60 percent) reported that their ward offices do not have landlines and 10 percent reported wards not having access to a mobile network. Metropolitan local governments were most likely to have one or the other for their wards and rural local governments were the least likely.

²⁷ In Province 6 all local governments have solar power.

Table 5: Portion of Local Governments with Internet Connections and Reliable Cellular Connections, by Province

Province	Able to Connect to Internet	Reliable Cellular Access
Province 1	86%	71%
Province 2	90%	81%
Province 3	80%	75%
Province 4	75%	83%
Province 5	89%	78%
Province 6	50%	10%
Province 7	50%	50%

Source: Estimated by the study team based on a representative survey of local governments.

64. **Nearly all local government centers were accessible by road.** Only in provinces 6 and 7 did 10 percent or fewer local governments reported that they were not connected by road. Overall, half of local governments have blacktopped roads to their centers, but only about a quarter of HEZ local governments and rural local governments have blacktopped roads. Provinces 2 and 6 have the lowest portion of local governments with blacktopped roads: 26 percent and 20 percent, respectively.

Human Resource Management

65. **Local governments across the country have a shortage of human resources as illustrated in Table 6.** Overall, there is a shortage of 5500 individuals compared to the number of positions envisioned in local government structures (approved positions).²⁸ However, the magnitude of the shortage is somewhat masked by the surplus of 3,300 positions in the “miscellaneous” category, which mostly consists unskilled workers like cleaners, office assistants, and drivers. Two thirds of them are contract staff rather than permanent employees.

66. **The shortage of high-skill staff is even more striking as shown in Table 7, which indicates the percentage of vacancies by service group and type of municipality.** One can see a particularly high vacancy rate for engineers: almost one half nationwide and over two thirds in sub-metropolitan municipalities. Surprisingly, vacancy rates increase with the level of urbanization. While small in absolute numbers, there is a surplus of health and livestock professionals, especially in metropolitan municipalities.

²⁸ Nationwide counts were derived from the sample using proportions of different strata in the total universe of all local governments.

Table 6: Approved and Filled Positions Across 753 Local Governments

	General Admin.	Revenue/ Account	Engin	Agric	Educ	Law	Health	Livestk	Misc.	Total	Total w/o Misc.
Approved positions	20,043	2,714	8,338	1,890	1,777	307	4,680	2,021	9,004	50,774	41,770
Filled positions	16,232	1,880	4,650	1,750	1,263	190	5,038	1,967	12,268	45,237	32,970
Out of which											
Adjusted	145	5	16	3	6	0	5	7	21	208	187
Deputed	7,746	1,443	1,062	796	964	29	3,448	953	1,777	18,217	16,441
Contract	4,825	139	2,653	839	248	112	1,400	855	7,980	19,052	11,072
LB Staff	3,517	293	919	111	45	49	185	151	2,490	7,760	5,270
Gap	3,811	834	3,688	140	514	117	-358	55	-3,263	5,537	8,800

Source: Estimated by the study team based on a representative survey of local governments.

Engin = Engineering, Agric = Agriculture, Educ = Education, Livestk = Livestock and Misc. = Miscellaneous

Table 7: Vacancy (+) or Redundancy (-) Rate for Approved Positions, by Local Government Type

	General Admin.	Revenue/ Account	Engin	Agric	Educ	Law	Health	Livestk	Misc.	Total	Total w/o Misc.
Metro-politan	21%	57%	64%	20%	59%	30%	-24%	-43%	-27%	14%	55%
Sub-Metro-politan	42%	50%	74%	39%	40%	45%	-81%	7%	-101%	34%	92%
Urban Municipality	21%	18%	40%	11%	30%	58%	4%	-2%	-24%	14%	29%
Rural Municipality	12%	34%	35%	5%	26%	13%	-12%	5%	-53%	4%	16%
Total	19%	31%	44%	7%	29%	38%	-8%	3%	-36%	11%	27%

Source: Estimated by the study team based on a representative survey of local governments.

One should note that these numbers capture present staff, whether inherited from the previous local bodies, seconded from the national civil service or (still very rare at the time of the survey) adjusted from the federal into subnational civil service. The shortage of technically skilled human resources will impact specific sectors. As illustrated in

Table 8, forestry and law are the two sectors that suffer the most from the lack of technically skilled staff. In addition, there are shortages of technical expertise specific to different types of municipalities. Rural municipalities have more acute challenges in the education and infrastructure sectors. By contrast, for metropolitan municipalities, more pressing needs are in IT, land/building, planning, and waste management.

Table 8: Proportion of Local Governments that See Services Disrupted/Lacking Due to Insufficient Staff, by Function

	Metro-politan	Sub-Metro-politan	Urban Muni-cipality	Rural Muni-cipality	All Local Governments
Administration	33%	91%	81%	71%	74%
Plan	67%	91%	72%	76%	76%
Information & technology	67%	73%	44%	53%	53%
Account	33%	64%	61%	61%	60%
Land/Building	67%	64%	61%	66%	64%
Forest	50%	100%	100%	93%	93%
Education	33%	73%	58%	81%	70%
Health	33%	73%	47%	45%	48%
Agriculture	17%	73%	61%	65%	62%
Infrastructure Development	50%	73%	58%	77%	70%
Law	67%	82%	83%	89%	85%
Environment	50%	73%	72%	66%	68%
Waste Management	67%	64%	61%	61%	62%
Other	0%	9%	17%	11%	12%

Source: Estimated by the study team based on a representative survey of local governments.

67. **Less than a third of the local governments report having their own laws/policies for managing their staff, in terms of leave approval, performance appraisal reporting relations etc.** There is a direct relationship between the level of urbanization and the likelihood that a local government will have its own laws/policies on staff management; so, metropolitan municipalities are more likely to have such laws as compared to rural municipalities.

68. **Over 8,000 local staff have not attended any training since the local elections in 2017.** This represents almost one fifth of all staff present in local governments, but for sub-metropolitan municipalities, this represents over one third of their existing staff (Table 9). However, only half of the local governments have prepared capacity building plans for either employees or elected officials.

Table 9: Estimated Number of Staff Not Participated in Any Training on a Relevant Subject After Formation of Local Government

	Metropolitan	Sub-metropolitan	Urban Municipality	Rural Municipality	Grand Total
Province 1	0	0	981	499	1,480
Province 2	12	36	562	229	839
Province 3	320	140	649	1,021	2,130
Province 4	40	0	321	210	571
Province 5	0	309	328	394	1,031
Province 6	0	0	342	964	1,306
Province 7	0	170	520	332	1,021
Total	372	655	3,695	3,621	8,343
Percent of present staff	8.37%	35.85%	19.63%	17.97%	18.44%

Source: Estimated by the study team based on a representative survey of local governments.

Planning and Public Financial Management

69. **The survey results show vast differences between local governments and provinces in the area of planning and PFM.** Only a quarter of Nepali local governments have multi-year development plans and this proportion ranges from 10 percent in Provinces 4 and 6 to 50 percent in Province 7. Where such a plan exists, planning almost always involved public consultations. Local governments receiving training on Medium Term Expenditure Framework (MTEF) greatly differ among provinces. Overall, less than a fifth of the local governments have received any training on MTEF, with the proportion ranging from zero in Provinces 4 and 6 to a quarter in Provinces 2 and 7. In terms of municipality type, a higher proportion of metropolitan municipalities received some MTEF training than others.

70. **At the ward level, 58 percent of local governments reported that wards were able to do ward-level planning and the same proportion were able to do monitoring work.** Only 38 percent of local governments reported that their wards could do ward-level data management. However, 93 percent of local governments reported that wards are involved in monitoring local government services.

71. **The local governments are developing their Public Financial Management practices.** Different software packages are being used by the local governments to prepare budget estimates. Less than 44 percent of local governments use the SUTRA to prepare budget estimate, while 68 percent use Excel. Only 6 percent of HEZ local governments use SUTRA while the rest rely on Excel. Of those that did not use SUTRA, the most commonly cited reason (42 percent) was the lack of trained staff. Out of those who did not use SUTRA last year, 60 percent are ready to use SUTRA for next budget estimates. In just under half of local governments (49 percent), budget estimates followed the SUTRA format, while 30 percent followed the federal format and 5 percent followed FMIS.

72. **In terms of budget execution, two thirds of local governments reported using Excel while only fifty percent used SUTRA.** Nearly all local governments reconciled their accounts periodically since only three local governments never did it. 58 percent of local governments reconciled their accounts monthly, while 21 percent did it quarterly, 10 percent semi-annually, and 9 percent annually. Seventy-nine percent of local governments have studied local revenue sources, with the proportion being lower for rural (less than 75 percent) and higher for urban municipalities (more than 85 percent). Revenue improvement action plans existed in only 25 percent of local governments, but for metropolitan municipalities this proportion

was 50 percent. On average, local governments collected 72 percent of estimated revenue. However, between provinces, this ranged from 40 percent in Province 2 to 95 percent in Province 4. In 57 percent of local governments, actual revenue collection was off by more than 25 percent. In these cases, the most common reasons cited were unrealistic estimations (62 percent of cases) and limited personnel (51 percent of cases). Excel was the most common revenue management system utilized, with 37 percent of local governments using it, followed by government developed software (23 percent) and the rest using development partners' or their own software.

73. **Revenue collection was in cash in 66 percent of local governments. Although 93 percent of local governments reported having a branch of commercial bank there.** In addition, only about half of the local government that collect revenue in cash deposit the funds daily into bank accounts. On the expenditure side, the average burn-rate of local governments' recurrent budgets was 80 percent and 75 percent for capital budgets. Surprisingly, the burn-rate was lower than the average in metropolitan municipalities with burn rates of 76 percent and 61 percent for recurrent and capital respectively. Those local governments with less than 60 percent capital budget burn-rates identified absence of technical staff (29 percent), default by contractor (29 percent) and low procurement capacity (24 percent) as the main reason for low capital budget execution.

74. **Less than one half of local governments (46 percent) have prepared procurement regulations, though most (83 percent) have a unit in their organizational structure designated to handle procurement.** The highest proportion of local governments with procurement regulations at 82 percent is among metropolitan and sub-metropolitan cities, but only 42 percent of urban municipalities and 38 percent of rural municipalities have them. Province 4 has the smallest portion of local governments with procurement regulations, at 17 percent, while Provinces 1 and 2 have the lowest portion of their local governments with a designated unit, at 67 percent and 68 percent respectively (Table 10).

Table 10: Portion of Local Governments with Procurement Regulations and Functional Procurement Unit in Place, by Province

	Regulations	Functional Units
Province 1	33%	67%
Province 2	73%	68%
Province 3	55%	95%
Province 4	17%	83%
Province 5	39%	94%
Province 6	60%	90%
Province 7	33%	92%
All Provinces	46%	83%

Source: Estimated by the study team based on a representative survey of local governments.

75. **The capacity to conduct international bidding is very low amongst local governments, with only 14 percent stating that they have such capacity.** On the other hand, at least 94 percent have capacity for national bidding, sealed quotations, direct procurement and through a user's committee. By far, the most commonly used procurement type is the users' committee. However, only 30 percent of local governments have a mechanism to avoid conflict of interest in forming their user committees. In Province 7, no local governments have such a mechanism.

Political Governance and Administration

76. **Mayors/Chairs are male in 97 percent of local governments and deputy mayors/vice chairs are female in 92 percent of local governments.** Over one third, 41 percent of assembly members are female while 21 percent are Dalits. There is little variation in these proportions across provinces, ecological zones and municipality type. Some 88 percent of local assemblies have judicial, legislation, resource projection, revenue and budget committees. Local governments in Province 5 have created the fewest committees, 50 percent have created account and revenue committees and 61 percent have created legislation, social affairs, administration, resource projection, and budget committees.

77. **Almost half, 48 percent of assembly committees have never received status reports from their respective thematic local government sections.** Some 27 percent have received them only “sometimes” at an irregular basis. Table 11 provides the proportion of local governments never receiving thematic section status reports by municipality type and ecological zone.

Table 11: Portion of Local Governments "Never" Receiving Thematic Section Status Reports.

Metro	12%		HEZ	76%
Urban	53%		Hilly Zone	47%
Rural	56%		TEZ	40%

Source: Estimated by the study team based on a representative survey of local governments.

78. **At least 88 percent of local governments have created units for education, health, agriculture, environment, vital registration, and development and planning.** On the other hand, less than one quarter of local governments have created governmental units for FM radio, alternative energies, forest/biodiversity, language/culture, and transportation.

79. **On relationships between local governments and wards, only one local government reported that there was no clear allocation of authority between the local government and the wards.** In 82 percent of local governments, ward chairs were clear about their roles, but the figure was only 65 percent in metropolitan local governments. More than half (57 percent) of local governments reported no disputes between ward chairs and mayors; though Karnali has more disputes than other provinces, particularly around the devolution of authority and office location. 88 percent of local governments reported that their wards meet at least monthly. Sudur Pashchim had the fewest local governments with wards that held monthly meetings (58 percent).

Sector Administrative Capacity

80. **Sectoral administrative capacity amongst local governments varies across sectors, ecological zones and provinces.** To manage and conduct sector level policies and work, at the minimum, local governments need to incorporate sectors into their organizational structures. To that extent, the incorporation rate of sectors into organization structure of individual local governments are above fifty percent for most sectors. Some sectors like education, basic health, social welfare related sectors, agriculture and local roads have been incorporated by over 90 percent of local governments (Table 12).

81. **Sectors related to economic development, except for cooperative sectors (89 percent) have modest incorporation rates.** Micro enterprise and economic data collection are incorporated by 56 percent and 55 percent of local governments respectively, but only 6 percent of local governments have unemployment records. Similarly, sectors related to the environment also have only modest incorporation rates amongst local governments. Bio-diversity and watershed sectors have been incorporated by 52 percent

of local governments while wildlife and mines & minerals sectors have only been incorporated by 37 percent and 27 percent respectively.

Table 12: Portion of Local Governments That Have Incorporated Sectors into Their Organizational Structures

Disaster Risk Management	77%	Fisheries	35%
Education	98%	Agriculture Extension	62%
Basic Health Services	97%	Horticulture	62%
Social Welfare	95%	Irrigation	71%
Vital Registration	95%	Forest	66%
Women	95%	Bio-diversity	52%
Children	95%	Watershed	52%
Youth	81%	Wildlife	37%
Senior Citizens	95%	Mines & Minerals	27%
Sports	84%	Soil Conservation	60%
Unemployment Records	6%	Waste Management	77%
Cooperative	89%	Community Parks	49%
Local Market Management	70 %	Environmental Management	76%
Micro Enterprise	56%	Drinking Water	83%
Economic Data Collection	55%	Sanitation	87%
Local Economic Development Plan	63%	Local Roads	97%
Agriculture	95%	Rural Roads	85%
Agriculture Production	72%	Agricultural Roads	63%
Livestock	72%		

Source: Estimated by the study team based on a representative survey of local governments.

82. **As noted above, there are regional disparities in capacities amongst local governments.** While the FCNA dataset has rich information on all sectors about regional variances, this note will illustrate this with reference to two sectors.

83. **Local governments across the country have an overall incorporation rate of 83 percent and 87 percent for drinking water and sanitation respectively.** However, compared amongst provinces, the incorporation rate varies from 90 percent (Province 1 and Province 6) to 75 percent (Province 4). Similarly, all Province 2 local governments have incorporated sanitation into their organizational structures but only 60 percent of local government have done so in Karnali (Province 6) (Table 13).

Table 13: Drinking Water and Sanitation Functions Incorporated into Local Governments, by Province

	Drinking Water	Sanitation
Province 1	90%	90%
Province 2	77%	100%
Province 3	80 %	85%
Province 4	75%	83%
Province 5	83%	94%
Province 6	90%	60%
Province 7	83%	75%
Total	83%	87%

Source: Estimated by the study team based on a representative survey of local governments.

84. **There is variance in the development and incorporation of settlement/urban master plans and land use plans across ecological regions.** Across the country, only 17 percent of local governments have settlement masterplans and 60 percent have land use plans. However, there is also difference across the ecological zones as illustrated by Table 14. More local governments in the TEZ have settlement master plans than in the Himalayan Ecological Zone (HEZ) or Hilly Zone. Similarly, more TEZ local governments have land use plans than HEZ or Hilly Zone local governments.

Table 14: Portion of Local Governments with No Master Plan and No Land Use Plan, by Ecological Zone and Municipality Type

	No Master Plan	No Land Use Plan
HEZ	88%	53%
Hilly Zone	88%	39%
TEZ	76%	37%
Metro	76%	29%
Urban	83%	25%
Rural	85%	43%
All Local Governments	83%	40%

Source: Estimated by the study team based on a representative survey of local governments.

85. **Sources of sector funding at local governments vary across sectors.** The results from the local government survey illustrating the sources of funds utilized by local governments by sector are presented in Table 15 below. Most local governments use revenue sharing funds for economic development (79 percent). Similarly, most local governments prioritize their own source revenue for economic development (78 percent) as well. Own source revenue is also used by many local governments in all other sectors apart from basic health service. No local government uses own source revenue for basic health services.

86. **Nearly all local governments (99 percent) use conditional grants for basic health services.** In addition to basic health service, most local governments use conditional grants for education (97 percent), economic development (90 percent) and agriculture (83 percent). Social development is the only sector where no local governments use conditional grants as a funding source.

87. **Equalization grants are the most favored funding source for social development, with 79 percent of local governments using it.** Other sectors where equalization grants are commonly used are

agriculture (76 percent), environment (76 percent) and basic health services (65 percent). However, no local government uses equalization grants for drinking water and sanitation and road sectors.

88. **Complementary grants are mostly used by local governments for economic development (90 percent), roads (86 percent) and drinking water and sanitation (71 percent).** While there is at least one local government utilizing complementary grants in each of the other sectors, the use is much lower. For example, the next most common uses of complementary grants are for the environment and social development sectors, with only 17 percent and 16 percent of local governments utilizing it respectively.

89. **In the case of special grants, no local government uses it for education, environment or drinking water and sanitation.** The most common use of special grants by local governments is for economic development (25 percent) followed by roads (17 percent).

Table 15: Percentage of Local Governments Using the Different Funding Sources for Each Sector

	Own Source	Revenue Sharing	Complementary Grant	Conditional Grants	Special Grants	Equalization Grants
Education	47%	23%	10%	97%	0%	56%
Basic Health Services	0%	16%	10%	99%	4%	65%
Social Development	61%	42%	16%	0%	13%	79%
Economic Development	78%	79%	90%	90%	25%	43%
Agriculture	61%	25%	9%	83%	13%	76%
Environment	56%	39%	17%	50%	0%	76%
Drinking Water & Sanitation	62%	45%	71%	58%	0%	0%
Roads	59%	63%	86%	58%	17%	0%

Source: Estimated by the study team based on a representative survey of local governments.

90. **Performance monitoring capacity is a major issue across all sectors for many local governments.** Many local governments do not have any personnel, resources, knowledge or physical infrastructure to monitor sector-level performance and outcomes. Sector-wise, settlement development, environment, disaster risk management, drinking water and sanitation, and agriculture had the largest portion of local governments without either any personnel, resources, knowledge or physical infrastructure to monitor performance (Table 16).

91. **Lack of resources was the most commonly identified capacity-related challenge that constrained performance monitoring in local governments.** As much as 30 percent of local governments do not have any resources to monitor performance of settlement development followed by environment (24 percent) and drinking water and sanitation (23 percent). Roads is the only sector where over 10 percent of local governments (13 percent) have adequate resources to monitor performance. In the other sectors, less than 10 percent of local governments have adequate resources.

92. **In the case of personnel and skills for monitoring, it was only basic health services (28 percent) and roads (21 percent) which saw more than 20 percent of local governments having adequate capacity.** Some 34 percent of local governments have no capacity regarding personnel and skills for

monitoring environment while 32 percent of local governments do not have it for settlement development. Only settlement development (25 percent), environment (15 percent) and drinking water and sanitation (10 percent) had more than 10 percent of local governments having no knowledge for monitoring. In contrast to the other capacities, a higher proportion of local governments had knowledge to monitor performance, albeit, it is still very low. The sector with the greatest number of local governments having adequate knowledge was the basic health services sector (38 percent).

Table 16: Portion of Local Governments with "Adequate Capacity" and "No Capacity" for Monitoring Outcomes and Performance in Each Sector

	Personnel/Skills		Resources		Knowledge		Physical Infrastructure	
	Adequate	None	Adequate	None	Adequate	None	Adequate	None
Settlement Development & Land Administration	6%	32%	5%	30%	17%	25%	10%	34%
Disaster Risk Management	3%	22%	5%	18%	18%	5%	1%	27%
Education	17%	12%	5%	11%	27%	4%	8%	9%
Basic Health Services	28%	3%	6%	8%	38%	3%	8%	10%
Economic Development	14%	8%	7%	10%	23%	4%	10%	9%
Agriculture	11%	14%	7%	17%	29%	7%	5%	19%
Environment	6%	34%	5%	24%	16%	15%	6%	31%
Drinking Water & Sanitation	11%	17%	7%	23%	19%	10%	6%	16%
Roads	21%	4%	13%	8%	37%	3%	11%	9%

Source: Estimated by the study team based on a representative survey of local governments.

Gender Equality and Social Inclusion

93. **At least 80 percent of local governments have Gender Equality and Social Inclusion (GESI) policies, including those for children, senior citizens, and the differently-abled, as well as for ensuring women's participation in local government activities.** However, 60 percent of local governments have never conducted a GESI audit. Nearly all local governments have included GESI in their budgets and through inclusiveness that encourages the participation of women and senior citizens, as well as ethnic and disadvantaged groups. To combat gender-based violence, nearly all local governments have awareness campaigns, four fifths provide counselling services, and two thirds provide monitoring. More than one half provide legal services and special programs, with 30 percent providing compensation to support victims. While only 2 percent of local governments reported having none of these programs, 10 percent local governments in Province 6 have no programs. Provinces 2 and 7 have enacted legislation against gender-based violence; Provinces 2 and 6 have legal support for victims; and Provinces 2, 4, and 7 have victim compensation provision.

Accountability & Transparency

94. **Local governments use a variety of methods to make their executive decisions public.** The most important tools include: a website (70 percent of local governments), notice boards (59 percent), social media (59 percent), newspapers (46 percent), public announcements (44 percent), and radio/TV (41 percent). There were some ecological zone differences, such as HEZ local governments being less likely to use websites (59 percent) and more likely to use notice boards (82 percent). Websites are also the common method used to inform citizens about services provided by the local government, with 81 percent of local governments using them. Using the Citizen Charters was the next most common (73 percent), followed by social media (66 percent), and advertisements (59 percent).

95. **The frequency of making public income and expenditure statements varied greatly, with 26 percent doing so semi-annually, 23 percent monthly, 18 percent quarterly and 15 percent annually.** 17 percent of local governments never make their income and expenditure statements public. While nearly all local governments use the federal act to implement Right to Information, and only 8 percent receive requests for information “frequently”, with metropolitan local governments more likely to get frequent requests. Nearly all local governments (92 percent) have a designated information officer that is made public.

96. **Budgets, plans, assembly decisions, and executive decisions are made public by more than 90 percent of local governments, with 82 percent providing details about activities and performance of thematic sections.** Nearly all local governments have websites that provide the following details: contact of officials (94 percent); policies, plans, and programs (94 percent); updates of local government activities (90 percent); laws and regulations (90 percent); and budget information (92 percent).

97. **Local governments engage external organizations in budget preparation at generally high but varying rates, with local business chambers and civil society/NGOs recording the highest (at 83 percent of local governments).** Fewer local governments engage community associations or other public institutions (76 percent and 64 percent, respectively). Province 2 is less likely to engage outside organizations than other provinces, and Hilly Zone local governments are more likely to do so.

98. **Some 83 percent of local governments have a grievance redress mechanism.** These local governments mostly use designated officials and complaint boxes (86 percent and 83 percent respectively), followed by public hearings (75 percent), social media (64 percent), social audits (61 percent), and complaint registers (51 percent). In the 96 (out of 115 sampled) local governments that have a grievance redress system, the average number of complaints registered was 16, with a wide variance (0 to 356); the average number of complaints addressed was nine. Three quarters of local governments conducted a social audit for the recent fiscal year. The most common reason for not conducting a social audit was “limited personnel”, cited by 57 percent of those not conducting the audit.

SECTION III: Recommendations—Blueprints for a Roadmap

99. **An important ingredient missing in Nepal’s move to fiscal federalism is a sequenced plan or a detailed timeline for introducing various elements of the fiscal federalism.** A reasoned implementation plan with an implementation calendar that is transparent and is adjusted as the process goes forward would be useful. If this were to be done, and if it were made widely available, it could form a basis for grading the progress made with the overall implementation of federalism. It could also be used to better manage expectations at the subnational government level and to ensure broad-based credibility in this long process of transformation to federalism. Such a roadmap might not lead to the equitable and inclusive society that the framers of the Constitution hoped for, nor will it lead to contented politicians, but it might result in more confidence in government leadership. The responsibility of developing the implementation plan could be entrusted to a “Roadmap Committee” which is then dissolved once the work is complete. A natural home for the committee might be the Inter-Provincial Council, or it might be established under the Intergovernmental Coordination Bill (Art. 235), if this idea could get buy-in from the other important stakeholders. Once the roadmap is in place and accepted by the Committee, its management and regular upgrading could be turned over to another body for tracking and updating. Some ideas about how such a committee might operate could be gained from Box 2, which reports the approach taken in Kenya.

100. **Further, international experience suggests that decentralization has benefitted from monitoring and evaluation.** Some successful countries have tracked the progress of decentralization; they have continuously looked for ways to make their decentralized public sector structure work better and engaged in incremental reforms until the different pieces of the decentralized system converged on the overall goals. The government of Nepal can benefit from investing in a decentralization cell with a mandate to continually evaluate the intergovernmental system.

101. **The NNRFC has a broad mandate to lead thinking in this area, including to track the performance of all local governments in the country, evaluate the success of the equalization grants, initiate enhancements of the database on local government finances, and generally grade the success of Nepal’s fiscal federalism.**²⁹ The importance of the NNRFC is emphasized in the Constitution by making its recommendations about intergovernmental transfers binding on government.³⁰ However, the existing secretariat can benefit from enhancing its staff cohort and research capacity in intergovernmental fiscal relations and will require richer access to data on which it can draw. Clearly, the NNRFC must have access to a decentralization cell.

102. **However, the Ministry of Finance also needs a fiscal analysis cell since its mandate is to provide leadership in evaluating fiscal policies that are in the best interest of the country, and its responsibilities go well beyond the mandate of the NNRFC.** These include tax policy and administration, expenditure and subsidy policy, the debt regime, and evaluation of the impacts of the NNRFC recommendations. The Inter-Provincial Council also has a stake in monitoring and evaluation, with a focus on sub-provincial governments. The government of Nepal has much work to do in deciding on the process by which it will continually monitor and adjust its fiscal system and where it will place the decentralization cells.

²⁹ Article 251, Constitution of Nepal.

³⁰ Article 60 (3), Constitution of Nepal.

Box 2: Source: Prepared by authors based on a review of Kenya's legislation and press

Like Nepal, Kenya also had substantial amount of power and resources assigned by a new 2010 Constitution to an entirely new level of government. Thus, Kenya's previous eight provinces and over 280 districts were replaced by 47 new counties. However, unlike Nepal's 2015 Constitution, Kenya's Constitution provided that, "...Parliament shall, by legislation, make provision for the phased transfer, over a period of not more than three years from the date of the first election of county assemblies, from the national government to county governments of the functions assigned to them." Furthermore, the transitional clauses of the Constitution explicitly, "...permit the asymmetrical devolution of powers to ensure that functions are devolved promptly to counties that have the capacity to perform them but that no county is given functions it cannot perform." Therefore, The Transition to Devolved Government Act (TDGA) of 2012 established a Transition Authority (TA) to facilitate and co-ordinate the transition to a devolved system of government. While not explicitly called for in the Constitution, the Authority was created in the implementing legislation as a mechanism to ensure that the Commission for the Implementation of the Constitution performs its role in monitoring and overseeing the effective implementation of the devolved system of government effectively. The time-limited nature of the Transition Authority distinguishes it from permanent constitutional bodies, like the Commission for Revenue Allocation, which is analogous to Nepal's Fiscal Commission.

The Authority's members were competitively sourced, approved by Parliament and envisioned by TDGA to serve until three years after the first general election under the new Constitution or upon the full transition to county governments, whichever is to happen earlier. Then it would be dissolved. This statutory status provided this body some independence from the executives at both national and subnational levels, who repeatedly tried to get rid of this constraint on their powers. Thus, the national government eliminated the Transition Authority's independent budget vote so that the authority would be treated as a sub-department in the parent Ministry of Devolution. Notwithstanding its limited funding, the Authority managed to oversee the transition process with the support of donors like UNDP and the World Bank for the envisioned three-year term. However, when the Authority proposed to extend its terms for an additional three years to address unfinished business (e.g., inventory of assets and liabilities), the national government was only willing to support a one year extension while the County Governors strongly opposed any move to extend the Authority's term, accusing it of most of the problems facing the Counties. After the one-year extension, all residual matters were handed over to the Inter-Governmental Relations and Technical Committee (IGRTC).

By having the overall responsibility of overseeing the implementation of devolution under the new Constitution, Kenya's Transition Authority was leading all aspects of devolution, that is all "three Fs" as they are known in Nepal (functions, functionaries, and finance). Thus, by law, the Transition Authority was mandated to facilitate the analysis (unbundling and costing) and the phased transfer of the functions assigned in the Constitution to county governments. In particular, the Authority was receiving and evaluating requests from each county government to hand over specific functions. Concerning the second "F" (functionaries), the Transition Authority was mandated to oversee the Assumption of Office procedures of the Governors, and facilitation for other elected and appointed leaders in taking up their roles and responsibilities. As far as the third "F" is concerned (finance), the Authority's role included ensuring provision of interim offices, housing, security, and relevant legislation. Preceding the swearing-in ceremonies for all 47 counties, the TA had already developed preliminary tools to prepare for county assemblies' successful initialization, e.g., by developing Interim Standing Orders, Speaker's Rules, Oath Books, the Mace, Speakers' Chairs, permanent County Coordinators, and Interim County Transition Teams.

Source: Prepared by Georgia State University team based on a review of Kenya's legislation and press

103. **Nepal embarked on federalism without a sequenced plan or a detailed timeline for addressing various bottleneck points in the implementation of a new system.** Nor did it have an action plan to guide the handoff of responsibilities and assets from the federal to the subnational governments.³¹ There is much work to do to get the sequencing right and the timelines reasonable.³²

104. **A review of the experience in various countries suggests that, success often depends on whether a coherent implementation strategy has been developed, and whether adequate mechanisms exist for managing the implementation process.** The process often includes multiple reform components, divergent interests (among central vs. local governments, sectoral ministries vs. central agencies,

³¹ One version of such an action plan was issued in December 2018 by the Inter-Provincial Council (2018). See Annex A to this report.

³² For a discussion of the elements of a roadmap for fiscal decentralization, see Bahl and Martinez-Vazquez (2006a).

bureaucrats vs. politicians vs. citizens, etc.) and insufficient information. Logically, and as experience shows, some decentralization measures (e.g., devolution of expenditure responsibilities) may not yield the desired outcomes without complementary reforms (e.g., providing for budget autonomy by eliminating mandates).

105. **To maximize the chances of reaching the objectives of federalism, the reform process needs to be strategically sequenced.** An appropriate ordering of the reforms process is needed for several reasons. First, sequencing the reform process will ensure that government maintains focus on pre-defined goals, undertakes complementary reforms (where necessary), while helping Government to also anticipate potential opportunities and risks to the successful implementation of federalism. For instance, various areas which require capacity building might be recognized early, and proactive action could be taken in anticipation of next steps. Otherwise, the process could be stalled at various stages, and implemented programs would likely be half-finished. In Mexico, for instance, decentralization reforms stalled as the Government did not anticipate the capacity deficits of local Governments and their potential impacts.

106. Second, developing a sequenced reform plan, could help identify potential political economy factors which could affect the reforms' implementation. The result is the taking of actions, as well as the formulation of policies and/or the amendment of laws which might cause the process to tilt off the course critical to meeting the goals set from the outset. In Indonesia's case, an unspecified transition period to phase-in a new formula for resource transfers at the subnational level created an entry point for some politicians to incline the process in favor of their constituencies without due consideration of the broader national interest and goal of improving equity.

107. **Third, a sequenced plan would also help reduce the adjustment costs associated with the introduction of federalism.** High costs of reforms could arise from lengthy debates over policy choices, duplication of policy actions and poor coordination, attributable to the absence of a documented sequenced plan. If relevant provisions are entrenched in the constitution or laws are passed before the objectives and the framework are well developed, for example, successful execution may be severely constrained since the provisions or laws may impose unwelcomed rigidities. The process, underscored by the rigid provisions or laws, would not easily respond, in a timely manner, to developments in the economy such as changes in population and income/revenue dynamics. Changes in revenue-mobilizing (or expenditure) rules may be needed, in certain instances, to match the expenditure (or revenue-mobilizing) needs and realities: thus, an element of flexibility is required in the process. In India, reforms related to indirect taxation at the state level faced major constraints because the constitution granted states tax-levying powers on goods while the transaction of service could only be taxed at the federal level. Part of the costs could also stem from policy missteps, coupled with lengthy debates and digressions, which could arise because of the absence of a documented sequenced plan. The decentralization structure of industrial nations such as the US has been forged through several decades of political deliberations while facing democratic bottlenecks as well. This is luxury which developing countries cannot afford in a world characterized by rapid change and the propensity to lag advanced countries.

108. **Some of the unintended costs of ignoring a well sequenced strategy, such as associated with weak or no borrowing powers of sub-national entities at the early implementation stages, may yield mild inefficiency costs regarding suboptimal financing of investments.** However, others could have broader and more devastating ramifications. For instance, granting significant borrowing powers to subnational governments without context-relevant borrowing and debt rules could place the country's economy on an unsustainable debt trajectory: that is, cause macroeconomic instability because of a strong temptation to indulge in fiscal indiscipline. A closely related and ubiquitous sequencing misstep involves the assignment of revenue responsibilities before clearly defining the expenditure functions. This could

culminate in inefficient allocation of funds and create fiscal deficit difficulties (because investment returns may be inadequate to recoup investment costs) resulting in macroeconomic instability. In Brazil, for instance, state governments were granted revenue mobilizing powers and guaranteed transfers under the 1998 Constitution. Yet, expenditure duties were not clearly spelt out. The ambiguity resulted in misunderstanding of roles and inefficiency of resource allocation. Another issue is the inadvertent social cost of protracted dependency which might arise when suboptimal sequencing results in a structure in which subnational governments rely, for too long and almost completely, on the federal government for their revenues or transfers to perform their service delivery and associated functions.

109. **A good approach would be to put an implementation plan in place and allow it to be adjusted as the process moves forward.** If the implementation plan is annotated with an action plan, it could form a basis for monitoring the progress of the overall federalism process. The responsibility for developing the implementation plan needs not solely be with one level of government or a single ministry. A “Roadmap Committee” could be entrusted to design the implementation plan. Ideally, the committee should have representation from major stakeholders, as well as entail technical staff. For example, it could be a body chaired by the Prime Minister, with members from MOFAGA, the Inter-Provincial Council, the local government associations, and a distinguished intergovernmental fiscal expert from outside government. A natural home for the committee might be the Inter-Provincial Council, or it might be established under the Intergovernmental Coordination Bill (Art. 235 of the Constitution), if this idea could get buy-in from the other important stakeholders. Once the roadmap is in place and accepted by the Committee, its management and regular upgrading could be handed to another body for tracking and updating.

110. **Drawing on the discussions in the previous section of the Policy Note and the Federalism Capacity Needs Assessment Report, the table below provides a blueprint for a roadmap.** The roadmap itself needs to be prepared through a consultative process with all stakeholders and owned by the government. The table below is intended to stimulate discussions for a federalism implementation roadmap by proposing ideas around three Fs (Functions, Funds and Functionaries) as well as organizational & institutional arrangements.

Table 17: Blueprints for a Roadmap

Issue	Description	Method in Implementation Plan	Mitigating Measure
Functions			
Concurrent responsibilities	Clarify concurrent expenditure assignments	Review unbundling exercise for concurrent assignments	Capacity of PLGs to assume service delivery responsibilities is essential
Recommendations: <ul style="list-style-type: none"> Review all the relevant sectoral legislations to make sure that functional assignment is clear Design a capacity improvement plan for PLGs in these areas 			
Devolution of service delivery responsibility	How exactly will devolved functions and functionaries be handed off from line ministries? What flow of resources will take place? Will there be a breakdown in service delivery for essential functions?	Plan for a slower phased in transition Clarify the shift of management responsibility and reporting lines Design capacity building interventions	Will the establishment of a contingency fund be necessary? An assessment of provincial capacity and needs to assume service delivery from line ministry must be

	What budget and management autonomy will be given to local governments?		undertaken before services are devolved Clarity on assignment of responsibility for management of health and education personnel must be put in place before devolution
Recommendations: <ul style="list-style-type: none"> Establish systems and tools to implement the Local Government Operations Act of 2017 (Act 2704) Establish communication channels between sector ministries and PLGs to address service delivery issues Review all the relevant sectoral legislations to make sure that functional complies with the constitutional mandate, for example: <ul style="list-style-type: none"> Review Town Development Act of 1988 Revise Public Procurement Act Review the Forestry Act Review Water Resource Act 1992 Transfer five regional emergency centers to provincial governments 			
Monitoring and evaluation (M&E)	Where will responsibility for M&E of service delivery and local government performance in general be placed?	Design development interventions for M&E Clarify lines of responsibility and reporting Allocate adequate funding for M&E function	Systems for monitoring and evaluation are not yet in place Database adequate to support M&E not in place Training programs for M&E not yet established
Recommendations: <ul style="list-style-type: none"> Establish a federalization cell to do continuous evaluation of the intergovernmental systems Design a capacity building program for federal ministries on M&E Design self-assessment evaluation tools for PLGs 			
Institutionalization of self-assessment for service delivery	Identification of institutional and organizational weaknesses for service delivery at the local level	There are existing tools, such as LISA, to identify service delivery weakness, which can be deployed immediately	Make sure LISA assessment is available to all local governments
Recommendation: Make sure that local governments' reports of LISA assessments are uniform			
Funds			
NNRFC and inter-governmental fiscal transfers	Dispute over how the duties and responsibilities of NNRFC will be interpreted	Clarity on the binding nature of recommendations Technical training of the secretariat staff	Commission is not fully staffed Initial review of the intergovernmental transfer system has not yet been done Need for stronger oversight of the NNRFC by the Parliament
Recommendations: <ul style="list-style-type: none"> Appointment of commissioners Staffing the NNRFC secretariat Design study tours to other federal countries to improve the technical capacity of the NNRFC Begin to develop an adequate data base to support the work of the NNRFC Establish an ongoing training program for NNRFC secretariat 			

PLGs government revenue mobilization	PLGs adopt distortive taxes PLGs need to be encouraged to adopt new taxes PLGs need to improve local tax and revenue administration	Capacity building and training Build incentives into grant programs Technical assistance in drafting new legislation including model laws	Capacity building and training program not yet in place Strong incentives in the legislation to promote increased local revenue mobilization are not in place No monitoring in place
Recommendations: <ul style="list-style-type: none"> Review the use of intergovernmental transfers to incentivize own source revenue collection Improve the capacities of subnational governments to administer tax bases, establish databases, and collect taxes Establish monitoring system for revenue collection Clarify tax assignment for shared taxes Establish divisible fund to share the natural resource royalties 			
Funds for investments	Underdeveloped domestic capital market limits subnational governments' ability to raise financing for investments.	Capitalization of domestic intermediaries (such as Town Development Fund)	Improve financial management capacities of subnational governments before promoting access to capital markets
Recommendations: <ul style="list-style-type: none"> Improve the capacity of subnational governments across public investment management cycle Improve transparency of subnational finances Strengthen the legal and institutional framework for PPPs Review Town Development Act (1988) and update it based on the provisions of the Constitution 			
Public Financial Management	Time delays in extending PFM programs to the subnational sector Limited capacity to absorb PFM improvements	Design technical assistance, capacity building and training programs for PLGs	Capacity building and training plan not yet in place
Recommendations: <ul style="list-style-type: none"> Strengthen the PFM capacity of subnational governments Identify projects and programs to be transferred to PLGs Prepare a plan to transfer them Preparation and implementation of an expenditure reporting system for PLGs by OAG 			
Accounting and reporting	Ensure comparability and accuracy in financial reporting Periodicity of external audits	Design capacity building and training programs for PLGs Provide incentives for compliance	Capacity building and training program not in place
Recommendation: Strengthen the capacity of subnational governments			
Alignment of plans	The linkages between various planning instruments are very weak.	Annual plans prepared by subnational governments are not aligned with medium term plans prepared by sector ministries.	Medium-term plans prepared with the involvement of subnational first, then, annual plans prepared by PLGs.
Recommendations: <ul style="list-style-type: none"> Promote citizen engagement and participation in medium term plans Involve subnational governments in the preparation of medium-term plans 			

Standardization of PFM software	Proliferation of PFM software (SUTRA, EazyTech, Shangrila); Proliferation of PFM software at the provincial level (NPSAS, LMBIS)	Identification of the best software in terms of coverage (planning, budgeting, accounting etc.) and user-friendliness to roll out across local governments	Familiarization of local governments with the selected software
Recommendations: <ul style="list-style-type: none"> • Training of local government finance officials on the selected software • Ensure the Budgeting and Accounting Software used by all governments are interlinked between budgeting and reporting and across all three tiers 			
Procurement	Current system promotes fragmentation of large contracts; Most projects procured by user committees without a formal tendering process	The quality of public works is low as projects less than \$100K are managed by user committees	The informal nature of procurement coupled with the absence of monitoring system undermines transparency and accountability across the procurement cycle.
Recommendations: <ul style="list-style-type: none"> • Establish standard procurement documents (contract, tender documents, etc.) • Make sure that user committees comply with procurement guidelines and use official procurement documents • Revise Public Procurement Act • Prepare sample Public Procurement Rules for PLGs 			
Functionaries			
Devolution of functionaries	Needs at each level not properly estimated Unfilled gap at subnational levels	Understand incentives structures for readjustment Design a program for redeploying federal staff at subnational levels by addressing incentives Create enabling environment for provincial governments to recruit through Provincial Public Service Commissions	Provincial Civil Service Commission legislation is not complete
Recommendations: <ul style="list-style-type: none"> • Finalize current staff profile assessments and development of model organizational structures for local governments as mandated by the Local Government Operations Act of 2017 (Act 2704) • Establish an institutional framework for making deputed staff (federal staff adjusted to subnational levels) accountable to subnational governments • Review the financing system for recurrent expenditures: there is a need for a financing plan for the sustainability of subnational wage bill • Draft the Civil Service Act that sets the basis for the formation of the Province Civil Service • Provide provinces with a model Province Civil Service Law • Draft laws that set the criteria for the formation and terms of service for Local Service 			
Identification of human capacity needs at the subnational level	The PLGs have the legal authority to carry out their own O&M surveys to determine their staffing needs. However, they don't have the capacity to do so.	Work with subnational governments to design an O&M survey similar to the one conducted by MOFAGA	Finalization of organizational structures for subnational governments
Recommendations: <ul style="list-style-type: none"> • Help PLGs to carry out their own O&M surveys • Draft law for that forms the basis of establishing the Provincial Public Service Commission 			

<ul style="list-style-type: none"> • Draft the Federal Civil Service Act that sets the basis for the formation of the Provincial Civil Service • Provide provinces with a model Province Civil Service Law • Draft laws that set the criteria for the formation and terms of service for Local Service 			
Misalignment employment profile at the federal level	Sector ministries' institutional inheritance is out-of-sync with their new federal mandate.	Sector ministries are under-capacitated with respect to their federal mandate (policy-setting & monitoring and evaluation) and over-capacitated with respect to implementation functions for which they are no longer responsible.	Improve the capacity of sector ministries vis-à-vis their new federal mandates
Recommendation: Equip sector ministries to undertake their new federal mandates on policy-setting & monitoring and evaluation			
Organizational and Institutional			
Gender Equality and Social Inclusion (GESI)	Many PLGs do not have a GESI plan M&E on progress is not adequate Training and monitoring of GESI budget practices is limited Clarify GESI extensions to new hiring	Improve GESI budget practices Establish Provincial Civil Service Commission and hiring/management rules	PCSCs management rules and authorization for hiring is not in place External monitoring of GESI outcomes not yet in place
Recommendations: <ul style="list-style-type: none"> • Promote local civil society for the engagement with socially excluded groups and to disseminate information on rights • Establish a monitoring system with local civil society on GESI plan • Put in place legislation to enable PCSC hiring and management practices 			
Investment accountability	Capital expenditures are too heavily biased in favor of small projects with neighborhood benefits Borrowing practices not yet established	Conditional grants to stimulate investments with areawide benefits Adopt local government revenue mobilization improvements	Structure of intergovernmental transfers to stimulate capital spending Incentives to increase user charges Institute formal borrowing practices
Recommendations: <ul style="list-style-type: none"> • Promote local associations • Use social mobilizers (drawing from Local Governance and Community Development Programme LGCDP experience) • Use Citizen Awareness Centers effectively • Amend domestic debt law to allow PLGs to raise domestic debt 			
Institutional framework for inter-governmental coordination	Confusion over roles and responsibilities of federal, provincial, and local governments in certain areas Monitoring of subnational governments' performance	Need clarity in responsibility for certain services Consider a more phased-in assumption of responsibilities for PLGs	No arrangement for a phased in responsibility and autonomy is in place No provision for monitoring performance is in place
Recommendation: Inter-Provincial Council (mandated by the Constitution) and Inter-Governmental Fiscal Council (mandated by the Intergovernmental Fiscal Arrangement Act) are the only two institutional coordination mechanisms established so far. There is a need for inter-ministerial coordination mechanisms with respect to the development of policy and the administration of the subnational systems. In the absence of intergovernmental coordination mechanisms, different administration tools and systems (in case of PFM, for example, SUTRA and MARS systems) are being promoted. There is a bill in the Parliament on intergovernmental coordination (Bill on			

Inter-governmental Coordination 2019) which is subject to discussions and criticism. It needs to be enacted as soon as possible after reaching a consensus among all stakeholders to ensure cooperation and coexistence in concurrent power-sharing among the federal, provincial and local levels.			
User committees and civil society involvement	Confused continued role for user committees Who will represent the interests of municipal governments?	Redefine capital investment planning	The role of civil society has not been addressed in detail
Recommendation: Use local civil society effectively as a stakeholder.			
Database	Inadequate accurate data to track fiscal performance of PLGs Inadequate data to populate and evaluate intergovernmental transfer programs	Develop a data base that integrates fiscal and socioeconomic data Produce the data on a timely basis	A plan to do this at the national level does not appear to be developing quickly
Recommendation: Appoint a Committee of experts to prepare a proposal for the content of a data base that could serve the goals of monitoring the performance and entitlements of PLGs.			
Local government preparedness	FCNA survey produced a significant list of needs for PLGs to effectively implement federalism	Action plan for follow up on these	No mechanism for follow up is in place
Recommendations: <ul style="list-style-type: none"> • Empower a task force to put an action plan in place • Consider a more phased in implementation of federalism, based on readiness 			
Legislative Actions	Important pieces of legislation for implementing federalism are not in place	Enact all required legislation for implementing Federalism	Key issues are PPSC legislation, bill of rights, some sectoral laws; others
Recommendations: Review Parliament's priorities and timeline for new legislation regarding: <ul style="list-style-type: none"> • Draft a new law for private firm registration and commercial enterprise regulations • Prepare a sample inter-provincial trade management law for the provinces • Prepare a sample law for consumer protection and market monitoring for PLGs • Draft a new law for the operation of stone, sand collection & crusher industries • Draft new laws for land use and management • Review the Land Acquisition Act 2034 (1977) and Immovable Property Requisition Act 2013 (1956) in the context of federalism • Draft a new law relating to management of squatters and unmanaged settlers • Draft laws relating to Nepal police - their functions, supervision and coordination with provincial police • Draft the province police integration law • Draft a new law setting criteria for recruitment, training, uniform and security of provincial police • Draft a domestic security law that also defines the CDO's roles at the federal and province levels • Review acts relating to prisons • Review laws regulating license issuance for FM radio and TV stations • Review the Forestry Act • Review Water Resources Act 			

Annex: Significant and Recent Achievements in the implementation of Federalism

Implementation of Federalism in Nepal

Significant Achievements to date

September 2019

Legal Framework for Federalism

Successful transition to federalism in Nepal requires significant amount of framework legislation. To-date, substantial progress has been made in setting up the legal framework needed for effective transition to federalism in Nepal, although additional improvements are needed in key areas.

1. **Key pieces of legislation have been enacted**, notably: (i) the Local Government Operations Act, 2017; (ii) the Intergovernmental Fiscal Arrangement Act, 2017; (iii) the National Natural Resource and Fiscal Commission Act, 2017; (iv) Staff Adjustment Act; and (v) an Act determining the bases and criteria on roles and responsibilities of the provincial public service commission (PPSC). The latter has paved way for the provincial governments to prepare their legislations to establish PPSCs within the framework given by the federal law.
2. **Numerous existing laws have been reviewed and have been either amended or replaced to reflect federalism requirements**. The Constitution guarantees fundamental citizen rights. The Civil Code Procedure Act 2074 and Criminal Code Act 2074 revised, replacing the Civil Code Act 2020. All 339 existing Acts of Parliament have been reviewed. The Staff Adjustment Act has been passed, replacing the December 2018 Ordinance. Significant progress has been made in drafting amendments to the Local Government Operations Act, the Public Procurement Act, 2007, and the sectoral Laws. As cooperatives has been taken as one of the pillars for economic development, Cooperative Act also has been amended.
3. **Several drafts of laws/bills are tabled in Parliament** (House of Representative and national assembly). Intergovernmental Coordination Bill (ICB), as per the Article 235, among others. The ICB represents an important milestone in outlining the process, aimed at providing mechanism for the implementation of concurring powers, that will ultimately contribute to strengthening inter-governmental relations and smooth implementation of federalism. Several other bills such as The Police Adjustment Bill and Financial Procedure and Fiscal Responsibility Bill, Federal Civil Service Bill are under review in Parliament.
4. **Model laws and guidelines**. Several ministries have issued model laws and guidelines to guide local governments and provinces in enacting their own laws and regulations. Approximately

34 model laws/guidelines have been issued by MoFAGA. The MOF has issued 7 model laws³³. Most LGs have adopted these model laws and guidelines, with some modifications.

Institutional Framework of Federalism

The roll-out of federalism must be supported by adequate institutional framework to attain optimal results. The federal government is called on by the Constitution to establish or develop several institutions and organizations. Several are commissions with appointed members whose mandate is to support in making federal system functioning more efficiently. In other cases, the entities will function as an additional check on the powers of government. In yet other cases, these organizational arrangements have to do with provisions on how the government should be managed. To date, significant progress has been achieved in this area of the reform since 2017.

5. **Provincial Public Service Commission (PPSC).** Provincial governments have started establishing their PPSC. Province 2 and 5 have formed their commissions and appointed chairperson. The Federal Civil Service Act is still under discussion in the Parliament. Along with the Federal Civil Service Act, and framework and standards for provincial civil service and local service, the provinces and LGs, will be able to enact their own civil service act, which will empower the PPSC to hire, fire and promote their employees. As PPSCs are either not established or not fully functional, the Federal Government has tasked the Public Service Commission to process the recruitment of about 10,000 staffs for local governments.
6. **Inter-Provincial Council (IPC).** The IPC has been created and is operational. Its mandate includes settlement of political disputes between the federal and provincial governments or between provincial governments. The IPC convened its inaugural meeting in December 2018, which provided a platform for the Prime Minister and Chief Ministers to discuss immediate challenges affecting implementation of federalism. The meeting resulted in the formation of a task force to propose measures for addressing federalism implementation issues raised by the chief ministers. The task force is headed by the Federal Home Minister, and consists of federal ministers of MOF, MoFAGA, and chief ministers of Provinces 2 and 5 as members, and the Chief secretary of the federal government its secretary. The Council has met three times as of date. At its second meeting, the Council laid out a “federalism implementation Action Plan,” which identified 29 actions that the federal government needed to take to allow a smooth transition to the federal governance structure. The federal government agreed to cooperate with the Inter-Provincial Council and to expedite the passage of necessary laws.
7. **National Natural Resources and Fiscal Commission (NNRFC).** The NNRFC is operational under the leadership of a constitutionally-appointed Chair. Its mandate includes recommending/determining the distribution of revenues to PLGs from the national

³³ (1) Provincial Finance Procedure Model Act; (2) Local Government Financial Procedure Model Act; (3) Provincial Tax and Non-Tax Revenue Collection Model Act; (4) Local Government Tax and Non-Tax Revenue Collection Model Act; (5) Provincial Revenue Distribution Model Act; (6) Appropriation Model Bill and (7) Provincial Finance Model Bill

consolidated fund. The NNRFC is a key component of the intergovernmental fiscal system in Nepal. Its formation is meant to give the government of Nepal a permanent and professional body for managing the distribution of intergovernmental transfers, guiding local revenue mobilization, and generally tracking the performance of the intergovernmental fiscal system.

8. **Significant progress has been made in setting up key other Commissions.** The Constitution provides for creation of the following commissions: (i) Commission for the Investigation of the Abuse of Authority, (ii) National Inclusive Commission, (iii) Commission for Indigenous Nationalities (iv) Madheshi Commission; (v); Tharu Commission, (vi) Muslim Commission, (vii) National Women's Commission, (vii) National Dalit Commission. All the new commissions have established and four of the commissions, namely, Tharu, Muslim, Madhesi and National Inclusive commission have chair or a member in the Commission.
9. **Intergovernmental Fiscal Council (IFC) has been established.** The IFC convened 4 times since its creation. Chaired by the Finance Minister and attended by Finance ministers of all seven provinces. The IFC provides important platform to discuss emerging issues such as revenue mobilization at PLGs levels; budget formulation and endorsement; fiscal authority; and bookkeeping, and human resource management; budget implementation, resource management, and problems in project implementation at PLGs levels.

Public Financial Management, Accountability & Transparency

The Government of Nepal has made significant strides in developing its national government PFM system. It has set up a Public Expenditure and Financial Accountability (PEFA) Secretariat, carried out PEFA assessment, and established a PFM steering committee. There has been a successful implementation of the treasury single account, a transparent expenditure reporting system, a revenue management information system and an upgraded audit system. The extension of PFM practices to PLGs is a high priority for the country.

10. **Treasury Regulatory Application (SUTRA).** The roll-out of SUTRA since 2017 has now reached LGs. SUTRA is a planning, budgeting and accounting software developed under the leadership of PEFA Secretariat based on the decision of MOF. The tool supports implementation of a structured financial management procedure for PLGs based on the Unified Charts of Accounts. The Financial Controller General's Office (FCGO) was able to generate reports from SUTRA for all LGs. For reporting on financial information, Provinces use a combination of tools, including Revenue Management Information System (RMIS); Treasury Single Account System (TAS); and Computerize Government Accounting System (CGAS)
11. **Consolidated Accounts.** Provincial Consolidated fund has been established in each Province and Local Consolidated Fund has been established in all LGs in accordance with the Constitution. The federal Government only disburses into these consolidated funds.
12. **Fiscal discipline and control.**

- (a) Most LGs have tabled their budget in their assembly and approved on time and executed the 2018 fiscal year budget.
- (b) All accounts of the LGs and Provinces are audited in a timely manner.
- (c) Single treasury account is under implementation at PLGs level.
- (d) There is more transparent expenditure reporting system of PLGs.
- (e) Revenue management information system is in place at PLGs, but not used by all PLGs
- (f) Audit methodology has been upgraded.
- (g) The FCGO has developed a software to capture LGs revenue and expenditure data. District treasury controller's office enters the financial information in the software.
- (h) The federal Government has mandated trimestral reporting by PLGs as a condition for the disbursement of federal transfers to PLGs.
- (i) The MOF has integrated all its PFM systems into the PFM Information System (PFMIS) and provided access for all its federal ministries to the PFMIS.
- (j) The MOF has issued guidance to the federal ministries to guide their preparation of the draft three-year MTEFs for the Fiscal Year 2019 budget cycle.
- (k) NNRFC and MOF has issued circulars to LGs to guide their preparation of the annual budgets, to be part of the Local Government Development Plan.
- (l) MOF has implemented measures to improve its budget execution, such as: (a) the issuance of a decree requiring all new externally-funded and national priority projects to have secured project filter clearance to obtain budgetary funds; (b) the adoption of the System for Automatic Spending Authorization and Program Approval; and (c) the adoption of a system of payments by account payee only. MOF has established the Revenue Management Information System at the federal level.

13. Risk-based auditing. The Auditor General Office has started risk-based auditing. Citizen Participatory Auditing- Nepal is the first pilot country to implement this tool, which is increasingly important in the federal context.

14. Procurement. Nearly all LGs have a functional procurement unit and have the capacity to conduct all forms of procurement, except international bidding in some local governments. Overall, 57% of LGs can use e-bidding, with usage more common in cities (76%) than municipalities (58%) or rural municipalities (49%). Almost all LGs (97 percent) have a list of vendors. All provinces adopted their own procurement guidelines and standards.

Political Governance and Administration

15. The Functioning of Local Governments. The creation of political and administrative structure of subnational governments have been essentially completed. LG Assemblies and executives were elected. Nepalis are now represented and empowered. Approximately 36,639 representatives including chairperson, vice-chair person and ward chair persons and council members were elected in the 753 LGs. Women and disadvantaged people are now represented. Every Mayor / Deputy Mayor; every local assembly has women. Every LG has representation for disadvantaged communities. The FCNA survey results show that provincial and LGs are

settling in and taking up their responsibilities. Elected leadership is in place with significant and legally mandated representation of women and Dalits on the councils at both the PLGs levels. Many LGs are discharging their duties in a competent manner. Nearly all assemblies (96%) have passed regulations on the operation of the assembly and attendance at the most recent LG assembly meetings was about 90% across the board. About 89% of LGs reported the assembly meetings always had an agenda circulated prior to the meeting.

- 16. The Executive Council.** The LG executive council has met in all LGs, with an average of 14.5 meetings per LG. More 70% of LGs “always” prepared and shared agendas in advance of the meetings. Most assemblies have created the eight committee types surveyed, with at least 88% having created judicial, legislation, resource projection, revenue, and budget committees.
- 17. Local Assembly.** The assembly meetings are taking place with about the same frequency in all LGs, and the meetings are reported to be well attended. Provincial governments have been passing thematic laws (mostly concerned with social development) and issuing regulations (mostly concerned with land management, agriculture, and cooperatives). The literacy rate of assembly members is over 90 percent. Female and Dalit members are reported to participate in the assembly deliberations. Most SGNs have a capital budget that lists projects by sector and wards, and budgets were approved on time.
- 18. Judicial Committee.** Almost LGs have formed a Judicial Committee and more than three quarters (77 %) of LGs have prepared manuals or guidelines for the committee. About 71 % of deputy mayors have had training on judicial affairs.
- 19. Sectoral Committee.** Almost all LGs have formed the sectoral committee with responsibilities allocated among Ward Chairs. These Committees have taken responsibilities of major social, economic and infrastructure sectors at local level.
- 20. Planning and Budgeting.** At least 80% of LGs have sector-specific plans for education, health, agriculture, roads, drinking water and disaster preparedness. At least 90% of LGs completed all seven steps in the planning process and given budget ceilings to wards. Nearly all (88%) of LG included both federal and provincial Conditional Grants in their budget plans. Around 90% of LGs did not have to make any changes to the approved budgets because of changes to Conditional Grants. About 77 % of local governments distinguish tax and non-tax sources of revenue in their budget estimates. Nearly all (96%) of LGs have an annual investment plan. For those local governments that have a multi-year development plan, in 80% of cases it is the basis for their annual capital budget. In about 90% of LGs capital investment plans are broken down by sectors and wards.
- 21. Ward Administration.** Almost all LGs reported there was a clear allocation of authority between the LGs and the wards. The ward chairs were clear about their roles in 82% of all LGs, and 93% of LGs reported that wards are involved with monitoring LG services.

22. **Disaster risks management (DRM).** Many LGs (77%) have incorporated DRM into their organizational structures. In Provinces 1 and 5, 67% and 72% of LGs respectively have established written cooperative agreements with other LGs to address common DRM issues.
23. **Education.** Nearly all (98%) LGs have incorporated education into their organizational structure and 95% have teacher/staff salaries and wages in their budgets, while 70% have a capital investment plan in place. Nearly all LGs (92%) have schools in their annual operation and maintenance plan and have a capital investment plan for the education sector (95%).
24. **Basic Health Services.** Nearly all (97%) of LGs have the health services function incorporated into their organizational structure. Almost all LGs (91%) own the health services infrastructure. Overall, 71% of LGs include health-related infrastructure in their asset records, though it is much more likely in cities (94 %) and the HEZ (88%). Almost all LGs (93%) include salaries and wages of health workers in their budgets, and 84% include health centers in their O&M plans. About 82% of LGs have a capital investment plan for health services, while 84% monitor the performance of their health services sector.
25. **Social Development.** At least 95% of LGs have incorporated the governmental functions regarding vital registration, women, children, senior citizens, and social welfare into their organizational structures. Sports have been incorporated by 84% of LGs and 81% of youth. Most (89%) LGs include spending for social development in their budgets.
26. **Economic Development.** At least 85% of LGs incorporated cooperatives into their organizational structure, 70% have incorporated local market management, 56% micro-enterprises, and 55% economic data collection. Economic development plans were in place in 63% of LGs. Most LGs partner with the federal government and provinces on economic development in a variety of ways, with most (89%) doing so through budget allocations and a large portion (71%) sharing information. At least 76% LGs work with federal and provinces on economic growth, poverty alleviation, and SDG localization through the national plan, while 61% work through the provincial plan and 74% have their own plan.
27. **Agriculture.** A large proportion of LGs indicated that key agricultural functions/offices were transferred to them and incorporated into their organizational structure. LGs are more likely to work with federal and provincial governments through allocations in the federal government, with 77% using this method, while 68% used information sharing.
28. **Roads.** Nearly all (97%) of LGs have incorporated local roads into their organizational structure, and 85% have incorporated rural roads. Most LGs (82%) work with the federal and provinces through the federal budget allocation, while 78% use provincial budget allocations, 66 percent joint partnerships, and 62 percent information sharing. Although 70% of LGs have prepared a road inventory, 81% have road maintenance in their O&M plans and 73% have prepared an annual maintenance plan.

29. **Gender Equality and Social Inclusion (GESI).** At least 80% of LGs have GESI policies, including those for children, senior citizens, and the differently-abled, and for ensuring women's participation in LG activities. Nearly all LGs have included GESI in their budgets and through inclusiveness that encourages the participation of women, senior citizens, and ethnic and disadvantage groups.
30. **Engaging citizens and non-government actors.** Local governments engage outside organizations in budget preparation at generally high but varying rates, with local business chambers and civil society/NGOs the highest at 83% of LGs. Fewer LGs engage community associations or other public institutions (76% and 64%, respectively). Most LGs (83%) have a grievance redress mechanism. These LGs use designated officials and complaint boxes most often (86% and 83%, respectively), followed by public hearings (75%), social media (64%), social audits (61%), and complaint registers (51%). Nearly 70% of LGs conducted a social audit for the recent fiscal year.
31. Capacity building for federalism is also strongly supported by Local Government Associations (Association of District Coordination Committees of Nepal (ADCCN), Municipal Association Nepal (MuAN) and National Association of Rural Municipalities (NARMIN). This involves orientation for elected representatives on their role and responsibility.

Gender Equality and Social Inclusion (GESI)

32. **Legislative backing and implementation of GESI.** The Constitution calls for legislation to promote equal voice in government by guaranteeing a prescribed number of legislative seats according to gender and ethnic background. In the 2017 elections, 38% of Assembly seats were won by women and 21% by Dalits. This has given women and minorities significant formal involvement in governance. Women won 91% of the deputy positions (deputy mayors and vice chairpersons) in municipalities and wards, while men won 98% of the chief positions. At present 25% of civil service employment is female compared to 11% in 1993.
33. **Executive actions on GESI.** The Government called for “mainstreaming” gender equality and social inclusion by including it in all decisions about governance and government operations, systems and their operations. For the 2017/2018 budget speech, about 36% of the total budget was classified as directly gender responsive and about 30 percent was classified as gender neutral. The very fact that it is part of the annual budget address of the Minister of Finance gives gender budgeting some creditability. The guidelines for gender budgeting have been introduced and provides a set of indicators to guide implementation of GESI policy. There have been training programs for government officers on gender-responsive budgeting.
34. **National Women Commission.** The National Women Commission has established an integrated platform for a comprehensive response system to coordinate expansion of access to services for gender-based violence prevention and response.

Fiscal Capacity and Local Government Revenues Mobilization

- 35.** The FCNA survey results highlight that: (i) most LGs distinguish between tax and non-tax sources of revenues in their accounting for revenues, and most have studied their revenue structure, though rural municipalities have lagged in this area; (ii) the rate of collections of own-source revenues against the budget estimates, for all municipalities, is about 72 percent; and (iii) 79% of LGs have studied local revenue sources.

Administrative Infrastructure and Connectivity

- 36.** Measurable progress was made in building the administrative infrastructure and connectivity at PLGs level. Most PLGs are in the process of building their administrative infrastructure and connectivity. According to the FNCA results, generally, most ministries in all provinces have access to electricity, telephone and internet. Nearly 54% of LGs owned at least some of their buildings and about 70% of cities felt that their building could accommodate an assembly meeting. Most LGs (82%) are connected to the national grid and all LGs have solar power in that province. Nearly all LGs centers were accessible by road and about 47% of LG have office building construction going on. Provinces have enough computers (one per essential staff).

Human Resource Management and Development

- 37.** A major “win” in the transition to federalism was the staffing of LGs by devolving all front-line staff in education, health, agriculture and administration. The Government reorganized the civil service, by re-allocating, adjusting, and transferring civil servants under public services into the federal and PLGs levels. Although the process is still incomplete, it has allowed LGs to have key officials and staff in place to support implementation of federalism.
- 38.** Organizational structures have been uniformed across provincial administrations. Some provinces have updated their organizational structures, and some are in the process of updating. Recruitment of deficit staff at LG has started by the FPSC. Recent deployment of senior level Joint Secretaries from the federal government to provinces as Secretaries was intended to further strengthen human resources capacity and effective implementation of federalism at sub-national level. Majority of sub-national staff have received training on federal affairs.

Monitoring and Evaluation

- 39.** Constitution has made specific provision for Monitoring and facilitation of developmental activities, coordination for balance development of the district. According to constitutional provisions in Article 220 there will be district council and will constitute among the elected

Mayors and deputy of all Rural/Municipality with the district. The role and functions are also provision (Article 220(7)). The Local Government Operation Act 2074 (clause 92-96) also has stipulated activities of District Council through the district Coordination Committee.

Institutional Capacity Building

Building capacity for federalism has been a priority of the Government. The transition to a federal structure significantly increases the need to provide training for government officials at all levels, because the assignment of responsibility for service delivery and PFM has changed dramatically. It also may require a different institutional arrangement to deliver this training and capacity building, because PLGs in the new federal regime have significant control over how they deliver their services and manage their systems.

40. **Provincial and Local Governance Support Program (PLGSP).** In August 2019, the Government of Nepal announced the four-year national flagship program, namely PLGSP with the budget of US\$130 million on institutional capacity development of all spheres of governments, more specifically the sub national governments. It is expected to be the main vehicle through which capacity gaps will be addressed. During the program period, PLGSP is expected to provide various levels of training to elected representatives and staffs and support to address the capacity gap areas. It is envisaged that the program will strengthen PLGs systems, procedures and intergovernmental relationships, to maximize benefits in terms of cooperative federalism and enhance the capacity of provincial and LGs to deliver services and effectively manage development processes.
41. **Local Development Training Academy (LDTA).** The Government has amended the LDTA Act to allow transfer of LDTA assets and properties to the provinces to establish the provincial level training units under the leadership of provincial government. Gandaki Province has already passed an act to establish a provincial level training academy. At present, the LDTA is mandated to train elected and staff members of LGs and to ensure quality control of capacity development efforts across the country.
42. **Framework for monitoring the progress of fiscal federalism.** The Government and USAID are collaborating to establish a framework for monitoring the progress of fiscal federalism in Nepal. This work previously concentrated at the federal level. Now, it focuses on the implementation of SUTRA and training of LGs on the preparation of financial reports. FCGO is providing PFM training support to LGs. PPMO is providing training to LGs on procurement. NPC has initiated capacity building for PLGs on preparation of MTEF. The NPC has issued MTEF guidelines to PLGs. MTEF guidelines are already being used at federal level.
43. **Provincial Coordination Council (PCC).** All provinces have created their PCCs to improve provincial and LGs coordination. Each province held at least two council meetings so far.

44. Nepal Administrative Staff College (NASC) and other Sectoral Training Academy. The NASC ACT has been amended to address the need for capacity building at all level of government. NASC has revised its training curriculum and training plan to accommodate the training needs of federal and PLGs staff. NASC is working towards establishing ‘Center for Federalism Studies at NASC to enhance capacity building for civil servants and elected representatives at all levels of government. Different training institutes in forestry, agriculture, revenue management, cooperatives and other sectors are providing various levels of general and specific training to government officials.

List of Best Practices in the Implementation of Federalism in Nepal

1. *Judicial committees* -settling disputes through mediation or regular judicial process
2. *Participatory planning* – providing an inclusive process in local planning and budgeting
3. *Local revenue mobilization* – providing flexibility and innovations in local resource mobilization
4. *Model laws and regulations for PLGs levels*
5. *Consolidated accounts at PLGs levels*
6. Online application to capture revenue and expenditure information from local governments
7. Implementation of System for Automatic Spending Authorization and Program Approval
8. Revenue Management Information System at federal level
9. Guidelines for MTEF at PLGs levels
10. Citizen participatory auditing
11. Grievance redress system at local government level
12. National Natural Resources and Fiscal Commission

