Budget allocation and implementation are important processes through which local governments deliver services to citizens. The effectiveness of budget implementation depends on local governments’ absorptive capacity and the transparency of the processes. In the federal structure, local governments’ budget allocation and implementation are expected to be more effective than in the unitary structure. If local governments can increase their absorptive capacity and accountability, then citizen’s trust towards them can increase. This can also help to make implementation of federalism more effective.
Budget Allocation and Implementation by Local Governments in the Federal Structure

September 2019

Democracy Resource Center Nepal (DRCN)
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Democracy Resource Center Nepal
Lalitpur
**LIST OF ACRONYMS**

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>APM</td>
<td>All Party Mechanism</td>
</tr>
<tr>
<td>CAO</td>
<td>Chief Administrative Officer</td>
</tr>
<tr>
<td>DCC</td>
<td>District Coordination Committee</td>
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<tr>
<td>DDC</td>
<td>District Development Committee</td>
</tr>
<tr>
<td>GoN</td>
<td>Government of Nepal</td>
</tr>
<tr>
<td>VDC</td>
<td>Village Development Committee</td>
</tr>
<tr>
<td>NNRFC</td>
<td>National Natural Resources and Fiscal Commission</td>
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</tbody>
</table>
Local governments are the closest administrative units that deliver public services to citizens in the current federal structure. Compared to local bodies in the previous unitary structure, they have more constitutional rights. Over the past decades, the central government undertook several efforts to delegate more power to the then local bodies, but none of these moves led to a fundamental departure from the highly centralized governance system.\(^1\) The practice of local governance began during the Panchayat regime, when local bodies were formed as a means to decentralize administration. Even after the restoration of democracy in 1990, the central government largely guided the local bodies.\(^2\)

In 1999, the Government of Nepal (GoN) enacted the Local Self-Governance Act to empower local bodies and consolidate decentralization in the country. The specific objectives of the Act included: engaging citizens, to the extent possible, in the governance process through decentralization; mobilizing local resources to develop local bodies; striving for social equality through equitable distribution of the budget and development outcomes; and making local bodies accountable by giving them the necessary authority for budget planning and implementation. However, the political parties and bureaucracy that had in principle accepted a decentralized governance system, in practice continued to follow the centralized governance system, undermining movement towards decentralization.\(^3\)

The GoN held local elections in 1992 and 1997 as way to increase democratic participation in local governance. However, on February 13, 1996, less than three years after the first local elections, the then Communist Party of Nepal (Maoist) launched an armed insurgency. Due to increased insecurity and political turmoil, the GoN was unable to conduct local elections after the completion of the tenure of local representatives elected in 1997.\(^4\) In the absence of elected representatives, as an interim measure, the GoN delegated the management of local bodies to civil service employees.\(^5\) Due to

\(^{1}\) The Village Development Committee (VDC), Municipality and District Development Committee (DDC) were the local bodies in the unitary structure.


\(^{4}\) Local body elections (only of municipalities) were conducted during the direct rule of the king in 2005. All political parties except the monarchist parties boycotted that election. The government formed after People’s Movement of 2006 invalidated the election.

\(^{5}\) Nepal government handed over the responsibility of functioning to the VDC secretary in the Village Development Committee, Executive Officer in Municipalities and Local Development Officer in District
the insurgency, these civil service employees mostly worked from district headquarters rather than their assigned VDCs. This made the functioning of local bodies largely ineffective.

The People’s Movement of 2006 paved the way for the peaceful resolution of the decade-long Maoist insurgency. Subsequently, the Interim Constitution was promulgated in 2007. During the transition period, a provision for the formation of an All Party Mechanism (APM) was envisioned to oversee local governments’ function and budget implementation. This arrangement ensured top-down accountability, but lacked accountability towards citizens. The budget allocation and implementation processes were politicized and lacked adequate transparency. The APM was eventually dissolved in 2012 and civil service employees continued to manage the local bodies with substantive authority. Although the role of the APM officially ended, its impact persisted and politicization of local governance continued.

The 2007 Interim Constitution’s mandate of a federal governance structure was realized in the Constitution of Nepal. It established a three-tier federal structure comprising of the federal, provincial and local governments. Nearly four thousand Village Development Committees (VDC) and municipalities under the unitary system were restructured into 753 local units, including six metropolitans, 11 sub-metropolitans, 276 municipalities and 460 rural municipalities. These local units altogether encompass 6,743 wards. At the district-level, a district assembly was established that would elect a District Coordination Committee (DCC) to facilitate coordination among all municipalities and rural municipalities in the district.

The Constitution provides executive, legislative and limited judicial authority to local units. As a result, the jurisdiction of local governments has significantly increased under the federal structure. The geographical area of most new local units is larger than that of local units under the previous system. The Constitution gives local governments the authority to raise taxes, establish a local treasury, and present and approve the annual estimates of revenue and expenditure through their municipal assemblies through legislation. Further, local governments now have the authority to make laws within their fiscal jurisdictions, devise plans and policies, and prepare annual budgets and implement them.

**RESEARCH OBJECTIVES AND METHODS**

This report focuses on the budget allocation and implementation processes of local governments in the federal structure. The report analyzes the absorptive capacity of local governments and the level of transparency and accountability they practiced during budget allocation and project implementation. This study was primarily based on qualitative research. During the study, three Democracy Resource Center Nepal (DRCN) research teams conducted field visits in 15 local units across eight districts (Bajhang, Bhaktapur, etc.).

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9 Part 17 of the Constitution includes provision on executive, Part 18 on local legislative and Part 19 has provision on local financial procedure.
Lalitpur, Myagdi, Nawalparasi West, Parsa, Salyan and Sunsari) from April to July 2019. Of the 15 local units visited, seven were rural municipalities, seven were municipalities, and one was a metropolitan city. Interviewees included: mayors/chairpersons; deputy mayors/deputy chairpersons; ward chairpersons and members; representatives of political parties; citizens; journalists; members of users committees; and contractors working in local projects. DRCN researchers based in Kathmandu also met with representatives of federal ministries, legal experts, and public finance management experts. A review of the historical context, legal provisions and other relevant documents related to local governance in Nepal was conducted. Publications by local governments including annual budget books were also reviewed. The findings of this study might not be generalized for all local governments. Names of respondents and local units were redacted in some cases concerning privacy issues.

The first section of this report provides a background on local governance in Nepal and the research methodology of this study. The second section is a comparative study of the provisions and basis for budget allocation and implementation between local governments in the federal structure versus the previous structure. The third section discusses budget allocation practices, while the fourth covers the process of project implementation. The final sections include a conclusion and recommendations.
BASIS FOR BUDGET ALLOCATION AND IMPLEMENTATION BY LOCAL GOVERNMENTS

Budget allocation and implementation authorities varied between the different tiers of local bodies under the unitary structure. Municipalities had relatively more rights than VDCs and District Development Committees (DDC) were primarily responsible for budget allocation.11 DDCs also had more resources and were more powerful as they implemented district-level projects and could issue directives and monitor projects implemented in their districts. DDCs provided technical assistance to VDCs and had the authority to examine and approve financial documents and conduct internal audits of VDC level projects. Municipalities had more autonomy than VDCs in terms of budget implementation and conducted their own internal audits.12 Under the federal structure, all local governments have equal constitutional authority. However, the size, population and condition of physical infrastructure, and economic, technical, administrative, and other capacities vary between local units. This can have a direct impact on a local government’s ability to mobilize resources, allocate budgets and implement projects and lead to unequal development outcomes.

Citizen participation is an important aspect of local governance. Local bodies under the unitary structure had to go through a 14-step budget planning process during which citizen participation was an important component.13 Under the federal structure, the planning

13 Fourteen step planning process: first, DDC gets budget ceiling and guideline from the central government (mid-November); second, DDC provides guideline and budget ceiling, along with calling a meeting to review the available resources (last week of November); third, preparation meeting to plan for next fiscal year with thematic section heads including the DDC (first week of December); fourth, determining budget ceiling for VDC municipality, including the ward and settlements (mid-December); fifth, collecting plans and projects from the settlement; sixth, ward-level meeting to choose and prioritize plans and projects (mid-December); seventh, meeting to prioritize plans and projects at the municipal/VDC level (first week of January); eighth, VDC/municipal council meeting to approve the prioritized plans and programs (second week of January); ninth, Ilaka level meeting to prioritize projects chosen by VDC/municipal level meeting (first week of February); tenth, thematic sectors planning meeting (mid-February); eleventh, integrated planning committee meeting (final week of February); twelfth, DDC meeting to five final shape to the district development plans (first week of March); thirteenth, District Council meeting, approval of district development plans with final amendments (mid-March); fourteenth, submitting annual district development programs to National Planning Commission and other related ministries (mid-April).
CASE STUDY 1: LOCAL GOVERNMENT BUDGET PLANNING AND PRIORITIZATION

Ensuring participation of citizens in the planning and prioritization processes is important for local governance. However, there were several examples where citizen participation in these processes were limited to a mere formality. Elected representatives conducted planning non-transparently and prioritized plans and programs for personal gains. “Ward chairpersons collect plans from settlements but remove them later and include their own plans,” said a civil society leader of a local unit in Province 5. “The process is repeated at the municipality level, where the mayor and deputy mayor again removed plans that came from the wards. Ultimately, only 20-25 percent of the plans from the settlement level are actually included in the budget. Nowadays, with the help of their supporters and affiliates, the mayor and deputy mayor include their plans directly at the settlement level,” he added. In a different rural municipality, a ward chairperson, who was the only elected official from his party in the rural municipality, said that the plans and programs sent from his ward were not included in the budget. “Projects and plans are prioritized through majority vote, but I am the sole elected Ward Chairperson [in the local unit] from my party. We had prioritized for construction of a drainage through the ward-level meeting, but the budget was allocated [by the municipality through majority vote] for the construction of a building.” Similarly, deputy mayors and vice chairpersons, who are supposed to hold major responsibility in the budget allocation process, claimed that they were being ignored in the processes. “The mayor and employees allocated the plans and programs without involving me. But I have to present it at the assembly and face the anger and criticism of citizens,” a deputy mayor of a local unit in Province 1 stated.

The self-interests of elected representatives and other locally powerful individuals also influenced the planning process at the local level. Elected representatives often amended budget allocation procedures to serve their personal interests. In a local unit of Province 2, a provision was made for the municipal executive members to select projects at their own discretion. The mayor, deputy-mayor, and the members of the municipal executive were allocated a fund of NPR five million, three and a half million, and one million respectively to choose the projects of their liking. In this way, local governments allocated budgets on an ad-hoc basis and disregarded the importance of public participation and accountability in the process. Furthermore, insufficient technical and administrative capacity led some local governments to allocate funds to projects without adequate research and cost estimation.

The lengthy process and provided the local governments with a more decisive role. Under the unitary structure, the central government, DDCs, and Ilakas would be involved in the budgeting exercise. 

process was reduced to seven steps. This shortened the lengthy process and provided the local governments

14 Seven steps of the annual planning process: first, receive an outline of fiscal transfers and budget and planning guideline (mid-January) and receive budget ceiling from the federal and provincial government (mid-March); second, estimating resources and determining budget ceiling (around April 25); third, ward and settlement level meetings for selection of projects and programs (by mid-May); fourth, prioritization of projects that came through wards (by end of May); fifth, formulating budget and programs (around June 20); sixth, approving budget and programs form the municipal executive (around June 25); seventh, approval of budget and programs from the municipal assembly (around June 25).

Ilakas no longer exist under the federal structure, and municipalities and rural municipalities now play decisive roles in budget planning, allocation, and implementation. This was expected to improve citizen participation in local governance.

Federal and provincial acts and regulations provide local governments with budget allocation and implementation guidelines. Based on these acts and regulations, local governments passed their own laws, including their Finance Act and Appropriation Act. Financial authorities are exercised by elected representatives and the chief administrator. Section 16 of the Act Relating to Operation of Local Government, 2017 defines the executive roles of the mayor/chairperson, deputy mayor/vice-chairperson, ward chairpersons and all members of the municipal council. Section 84 of the same Act determines the functions, duties and rights of the Chief Administrative Officer (CAO). Section 65, 66 and 67 of the same Act has provisions to establish several committees that are key to the budget planning and allocation processes. These include the Resource Estimation and Budget Ceiling Determination Committee (chaired by mayor/chairperson), the Local Revenue Consultation Committee, and the Budget and Program Formulation Committee (chaired by deputy mayor/vice chairperson).

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The Local Level Plan and Budget Formulation Guideline, 2017 directs local governments to prepare a thematic list of ward-level projects prioritized by ward committees, and projects that are deemed necessary at the local level. A five-member working committee, headed by members assigned to the respective thematic areas, should hold a discussion on the thematic lists. The projects are then prioritized based on a select list of criteria. The prioritized projects for the annual budget are prepared by the Budget Plan and Program Formulation Committee, which is then submitted to the municipal executive. The budget is subsequently submitted to the municipal assembly for approval.

3.1 BUDGET ALLOCATION BY THEMATIC AREA
The Local Level Plan and Budget Formulation Guideline, 2017 requires local governments to allocate budgets by thematic area. However, many local governments included in this study had not clearly allocated funds by thematic area. There were similar patterns in the way budget allocation was done across the local governments included in this study. Most local governments prioritized infrastructure development over other thematic sectors. For example, Lalitpur Metropolitan City allocated 34 percent of its total budget for infrastructure development while the second largest amount being just four percent, was allocated for social development. Thori Rural Municipality in Parsa allocated 26 percent of its total budget for infrastructure development, with the second largest amount also of just four percent being allocated for economic development. Jay Prithivi Municipality in Bajhang allocated 18 percent of its total budget for infrastructure development, with the second largest amount of six percent being allocated for social development. In most of the local units, infrastructure development was clearly the major priority but the degree of priority varied by unit.

A study conducted in 2018 found that local residents prioritized infrastructure development, with roads and electricity being identified as major needs.

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17 Separate lists need to be prepared for thematic areas such as economic development, social development, infrastructure development, environment and disaster management, institutional development and service delivery, financial management and good governance.

18 When municipalities and rural municipalities prioritize their plans and programs, they need to do so on the basis of criteria’s like feasibility of the project, technical capacity, budget ceiling, avoiding possible duplications and inter-thematic complementarity.

19 About 63 percent of the respondents said that physical infrastructure is their main necessity in a study conducted in 2018. Within the category of infrastructure development, roads (36 percent) and drinking water (24 percent) were the first and second priorities of the respondent. See, Diagnostic Study of Local Governance in Federal Nepal, 2017. Available at https://asiafoundation.org/wp-content/uploads/2018/07/Diagnostic-Study-of-Local-Governance-in-Federal-Nepal-07112018.pdf; accessed August 30, 2019. Similarly, roads (49.2 percent) and drinking water (26.6 percent) were identified as the first and second priority by citizens in another study. See,
During DRCN interviews, elected representatives argued that the majority of the budget was allocated to infrastructure development in line with citizens’ demands. Practices from the unitary structure have continued to influence how local governments allocate funds in the federal structure. In the unitary system, with limited resources and low absorptive capacity, local bodies chose to allocate their budget towards a few sectors with a large portion of them being allocated towards physical infrastructure. In the federal structure, local governments have the authority to allocate budgets to different sectoral areas including education, health, agriculture, and livestock. However, elected representatives and citizens still perceive that the major responsibility of local governments is to develop roads and other physical infrastructure. Elected representatives believed that the federal government would continue to allocate budgets in sectors besides physical infrastructure. Similarly, employees responsible for thematic sectors conceded that they were unable to convince elected representatives to allocate budgets for sectors other than infrastructure development.

Local representatives also claimed that a lack of clarity in legal provisions regarding the jurisdiction of local governments made it difficult for them to prioritize funds in certain thematic areas. Even though the Constitution and the Act Relating to Operation of Local Government, 2017 delineates the jurisdiction of local governments, delays in enacting framework legislation for different sectors has created confusion about the specific roles of local governments. The Mayor of Baghchaur Municipality in Salyan explained, “We have not been able to make education laws as they might contradict with imminent federal framework laws.” This kind of confusion was also prevalent concerning other thematic sectors. In sectors where the roles of local government remained unclear, the federal government had been sending programs through conditional grants. Due to which the conditional grant amount sent to the local governments was larger than the equalization grant. These conditional grant programs were a continuation of earlier programs conducted by federal line-ministries. Since, the federal government was allocating budgets in these thematic sectors, local governments had found the flexibility to invest in infrastructure development disproportionately.

3.2 BUDGET ALLOCATION FOR WARDS

Local governments faced difficulties while allocating budgets and projects across wards. Conflicts ensued during allocation and in some cases led to the postponement of municipal assemblies. Disputes mainly arose in two ways. First, representatives of each ward were dissatisfied with the way funds were allocated and demanded a bigger budget for their wards. Second, ward representatives demanded that more funds be allocated at the ward-level than the municipal level. The main objective of both these demands was to ensure that their respective wards received bigger budgets.

Funds were allocated to wards mainly in two ways: first, by giving an equal amount of funds to all wards in a local unit; second, by allocating funds based on factors like population, geography, and the revenue raised at the ward-level. Disputes were prevalent with both approaches. A ward chairperson in Annapurna Rural Municipality of Myagdi was dissatisfied that all wards were allocated equal budgets. “My ward is larger than others in terms of both population and geography. We should have been allocated a bigger budget,” he said. Equal budgets were allocated to the wards in Sunwal Municipality of Nawalparasi West and Bhaktapur.


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**Note:** A total of Rs 85.1 billion was sent under fiscal equalization, and a total of Rs 109.85 was given towards conditional grants by the federal government for fiscal year 2019/20.
Municipality too. In Chhatreswari Rural Municipality in Salyan, wards were allocated equal budgets for fiscal year 2019/20, but ward chairpersons were dissatisfied and the ensuing dispute led to the postponement of the municipal assembly.

In Malika Rural Municipality in Myagdi, a resolution on the basis for budget allocation to wards could not be reached. To avoid further dispute, all wards were allocated an equal budgets. In other local units where the budget was allocated to wards based on population and geography, conflicts came in other forms. For example, in Changunarayan Municipality in Bhaktapur, two ward chairpersons accused the municipality of discriminating against their wards during budget allocation because they were from a different political party than the Mayor and Deputy Mayor. Disputes arose due to a lack of concrete criteria for allocation of budget to wards and the inability of elected representatives to reach consensus.

### 3.3 ALLOCATION FOR RECURRENT AND CAPITAL EXPENDITURE

The fact that local governments are responsible for covering the salary and benefits of elected representatives meant that their recurrent expenditure increased. Several municipalities and rural municipalities allocated budgets to increase administrative and technical capacity, which also increased their recurrent expenditure. Similarly, the increase in fiscal transfers provided by the federal and provincial governments to local governments meant that the composition and size of their budgets changed. These changes impacted on the composition of recurrent and capital expenditure allocation.\(^{22}\)

Local governments allocated a significant proportion of their discretionary budget for capital expenditure. The proportion allocated to capital expenditure by local governments was much higher than that of the federal government.\(^{23}\) Local units visited by DRCN were found to have allocated about 60 to 66 percent of their discretionary budget for capital expenditure (as shown in Table 1). Pokhariya Municipality in Parsa allocated an even larger proportion (77 percent of the discretionary budget) for capital expenditure.

<table>
<thead>
<tr>
<th>Local Unit</th>
<th>Recurrent NPR</th>
<th>Recurrent %</th>
<th>Capital NPR</th>
<th>Capital %</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pokhariya Municipality</td>
<td>62,671</td>
<td>22.86</td>
<td>211,436</td>
<td>77.14</td>
<td>274,107</td>
</tr>
<tr>
<td>Chhatreshwari Municipality</td>
<td>69,134</td>
<td>38.74</td>
<td>109,351</td>
<td>61.26</td>
<td>178,485</td>
</tr>
<tr>
<td>Changunarayan Municipality</td>
<td>198,288</td>
<td>35.39</td>
<td>362,000</td>
<td>64.60</td>
<td>560,288</td>
</tr>
<tr>
<td>Baghchaur Rural Municipality</td>
<td>70,350</td>
<td>34.14</td>
<td>135,715</td>
<td>65.86</td>
<td>206,065</td>
</tr>
</tbody>
</table>

Source: Statistics, and planning and budget booklet for Fiscal Year 2018/19 provided by the concerned local governments

The data in Table 1 does not include the budget allocated for conditional grants. Therefore, it is important to compare this data with that of local governments which allocated recurrent and capital expenditure from their total budget (including the conditional grant). Such local governments allocated somewhere between 40 to 50 percent of their total budget in capital expenditure. The proportion of allocated capital expenditure in Thori Rural Municipality in Parsa was even higher (84 percent).

\(^{22}\) While allocating for recurrent and capital expenditure, some local governments had only included the allocation from their discretionary funds, while others had allocated from their total budget (including conditional grants).

\(^{23}\) The administrative budget of the federal government in Fiscal Year 2018/19 was 62.83 percent, while the capital budget was 26.21 percent. They had allocated the remaining budget for financial management.
The proportion of capital expenditure in local units that included conditional grants while allocating for recurrent and capital expenditure was lower than that of local units that only allocated from their discretionary budget. This was because local governments received a substantial portion of their recurrent expenditure from the federal government. For example, the salary of teachers at schools was still provided by the federal government through conditional grants.

Table 2: Administrative and capital expense allocation according to the total budget (NPR in thousand)

<table>
<thead>
<tr>
<th>Local Unit</th>
<th>Administrative NPR</th>
<th>Percentage</th>
<th>Capital NPR</th>
<th>Percentage</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunwal Municipality</td>
<td>386,808</td>
<td>49.11</td>
<td>400,739</td>
<td>50.88</td>
<td>787,547</td>
</tr>
<tr>
<td>Susta Rural Municipality</td>
<td>184,100</td>
<td>46.12</td>
<td>215,072</td>
<td>53.87</td>
<td>399,172</td>
</tr>
<tr>
<td>Jay Prithvi Municipality</td>
<td>313,553.5</td>
<td>60.63</td>
<td>203,542</td>
<td>39.36</td>
<td>517,095.5</td>
</tr>
<tr>
<td>Bhaktapur Municipality</td>
<td>879,388</td>
<td>50.71</td>
<td>854,612</td>
<td>49.28</td>
<td>1,734,000</td>
</tr>
<tr>
<td>Thori Rural Municipality</td>
<td>51,300</td>
<td>15.30</td>
<td>283,959.6</td>
<td>84.69</td>
<td>335,259.6</td>
</tr>
</tbody>
</table>

Source: Statistics, and planning and budget booklet for Fiscal Year 2018/19 provided by the concerned local governments

A large proportion of capital expenditure in the total budget is generally viewed positively because it allows for the possibility of allocating more budget for development-related projects. However, recurrent and capital expenditures should be taken as complimentary expenditures rather than separate from one another. For example, a lack of skilled technicians would reduce the recurrent expenditure. But, this could hamper capital expenditure by affecting project implementation, monitoring, and evaluation. In this context, a fine balance between capital and recurrent expenditure could help to improve the absorptive capacity of local governments.

3.4 FISCAL TRANSFERS IN THE LOCAL GOVERNMENT BUDGETING PROCESS

Local governments receive federal and the provincial grants mainly under four headings: equalization, conditional, matching, and special grant. Similarly, intergovernmental revenue sharing is an important financial source for local governments. During the course of this research, local representatives complained about a lack of adequate communication from federal and provincial governments when fiscal transfers were made. As a result, local representatives said they were often unaware of why the transfers had increased or decreased from year to year. Some of them were even suspicious that certain fiscal transfers were politically motivated. “The equalization grant we received decreased by NPR 30 million over the previous year. But we are not aware why it was reduced,” explained the chairperson of a rural municipality in Province 7. Since, equalization grants are determined through specific criteria set by the National Natural Resources and Fiscal Commission (NNRFC), it was unlikely to have been politically motivated. However, the lack of consultation around fiscal transfers, and lack of awareness among local representatives about methods of fiscal transfers and revenue sharing, made them suspicious.

24 NNRFC made the following criteria for recommending basis and modality of revenue sharing for Fiscal Year 2018/19: population (70 percent), area (15 percent), Human Development Index (5 percent), Least Developed Index (10 percent) and a minimum score for revenue sharing. Criteria for Equalization Grant: difference between local level’s expenditure needs and revenue capacity (70 percent), Human Poverty Index (10 percent), Social and Economic Discrimination Index (5 percent), Infrastructure Index (15 percent) and minimum grant. See, Government of Nepal. 2018/19. Information Booklet,
Some elected representatives also questioned the basis and indicators used for fiscal transfers. Since various statistics on newly restructured local units were unavailable, the nearest proxies were used for determining the amounts for revenue sharing and equalization grants. The NNRFC also stated that the unavailability of statistics on newly restructured local units as a limitation when determining fiscal transfers. Local representatives also complained that fiscal transfers were not able to address local needs because data on parameters important in determining transfers, like population, was constantly changing and not regularly updated. These limitations meant that fiscal transfers currently being practiced were not capable of adequately addressing fiscal imbalances prevalent amongst local units.

Elected representatives also pointed out various challenges with conditional grants. A planning officer at a local unit in Gandaki Province said that conditional grants were dictating the functions of local governments and limiting the government’s performance. DRCN researchers also found instances where inadequate and excess budgets were allocated via conditional grants for specific programs. For example, in Konjyosom Rural Municipality in Lalitpur, NPR 80 million was allocated for social security payments but a representative claimed that only NPR 25 million was spent. At Annapurna Rural Municipality in Myagdi, an employee at the Livestock Services Section stated that inadequate budgets were allocated in some of the conditional grants program. “NPR 15 thousand was allocated for goat breeding but the price of one male breeder goat ranges from NPR 40 thousand to NPR 350 thousand,” he said.

Another representative of the same section added that conditional grants were sent without clear explanations and guideline. Elected representatives argued that the programs in conditional grants did not match local needs and contexts. “Agriculture-related programs are not required in metropolitans. And what is the use of programs on Ayurveda in our local unit, when we do not have any infrastructure for Ayurveda?” the Chairperson of Konjyosom Rural Municipality questioned. Similarly, local representatives also pointed out that some conditional grants were too small for their proposed programs and hence, ineffective. This was primarily because the data required for conditional grants were not maintained properly, and the grants were provided without adequate study.

Although the Constitution guarantees the autonomy of local governments, their main source of finance is the fiscal transfers provided by the federal and the provincial governments. The local governments determined the size of their budget based on these transfers. However, local representatives complained that their annual budget formulation was affected by the delays in sending the estimates of the fiscal transfers. Even though the budgets of the federal, provincial and local governments were announced sequentially, stakeholders expressed their dissatisfaction that local budgets had to be prepared in a rush because they were given a very short timeframe within which to prepare them. Overall, the best practices of grants allocation such as transparency, predictability, and timely sanctioning of grants were not fully followed by the federal and the provincial governments.

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26 Federal government is required to present its budget by Jeth 15 (end of May), Provincial government by Asar 1 (Mid-May) and Local government by Asar 10 (May 24/25), in their respective legislature.

25 For example: Human Poverty Index is available only for the district-level, Human Poverty Index of Provincial and Local level were prepared on the basis of geographical area, rural and urban area and district-level statistics. Government of Nepal. 2018/19. Information Booklet, National Natural Resources and Fiscal Commission. Kathmandu: National Natural Resources and Fiscal commission.
BUDGET EXPENDITURE AND PROJECT IMPLEMENTATION

Local governments’ budget expenditure and project implementation were affected by factors including population, geography, state of physical infrastructure, revenue mobilization capacity, absorptive capacity, their technical capacity, and other administrative capacities. VDCs under the unitary structure took technical and administrative assistance from DDCs when implementing their budgets. Under the federal structure, all local governments including rural municipalities are solely responsible for budget implementation.

4.1 PROCEDURES AND BASIS FOR BUDGET EXPENDITURE

The Local Level Plan and Budget Formulation Guideline, 2017 recommends that a municipal assembly should approve its annual projects and programs by the last week of June, after which the projects and programs should be implemented by the local executive. While spending the budget to implement the projects, local governments should specify the modality, deadline, and the authority/official responsible for project implementation. Similarly, criteria for the monitoring and evaluation of projects should be based on applicable laws, including the Public Procurement Act and Rules.

During this study, DRCN researchers found that allocated recurrent funds were mostly fully spent by local governments because they included regular administrative expenses, expenses to maintain and repair assets, and expenses to procure logistics. Only in exceptional case when employees were unavailable or social security allowances were not spent did recurrent funds go unspent. Conversely, the inability to spend allocated capital funds was found to be a larger problem. Projects under capital expenditure were implemented through different procurement methods depending upon the cost of the project. These public procurement methods aimed to ensure financial discipline while maintaining procedural transparency during project implementation. The Public Procurement Act, regulations and procedures should be followed while implementing projects and spending budgets.

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28 Public Procurement Act, 2007, Section 8 requires use of various types of procurement methods based on purchase value, and nature of work. The procurement methods stipulated in the Act for procurement of goods and construction work are: (1) By inviting open bids at international level, (2) By inviting open bids at national level, (3) By inviting sealed quotations, (4) By procuring directly, (5) Through participation of users’ committee or beneficiary group, (6) Through force account, (7) Through lump sum piece rate, (8) Through catalogue shopping from manufacturer or authorized distributor/seller, (9) Through limited tendering, (10) Through buy back method. And, Procurement of Consultancy Service can be done by: (1) By requesting competitive proposals, and See, Government of Nepal. 2007. Section 8. Public Procurement Act, 2007. Kathmandu: Government of Nepal. Acts and regulations including, Financial Guideline, Users Committee Formation Guideline made by the municipalities themselves under the Public Procurement Act, 2007, Public Procurement Rules, 2007 have guided local governments for these methods and procedures.
4.2 EFFORTS TO INCREASE ABSORPTIVE CAPACITY

Various factors had impeded budget implementation at the local level. The absorptive capacity of local governments, particularly concerning the implementation of projects under capital expenditure was affected by several factors including project selection and cost estimations done without proper study; the politicization of project selection and implementation; limited administrative and technical capacity; lack of public participation; procedural hurdles in the Public Procurement Act; and ineffective monitoring and evaluation. Considering these limitations, local governments used different practices to increase their absorptive capacity and make project implementation more effective. They chose from various public procurement methods depending upon the nature of the project, the possibility of users participation, local governments’ administrative capacity, and the estimated cost of the project.29 The objectives of these practices were to determine the most effective procurement method for each project and to make necessary changes where required.

Most projects undertaken at the local level were small. Because of this, local governments decided to implement them mainly through users committees. However, some local governments decided to award even small projects to contractors due to the limitations and complexities of implementing them through users committees. Duhabi Municipality in Sunsari, and Chhatreshwari Rural Municipality and Baghchaur Municipality in Salyan, decided to implement projects up to NPR one million through users committees and projects of larger amounts through tenders. The CAO of Duhabi Municipality said this was done because, “Construction work requires professional expertise and technical know-how. Hence, contractors are better equipped at implementing these projects.” However, some local governments were even implementing projects over NPR 10 million by dividing the work across several users committees.

Local governments also took some measures to make project implementation through users committees more effective. In order to increase citizen participation they reduced the percentage of beneficiary contribution. Duhabi Municipality of Sunsari reduced the required beneficiary contribution from 25 percent to 15 percent. Lalitpur Metropolitan reduced it to 10 percent. In some places, DRCN researchers found that local governments were using heavy machinery in project implemented by users committees, despite the law prohibiting such practices.30 For example, a local unit in Myagdi allowed users committees to use bulldozers and other construction related machinery in road construction. Elected representative however, claimed that they had chosen the vendor that provided the machineries for the lowest rate. Due to a lack of resources and technicians needed for monitoring and evaluation, local governments in different places decided to prioritize a few large projects instead of dividing resources across many smaller ones.

Local governments had started different practices for implementing projects and by doing this were exercising their constitutional rights. This had given the local governments the opportunity to implement projects according to local needs and capacities.

29 Public Procurement Regulation, 2007, Rule 97 allows procurement of construction work of physical infrastructure and construction for a project with a costing of a maximum of Rs 10 million, and which can utilize the local capacity, resources, and can be completed at local level, through a project users committee. See, Government of Nepal. 2007. Public Procurement Regulations, 2007. Kathmandu: Government of Nepal.

30 According to the Rule 97 of Public Procurement Regulations, 2008, use of heavy machinery such as loader, excavator, roller, dozer, grader, bitumen distributor, bitumen boiler, for construction is prohibited in construction work conducted by users committee.
4.3 USERS COMMITTEES
Local governments can implement development projects within their jurisdiction through users committees by issuing procedures regarding the formation, mobilization and management of these committees.\footnote{The Guideline has provisions to call for a general assembly of beneficiaries while forming the users committee, form a committee of seven to 11-members, which should be inclusive, at least 33 percent of the members should be women, at least one of the chairperson, secretary or treasurer should be a woman, an individual should not be a member of more than one committee, form the committee unanimously as far as possible, else form the committee with decision through simple majority of the beneficiaries, conduct the project in the supervision of an executive member of municipality or other designated person, prioritize project which involve contribution from users when assigning projects to users committee, prohibit sub-contracting to other construction contractors, individuals or organizations.}

USERS COMMITTEE FORMATION
Local governments faced various challenges during users committee formation. Challenges include: a difficulty with finding users to work on committees; politicization during committee formation; and the provisions for inclusion of disadvantaged groups being followed for a mere formality. Elected representatives in Lalitpur Metropolitan City said that it was difficult to find members to form the committee because most people in the city were busy with their jobs. Similarly, elected representatives in Jay Prithvi Municipality in Bajhang, Malika Rural Municipality in Myagdi, and Sunwal Municipality in Nawalparasi West, said that because most young people had migrated away for work, there was a shortage of individuals to work in users committees.

Even though political party affiliates were not allowed to become members of users committees, political influence was rampant. Locally influential people occupied executive positions in users committees with the intention of extracting financial benefits through project implementation. “Users committees are formed by including the cadre of multiple political parties and influential ones to make financial gain,” a ward chairperson from Chhatreshwari Rural Municipality in Salyan claimed. A deputy mayor in a local unit of Province 2 similarly admitted that the influence of political parties was prevalent even after the formation of users committees. Another official in the same municipality claimed that users committees were functioning as sub-contractors of political leaders for political and financial benefits. Locally powerful people directly and indirectly connected to the elected representatives seemed to have enabled the former’s influence in the formation of users committees. In some cases political and other personal disputes had also delayed in users committees formation.

In order to ensure gender inclusion in the users committees, 33 percent of members should be women. However, in practice, inclusion in most committees was treated as a mere formality. Executive positions in users committees of most projects were occupied by men, and women members were given less priority and responsibility. A resident of Sunsari said, “Till now no users committees have a women president.” Women members of the users committees were also not actively involved in the processes of project implementation. “Even though three women are included in the committee to comply with the provisions, they do not actively participate. They are mostly busy with their household chores,” claimed a users committee chairperson in Susta Rural Municipality in Nawalparasi West.

PROJECT IMPLEMENTATION BY USERS COMMITTEE
Technical expertise was required during project implementation, which meant users committees relied on technicians provided by the municipality for implementing projects. Delays by municipalities
in providing required technicians led to ineffective project implementation. The chairperson of a users committee in a rural municipality of Province 2 shared his experience regarding such delays, “Even after I called the engineer multiple times he did not come to the project site. He provided instructions through the phone. We completed the project accordingly, but later he said that we did not follow the necessary standards and recommended a deduction in our payment.” Users committees were allowed to appoint their own technicians in case the municipality was not able to provide them, but users committees in places that DRCN visited were not aware of this provision. A shortage of technicians affected project implementation in remote areas. However, there was evidence to suggest that when technical assistance was provided in a timely manner, users committees were able to implement projects effectively. [See, Case Study 2]

CASE STUDY 2: LOCAL REPRESENTATIVES’ EXPERIENCE WITH USERS COMMITTEE

Almost all projects in Bhaktapur Municipality were implemented through users committees. Representatives that DRCN spoke to said many projects were completed for less than the estimated cost. The CAO provided an example of a bridge construction project in Bhaktapur for which NPR 5.1 million was originally allocated for the project which finished on time and well under budget. The technician working with the users committees estimated the cost of constructing the bridge to be NPR 4.6 million. An advance of NPR three million was provided but the project was completed within NPR three and a half million. After evaluating the project, the remaining NPR half million was released. “The project was completed in time because the users committee was provided with the necessary technical and administrative support,” said the CAO. The Deputy Mayor further claimed that some users committees saved 20 to 60 percent of the estimated project costs.

ADVANCE PAYMENT TO USERS COMMITTEE

After users committees are formed, they can receive an advance of a maximum of one third of the estimated cost of a project. However, some local governments introduced a zero advance provision to discourage users committees from delaying work and leaving the project incomplete after an advance was received. Due to the zero advance provision, users committees in certain places had to arrange initial project investments on their own, which they borrowed with interest. The zero advance provision increased the financial burden on users committees. The chairpersons of two users committees (irrigation and road-construction) in one local unit of Province 2 shared that they had to borrow money with interest to start projects. Even though they completed their projects around February 2019, the municipality did not release payments until May 2019. This delay meant that the users committee had to bear the burden of interest payments for a longer time. The users committee chairperson stated that this experience of struggling to manage the finances discouraged them to be part of users committees in the future. The users committees also had to forge documents, bills, and receipts to conceal the interest amounts they had to pay on the borrowed funds. When advance payments were not made, users committee members shared they had to buy construction materials on credit. This also meant the vendors would supply substandard materials at higher rates, and the committee had little bargaining power when they bought the materials on credit. While the zero advance provisions were aimed at regulating users committees and ensuring increased financial discipline, it had unintended negative outcomes and led to non-transparent financial practices.

**SUB-CONTRACTING BY USERS COMMITTEES**
Several users committees sub-contracted some or all of their project implementation responsibilities. A lack of technical expertise needed for project implementation; the municipality failing to provide project criteria and other relevant information in an understandable language; and the difficulty of ensuring user participation and raising the required users contribution, were reasons why users committees found it easier to sub-contract project work. In many cases, users committees took commissions from contractors when handing over the projects. Contractors and the users committees were both looking to benefit financially from such illegal deals. The quality of projects was therefore compromised. Once the projects were completed by the contractor, the users committee members submitted documents to the local government themselves to receive payments. In this regard, the essence of a users committee was questionable if it had sub-contracted the work. [See, Case Study 3]

There were several factors that limited the performance of projects implemented by users committees. First, the users committees found it difficult to ensure adequate citizen participation. Second, powerful local individuals influenced the formation and functioning of users committees for their interests. Third, local governments were unable to provide adequate technical assistance to the users committees, which compromised the quality of projects. Finally, provisions like zero advance to users committees hindered their performance and compromised transparency in their action. However, DRCN also came across several instances where with adequate technical assistance provided, and effective monitoring in place, users committees performed proficiently to implement the projects.

**CASE STUDY 3: SUBCONTRACTED USERS COMMITTEE PROJECTS**

A users committee in a local unit of Province 5 sub-contracted a NPR seven and a half million project for blacktopping a road. Although sub-contracting of projects by users committees is prohibited under the law, the committee chairperson explained his actions: “All the young people of my settlement have gone abroad for employment. Since there are not enough people that can join the users committee, the users requested me to head the committee. We formed the committee, but it was very difficult to work.” The chairperson went on to explain the steps that led to the hiring of the contractor. The chairperson said that the technician had advised the users committee to raise NPR 1000 per foot from the beneficiaries to build the road, but users protested. Finally they agreed to raise only NPR 800 per foot. Users committee had to contribute NPR 2.9 million, but they came up short by NPR 1.2 million. “Even then it took more than two to three months to just raise the money. We then realized that we did not know how to undertake the work. We had neither the equipment nor the necessary contacts. So we gave the entire project to a contractor,” he said.

The contractor who was assigned the project was a local resident. When interviewed, the contractor explained his role in the project: “I am a staff of a construction company, not a contractor. I helped because I knew the users committee members and they were struggling to do their work. I do not have any benefit in this. Instead, I waived NPR half million I was supposed to receive from them. I even put in the initial investment. I also prepared the receipts, attendance details, and bills required by the local government.” The contractor completed all the required work and the committee chairperson only had to go to the office to receive payment for the project after its completion.
4.4 TENDERS
Local governments implemented some larger projects through the tender process. Elected representatives explained that the users committees lacked the technical capacity to implement projects and that it was better to implement through an open bidding process. Once the local governments decided to procure services of contractors for project implementation, they were supposed to make an open call for bids to ensure adequate transparency and cost-effective project implementation. However, stakeholders pointed out that the tendering process was long and tedious, and that many technical complexities prevailed in the process of calling tenders, issuing notice, determining timeline and during implementation. Stakeholders also pointed out instances of irregularities when projects were implemented through the tender process.

Local stakeholders reported that the tender process, consisting of multiple steps, was lengthy and the time it took to complete delayed project work. A contractor in Sunwal Municipality in Nawalparasi West explained, “The tender notices are issued very late, around September [third month of the fiscal year] and it takes till December [sixth month of the fiscal year] to complete formalities and to finally sign the contract.” Such delays meant that projects implemented through tenders would be rushed for completion during the last months of the fiscal year.

The main objective for implementing projects through the tender process was to establish competition among contractors, which would ensure quality work at a low cost. However, competition was found to have been deterred even when bids were called for. In one example, a local citizen in Province 2 said that his municipality published tender notices in a newspaper that was only locally circulated. “On the day the tender notices are published, all copies of the newspaper are bought off before they reach the news stand. This is done through a nexus of contractors, journalists, elected representatives and local government employees,” he added. E-bidding processes introduced to increase fair competition and transparency were also claimed to be ineffective. The CAO of Chhatreshwari Rural Municipality in Salyan claimed that e-bidding process had not solved the irregularities prevalent in the tender process.

Similarly, local representatives explained that because the lowest-bidding contractors had to be selected, there was a tendency to propose amounts that were significantly lower than the estimated project cost. Representatives expressed their doubt that a contractor bidding 30 to 40 percent lower than the estimated cost would be able to uphold the quality during project implementation. In many cases, after winning the bids contractors would take the advance payments and not start projects or start them too late into the fiscal year. This directly affected the project implementation process and hampered the absorptive capacity of the local governments.

4.5 PROJECT MONITORING
The Local Level Plan and Budget Formulation Guideline, 2017 includes various provisions and procedures for project monitoring and evaluation. Effective project monitoring can help local governments ensure proper fiscal management, transparency, and accountability.

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34 The guideline includes these provisions: arrange for regular monitoring, prepare a monitoring report through use of specific monitoring indicators, form a Local Developmental Problem Solution Committee chaired by mayor/chairperson of (rural) municipality which needs to meet three times a year. The local governments can form various committees for monitoring, supervision and evaluation, and can prepare required guideline for monitoring and evaluation.
PROJECT MONITORING RESPONSIBILITY

Deputy mayors and vice chairpersons are mainly responsible for monitoring development projects. The ward committees are responsible for monitoring projects in their wards. A separate committee is also formed from among users to monitor the projects implemented by each users committees. Technical staff are also responsible for monitoring the projects. Local governments in some places also divided monitoring responsibilities between ward committees and the municipal monitoring committee.

DRCN researchers encountered several cases in which project monitoring was impacted by disputes between elected representatives and local-level employees. A deputy mayor in a local unit in Karnali Province explained that the CAO was interfering with her work. “The CAO does not have confidence in elected representatives. He tries to be a know-it-all. He went to the field to monitor projects at the end of the fiscal year when there is a long line of service seekers at the office. We work as per the law, but the officer does not trust us. He goes and monitors the same projects that I have already monitored,” she said. However, a ward chairperson and a section officer of the same local unit believed that the CAO’s actions were directed towards trying to establish a system based on rules and laws. Similar disputes between representatives and employees were prevalent in other local units, where elected representatives often said that the government officials did not obey them, while the officials accused the elected representatives of not following the law and working at their own discretion. The deputy mayors and vice chairpersons of local units have a major role in monitoring projects, while the CAO is responsible for maintaining financial discipline in the local government. Both have a key role in effective project monitoring, but the lack of required coordination between them affected the monitoring process.

TECHNICAL CAPACITY IN MONITORING

There were questions raised about the effectiveness of monitoring conducted by elected representatives due to the lack of technical staff at the local level. The CAO of a local unit in Province 3 explained the problem in his unit: "There are more than 150 projects in this rural municipality. Technicians need to visit each project at least for the cost estimation and to observe the beginning of the project. The quality of work suffers if monitoring is not done properly. [Without the required capacity] the elected representatives can only do observation not monitoring. Sufficient technical workforce is important to make monitoring effective. In addition, users committees should also be given basic technical knowledge." Elected representatives also complained that the lack of technical and administrative staff was affecting project monitoring. “The CAO and accounts officer are frequently transferred. There are only three technicians: two overseers and one engineer,” an employee at Pokhariya Municipality in Parsa said. A ward chairperson of the same local unit complained that he faced problems in implementing and monitoring projects because the technical staff were not experienced. "We do not have a technician at the ward and have to depend on the temporarily placed engineer at the municipality for assistance. However, the engineer is not experienced and does not even know how to make cost estimations. Monitoring projects has also been difficult due to the lack of experienced technical staff,” he added. Lack of technical staff was not a major challenge in urban areas like Lalitpur Metropolitan City and Bhaktapur Municipality. In Bhaktapur Municipality, the Deputy Mayor stated that she was an architect and familiar with the technical aspects of project monitoring and claimed that monitoring was effective in her municipality. However, elected representatives of Konjyosom Rural Municipality, a comparatively remote local unit in Lalitpur, shared that a lack of technical capacity was a major problem during monitoring.
EFFECTIVENESS OF MONITORING

The local government staff and elected representatives shared that they found it difficult to monitor and evaluate projects implemented by users committees. An official at a rural municipality in Myagdi said, “Users committees pressure the technician to increase the valuation of completed projects. I had to change the valuation of two projects three times due to this.” Even when the technician pointed out that the projects had not met the required criteria, the committee members would call elected representatives and influence the monitoring process through their political party connections. A ward chairperson in Bagchaur Municipality in Salyan said that the users committee members became upset with him because payments were deducted after the evaluation found that the project did not meet the required criteria. The lack of technical capacity and difficulty in taking action against the users committees meant that the monitoring of projects at local level was far from effective in several local units.

The elected representatives also shared their experiences about the limitations of project monitoring. “Earlier I used to go for monitoring and submit my report to the municipality, but no actions were taken. They even released most of the project payment without my knowledge. I have stopped going for monitoring since,” explained the deputy mayor of a local unit in Province 2. Most deputy mayors and vice chairpersons who have a major responsibility in project monitoring are women. The interference in their responsibility, undermining their authority had also impacted in project monitoring and raised questions regarding the transparency in the process.

Stakeholders in some local units also said that the monitoring of projects implemented through the tender process was ineffective. A CAO said that the Public Procurement Act had not given authority to the local governments to take action against contractors who did not complete their work on time. He further emphasized that a provision was needed that would ensure stringent action against non-complying contractors. The Public Procurement Monitoring Office under the Office of the Prime Minister and Council of Ministers had also raised this issue in its annual report.35

4.6 RELEASE OF PAYMENTS

Users committee members reported the delay in payments of completed projects was a major problem. Local governments were mostly making payments in the final months of the fiscal year. Users committee members shared that they struggled to arrange required documents like Value Added Tax and Permanent Account Number receipts, which delayed payments. A users committee member in Sunwal Municipality in Nawalparasi West shared that he had to take help from a local agent to arrange necessary documents to receive the payment. The chairperson of a users committee in Susta Rural Municipality in Nawalparasi West explained that he had implemented a river embankment project worth NPR 180,000 but the payment was delayed, “I completed my responsibility. Even though it was a very small project, I have had to make so many trips to the municipality office just to receive my payment. The laborers who worked on the project keep asking for their wages but the rural municipality office keeps postponing the payments. The employees in the municipality keep asking for one or another document.” In some cases, users committee members said they sub-contracted their work in order to avoid such bureaucratic hassles associated with payments of completed projects.

The local users committees also accused officials at local governments of delaying payments in order to extract bribes from them. In a local unit of Province

35 The report has said, “Procurement agreements are not being concluded on time specified in the tender, because there is no penalty for delay. Section 27, 6(a) of Public Procurement Act, 2007 has not clearly specified what action would be taken against the officials responsible for the procurement if the work is not completed in the stipulated time.” See, Government of Nepal. 2018/19. Annual Report of the Public Procurement Monitoring Office, 2018/09. Kathmandu: Government of Nepal.
DRCN was told that payments were not made by the municipality unless 25 to 30 percent of the project cost was provided to the employees as a bribe. One interviewee claimed that 10 percent of such bribes would go to the Mayor and the Deputy Mayor, 5 to 10 percent to the ward committee, and 10 percent was divided among official. A chairperson of a users committee in another local unit of Province 2 shared their experience wherein the municipality engineer had asked for commission through a third party to approve the evaluation report for the final payment. As such, the users committee members generally perceived that the employees were intentionally delaying the payments to extort such ‘commissions.’ Payments were also delayed in several local units due to the absence of CAO and account officers and frequent transfers of personnel in these positions. Without officials present to approve projects or undertake evaluation reports, payments could not be released. An efficient payment process was important for effective public expenditure management, but the examples above highlight that the local level payment process was in part challenged by procedural complexities and was often times not transparent.

Local governments were adopting some new practices for project implementation that they hoped will increase their absorptive capacity and ensure transparency. However, examples of procedural complexities and irregularities persisted when projects were implemented through both the users committee and the tender process. Project implementation and monitoring was also affected by the lack of technical capacity at the local level. Similarly, grievances about delayed payments and irregularities were widely heard from service seekers. Despite these issues, users committee members and construction contractors communicated that it was far easier to work in the current system than the earlier one, as the project agreement, implementation, monitoring and payments were done at the municipal level. “Earlier, we had to spend time and money to travel to the district headquarters to make agreements and receive payments, but now it can be done nearby. It was difficult to get a hold of the employees before elected representatives took office, now at least we can easily share our problems with elected representatives,” explained one member of a users committee.
Budget allocation and implementation are important processes through which local governments deliver services. Importantly, the effectiveness of budget implementation depends on the absorptive capacity of local governments and the level of transparency in their affairs. Under the federal structure, budget allocation and implementation through local governments is expected to be more effective than under the previous unitary structure. In this context, budget allocation and implementation practices of local governments can be analyzed through administrative, fiscal and political aspects.

**ADMINISTRATIVE ASPECT**

For effective budget implementation, newly formed local governments need to increase their administrative capacity and for this reason, many federal level employees were integrated to the local levels. Even after the integration was completed, local governments still face a staff shortages. This has limited the administrative capacity of local governments and the effectiveness of their budget implementation. The Public Service Commission was in the process of filling vacancies at the local level. Local governments were hopeful that adequate staffing would help to improve their absorptive capacity.

Lack of administrative and technical resources and other non-transparent practices at the local level had delayed project implementation. To improve effectiveness, local governments have used different methods of public procurement according to their local necessities and choices. These efforts at reform could be considered an important development in Nepal’s local governance practice. Some local governments were focused on ensuring effective implementation through users committees while others, pointing to various limitations of users committees, chose to implement projects through the tender process. However, administrative capacity limitations, the influence of locally well-connected and powerful individuals in project prioritization and implementation, and delays existed in projects implemented through both procurement methods. If these challenges facing project implementation persist, it could lead to a deterioration of citizen’s trust in their local governments.

**FISCAL ASPECT**

A lack of clarity about the jurisdiction of local governments was prevalent. Local governments continued to rely on federal policies and conditional grants to deliver services in thematic areas like education, health, agriculture and livestock. Similarly, the delay in legislating framework laws necessary to clarify responsibilities in the exclusive and concurrent powers between the three tiers of government also limited local governments’ jurisdictions and consequently their performance. The major revenue source for local governments was still fiscal transfers from the federal and provincial governments. For effective fiscal transfers, inter-governmental coordination is required. The lack of coordination among the governments led elected representatives to believe that the federal and provincial governments were dictating their plans,
claimed that their authority in budget allocation and implementation was being undermined. Conflicts between the elected representatives of different political parties and within the same political party also complicated the budget formulation and implementation process.

It is important to have citizen participation during the budget planning, allocation and implementation process. Nevertheless, local governments were found to have prioritized projects and programs at the discretion of elected representatives and influential individuals. Similarly, political party influence in users committee formation and operation that was prevalent at local level was detrimental to citizens’ participation in local governance.

Local governments need to focus on increasing their absorptive capacity and accountability towards citizens. This would ensure that local governments effectively implement their projects and fulfill the needs of their citizens. This would also increase the citizens’ trust in their governments and expedite the implementation of federalism.

POLITICAL ASPECT

The balance of power at the local level also affected budget allocation and implementation. The sharing of resources among wards, and between wards and municipality influenced the priorities of budget allocation and implementation. Similarly, female deputy mayors and vice chairpersons of various municipalities...
RECOMMENDATIONS

TO LOCAL GOVERNMENTS

- Meaningful public participation should be ensured in the budget planning processes. Projects must be prioritized after estimating the costs and technical resources required for quality project implementation.

- Information of public importance, such as the criteria and list of projects prioritized at the ward and municipal levels, should be published at ward and municipal offices.

- A large proportion of budgets are spent on road construction and physical infrastructure development. Future budgets should give sufficient priority to other sectors, including social and economic development, by identifying local needs in these sectors.

- Adequate funds for recurrent expenditure should be allocated for the implementation, operation, and maintenance of capital projects.

- Ward budgets should be allocated only after assessing factors like the expenditure responsibilities of the ward, its population and geography, situation of physical and other infrastructure.

- A work plan should be developed to avoid rushed project implementation and payments at the end of the fiscal year. Work plans should be strictly followed.

- Users committees should receive adequate orientation on the technical and procedural aspects of project implementation. Importantly, technical and administrative assistance to the users committees should be provided on time, and documents like cost estimation should be available in a language that can be easily understood.

- Provisions that discourage public participation, such as zero advance provision to users committees and practices that add additional financial burden on users should not be made.

- The illegal and non-transparent practice of publishing an open bid for project implementation in a newspaper that is only locally circulated in small numbers should be discontinued.

- Adequate administrative and technical resources should be allocated for effective monitoring.

- After a project is completed, evaluation should be conducted in a timely manner. The payment process should be simple and efficient.

- The budget allocation and implementation processes should maintain transparency and remain accountable to citizens.

TO PROVINCIAL AND FEDERAL GOVERNMENTS

- Federal and provincial laws related to exclusive and concurrent powers of local governments should be enacted without delays. Local governments should be adequately consulted while drafting such laws.

- Federal and provincial governments should adequately coordinate with elected representatives before providing grants (particularly conditional grants) to local governments. Elected representatives
and employees of local governments should be made aware of the criteria, indicators and limitations of the methods used for fiscal transfers.

**TO THE NATIONAL NATURAL RESOURCES AND FISCAL COMMISSION**

- Fiscal transfers to local governments should be made more equitable and effective by updating the necessary statistics of local units to reduce the vertical (among three tiers of governments) and horizontal (amongst local governments) fiscal imbalances.
# ANNEX 1

## LOCAL UNITS WHERE FIELD STUDY WAS CONDUCTED

<table>
<thead>
<tr>
<th>District</th>
<th>Local Units</th>
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<tbody>
<tr>
<td>Sunsari</td>
<td>Duhabi Municipality</td>
</tr>
<tr>
<td>Parsa</td>
<td>Pokhariya Municipality, Thori Rural Municipality</td>
</tr>
<tr>
<td>Bhaktapur</td>
<td>Bhaktapur Municipality, Changunarayan Municipality</td>
</tr>
<tr>
<td>Lalitpur</td>
<td>Lalitpur Metropolitan City, Konjyosam Rural Municipality</td>
</tr>
<tr>
<td>Myagdi</td>
<td>Annapurna Rural Municipality, Malika Rural Municipality</td>
</tr>
<tr>
<td>Nawalparasi West</td>
<td>Sunwal Municipality, Susta Rural Municipality</td>
</tr>
<tr>
<td>Salyan</td>
<td>Bagchaur Municipality, Chhatreshwari Rural Municipality</td>
</tr>
<tr>
<td>Bajhang</td>
<td>Jay Prithvi Municipality, Bitthadechir Rural Municipality</td>
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ANNEX 2

DEFINITION OF TERMS

Revenue Sharing: The sharing of revenue collected by a government of a certain tier with governments of other tiers to address the expenditure responsibilities of various tiers.

Fiscal Equalization: Financial grants given to provinces and local units by the Government of Nepal based on the gap between the latter’s expenditure responsibilities and revenue capacity; and financial grants given by provinces to all local units within its territory based on the expenditure and revenue capacity of the local unit as per the recommendation of the NNRFC.

Fiscal Transfers: An arrangement for financial transfers in the form of revenue sharing, royalty sharing and grants as per the recommendation of the National Natural Resources and Fiscal Commission by the GoN to provinces and local units and from provincial governments to local units.

Special Grant: Grants provided by the GoN to provinces and local units for specific projects conducted to develop and deliver basic services like education, health, and drinking water to carry out balanced development of inter-provincial and inter-local levels, and advance or develop economically and socially discriminated classes or communities. There is a provision that provinces can also provide special grants to local units by making provincial legislation.

Complimentary/Matching Grant: Grants provided by GoN to provinces or local units to conduct a plan on infrastructure development. Feasibility, cost, results or gains from the plan, financial and material capacity or human resources required for implementation, and the necessity and priority of the project are taken into consideration when providing a matching grant. The matching grant is provided as a certain proportion of the total cost of the project.

Conditional Grant: Grants provided by GoN to provincial governments and local units, and by provincial governments to local units to implement a plan in line with national policy with the recommendation of the NNRFC. The GoN can fix necessary terms on project implementation while providing conditional grants and the concerned province and local units must abide by the terms. There is also the provision for provinces to provide conditional grants to local units as per the terms fixed by NNRFC under provincial legislation.

Established in 2014, Democracy Resource Center Nepal (DRCN) is a non-governmental organization focusing on research and observation of social and political issues in Nepal. DRCN has produced objective and field-based research around Nepal’s Constitution, state restructuring process, and implementation of federalism. DRCN also observed all phases of the local, provincial and federal elections conducted between May and December 2017.
Budget allocation and implementation are important processes through which local governments deliver services to citizens. The effectiveness of budget implementation depends on local governments’ absorptive capacity and the transparency of the processes. In the federal structure, local governments’ budget allocation and implementation are expected to be more effective than in the unitary structure. If local governments can increase their absorptive capacity and accountability, then citizen’s trust towards them can increase. This can also help to make implementation of federalism more effective.