

*Unofficial translation for internal use.
DASU/Danida*

Local Authorities Fiscal Commission Report, 2000

His Majesty's Government
Local Authorities Fiscal Commission
Shree Mahal, Pulchowk

TABLE OF CONTENTS

Chapter One

Introduction.....	1
1.1 Statement of the Subject.....	1
1.2 Need for the Study.....	2
1.3 Composition of the Local Authority Fiscal Commission.....	2
1.4 The Scope and Subject Matter of the Commission.....	3
1.5 Methodology of the Study.....	3
1.6 Limitation of Study.....	4
1.7 Structure of the Report.....	4

Chapter Two

Fiscal Decentralization: Theory, International Assumptions and Customs	7
2.1 Importance and Need of Decentralization.....	7
2.2 Main Elements of Decentralization.....	7
2.1.1 <i>Kinds and Phases of Decentralization</i>	12
2.3 Fiscal Decentralization	12
2.4 Basis of the Sources of Revenue of Local Bodies: Theory and Practice	15
2.4.1 <i>Determination of Local Tax Rate and the Centre's Role</i>	16
2.4.2 <i>Revenue Collection Administration</i>	17
2.4.3 <i>Tax and Revenue Base of Intermediary Local Bodies</i>	18
2.5 Central Grant to Local Bodies : Concept and Practice.....	18
2.5.1 <i>Allocation of Revenue</i>	18
2.5.2 <i>Grant-in-Aid</i>	19
2.5.3 <i>Kinds of Grant</i>	19
2.6 Accounting System and Auditing.....	22
2.6.1 <i>Budget Preparation</i>	22
2.6.2 <i>Budget Implementation, Accounting of Transaction and Internal Control</i>	23
2.6.3 <i>Audit of Transaction</i>	23
2.6.4 <i>Accountability of Local Bodies and Fiscal Management</i>	24

Chapter Three

Provision of Local Bodies in Nepal.....	25
3.1 Attempts for Decentralization in Nepal.....	25
3.2 Decentralization Policy	26
3.2.1 <i>Constitutional Basis</i>	26
3.2.2 <i>Policy Basis</i>	26
3.3 <i>Local Self-Governance Act and Regulation</i>	27
3.3.1 <i>Existing Institutional Provision for Consolidation of Local Bodies and Decentralization</i>	27
3.3.2 <i>The Scope of Functions and Responsibilities of Local Bodies</i>	30
3.4 Organization of Local Bodies.....	35
3.4.1 <i>The Existing Institutional Provision of DDC</i>	35
3.4.2 <i>Existing Institutional Arrangement of Lower Level Local Bodies</i>	37
3.4.3 <i>Provision of Human Resources</i>	39
3.5 Review of the Provisions of Local Bodies	40
3.6 Recommendations and Suggestions	42

Chapter Four

Fiscal Status and Authority of Local Bodies	49
4.1 Historical Background of Fiscal Decentralization	49
4.2 Fiscal Status of the DDCs	49
4.2.1 <i>Internal Resources of DDCs</i>	49
4.2.2 <i>Composition of Expenditure of DDC</i>	51
4.3 Fiscal Status of Lower Local Bodies (VDC and Municipality).....	53
4.3.1 <i>Fiscal Status of Municipalities</i>	53
4.3.2 <i>Fiscal Status of VDCs</i>	56
4.4 Review of the Tax and Revenue System of Local Bodies	59
4.5 Power and Source of Tax Revenue of DDC.....	62
4.6 Power and Source of Revenue of Lower Local Bodies.....	62
4.7 Rates of Tax Revenue.....	63
4.8 System of Revenue Collection of Local Bodies.....	64
4.9 Fiscal Powers and Status of Local Bodies : Problems and Challenges.....	65
4.10 Areas of Improvement Needed in the Revenue Rights of Local Bodies.....	67
4.10.1 <i>DDC</i>	67
4.10.2 <i>Lower Level Bodies</i>	69

4.11	Improvement to be Made in the Rates of Tax - Revenue.....	73
4.12	Scope of Improvement in the System of Revenue Collection in the Local Bodies	74
4.13	Recommendation and Suggestions.....	76

Chapter Five

Provision for Central Grant and Revenue Allocation for the Local Bodies.....	79	
5.1	The Present Arrangement of Revenue Allocation.....	79
5.1.1	<i>The Revenue Rights of the Local Bodies Provided by the Centre in the Form of Tax, Grants, and Allocation</i>	<i>79</i>
5.2	Sources of Revenue to be allocated between the Centre and the DDC and Scope of Improvement in the Rates.....	80
5.2.1	<i>Proposed Rate of Allocation among Local Bodies.....</i>	<i>81</i>
5.3	Central Grant to the Local Bodies	81
5.3.1	<i>Central Grant to DDC.....</i>	<i>81</i>
5.3.2	<i>Central Grant to the VDCs and Municipalities.....</i>	<i>84</i>
5.3.3	<i>Grant from DDC to the VDC and Municipality.....</i>	<i>85</i>
5.4	Joint Review of the Grants to the Local Bodies	85
5.4.1	<i>Grant Distribution Administration.....</i>	<i>87</i>
5.5	Review of Grants and the System of Allocation	88
5.6	Recommendations and Suggestions	89

Chapter Six

Accounting System and Accountability of Local Bodies	93	
6.1	Existing Provisions.....	93
6.1.1	<i>Budget Preparation</i>	<i>93</i>
6.1.2	<i>Budget Implementation, Accounting and Internal Control.....</i>	<i>93</i>
6.1.3	<i>Fulfillment of Accountability</i>	<i>94</i>
6.2	Review of the Accounting System of Local Bodies and Accountability	96
6.3	Recommendations and Suggestions	98

Chapter One

Introduction

1.1 Statement of the Subject

The Constitution of the Kingdom of Nepal, 2047 (1990) has vested the sovereignty of the country in the people of Nepal and accepted the democratic system of governance. The main objective of any democratic system is the maximum welfare of the people. In this system, there is the provision of the rule of the people for the sake of the people. One of its powerful and effective means is decentralization. From this means people get the opportunity of maximum involvement in the system of governance. Keeping this fact in view, the Constitution of Nepal, 1990 has declared, referring to decentralization in the Directive Principles of State, that "the main responsibility of the state will be to strengthen public good through maintenance of law and order and protection and promotion of human rights and maintain a system wherein people can share the benefit of democracy by creating opportunity of maximum participation of the people through the medium of decentralization".

Although the process of decentralized governance had been started about four decades ago, it has not attained the expected goals. After the restoration of democracy, three Acts relating to local bodies were implemented in 1991. As those Acts could not provide desirable rights for autonomy, the Local Self Governance Act, 1999 has been brought about with provisions for increased autonomy. This Act has, on the one hand, developed several legal rights to the local bodies and on the other, enjoined in them several responsibilities as well. The local bodies have also been given fiscal rights in order to materialize those rights and responsibilities.

It is necessary to make public service more effective by making the local bodies, which are used to the luxury of grant, financially more active, more capable and considerate. For this purpose, it is necessary to make fiscal decentralization more effective by scientifically implementing financial rights in the form of collecting tax, service charge, fee etc. granted to local bodies by the Local Self-Governance Act, 1999 and Local Self- Governance Regulation, 1999. It is also equally necessary to identify appropriate new areas of fiscal rights in addition to those provided by the prevailing law and simplify the allocation of central revenue. It is felt that decentralization can directly benefit the people only if detailed study is done about systematizing the accounting and auditing systems, the tax-revenue raised locally and the allocation of central revenue and thus putting fiscal decentralization gradually into practice; and identifying new area of revenue and handing them over to the local bodies. It is necessary to make the budget formulation implementation and monitoring aspects more effective in order to bring efficiency in the management and mobilization function of the local bodies. Similarly, local bodies can function effectively only if it is accompanied by institutional consolidation, enabling of technical aspects, fulfillment of responsibility and transparent management of expenditure and work accomplishment.

Our whole development campaign has not given the desired output because of weakness and short comings in the management of income and expenditure. Therefore, it will be useful to take decentralization in the form of important and suitable alternative for increasing the effectiveness of public spending. In addition to improving the process of public spending, it has become necessary to look for alternative means of service delivery to the people. Therefore, it has become necessary to bring effectiveness in the implementation of decentralization by conducting a comprehensive study of financial decentralization in all its aspects in order to make the local bodies - the Village Development Committee (VDC), the Municipality and the District

Development Committee (DDC) - Civil Societies (NGO, User Group, Cooperative Union) and the Private Sector, capable and active in a coordinated manner, and identifying appropriate and practical ways and means.

1.2 Need for the Study

To make the local bodies capable and effective, it is necessary to activate them to use the rights and powers granted by the Local Self-Governance Act, 1999. The local bodies have not been able to use many rights granted by the Act. In this regard, request is coming from representatives and Associations related to local bodies that several fiscal processes and means should be clarified and HMG should assist in the consolidation of local bodies. Article 237 of Local Self-Governance Act has made a provision for Fiscal Commission. According to the Act, the scope (TOR) of the commission is "to conduct study and research about the tax levied by the local bodies and the allocation of revenue between HMG and local bodies; and render policy recommendations regarding timely restructuring of the system of tax and accounting". For the first time, local bodies have been given comparatively more financial powers. The local bodies should be economically more capable in order to effectively use these powers and provide public service. It is desirable to provide appropriate assistance by identifying the kinds of improvement needed in the financial status, especially internal resources of the local bodies and the mobilization of resources provided by HMG. The present study was needed to fulfil this objective.

1.3 Composition of the Local Authority Fiscal Commission

The Local Authority Fiscal Commission was created, for the first time in Nepal, by the decision of HMG (Council of Ministers) on 2056/10/24 with the objective of conducting study and research about the tax to be levied by the local bodies in accordance with Art 237 of the Local Self-Governance Act, 1999 and the revenue to be allocated between HMG and the local bodies.

The composition of the commission is as follows:

- | | | |
|-----|--|------------------|
| 1. | Dr. Shakar Prasad Sharma, Member, National Planning Commission | Convener |
| 2. | Secretary, Ministry of Finance | Member |
| 3. | Secretary, Ministry of Law, Justice and Parliamentary Affairs | Member |
| 4. | Secretary, Ministry of Water Resources | Member |
| 5. | Secretary, Ministry of Physical Planning and Works | Member |
| 6. | Secretary, Ministry of Culture, Tourism and Civil Aviation | Member |
| 7. | Secretary, Ministry of Forest and Soil Conservation | Member |
| 8. | Secretary, Ministry of Industry, Commerce and Supply | Member |
| 9. | Secretary, Ministry of Local Development | Member |
| 10. | Chairman, Federation of Industry and Commerce | Member |
| 11. | Mr. Akkal Bahadur Bista, Achham | Member |
| 12. | Representative, Association of DDCs | Member |
| 13. | Representative, Association of Municipalities | Member |
| 14. | Representative, Association of VDCs | Member |
| 15. | Mr. Khem Raj Nepal, Joint-Secretary, Ministry of Local Development | Member Secretary |

Invitee Members

1. Dr. Jagadish Chandra Pokhrel, Member, National Planning Commission
2. Auditor General
3. Mr. Krishna Prasad Sapkota, Association of DDCs
4. Chairman, Nepal Chamber of Commerce

(The name list of Commission Members is given in Annex - 1)

The original deadline for the Commission to submit its report was 31 Jestha, 2057 (15.6.2000). But as the importance and comprehensiveness of the study demanded additional study, as additional fiscal statistics and other information were needed from the DDCs and VDCs and as interaction had to be done in the regions, HMG (Council of Ministers) decision of 2057/3/19 extended the term to 30th Ashwin, 2057 on the request from the commission.

1.4 The Scope and Subject Matter of the Commission

The Local Authority Fiscal Commission was required to conduct study and present policy recommendations to HMG on the following subject matters:

- Tax to be levied by local bodies;
- Revenue to be allocated (shared) between HMG and the Local Bodies; and
- Policy to be adopted to make the tax structure and accounting system of local bodies up-to-date.

1.5 Methodology of the Study

The main subject of the Commission's scope of work is the financial aspects of local bodies. As financial activities are undertaken by different sectors of the state, it is appropriate to carry on the study with the participation of all the sectors (involved in finance). With this fact in view, the meeting of the Commission on 2056/11/30 had decided to form the following 3 sub-committees with involvement of different ministries of HMG, Federation of Industry and Commerce, Nepal Chamber of Commerce and members of the Commission:

- a: Tax, Revenue Collection and Determination Sub-Committee
- b: Central Revenue Division Recommendation Sub-Committee
- c: Accounts and Audit Recommendation Sub-Committee.

The terms of reference of the sub-committees, names of members of the sub-committees and names of personnel of the Commission Secretariat are given in Annex - 2.

Along with the study of the sub-committees, which presented their reports on 2057-2-31, the Commission had followed the following methodology of study in accomplishing its work:

1. Detailed study of the tax that the local bodies can levy in accordance with the provisions of the Local Self-Governance Act (1999), Local Self-Governance Regulation, 1999 and Local Body (Financial Administration) Regulation 1999, the revenue to be allocated between HMG and local bodies, the accounting and auditing systems of local bodies and the provision of their powers and responsibilities;
2. Study of the methods of budget formulation, revenue collection and service delivery of HMG;

3. Study of available literature on the international concept (assumption) of decentralization, particularly financial decantation and local bodies (reports of former Commission, High Level Committees, other study reports, books and materials available in the internet);
4. Study of the attempts of decentralization in Nepal, the present status, administrative, financial and organizational capability of local bodies;
5. The study and analysis of the financial details obtained from 34 DDCs, 58 Municipalities and 75 VDCs from among the total of 75 DDCs, 58 Municipalities and 3913 VDCs.
6. Analysis of suggestions obtained from multi sectoral seminars and discussions conducted in the 5 Development Regions;
7. Study of suggestions from interaction and discussion with professional experts;
8. Study of suggestions obtained from various organizations and specialists;
9. Study of policy and action related concepts of different sectoral ministries;
10. Study of suggestions obtained in response to public announcement; and
11. Study and analysis of other interrelated subjects and aspects discussed and decided in seven meetings of the Commission conducted on different dates.

1.6 Limitation of Study

Decentralization is an important component of the entire state management. As fiscal decentralization is an important condition of decentralization, the central focus of this study has been on the fiscal aspects. As the scope of study of the commission was related to the tax that local bodies can levy, allocation of central revenue, the system of taxation and accounting in the local bodies, this study has been limited within the boundary of these subjects. Having conducted discussion and interaction with all concerned agencies regarding the financial status, resources and capability of local bodies, all opinions, counseling, information, statistics and suggestions obtained from them have been incorporated in the study report.

In analyzing the fiscal status, the fiscal details for two years obtained from 34 DDCs and 75 VDCs have been taken as the basis. In the case of municipalities, available secondary statistics has been used. From the reading materials, only the means and ways that are practicable and useful in the context of Nepal have been taken. More secondary information are used than primary ones. As sufficient time has not passed since the enforcement of the Local Body (Financial Administration) Regulation, 1999 for the evaluation of its strength and weaknesses, it has not been possible to assess all circumstances (conditions). As detailed study of separate impact in different geographical, regional and local conditions of the different rates of tax, total income and appropriateness of expenditure could not be conducted, only polices in terms of rates of tax have been recommended.

It was not possible to provide fullness by preparing implementation process and conditions because it would need additional time. Because of lack of related information in the local bodies and because of lack of detailed study about the resources and resource management of the local bodies in the past, it was not possible to incorporate all aspects of local bodies in presenting the report in the limited time.

1.7 Structure of the Report

This report is divided into six chapters. Chapter one is introductory. Thereafter, the composition of the Local Authorities Fiscal Commission, members of the commission, subject and scope of

the study of the commission have been presented. At the end is presented the methodology and limitation of the study. In chapter two, the conceptual area (surface) of local decentralization and international customs and recognitions have been incorporated. In this chapter, special discussion is made on the main components of decentralization and the concept, customs and assumptions of fiscal decentralization. Thereafter, the main topics of the report internal resources of local bodies, allocation of revenue and grant-in-aid and the system of accountancy have been analyzed.

Chapter three is concerned with the legal infrastructure of decentralization and the organization of local bodies. In this chapter brief description is made about the historical background of decentralization and policies and legal and institutional provisions of decentralization in Nepal. Thereafter, the chapter contains the functional responsibility given to local bodies and the assessment of their capabilities to fulfil those responsibilities together with measures to improve those capabilities.

In chapter four, discussion is made about the financial status and financial powers of the local bodies. In this chapter analysis of the status of internal resources, and status of financial autonomy and expenditure of the DDCs, Municipalities and VDCs is done on the basis of data obtained for fiscal years 2054/055 and 055/056. Along with this, matters relating to the present fiscal powers and improvements needed in them are recommended. In chapter five, analysis is done about the allocation of revenue and grant from the center and measures for improvement are also presented. In this chapter, along with other recommendations, format is suggested for determining the grant from the center to the local bodies. Finally in chapter six, discussion is made about the accounting system of local bodies and their accountability. This chapter also contains the accounting system and auditing system of the local bodies including suggestions for improvement.

Chapter Two

Fiscal Decentralization: Theory, International Assumptions and Customs

Before discussing fiscal decentralization, it is necessary to discuss and understand other elements of entire decentralization. Therefore, components of decentralization, its phases, theoretical aspects of fiscal decentralization and its practices have been discussed respectively in this chapter.

2.1 Importance and Need of Decentralization

Throughout the world there is a desire in the people to search for self-determination or to influence the decision of the government. It is believed that decentralization helps the process of political consolidation of a country by involving different classes and communities of the people in the systematic and formal process and service delivery to the people in accordance with their wish through good governance.

Therefore, the countries which have attained maturity in the democratic process have created local bodies and are operating them through election.

The main assumption of decentralization is the principle of subsidiarity. According to this decisions affecting the life of the people should be made by units close to the people and service that can be rendered at lower levels should be performed by the lowest units. This principle seems to have been accepted as the guiding principle of federal systems like the United States of America and the European Union. Public responsibilities are determined according to this principle. Decentralization becomes an important factor providing sustainability to development through the adoption of a participatory process and the consolidation and development of the democratic process itself.

2.2 Main Elements of Decentralization

Decentralization is found to have been practiced differently in different countries. Therefore, it is difficult to view decentralization of a particular country on the basis of a specific structure. Nevertheless, similarities are found in democratic countries in some indispensable elements. These elements have been presented in the following four categories:

- a. Legal infrastructure and political commitment;
- b. Fiscal resources and management;
- c. Organizational capability; and
- d. Public service/satisfaction.

These four elements supplement and complement each other. In comprehending them and taking decisions, two other aspects - principle of subsidiarity and good governance - should also be taken into consideration.

(a) Legal Infrastructure and Political Commitment:

Decentralization should be done on the basis of law and political commitment becomes indispensable for it. In some countries of the world, there are constitutional provisions for decentralization and local bodies. In Nepal, the Constitution mentions decentralization as the Directive Principles of State and provisions of local bodies and their rights and responsibilities are made through legislative Act/Regulation.

The geographical area and sectoral jurisdiction of the local bodies must be specified by law. Under the sectoral jurisdiction and geographical area, the number and structure of local bodies are important subjects. It is found that some countries have created small but large number of local units with political participation and democratic representation as the main criteria. Nepal is also one of such countries. On the other hand, there are many countries which are moving ahead with the belief that there should be financially self contained and autonomous local bodies for which the area should be expanded and the number reduced. In many countries with large number of small local units there is also an intermediary unit. But most of such intermediary bodies are an extension of the central government and there is no provision of election. In Nepal, however, the DDC is an intermediary body and it is composed through indirect election. Generally the intermediary body is vested with the type of responsibility performed by the central government (like supervision, inspection, monitoring, enabling, auditing etc).

In respect of jurisdiction, the division of power between the central and local bodies is important. The division of power and jurisdiction should have been done in accordance with the principle of subsidiarity, but in countries with unitary type of government there is the direct influence of parliamentarians over the development at the local level. But in many countries with the federal type of government, the power has flown upward from lower levels. The federal government is usually centered around central level programmes and local governments are successful in retaining greater local level powers with them. In this context, instead of making comparison as to which form is good or bad, it is more important to see if the people are getting public services and utilities in standard form from efficient component of the government or not. For this purpose, the assumption is that the minimum standard and service and utilities should be determined and efficient and capable governance mechanism should be entrusted with such responsibilities and powers. Whether the local bodies have fulfilled their responsibilities, if they violate what punishment should be meted, on what basis to examine if they have fulfilled or not, what form of reward to be awarded for those that have excellent performance : these subjects should be clearly mentioned in the regulations or procedure of work. This becomes an important aspect of decentralization.

Another element indispensable for successful implementation of decentralization is political commitment. A good law cannot achieve the desired goals of decentralization if it is not implemented with political commitment. In the context of Nepal the positive conceptual aspect is that all political parties have pleaded in favor of local autonomy and decentralization. The practical aspect of commitment is that central bodies feel equally responsible for decentralization and always remain effortful as a campaign and policy of the government. Therefore, it becomes necessary for all the central government bodies or components to go on performing their activities in accordance with the decentralized structure. Implementation of decentralization will be impeded if even a single agency or body fails to cooperate. Decentralization should be reflected in the life style of the citizens (leaders, people, administrators and all concerned) and for this purpose there should be consistent process of suitable laws, policy, regulation, effective implementation of planned development and the means of improvement. Similarly congenial political environment both at central and local levels is indispensable for effective implementation of decentralization.

(b) Financial Resources and Management of Local Bodies:

Local bodies should be provided financial power and resources in conformity with the powers of decentralization. Under financial power fall functions like determination and implementation of tax, fee, service charge and fines or penalties to be mobilized by local bodies. Under financial resources fall the grant provided by the central to the local bodies or amount allocated from the central revenue, resources derived from mobilization of local revenue and loans. Resources are provided in different ways in different countries. In some countries, central grant forms a large component of resources of local bodies while in some others the financial powers of local bodies

are larger. How-so-ever it may be, there is uniformity of view that for the fiscal independence of local bodies, there should be some own local resources in addition to central grant. Similarly there is almost a uniformity of view that the local resources mobilized by local bodies should also be reflected as part of the total public resource mobilization. In Nepal, however, the process of reflecting local resources in the public finance is not yet developed¹. It is observed that in the total resources of local bodies, the part of their own local resources are different on account of the difference in the quantity and quality of service delivered to the people. Among the countries where major part of local revenue is derived from their own resources, some examples are : Poland (71%), Iceland (90%), Germany (68%), Denmark (78%) Mexico (96%) and Norway (61%). In some countries, the bulk of resources are obtained from central grant. Example of this kind are : Netherlands (73%), Ireland (74%), United Kingdom (72%), Uganda (77%) and Ghana (69%). Among countries having almost equal proportion of central grant and local resources some examples are : Belgium (46% and 54%) and (Canada (53% and 47%). What it shows is that more important than having greater or smaller proportion of central grant is the fact that there should be adequate resources for the local bodies to deliver the specified services. For the sake of enabling the local bodies to deliver the specified services, the central government can either increase central grant or expand the base of local resources. Similarly, it is also seen that if the central government is getting its functions performed through local bodies, the center transfers its resources allocated for such functions to the local bodies.

The process of providing central grant and the criteria of such grant should be objective as far as possible and there should be transparency, certainty and regularity of the decision making process. Only then the provision of financial resources is considered appropriate. Discretionary decisions and unpredictable grant cannot create congenial condition for the financial independence, autonomy and effort of the local bodies.

If mobilization of revenue is one main aspect of the effectiveness of fiscal resource management, the determination of revenue allocation, control of expenditure and financial discipline is another important aspect. Therefore, capable and authoritative body must indulge in a regular process of developing and consolidating the parameters in the management of local finance, monitoring and evaluation, taking action and making such action transparent. In this respect, the common (universal) convention has been as follows: increased power to local bodies should be based on the development of capability of allocating budget on the prioritization of service delivery, determining tax rate with the involvement of tax payers and making the (remarks) pointed out by audit transparent and carrying out (suggested) improvement. For this purpose, an agency is needed to develop parameters and assist in enabling local bodies as needed.²

(c) Organizational Management and Capability of Local Bodies:

For effective decentralization, organizational capability of local bodies is one important aspect. Even if there are resources and the entire legal and political admosphere is congenial, desired result cannot be attained in the absence of organizational capability. Under the organizational management and capability fall subjects like organizational structure of local bodies, human resource (both number and quality), authority and assistance given to them in internal management work and their appropriate use.

For the decentralization process to be effective, the local bodies should normally have the power to determine their own organizational structure and mobilizing human resource (recruitment,

¹ Fiscal Decentralization and Sub-National Government Finance in relation to Infrastructure and Service Provision; Country Report (Switzerland): NALAD, November 1999; Page-21.

² Fiscal Decentralization and Sub-National Government Finance in relation to Infrastructure and Service Provision: Synthesis report on 6 Sub-Saharan African Country Studies, NALAN, May 2000, P. 45-46.

posting, determining the conditions of service and evaluation). Similarly the capacity to establish the management system (like financial management, upgrading the efficiency of personnel, office administration) and the external assistance to be given to local bodies should be clearly spelled out. In addition, managerial accountability should be clearly specified.

To determine accountability, there should be a clear division of powers and responsibility between the elected representatives and the paid personnel. Atmosphere of mutual cooperation and noninterference between the elected representations and the officials should be generated so that the political manpower can concentrate in policy issues and the civil servants in policy formulation and decision implementation.

Technical manpower is a very important aspect of organizational capability. Local bodies can be effective if their technicians in the field of policy, programmes, plan (long and short term) formulation and delivery of services are adequate and skilled. This will facilitate to win the confidence and cooperation of the people. Management of information is important for making the management of the local bodies more objective. Therefore, the capability of the local bodies can be measured from the extent to which the process of collecting information, updating and analyzing them and working on the basis of information is developed.

In the same way, local bodies will be capable to the extent to which there is continuity and regularity in respect of central encouragement, recognition, direction and action. The roles and capabilities of the concerned Associations of local bodies, and the relation of local bodies with the civil society and the private sector have an important impact on the capability and trust, worthiness of the local bodies, culminating in the effectiveness of the very process of decentralization.

(d) Public Service and Satisfaction:

Decentralization is not an end in itself; it is only a means. The main end (goal) of decentralization is the increase and effectiveness in public service and balanced development to be thus achieved. Local bodies can efficiently and skillfully deliver public service according to the principle of subsidiarity. This ensures the best utilization of the resources.

Likewise, as the local bodies are close to the people, they are more responsive to people's wishes and pressure. Therefore, for the success of the process of decentralization, public satisfaction is one basic element. For this purpose, the services to be provided by the local bodies should be specified (fixed) and continuous.

Similarly, there should be a provision of working through direct involvement/participation of the people, by clearly determining how and in what way the local bodies can deliver those services in a planned manner.

According to the concept of fiscal federalism³, the three main functions of public sector are: resource allocation function, redistribution function and macro economic stabilization. Among these, the resource allocation function is recognized to be the most appropriate one for local bodies. The functions of local bodies can be classified into the following four categories⁴:

- a. Public service (like micro roads, town planning, gardens, water supply, electricity);
- b. Merit goods (social priority services) like health, education, sports, settlement, social welfare.

³ World Development Report, 1999-2000.

⁴ David King (ed) Local Government Economics in Theory and Practice, 1992, P-24.

- c. Functions to be performed under exclusive local authority (monopoly) like city transport, management of bus park etc; and
- d. Functions to be performed on grounds of externality, like management of physical waste, control of pollution, environmental protection etc.

It is observed that different responsibilities and functions have been entrusted in different places in accordance with time, space and environmental factors (Annex - 3). Therefore, which function should be or should not be entrusted to be local bodies assumes secondary importance. But, it must be clearly specified why that function is given to the local body and what services, in what quantity and quality, can be expected from them. In other words, the minimum quality of given services should be clearly defined and the people should be informed what action will be taken against whom if the quality of service is not met.

Only then the increase or decrease in public service can be measured from which the people will get a basis of expressing their satisfaction or discontent. Fulfillment of responsibility is difficult if there is overlap in jurisdiction (or scope of work). If there is overlap in the jurisdictions of central and local bodies, the local bodies tend not to move ahead in doing such work and there is evidence of this tendency.

If the analysis is done in another way, the functions of local bodies is classified on the basis of resources and responsibilities as follows⁵:

Table 2.1
Resources and Classification of Function

Function	Own Resources	Central Resources
Fully representative	-	++
Partly representative	+	+
Fully autonomous	++	-

After classification in this manner, the respective resource base of each function becomes clear. For the functions to be performed as fully representative, there should be a provision of central grant; the resources for the partial representative function should be jointly provided by the central and local bodies; and the functions with full autonomy must be based entirely on local resources. If there is clarity between the functions and resources in this manner, it will help the local bodies in working in a responsible way and the people will also get encouragement and rationale to make their assessment of local bodies and pressurise them to fulfil their responsibilities. It will eventually increase public satisfaction and public service. In some countries there are some unfunded mandates also to be fulfilled if the local bodies have the capability. But there is an assumption that such functions should be very limited. Assigning unfunded functions to local bodies will result in attempts to waive responsibility and also to the possible misuse of resource.

For increasing the public service and satisfaction through decentralization, the process of involvement and participation of citizens in the formulation, implementation, supervision and evaluation of plans of the local bodies should be followed. Therefore, the satisfaction of the citizens can also be measured on the basis of the extent of involvement of citizens in policy and

⁵ Jesper Steffensen and Mikael Holm, Paper on the principles for the finance of the future regions in connection with the administrative territorial reform in Latvia, NALD, Sept. 2000

plan formulation, whether plans are or are not formulated, whether those plans have or have not incorporated the aspirations and priorities of the people and the extent to which they are in conformity with the national policies, strategies and programmes. For this reason, long term and short term plans should be prepared on the basis of policy, planning and programmes with maximum interaction and discussion with the people and each local level programme and plan should get a place in the regional or central plan.

The success of decentralization of any country can be measured on the basis of how much of these four elements are incorporated in the process of decentralization of that country, what the status of their implementation is and how dynamically the process of improvement is moving forward through their mutual relationship and interaction. In many countries, a separate agency has also been created to conduct studies, research, analysis and policy formulation about these elements.

2.1.1 Kinds and Phases of Decentralization

Decentralization is taken as a continuous and phase-wise process. To give increasing decision making power to citizens and their representatives is political decentralization. In the economic decentralization, local bodies are given financial powers. In administrative decentralization, the jurisdiction and decision making powers of different bodies are made clear. Four phases are found in the decentralization of authority for public service delivery.

The first phase is called deconcentration of authority. In this, the center provides decision making powers to some degree to its own branches or field offices. The second is a phase of delegation of authority in which, apart from some authority to make decisions regarding services, some additional management authorities are provided through regulations. The third phase of decentralization is the devolution of authority. Finally, to transfer right, and responsibilities to the lower body with a view to empowering/enabling them, to the extent of creating a condition of zero impact of the central government in that respect is to reach the phase of full decentralization of allocating power. In this phase, functions like allocating powers to local bodies, mobilization of resources (including the power to impose taxes and fees) and management of manpower are determined by law. The higher level of decentralization is privatization of services under which all forms of possible services are provided by private agencies with or without profit motive. But, in this condition, the responsibility of determining the quality of service, monitoring and delivering the specified services to the people remains with the government or the local bodies.

2.3 Fiscal Decentralization

Fiscal decentralization denotes the financial autonomy and responsibility given to the local bodies. This issue is now being widely discussed in all countries rich or poor, big or small. Everywhere decentralization is in demand. The decentralization of work and responsibility automatically demands, in the local bodies, the capital expenditure and power to mobilize revenue.

Working through local bodies is justified on grounds of economic efficiency. Similarly, fiscal decentralization is considered necessary with a view to carrying the government close to the people from political perspective and for the sake of working in accordance with the desire of the common people and in their priority. Likewise, fiscal decentralization is considered useful for the best possible utilization of public expenditure and increasing effectiveness in revenue mobilization.

While bringing about change or improvement in the fiscal management of local bodies, attention should be paid to the following four aspects of fiscal decentralization:

- a. The entire legal infrastructure, institutional structure and coordinational process;
- b. The financial resource of local bodies and financial relation with the central body;
- c. Management capability of local bodies; and
- d. Good utilization of financial resource and public satisfaction.

As these issues are supplementary and complementary to each other and have deep interrelation with each other, they should be considered not in isolation but in their entirety.

Elements of Fiscal Decentralization⁶

The essence of decentralization is the transfer of the responsibility of public service delivery to the local bodies. The kind and quality of service, however, depends on the type of decentralization selected by the state (political or economic transfer, handing over, allocation, privatization). While decentralizing the function of service delivery, resources or finances necessary for such function should also be provided for. In other words, the total expenditure needed for the delivery of specified services should be matched by the finances from different sources. This position can be expressed in the following formula:

$$\textit{The revenue for public service} = \textit{Internal resources} + \textit{Central grant} + \textit{external grant} + \textit{Loan}$$

In this formula,

- Revenue for public service means the expenditure needed for delivery of specified public service or the construction of its infrastructure;
- Central grant means unconditional grant, conditional grant, specified amount for special programme and the grant provided for achieving equality (with more developed bodies);
- External grant denotes grant to the local bodies from donor agencies; and
- Loan denotes the legal loan borrowed by local bodies from national or foreign institutions.

According to this formula, the quantity and quality of service provided by local bodies depends on the resources available to them. Therefore, the more access they have to internal and external resources and grants, the higher will be their capability to render services.

In studying this formula, there are two sides to it. They are:

- a. The expenditure needs of local bodies and the level of their service; and
- b. The source of income of local bodies and the revenue available to them.

(a) Expenditure Needs and Level of Service

The amount mentioned in the formula denotes the total need of expenditure of local bodies : for this purpose it is necessary to know the level and kind of service decided by the state. Then, total amount needed can be determined by calculating the specified expenditure of local bodies on each level of these services on an annual basis. The norms of calculation can be different : just as, per unit cost; the average of the total cost of last 3-4 years; the rationale of local expenditure; the rationale of national expenditure, or the study of the expenditure and achievement of some sample local bodies.

Eigil Carner Nielson, PLS Consult, Denmark; Fiscal Decentralization - brief concept paper; Issue Paper No. 2, for Local Authorities Fiscal Commission, Nepal, May 2000.

In this rationale, only the amount expended by the local bodies on an annual basis is incorporated. In less developed countries, local bodies have to search for new service or have to spend for the continuity of the existing services in order to fulfil their responsibility of service delivery. In this way, both kinds of service expenditures done by local bodies should be reflected in the total expenditure. It is necessary to assess the amount needed for each new infrastructure building plan and programme every year. Along with this, attention must be given to the increase in annual expenditure on account of upgrading the level of service.

(b) The Source of Income of Local Bodies and Available Revenue

Assessment of source of income follows assessment of total expenditure. From this, the balance between the need for expenditure and the available revenue can be seen. While analyzing the source of expenditure need, it is assessed as to how much local bodies can meet by mobilizing the resources allocated to them and how much of grant and loan will be needed, from what sources, to meet the remainder. As mentioned above grant is provided in different forms (lump sum grant, conditional or unconditional grant, re-imbusement grant, special grant, donor agency grant). Similarly, resources can be mobilized by borrowing and by stimulating the investment of private agencies and cooperating organizations (Like the NGOs).

After calculating the total income and expenditure, it should be calculated whether there is deficit or surplus fiscal position. The local bodies with deficit resources can adopt a number of measures. For example: (a) Specify the priority of expenditure in most essential and efficient sector, (b) find out less expensive ways of service delivery, and (c) improve the administrative and service delivery mechanism.

Similarly they can look for ways for increasing the income through increased resource mobilization, and change the rates of tax and fee. Local bodies can reduce the kind and level of their services; can invite the private sector or the civil societies and attract their investment. If the deficit is still not met, local bodies can ask for increased grant or request the higher body to deliver such services.

In this fiscal analysis, if the local bodies have taken over the services provided earlier by line agencies of the central government, it might also be necessary to transfer such budget (provided to the line agencies) to the local bodies.

After the balance between the expenditure need and source of income becomes clear, it provides a basis for constant dialogue, tug-of-war and agreements between the center and local bodies regarding responsibilities, local resources, the grant-in-aid policy and division of power. Such a rationale helps the process of fiscal decentralization on the basis of objective facts.

The centre should adopt a strategy of relinquishing fiscal control over local bodies and gradually increasing their fiscal capability. From the angle of service cost, relinquishing of central control includes such subjects like the kind and level of service to be provided by the local bodies themselves, the number and level of employees, pay scales and privatization of services. Relinquishing of income includes rate and kind of tax and fees, and the control of loan to the local bodies in proportion to their income. Along with these strategies, if the centre increases its own capability of supervision and audit, and if it starts facilitating the local bodies instead of controlling them, the process of fiscal decentralization can be successful.

Local bodies have to change their attitude towards the people. In the changed context, the local bodies have to present themselves as salesmen of services and view the people as their customers. They should shun the practice of viewing themselves as donors and the people as 'target' group. For this purpose, the local bodies should have commitment, source of income and utilization capability.

In sum for successful implementation of fiscal decentralization, there should be a reasonable combination of the following components:

- Specification of responsibility and the power to define priority and investment accordingly;
- Responsibility and power to mobilize revenue;
- Objective and transparent system of central grant;
- Provision of loan and control; and
- Mechanism to aggregate all the above components and operate as a balanced and dynamic system.

2.4 Basis of the Sources of Revenue of Local Bodies: Theory and Practice

In many countries, the local component of the total resources is found to be increasing, and along with the growth of resources, the volume of service to be provided on the basis of local resources is also increasing. According to this, a trend is visible whereby local bodies spend their own resources in providing services expected from them, and the central grant is spent on the redistributed services formerly provided by the central authority. According to a study conducted for the Congress of Local and Regional Authorities of Europe, the finding that among 34 of 39 member states, the local budget comprises almost 9% of the GDP and 22% of the government budget indicates that the local bodies have sizable resources. According to the same study, the local bodies have raised 18% from local tax, 12% from fee and service charge, 51% from grant, 7% from loan and shares and 12% from other sources⁷.

In this way, tax, service charge, fee, central grant and loan comprise the resources of local bodies. In categories of internal resource of local bodies, tax, fee and service charge are the main sources. A brief discussion is done hereunder about these resources.

1. Tax

In granting taxation power to local bodies, four basic considerations are made:

- a. **Efficiency of internal market (specially capital and labour):** Tax should be determined in consultation with professional organizations in such a way as not to have an advance impact on the economy and industry. The local bodies should impose taxes, in consultation with civil society, on such grounds which are stable and localized, like land and building.
- b. **Equity in the weightage between the local bodies and the people:** Among the local bodies there should be equity between the basis of tax and the income from tax as far as possible.
- c. **Administration cost and simplicity:** Tax administration should not be expensive and complex.
- d. **Adequacy:** The basis of tax should be such from which adequate taxes could be collected and there should be continuity and expansion.

Income tax, value added tax and industrial tax are imposed by the decision of central government and these are also collected by central agencies. Tax based on property appears to be most suitable for local bodies and this is the main resource of local bodies throughout the world. Among other tax bases of local bodies, some are: natural resource utilization tax, professional tax, entertainment tax, vehicle tax, haat (market) tax and such other localized taxes.

⁷ Finance of Local Authorities, Third Consolidated Report; Congress of Local and Regional Authorities of Europe, Oct. 1997, P-34.

2. Service charge and Fee

Collection of public service fee (water supply, solid waste management, means of entertainment and local service facilities) and mobilization of expenditure necessary to create those services by local bodies are also considered appropriate. This will not only lead to increase in the revenue of local bodies, but will also assist in ensuring best utilization of those resources. In the United States of America, 14% of the revenue of the States and local bodies is raised from user (consumer) fee⁸. In the developing countries, it is difficult to raise user fee in excess of the cost of services.

Fees and service charges are either negative or positive type. In the negative type of fee fall fines, fees for granting permit etc, while, in the positive type fall charges for the use of road, drinking water, sewerage and electricity.

3. Loan

Generally, loan is not seen comprising a major component of resources of local bodies. Theoretically, the local bodies should be authorized to take loan, but if there is a trend of deficit budget and excessive borrowing, it will have an adverse impact on the whole economy and it must not be allowed to borrow only in accordance with the agreement to fulfil objectives set in advance. The limit of loan should be based on the repayment capability of the local body. As the local bodies have to repay with the revenue raised from user fee or other such income, there is an assumption that borrowing should take place with caution. Similarly, it is believed that the loan resource should not exceed the difference between the income and the expenditure need of local bodies.

4. Capital Collection

There is an increasing trend of the public sector using the participation of the private sector in the development or promotion of private goods. From this practice, the public sector can increase public utilities and divert its investment to promote expansion of other public goods. In the context of increasing the participation of the private sector in the promotion of quantity and quality of public utilities the increase in private sector participation in itself is an important alternate resource.

2.4.1 Determination of Local Tax Rate and the Centre's Role

Generally, it is thought appropriate that the body with the responsibility of tax should be authorized to determine the tax rate. By this means, the local bodies can formulate work plan according to the size of their income or can mobilize revenue to match the size of their programme. From the angle of tax autonomy, the tax resources of local bodies can be divided into four classes :- (a) local bodies determine the tax base and rate of tax themselves; (b) local bodies only fix the tax rate; (c) local bodies identify only the tax base; and (d) local bodies identify tax base both for the central and local purpose.

The capability of local bodies to determine taxes is inadequate in the beginning. If they start imposing taxes arbitrarily, it will bring economic imbalance, and restlessness and disturbance in the population, resources and the professions. Although local bodies may not be very arbitrary, as people can change the structure of leadership through election, it will surely have adverse impact never the less. In some places it is presumed that the local bodies do not have the capability while some others suspect that local bodies may unnecessarily waive taxes or indulge in such other malpractices. In Nepal, there are several examples of waiving loan or taxes for cheap popularity.

⁸ Roy Bahl, Worldwide trends in Fiscal Decentralization, 1999, The World Bank.

Power to determine the tax rates are given and should be given to local bodies also with a view to making them aware of their responsibilities and functions. According to this assumption, the Declaration of European Union on Local Authorities has a provision that, within the limits specified by the central and regional authorities, the local bodies can determine and change the rate of taxes. This helps meet both the objectives of maintaining minimum difference in inter-agency tax rate and giving the feeling of financial autonomy.

For the sake of avoiding great difference among tax rates of local bodies, it is not felt inappropriate that the central authority specifies the basis of tax determination and also makes⁹ some limits. But the centre should also give the local bodies some space for maneuver. It is more effective to provide these powers, limitations and autonomy through laws or regulations. The centre should examine whether the local bodies have decided the taxes objectively and impartially and also whether they have the necessary technical knowledge and skill for tax determination. In Australia, although the determination of tax rates is done differently in the different states, there is uniformity in determining the basis of valuation, giving lower bodies space to maneuver and fixing the maximum limit in tax rates⁹.

There are simple principles of fixing tax rates. They are: (a) service charge should not be very different from the cost of service; (b) rate of tax should be so fixed that the tax payer can afford to pay; and, (c) rates should be fixed with a view to maintaining a positive balance between the cost of collecting the tax and the amount of tax thus collected.

Another important aspect of determining tax rate is the confidence and cooperation of the people. For generating public confidence local bodies can adopt processes like tying the tax amount to the programme of increasing public services for the sake of transparency and involving the people in determining tax rates.

There is also an assumption that even if the power to decide taxes is delegated to the lower bodies, it should not be construed that the centre's responsibility is over. But that role should be as a helper or enabler in maintaining minimum standard and rather than that of controlling the local bodies. In this respect, the central body should provide assistance in the form of functions like developing parameters, auditing, human resource development and comparative study. The local bodies should develop a process of deciding taxes with the help of professional organizations representing the tax payers.

2.4.2 Revenue Collection Administration

Under the revenue administration fall functions like identification and registration of tax payers or users, determination of tax or user fee, tax or fee collection and enforcement. All revenue related powers and tax bases may not be equitably present in all the local bodies. The local bodies should themselves be capable to use the power of taxation. For this purpose, the local bodies need assistance in various skills and techniques.

The revenue management system of local bodies should be transparent, simple and unified as far as possible so that the tax payer and users may have minimum difficulty. Similarly, it is necessary to make provisions for the development of capability, incentives, guidance and control of personnel involved in revenue administration. Action based performance evaluation system and effective auditing system help the revenue administration.

There are no two opinions about the fact that entrusting the revenue collection helps their efficiency because they are directly concerned with the result of collection. Along with this, as

⁹ Local Government in Asia and the Pacific (ESCAP homepage); Country Report: Australia.

revenue collection is a little complex and technical matter, programmes of organizational consolidation should be conducted using specialized agencies in providing training, skill and knowledge and increasing incentives. Revenue administration should be always conscious about public good and facilities. If proper attention is not paid about the career development of the personnel, there is a strong probability that revenue administration will be corrupt.

2.4.3 Tax and Revenue Base of Intermediary Local Bodies

The source of revenue of intermediary local bodies is relatively scanty. Because direct tax goes to lower bodies and income tax goes to the central body, the intermediary bodies have no universal revenue base. Among most of developing countries, the amount of user fee also does not appear to be substantial. Therefore, it is necessary to make special provisions for the financial resources and fiscal autonomy of the intermediary local bodies.

In this respect, the federal systems of countries have adopted two types of measures. One measure is the transfer of some taxes like income tax and value added tax to the intermediary bodies. But, before giving such power, it is important to verify that the revenue administration of such bodies is efficient and smart. The second measure is the allocation of central tax. This division can be made in different ways. In some countries there is a convention of imposing additional taxes for the sake of intermediary bodies¹⁰. In some others, there is a practice of leaving part of the central tax collected from particular area of the intermediary body for the sake of that body. As an example, in Argentina and Mexico, the central government sends back all the money raised as VAT from the state to the respective states themselves¹¹. Apart from the grant and allocation of revenue from the centre, the revenue derived from the allocation of resources of lower bodies is also substantial source of income for the intermediary bodies.

2.5 Central Grant to Local Bodies : Concept and Practice

From an economic point of view there are various reasons behind the need for central grant. Central grant to the local bodies is needed to remove the difference between revenue need and the available resources. Likewise, it is less expensive and more efficient to get the central redistributive services done through local bodies and they need central grant for such function. Central grant is necessary to avoid or at least minimize the difference in the quality of services in different local bodies. Similarly grant is necessary to carry out functions that have an impact across the frontiers of the local bodies, like control of pollution.

Central grant is provided to local bodies basically in two forms. One form is the allocation of revenue and the other a straight grant.

2.5.1 Allocation of Revenue

According to this form, a specified part of revenue raised by the central body is given to the local bodies. Even the allocation is carried out in two ways. The first is that additional tax is added to the central tax and the total additional tax is sent back to the local bodies. The second is that the total revenue raised by the centre is divided. In the first form, local bodies get the amount specified for them, while, in the second form, a formula has to be thought out for allocating

¹⁰ James MC Master, Urban Financial Management, A Training Manual, P-28, EDI, The World Bank 1991.

¹¹ World Development Report, 1999-2000.

shares. As an example, in the Netherlands, local bodies get 14% of personal income tax¹² and in South Korea they get 15% of internal revenue¹³.

In addition to this is another form of revenue allocation in which local bodies raise (collect) the revenue, send a specified percent to the centre and retain the remainder with them.

2.5.2 Grant-in-Aid

Another form of sending revenue to the local bodies is through direct grant. It is also found that the central authority likes this because it has some advantages instead of giving taxation power or allocating the central revenue. In this form, the central control over the local expenditure increases, it helps maintain fiscal equity among local bodies and the centre can control the policies of local bodies in accordance with national priorities. More importantly, the central authority can take the grant as a weapon of making the local bodies accountable. The grant helps the centre to impose conditions to local bodies regarding the utilization of the grant and make them accountable.

There are some norms of central grant's appropriateness. They are: autonomy, adequacy, equity, predictability, simplicity and transparency. If the grant is inspirational and it also fulfils the desire of the centre, it will bring balance between the centre and local bodies and revenue administration can be clear and transparent.

2.5.3 Kinds of Grant

Different countries have classified grants in their own ways, yet there are two types of grant: non-matching and matching.

Non-matching grant: Such grant is provided by the centre without the investment request from local bodies. Local bodies do not have to put in extra effort to get such grants. Non-matching grants are also of two kinds: conditional and unconditional. In providing conditional non-matching grant, the amount should be spent only on the specified subject. Therefore, such a grant has an impact on the expenditure structure of local bodies. Such a grant is provided to increase investment in a programme of central priority, but having no priority from local bodies or it is done with the objective that the centre will bear the burden of the cost. Generally such sectors affect more than one local body; as for example, pollution control, secondary education, regional development, agriculture technology etc.

Non-matching grant is provided without any hook. Local bodies can invest such an amount in sectors of their choice and priority. Therefore, such a grant provides the local bodies an opportunity of giving tax relief to the people. Seen from another angle this has a danger of the local bodies indulging in cheap popularity by avoiding measures of direct taxation.

The recipients of grant obviously like the non-matching grant, because it gives them freedom to invest in their own objectives and priorities and it does not interfere in their jurisdiction. But for this very reason, there is a danger that local bodies will invest according to their vested interests and decrease their effort to mobilize local resources. In the view of the centre, it is good to provide

¹² AHJ (Bert) Helmsing; Local Governance and Finance, Institute of Social Studies, Class Material for Team II 1998/99, P-39.

¹³ Huh, Myung Hwan, Ministry of Government Administration and Home Affairs; "Grants in Aid in Korea", in Local Administration in Korea, NIPA 2000.

such grant with a view to giving them minimum financial base and supervising the practice of their decision making power. But non-matching grant alone cannot fulfil the expectations of the centre and objectives of the state. Therefore, from the view point of the autonomy of local bodies, it is useful to provide matching grants how-so-ever less attractive it may be.

Matching Grants: The very name implies that such a grant gives a certain burden to the local bodies. In other words grant is provided in such areas of investment where the local bodies have indicated their desire, priority and commitment through allocation of budget. Matching grants are also of two kinds: unlimited and limited. In the unlimited matching grant, the centre keeps its purse open, and any amount of such grant may be provided if the specified conditions and basis are met. But, in the limited matching grant, the volume of grant is available only up to a specified limit.

The provision of unlimited grant seems to be appropriate for services and facilities that cannot be specified as accessible only to local users. Regarding the ratio of (central-local) burden of expenditure, the question of what proportion of grant should be made available by the centre on what kinds of services would be appropriately answered by the theory that in services which mainly benefit the local users, there should be small ratio of grants and in services where there is much spillover effect, the central grant should be higher in percentage.

The provision of unlimited grant is applicable only in the case of local bodies with larger financial capability. This is its main weakness. If services are necessary but the internal capability of a local body is weak then such a local body cannot get the benefit of such grant compared to neighboring local body. Seen from another angle, this provision inspires local bodies to invest in the needy sectors. Therefore, such a system helps the direction of the performance of local bodies to a great extent.

Donors like the limited matching grant because in this system, the allocation of volume of grant is specified. In the case of the unlimited grant, the centre cannot know in advance what volume of grant could be eventually necessary. Some studies have also shown that limited grant provides more incentive than the unlimited grant. Probably, the common human psyche of wanting to share higher amount of benefit in a competitive manner and the limited matching grant are identical in nature.

In sum, matching grant helps in investment in specified sector while unmatching grant helps in the programmes benefitting local users. Therefore, each country should design the provision and structure of grants in accordance with its environment, policy, aspirations and expected results. It is found in the case of some countries that if the centre and local bodies have common interest in doing a certain function and if it is felt that the local bodies can do them in shorter time and with less cost, there is a convention that the centre reimburses the cost incurred by the local bodies. Reimbursement grant stimulates competition among local bodies and increases efficiency in mobilization of resources. In general, in stead of limiting to any one form of grant, most of the countries have adopted multiple grant systems.

The objective of grant determines the structure of grant. The following table presents some conceptual aspects and objectives of some grants:

Table 2.2
System of Grant according to Objectives

<i>Condition</i>	<i>Provision to be made</i>
(a) Because of deficit finance, making up the deficit	(a) Non-matching grant, review of allocation of revenue, change in tax base or responsibility.
(b) To bring equity among local bodies with un	(b) Non-matching, unconditional grant

<i>Condition</i>	<i>Provision to be made</i>
even local resources	
(c) Spill over of benefits from investment	(c) Unlimited matching grant
(d) To ensure level of service throughout the country	(d) Conditional non-matching grant
(e) Attracting public investment in subjects with central priority but without local priority	(e) Conditional unlimited matching grant

Grant administration:

Tasks that fall under grant administration:

- a Identification of need of grant,
- b Determination of grant structure,
- c Institutionalization of structure by law,
- d Determination of the process, responsibility and time-table of implementation and flow of information,
- e Checking if grant distribution is lawful,
- f Checking if the grant utilization in according to policies and directives and if it is effective and efficient,
- g Taking action if the grant utilization violates policy, rules, regulation.

Components necessary for grant administration:

- a Financial condition and primary functions of local bodies,
- b Provision of simple and transparent formula of grant and transparent and written grant regulation,
- c A system of fiscal management, control, supervision and capability development.

If formula and parameters of grant distribution are fixed, it is regarded highly scientific. A separate provision is required to start a grant system based on formula. For this purpose one alternative is constituting a special expert team in the form of the task group or committee and giving it the task of preparing the basis of grant in consultation with local and national representatives of the people. Another alternative is to create an independent commission, like ones found in India and Japan, and activate it. After the system of grant is determined, it is good to make it public. With whatever agency/institution this process is followed, it should be made to work as a technical committee for annual and advance discussion and negotiation so that it would facilitate the pre assessment of grant and formulation of budget for local bodies.

It is necessary to have some precautions in starting a new grant system, because, in distributing the grants in a new way, the amount of grant may at once be smaller or higher and such a system may be politically unacceptable. Therefore, a new system may be implemented in phases under which, in the beginning the grant in the old system may be larger than the grant in the new system. But the amount under the new system should gradually grow, finally replacing the old one in a period of three to five years.

2.6 Accounting System and Auditing

Accounting and Auditing is an important component of the entire financial management of the Local Bodies. The accounting system ensures the necessity that the local bodies have to maintain efficient records of their financial transactions. The auditing system checks whether all the financial transactions of the local bodies have been done properly, as per rules and in accordance with budget projection. Auditing also investigates work done in an unacceptable manner, identifies the person involved in it and makes recommendations for action. Thus, accounting and auditing is a mechanism of making the local bodies accountable. This inspires transparency and also guides improvement in policies.

2.6.1 Budget Preparation

In talking of the accounting system, mention should be made of budget formulation, accounting and audit. So, these are described in that order.

Budget preparation: The accounting system starts with budget preparation. Budget principally provides the basis of allocation of resources between the main tasks and responsibilities. Along with providing legal authority for spending the allocated resources, budget also gives a glimpse of the entire economic status. There are two aspects of formulating the budget of the local bodies. Those are income and expenditure. In income a projection is done as to what economic resources would be available from which sources. In this projection, analysis is made of internal and external resources. Under the internal resources, mention should be made of area and rates of service charge/fee etc., while under the external resources, the revenue to be derived from allocation of central revenue, grants, loans and foreign assistance should be mentioned.

Similarly, in estimating expenditure, first it is decided as to which services at which level would be provided to the people then it is assessed as to what amount of resources would be spent on which sector. In assessing expenditure in this manner, it would be appropriate to differentiate between overhead expenditure and capital expenditure. After the income and expenditure is thus projected, the budget is presented to the concerned body and, after endorsement from that body, the budget becomes complete.

Budget is mainly prepared from two perspectives. One is the budget of annual income and expenditure, and the other is the budget of long term capital investment. The long term investment budget emphasizes the generation of long term capital (like roads, schools, health post, irrigation canal etc.). Principally, resources of capital investment budget should also be agreeable to its nature. Generally, resources of capital investment are loan for such topics (headings), special objective grant and revenue earned from fixed property sales. In addition to these, if a local body has a surplus from the present budget, such a surplus can also be used for capital investment.

In the annual budget, estimate is made about the income and expenditure on the services regularly provided by the local body. The expenditure headings are salary and allowances, expendable goods, regular repair and maintenance and responsibility of repayment of loan (capital and interest). In the practice of some countries, differentiation is made in the form of annual and development budget, and under the development budget, salary and allowances concerning development work, and some expenditures usually considered annual expenditure are also incorporated.

Seen from the view of accounting system, subjects that need to be determined before preparing the budget are as follows:

- a. Source of income and the expenditure sector should be clearly stated;
- b. Budget headings should be made clear;

- c. Budget classification process and basis should be made aware;
- d. There should be provision for improvement that can be done within the fiscal year;
- e. It should be clearly stated as to when and by whom the budget will be prepared and who will be responsible;
- f. If the weight of expenditure is higher than the income in the income expenditure estimate, cut in expenditure should be emphasized;
- g. Overhead expenditure should not be borne by amount transfer, borrowing or loan; and
- h. The tasks concerning these matters should be implemented by preparing appropriate formats or forms.

2.6.2 Budget Implementation, Accounting of Transaction and Internal Control

An approved budget is spent or implemented in the decided programme by duly completing the processes. In implementing the budget, accounting and control management should also be considered. Such a process should be predecided and transparent. In this process, in addition to the accounting of transaction, information necessary for decision makers (like whether revenue assessed by the budget is being collected, whether expenditures are being done within the limits of the budget, and whether the actual expenditure is being done fulfilling all formalities) should also be provided on a regular basis. From these information, it becomes easy for taking corrective steps in time and making decision regarding control according to the actual condition. The accounting of income and expenditure should be transparent and simple. There should be an effective provision of sending the accounting report to the concerned bodies on a regular basis. Only if such a provision exists can the internal transaction of local bodies be balanced, and a congenial environment can be created for fulfilling the responsibility and accountability with honesty and providing public services regularly.

For account keeping and control, the following matters must have been determined:

- a. Clarity regarding sources of income and authority for expenditure;
- b. Clear explanation of expenditure process and accountability;
- c. Uniform forms for all local bodies;
- d. Responsible account unit or individual;
- e. Provision for summary of periodic income and expenditure;
- f. Measures, alternatives and process taking corrective (improvement) action;
- g. The process of utilizing the service of external agency - individual (through contract);
- h. Provision for making the transaction public;
- i. Provision for internal and external auditing and their observation; and
- j. The provision of making the audit report public at the local level according to the provision of the Local Self-governance Act.

2.6.3 Audit of Transaction

Internal audit, internal control and improvement and final audit are done for the sake of fiscal discipline, accountability and control. The more autonomy the local bodies assume, the more need for control there will be from independent external agencies. As the local bodies are allowed to perform their regular functions and transactions through regulations, processes, parameters and necessary training, there is no external interference. Along with this, it must be

ensured that the local bodies have reasonably utilized their powers, have fulfilled their responsibilities to the people and the public sector, and all activities have been conducted in accordance with rules and regulations. For this necessary conditions are:

- a. Clarity of process and authority (with respect to accounting and internal control);
- b. Limitation of audit and compulsory points to be included in the report;'
- c. Agency to conduct audit, authority to appointment auditor and its procedure;
- d. Agencies to which audit report is to be presented (including the procedure to make it open for transparency);
- e. Comments of audit, the agency and procedure to implement the suggestions and provision of action;
- f. Along with the audit of procedures and papers, the process of impact audit.

In some countries there is a provision of forming separate agency for auditing of local bodies. In some others this function is entrusted to the body responsible for grants. In Nepal, the process of audit adopted in the government and other sectoral activities is followed in the local bodies as well. According to this process, the final audit of DDC accounts is conducted by the Auditor General and in the case of municipalities and VDCs it is done through registered auditors. The internal audit of the VDCs is done by the DDC and the internal audit of DDC, and Municipalities is done by the Internal Audit Section.

2.6.4 Accountability of Local Bodies and Fiscal Management

Participation and accountability are the two main features of decentralization. Accountability is a must for participation. Participation is considered meaningful only when there is an environment under which the citizens can compel the local bodies to fulfil their responsibilities through the participatory measures and means. Similarly, if the local bodies cannot become responsible or are unable to win the trust of the people, there will be no effectiveness in the local revenue mobilization, development work and service delivery. Therefore, accountability has the higher importance in the empowerment of local bodies.

Mechanisms to Ensure Accountability:

The central agency should ensure accountability mainly through two mechanisms : by auditing the grants, other resources of local bodies and their utilization and by experiment of their programmes. For the effectiveness of this provision the centre should have the capability to audit and monitor the programmes of each local body and this action must be regularly done in specified intervals. There should also be the provision of effective body with legal powers to take action as needed.

For the sake of accountability, the autonomy of the source of revenue and the expected responsibilities should be simultaneously decided. Similarly, it appears to be convenient if the responsibility of implementation and the quantity and quality of work is determined while developing the programme.

One way of ensuring accountability from the people's side is election. But, as the distance between elections is long, short term measures for instilling immediate accountability can be adopted: like, activating the accounts committee, forming pressure groups, asking questions and requesting answers in public functions, making the performance audit of local bodies public, conducting regular interaction programmes and the like. The local bodies themselves should take initiative to justify that they are accountable by adopting these measures. All concerned agencies and or parties should extend full cooperation in the above activities in accordance with the expectation and interest of the centre and the people.

Chapter Three

Provision of Local Bodies in Nepal

3.1 Attempts for Decentralization in Nepal

Decentralization has been adopted in some form or another in almost all the countries of the world. Different forms and structures of decentralization are in vogue in different countries of the world on the principle of subsidiarity, as it would not be convenient to run the whole state machinery and provide public service from the central government alone. Their selection and use is dependent on geographical composition of particular states, population, condition of development infrastructure, social values and assumptions and the level of civic consciousness.

In the history of Nepal, decentralization seems to have been inspired more by the wish fulfillment of the rulers on simplicity in administration rather than public services and utilities. It was only with the establishment of democracy in 2007 (1991 AD) that consciousness in the affairs of the state was raised and public participation in governance gradually started growing. As a result of this, attempts for decentralization also have been being made. It is found that the different administrative reform and planning commissions from 2013 (1956) to 2025 (1968) and the administrative reforms commission of 2032 (1975) have recommended adoption of decentralization in different forms. In the context of the modalities of implementing decentralization, different recommendations have been made by different commissions formed in different dates. Bishwa Bandhu Thapa Commission in 2020 (1963), Bhoj Raj Ghimire Commission in 2024 (1967), Jaya Prakash Commission in 2034 (1977) and Randhir Subba Commission in 2039 (1982). In view of these recommendations, there have been various forms and structures of central and local administration. In the Panchayat period also, Village Panchayat, Town Panchayat and District panchayat were created with elected representatives of the people. The Village, Town and Districts Panchayats were given power through separate local body Acts and through the Decentralization Act 2039 (1982) and Decentralization Regulation 2041 (1984). Although the Constitution of Nepal 2019 (1962) regarded decentralization as the one of the foundations of governance, decentralization could not be effective as there was no open and pluralistic society and the actual decentralization became a mechanism of control and supervision of the state.

After the popular revolt of 2046 (1990), democracy was restored. For organization and mobilization of local bodies, VDC Act, 2048 (1992), Municipality Act, 2048 (1992), and DDC Act, 2048 (1992) were passed. For administrative reforms a High Level Commission was formed in 2048 (1992) and it has given several recommendations for administrative reform and decentralization. Likewise, a High Level Decentralization Coordination Committee was formed in 2053 (1997). That committee has also given several recommendations. On the basis of recommendations of these commissions and committees, the Local Self Governance Act, 2055 (1999) has been formulated and is in operation now. The present VDCs (3913), Municipalities (58) and DDCs (75) are formed and operative under this Local Self-Governance Act. In this chapter and the subsequent chapters, analysis of subjects and recommendations have been made on the basis of the study of the Local Authorities Fiscal Commission, recommendations obtained from different regional seminars organized by the Commission and interaction with decentralization experts (annex - 4).

3.2 Decentralization Policy

3.2.1 Constitutional Basis

The Constitution of the Kingdom of Nepal, 1990 does not make any specific provision for decentralization. Yet, it has adopted a directive principle taking the fruits of development to the people through decentralization and wider participation of the people in the governance of the state. It has made a provision of having 15 members of Parliament in the National Council, elected from local bodies, which makes it clear that the Constitution recognizes the existence of local bodies. In addition, mention has been made that formation and functions of local bodies will be made and regulated through law in accordance with the concept of participatory state governance.

3.2.2 Policy Basis

The Ninth Plan 1998-2003, mentions the policy and programmes regarding decentralization and local bodies. This plan includes such policies as developing power, responsibility and resources necessary to make the local bodies effective and capable, to launch development by creating an action oriented institutional mechanism which assumes accountability as a people centered body, transferring authority to mobilize internal resources and collect revenue, and encouraging private sector and civil society for active participation.

The Ninth Plan has the following policies on decentralization:

- Institutionalization of participatory governance in resource mobilization, allocation and balanced and equitable distribution of output;
- Consolidation of local bodies and institutionalization of the process of participatory development;
- Strengthening the relationship between the central government and the local bodies;
- Developing the district as a development centre in accordance with the concepts of decentralization and regional development;
- Making the local bodies responsible to the people by gradually transferring responsibility at the local level;
- Increasing transparency in work performance;
- Making the local bodies self-help oriented by identifying their economic resources.

Decentralization and consolidation of local bodies are the main components of development on which the Ninth Plan has laid highest emphases. Along with this, there is the policy that decentralization will be centered in the development of autonomous local bodies that are capable, efficient, firm and responsive to the needs of the people, and management of entire development at the local level by developing authority and needed budget, by developing human resource and flow of needed information.

Programms Relating to Decentralization Mentioned in the 9th Plan¹⁴

- Developing one training centre under the Local Development Training Academy specially for the development of technical capability of VDCs;
- Adopting favourable attitude towards developing suitable and necessary leadership and manpower;

¹⁴ 9th Plan, Decentralization Part, p.p. 690-696.

- Providing continuity to local development grant, (for DDCs, VDCs and Municipalities with scanty resources);
- Provision for monitoring and evaluation by creating a Monitoring and Evaluation Section and a District Development Problem Solving Committee in the DDC¹⁵.

3.3 Local Self-Governance Act and Regulation

The Local Self-Governance Act (1999) and Regulation (1999) have provided legal basis for local bodies. The Act mentions the principles and policies to be adopted by the state for developing a system of local self-governance. These principles and policies are as follows:

- Devolution of necessary power, responsibility and resources to make local bodies capable and effective;
- Development of institutional process and functional mechanism for fulfillment of responsibility;
- Directing the local bodies to adopt democratic process, transparent working methods, creation of civil society based on public accountability and popular participation;
- Encouragement for the involvement of Private Sector;
- Devolution of authority to mobilize revenue;
- Development of local leadership.

According to these policies, the Act and Regulation have made the following provisions regarding the local bodies:

- Creation and operation of local bodies;
- Composition, work responsibility, duties and rights;
- Tax, revenue and other resources to be mobilized by the local bodies;
- Local bodies to work in cooperation with NGO, community organization, user group and the private sector;
- The work of other sectors should also be brought under one umbrella of local bodies; and
- Relation between the central and local bodies.

3.3.1 Existing Institutional Provision for Consolidation of Local Bodies and Decentralization

Provision of Local Bodies

The Local Self-Governance Act has made provision of local bodies at two levels. They are : the DDC as an Intermediary Local Body at the district level and the VDC and Municipality at the local level. Each DDC is divided into 9 to 17 Ilakas. Similarly, each VDC is divided into 9 Wards and the Municipalities are divided into 9 to 35 Wards on the basis of area, population etc. In each one of such wards there is provision of a Ward Committee. As the number of wards is large (there are 9 wards in all VDCs), the number of representatives seems to be really very large. The following table shows that number:

¹⁵ 9th Plan, Evaluation and Monitoring Part, p.p. 704-712.

Table 3.1**Number of Representatives**

Organization of Local body	Maximum and Minimum Number			Total number of representatives			Total No.
	DDC	Muni*	VDC	DDC	Muni*	VDC	
Council	42-262**	53-197	53	9438	4262	201737	215437
Executive	14-28**	13-39	13	1492	1038	50869	53399

*Municipality ** Excluding the Members of National Council

Local bodies are very dissimilar from the view point of area, population and economic potentialities. The smallest district, Bhaktapur (119 sq. km) is 67 times smaller in area than the largest district, Dolpa (7889 sq. km). Similarly, the largest district in population, Kathmandu (6,75,000) is 135 times larger than the smallest district, Manang (5000). This dissimilarity may be the result of the past practice of forming local bodies without specific principle or basis. It appears that this will create great difficulty in attaining equity in fiscal matters and ratio of political representatives.

The composition of lower local bodies is done through direct election while the composition of intermediary local bodies is done through the election of lower body representatives (indirect).

Classification

There is provision for classification of local bodies by HMG. While classifying the municipalities, local population, source of income and the availability of physical and social utilities are considered the basis. As of now, municipalities are classified as Metropolis, Sub-Metropolis and Municipalities. In the cases of DDCs and VDCs, there is provision of classifying on the basis of differences, transportation, communication, education and health (including population in the case of VDCs), but such classification has not been done as yet. Similarly, as classification does not involve the functional bases such as work responsibility, fiscal authority, fiscal attempts and discipline, there is no complete justification for its utility and meaning. Along with this, although the municipalities have been classified, the importance of classification has not been established because there is no difference in the amount of authority and autonomy.

Provision for the Promotion of Capability of Local Bodies

There is an autonomous institution (Local Development Training Academy) for the training and orientation of the office bearers and personnel of the local bodies. Under the Academy, four Rural Development Training Centres, one Urban Development Training Centre and two Women Development Training Centres have been providing training in different areas like planning, programming, office management, leadership development and legal affairs. The Academy has not been able to provide special training in technical and fiscal mobilization.

Programmes Run for Consolidation of Local Bodies

Some programmes are being run in Nepal with foreign assistance for consolidating the local bodies. Among them, the important ones are : Participatory District Development Programme and Local Governance Programme with UNDP assistance; Decentralization Assistance

Programme with Danida assistance; and Urban Development through Local Effort Programme with GTZ assistance. Similarly, the programmes being run with SNV and European Union assistance are also trying to conform to the UNDP supported programmes.

The strategic central focus of the programmes being run with UNDP assistance is oriented towards data based planning process in the local bodies, empowerment of community organizations through social mobilization, and enhancement of management capability. But these have not incorporated the entire district and they have not been able to focus their attention on strengthening the capability of local bodies in resource mobilization. The programme run with Danida assistance aims at developing the capabilities of all levels of local bodies but is has not yet been able to provide assistance adequately, specially in the field of resources mobilization in most districts. The GTZ assisted urban development is focused in some municipalities only, and has been helping the financial resource mobilization to some extent. In sum, at present there are no adequate programmes supporting the local bodies in mobilizing financial resources.

Provision of Supply of Capital Needs of Local Bodies

The local bodies need capital for their long-term investment programmes and implementation of their plans. In this respect, the Town Development Fund has been investing loan capital to the municipalities as an autonomous institution. But there has been no institutional arrangement to provide loan capital to DDCs and VDCs. As local bodies have to obtain authorization from HMG to get loan or assistance from foreign sources, there is as yet no provision for the local bodies to issue bonds for mobilizing resources. Nor is there a convenient and suitable environment for granting loans to local bodies. Thus, local bodies are fully dependent on HMG for long term investment.

Provision for Help, Control and Supervision of the Local Bodies

It is necessary to have an institutional arrangement of a body to enhance the effectiveness of local bodies and the decentralization campaign through proper supervision, monitoring and assistance. For this, the Ministry of Local Development has been regarded as the lead agency. It has also been working for attaining coordination among central agencies. But such a central mechanism has not been felt effective. The Ministry is itself running several types of local development programmes. But the number of the local bodies, specially VDCs, is so large that the Ministry does not have adequate capability to cope with the demands of monitoring, supervision and assistance.

The Act has made a provision of a permanent Decentralization Implementation Monitoring Committee. This committee has been formed and it has started to function. The jurisdiction of this committee appears specially to be policy monitoring. Therefore, the role of this committee is not clear regarding help, control and assistance to the local bodies. The Act has made a provision of Local Authorities Fiscal Commission. The Act has made its role as advisory and as it has been formed for the first times, there is no clear policy about its role also.

Sectoral Ministries of HMG do not seem to have played any role to assist the decentralization programme. There is no evidence of a collective awareness that it is the responsibility of all the Ministries to strengthen the local bodies and make them effective. Central agencies do not seem to be prepared to hand over several functional powers, vested with them that can be exercised locally, to the local bodies.

Association of Local bodies

DDC Association, Municipality Association and VDC Association are there to work for the collective interest of local bodies and for effective implementation of decentralization. These Associations have been advocating at the central level working as pressure/influence group and

assisting in the enhancement of capability of their respective members (local bodies). They have been fulfilling very important role responsibilities by advocating in the interest of their local bodies and working as pressure/influence groups with HMG in the field of formulation of policy, laws and regulations. But programmes are still not launched towards forming fiscal policy, formulating programmes, fiscal mobilization, fiscal discipline, and administrative consolidation.

Decentralization and Political Consensus

Political consensus is an indispensable pre condition for the success and effectiveness of decentralization. Although the political parties have consensus on this in principle, they have different views regarding its process and priority. The political parties have not yet paid sufficient attention to practical issues like granting full autonomy of action to lower bodies, and processual issues like conducting party political training, solving problems through all party meetings, making their income and expenditure transparent and regulating meetings of the councils and executive boards.

3.3.2 The Scope of Functions and Responsibilities of Local Bodies

The scope of functions and responsibilities of the local bodies is presented in Table -3.2:

Table 3.2

Powers, Functions and Responsibilities of Local Bodies

Village Development Committee	Municipality	District Development Committee
a) Agriculture	a) Finance	a) Agriculture
b) Rural water supply	b) Physical development	b) Rural water supply and settlement
c) Works and transport	c) Water resources	c) Hydropower
d) Education and sports	d) Education and sports	d) Works and transport
e) Irrigation, soil erosion and river control	e) Culture	e) Land reform and management
f) Physical development	f) Works and transport	f) Women's development and handicapped
g) Health services	g) Health services	g) Forest and environment
h) Forest and environment	h) Social welfare	h) Education and sports
i) Language and culture	i) Industry and tourism	i) Labour wage
j) Tourism and cottage industry	j) Approval of building design	j) Irrigation, soil erosion and river control
k) Miscellaneous	k) Miscellaneous	k) Information and communication
	Optional works	l) Language and culture
		m) Cottage industries
		n) Health services
		o) Tourism
		p) Miscellaneous

But the functions and responsibilities so specified have not yet been vivid. There is widespread overlap in the scope of work among the local bodies and between the central and local bodies. Then, the centre continues to do many activities that are more appropriate for the local bodies, and the works of local bodies are also not classified on the basis of levels. As a result, there is a scenario of lack of proper division of responsibility, and, even if there is the division of responsibility, it is not possible to pinpoint accountability. Tables 3.3 and 3.4 vividly show the overlap of work.

Table 3.3

Division of Functions and Responsibilities Between Central and Local Bodies

(Based on Local Self-Governance Act, 1999)

<i>SN</i>	<i>Functions or Responsibilities</i>	<i>Centre</i>	<i>DDC</i>	<i>Muni</i>	<i>VDC</i>
1.	Relating to physical development				
a.	Plan formulation and implementation of land use	✓	✓	✓	✓
b.	Plan formulation and implementation of settlements and Haat (market)	✓	✓		
c.	Residential area plan formulation and implementation	✓		✓	
d.	Quality of buildings and other physical infrastructure	✓		✓	✓
e.	Approval of building designs			✓	
f.	Development of greenbelt, entertainment area	✓		✓	
g.	Public lavatories			✓	
h.	Construction of community buildings and guest house			✓	✓
i.	Water supply and sewerage plan implementation, operation / maintenance	✓	✓	✓	✓
2.	Relating to water resources, environment and sanitation				
a.	Water source protection and utilization	✓		✓	✓
b.	Irrigation programme implementation	✓	✓	✓	✓
c.	Control of soil erosion and river encroachment	✓	✓	✓	✓
d.	Assistance in pollution control, environmental conservation and consolidation	✓	✓	✓	
e.	Management of soil waste and sanitation programme	✓		✓	✓
f.	Generation and distribution of electricity	✓		✓	✓
g.	Management of micro hydro and other energy programme	✓	✓		
3.	Forest and Environment				
a.	Plan formulation and implementation of forestry, geodiversity and soil conservation	✓	✓	✓	✓
b.	Programmes of environment and afforestation	✓	✓	✓	✓
4.	Education and sports development				
a.	Permission for running pre primary school with private resources			✓	✓

<i>SN</i>	<i>Functions or Responsibilities</i>	<i>Centre</i>	<i>DDC</i>	<i>Muni</i>	<i>VDC</i>
b.	Recommendation for permission to open school or close them on priority		✓		
c.	Assistance in management of schools in respective areas and recommendation for opening or closure			✓	
d.	Management and supervision of schools in respective areas				✓
e.	Assistance in making primary school available in mother tongue			✓	✓
f.	Assistance in supervision, monitoring and management of schools	✓	✓	✓	✓
g.	Provision of scholarship for students of depressed committees	✓		✓	✓
h.	Implementation of audit and informal education programmes	✓	✓	✓	✓
i.	Operation and management of libraries/reading rooms			✓	✓
j.	Development and implementation of sports programmes	✓	✓	✓	✓
k.	Organizing sports development committee	✓	✓	✓	✓
5.	Relating to Culture				
a.	Repair, maintenance and improvement of places of religions importance	✓	✓	✓	✓
b.	Protection, improvement and use of archeological objects, language, religion, art and culture	✓	✓	✓	✓
6.	Work and Transport Related				
a.	Construction, maintenance, repair of mule track, rural roads and unmetalled roads, culverts and bridges not under HMG care			✓	✓
b.	Parking of bus, rickshaw, tanga, trucks etc.			✓	
c.	Determining the maximum limit of hand cart, rickshaw, tanga etc. and registration and licence			✓	
d.	District road master plan, construction, operation, monitoring and evaluation of district roads		✓		
e.	Construction and repair of suspension bridge	✓	✓		
f.	Necessary provision for means of transport (vehicles)		✓		
g.	Issuing, renewing and cancellation of class D contractors		✓		
h.	Development and improvement of ropeway and water ways	✓	✓		
7.	Relating to Health Services				
a.	Operation and management of Hospital, Ayurvedic Dispensary and Health Centres	✓	✓	✓	
b.	Opening, operation and management of Health Post, Sub Health Post	✓	✓	✓	✓
c.	Formulation and implementation of public health programmes like family planning, maternity and child care, extended inauclation, nutrition, population education and health education.	✓	✓	✓	✓
d.	Provision for prevention of epidemics	✓	✓	✓	

<i>SN</i>	<i>Functions or Responsibilities</i>	<i>Centre</i>	<i>DDC</i>	<i>Muni</i>	<i>VDC</i>
	e. Control or prohibition of public use of things harmful for public health	✓	✓	✓	
	f. Control or prohibition of use and sale of edible objects harmful for public health	✓	✓		
	g. Inspection and monitoring of surgical equipments	✓	✓		
	h. Primary health education	✓			✓
8.	Relating to Social Welfare				
	a. Provision for cremation of unclaimed dead bodies			✓	
	b. Programmes for the welfare of women and children	✓	✓	✓	✓
	c. Control of immoral profession/trade	✓	✓	✓	
	d. Removal of social ill practices	✓	✓		
	e. Protection of orphans, helpless, old and disabled people	✓	✓	✓	✓
9.	Relating to Industry and Tourism				
	a. Work as motivator in promotion of small and cottage industry	✓	✓	✓	✓
	b. Protection of touristic heritage	✓	✓	✓	✓
	c. Identification and development of industrial area	✓	✓		
10	Relating to Agriculture and Land Reform				
	a. Policy formulation, implementation supervision and monitoring of Agriculture and Livestock	✓	✓		✓
	b. Provision for seeds, fertilizers and other agricultural inputs	✓	✓		
	c. Promotion of agricultural fair, market place etc.	✓	✓		
	d. Protection and consolidation of fallow and governmental land	✓	✓	✓	
	e. Provision for grazing land	✓			✓
11	Miscellaneous				
	a. Eradication of misuse of child labour	✓	✓	✓	✓
	b. Human resource development	✓	✓	✓	✓
	c. Assistance in cooperative development	✓	✓	✓	✓
	d. Promotion of trade and commerce	✓		✓	
	e. Control of Natural disasters	✓	✓	✓	✓
	f. Vital registration (birth, death, other events)			✓	✓
	g. Provision for slaughter house			✓	✓
	h. Kanjihouse, detention and auction of stray cattle			✓	
	i. Street light management			✓	
	j. Permission for construction and operation of cinema hall		✓	✓	
	k. Provision for Haat (Market) fair	✓		✓	✓
	l. Management of operation of fire brigade	✓		✓	

<i>SN</i>	<i>Functions or Responsibilities</i>	<i>Centre</i>	<i>DDC</i>	<i>Muni</i>	<i>VDC</i>
	m. Location determination and management of crematorium			✓	
12.	Optional Functions				
	a. Provision for good quality school education	✓		✓	
	b. Operation of literacy programme	✓		✓	
	c. Control of unauthorized settlement	✓		✓	
	d. Land use programmes	✓		✓	
	e. Electric supply and communication services	✓		✓	
	f. Museum and zoo	✓		✓	
	g. Job oriented programme	✓		✓	✓
	h. Ambulance service	✓		✓	
	i. Corpse carrying vehicles	✓		✓	
	j. Prevention of natural disaster and relief activities	✓		✓	

Table 3.4

Agency Functions Being Conducted by Local Bodies

<i>SN</i>	<i>Functions</i>	<i>DDC</i>	<i>Muni</i>	<i>VDC</i>
1.	Relating to Social Security			
	a. Preparing records and identification letters of senior citizens, helpless widows and disabled		✓	✓
	b. Receiving distribution and adjustment of social security fund	✓	✓	✓
2.	Relating to Election			
	a. Collection and updating of voter list		✓	✓
	b. Involvement in all levels of election	✓	✓	✓
3.	Relating to National and International Campaigns			
	a. Feeding polio-plus, vitamin A etc.	✓	✓	✓
	b. Involvement in population education, AIDS etc.	✓	✓	✓
	c. Involvement or coordination in different surveys, data collection etc.	✓	✓	✓
4.	Relating to Emergency Service			
	a. Collection of information about natural disasters and distribution of relief goods		✓	✓
5.	Management of Meetings, Ceremonies			
	a. Meetings of Ward Committees, Sectoral Committees, Board and Council	✓	✓	✓
6.	Recommendation and Certification			
	a. On the spot inspection and recommendation		✓	✓
	b. Publishing notices of different agencies		✓	✓

As the areas of VDC and municipalities are different, having similar functions cannot be considered overlap. Because of several overlaps in relation to other agencies, the function of mobilizing fiscal resources for the local bodies is being greatly hampered. It has not been possible to make effective utilization of scarce resources because of lack of uniformity in work responsibility, discharge of responsibility, formulation of long term plan, budget management etc. There can be efficiency in mobilizing fiscal resources and it can be assumed that the expenditure will be put to good use only if overlaps are removed and clarity is made in the scope of work of the central, regional, district, municipal and village level bodies.

3.4 Organization of Local Bodies

3.4.1 The Existing Institutional Provision of DDC

In studying the institutional arrangement, there are three levels in the DDC. They are: District Council or policy formulation level, executive level and implementation/administration level.

District Council

The District Council is formed in accordance with Art. 172 of the Local Self-Governance Act, 1999. The District Council is comprised of the Mayor and Deputy Mayor of each Municipality, Chairman and Vice-Chairman of all VDCs, Members of House of Representatives and National Council from that district, Members of the DDCs and 6 Members nominated by the District Council. In the 75 districts of Nepal, there are 9438 councilors. District Council is the highest body of the DDC. The Council performs important functions like approving the programme and budget of the DDC, formulating policies, passing tax, fee and service charge policy etc. But determining tax revenue is a technical function, and there is no provision for inclusion of experts for exercise to be done before determining tax rate.

District Development Committee

Art. 176 of the Local Self-Governance Act has made the provision of a DDC as the executive of the District Council in each district development area. According to it, the DDC has Ilka (area - constituency of DDC) representatives elected @ one from each Ilaka, President and Vice President elected by the Village and Municipal Councils, two Members nominated by the District Council, and Members of Parliament form that district as ex-officio members. The 75 DDCs have 1492 representatives. As the executive body of the District Council, the DDC implements programmes and decisions passed by the Council and also implements district activities/programmes related to DDC.

Office of DDC

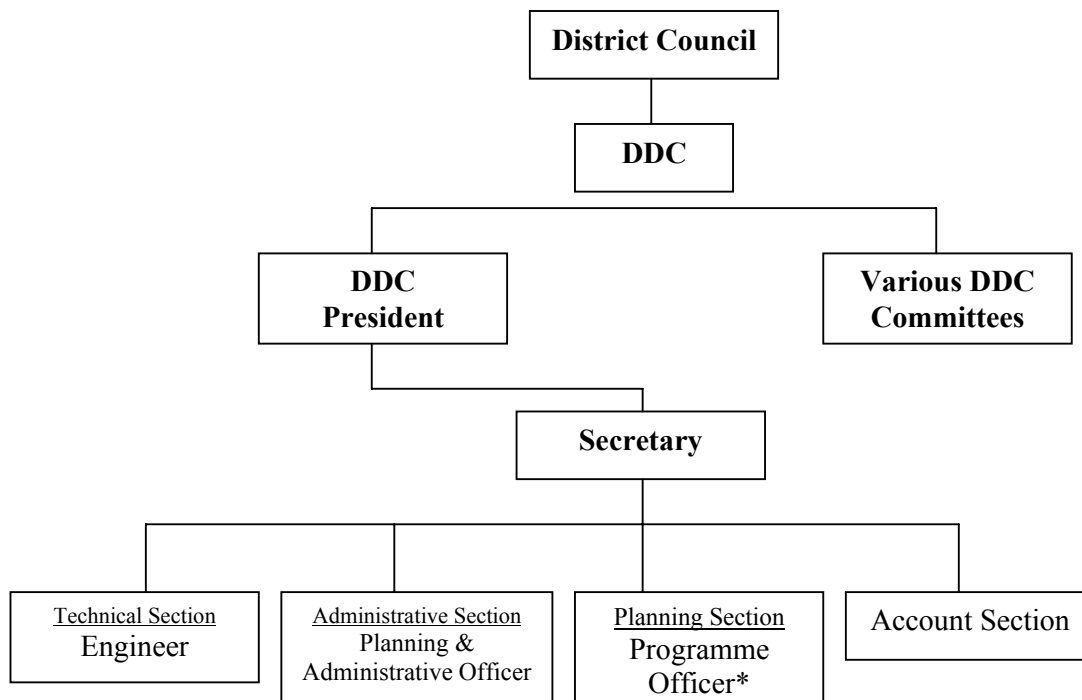
According to Art 248 of the Local Self-Governance Act, there is a provision of an office of DDC and according to Art 249, DDC can have necessary staff position with the approval of the District Council. There is a provision that DDC can maintain different sections and units in accordance with its work load, and nature of work. The old organizational structure prepared by the Ministry of Local Development is uniformly retained in all the districts and no attempt has been made to adjust it on the basis of changing times and individual district work load. In general, the district structure is found to tally with the chart presented as Annex 3.1.

In the organizational structure of DDC office, there is no independent mechanism for looking into tax and revenue issues. The fiscal activities specified by the Act cannot be effective in the absence of mechanism for tax administration. Therefore, it appears necessary that there should be

a mechanism to look into fiscal administration. In the present DDCs it has become necessary to develop budget with crores of Rupees and the accounting system should be developed accordingly. It has, therefore, been necessary to enhance skill of personnel of DDC.

Chart 3.1

Organization Structure of DDC Office



*Only in districts with donor assisted programmes.

Human Resource in DDC

DDC has HMG personnel and three other types of personnel drawing salary from Administrative grant, from contingency fund and DDC fund. A Second Class Gazetted officer of HMG is posted as the chief administrative officer of DDC. All other personnel are under him. The list of HMG personnel is as follows:

- | | |
|--|------------------------|
| 1. Local Development Officer (Secretary) | - Gazetted class II |
| 2. Planning, Monitoring and Administrative Officer | - Gazetted class III |
| 3. Engineer | - " " " |
| 4. Accountant | - Non-Gazetted class I |
| 5. Overseer | - " " " " |
| 6. Kharidar (vital statistics) | - " " " " II |

In analyzing the human resource aspect of DDC, functions like coordination, fiscal administration, technical aspects, administrative supervision and plan monitoring are performed by personnel deputed by HMG. From the view point of revenue mobilization, the existing numerical strength of human resource cannot be considered small. But, with in the organization, it appears that, DDCs should be more focused towards creating a Tax/Revenue Section/Unit, data

management, upgrading the level (quality) of manpower, development of policy and programme for effective mobilization of revenue. It is also necessary that the Council should critically examine the tax, revenue and income expenditure of DDC.

3.4.2 Existing Institutional Arrangement of Lower Level Local Bodies

Like the DDC, the organization structure of municipality and the VDC has three main components. The first is the Village or Town Council, which is the apex body of VDC or Municipality. The second is the Executive Board which implements the decisions and directions of the Council. The third is the Office of the VDC or Municipality which runs the daily activities under the Executive Board.

The Village or Municipal Council

In Articles 8 and 78 of the Local Self-Governance Act, there are the provisions of Village Council and Municipal Council respectively. Accordingly, the Village Council is comprised of the Chairman and Vice-Chairman of VDC, Ward Chairman from each ward, female ward member and other ward members, and six other persons nominated by the Village Council. Similarly, the Municipal Council is comprised of the Mayor and Deputy-Mayor, Ward Chairman from each ward, female ward member and other ward members and 6-20 other members nominated by the Municipal Council. In the 58 Municipal Councils and 3913 VDC Councils, there are altogether 4262 and 201737 Councillors respectively.

The Village or Municipal Council is the level to determine policies and programmes. The Council does important policy related functions like approval of the budget and programme presented to it, approval of proposal to levy and collect tax, fee and charge, disposal of fixed assets, approval of proposals for loan, selection of auditor, reconciliation or action on irregular expenditure etc.

Executive (VDC or Municipality)

To implement the decisions of the VDC or Municipal Councils as their executives, there is the provision of VDC or Municipality. The Municipality is comprised of one elected Mayor, one elected Deputy-Mayor, one elected Ward Chairman from each ward, and two members nominated by the Municipality including one female member from among the nominated Councillors. Similarly, the VDC is comprised of one elected VDC Chairman and one Vice Chairman, one elected Ward Chairman from each ward, and two members nominated by the VDC, including one female member, from among the nominated Village Councillors. The 58 Municipalities and 3913 VDCs of the Kingdom are represented respectively by 1038 VDCs and 50869 members.

There are provisions that the VDC and Municipality implement the decisions of their respective Councils, work for developing public service and utilities and also use judicial rights.

There is no provision of committees in both these lower level local bodies to decide tax revenue (except Rule 72 in the case of VDC suggesting that advice can be taken).

VDC and Municipality Office

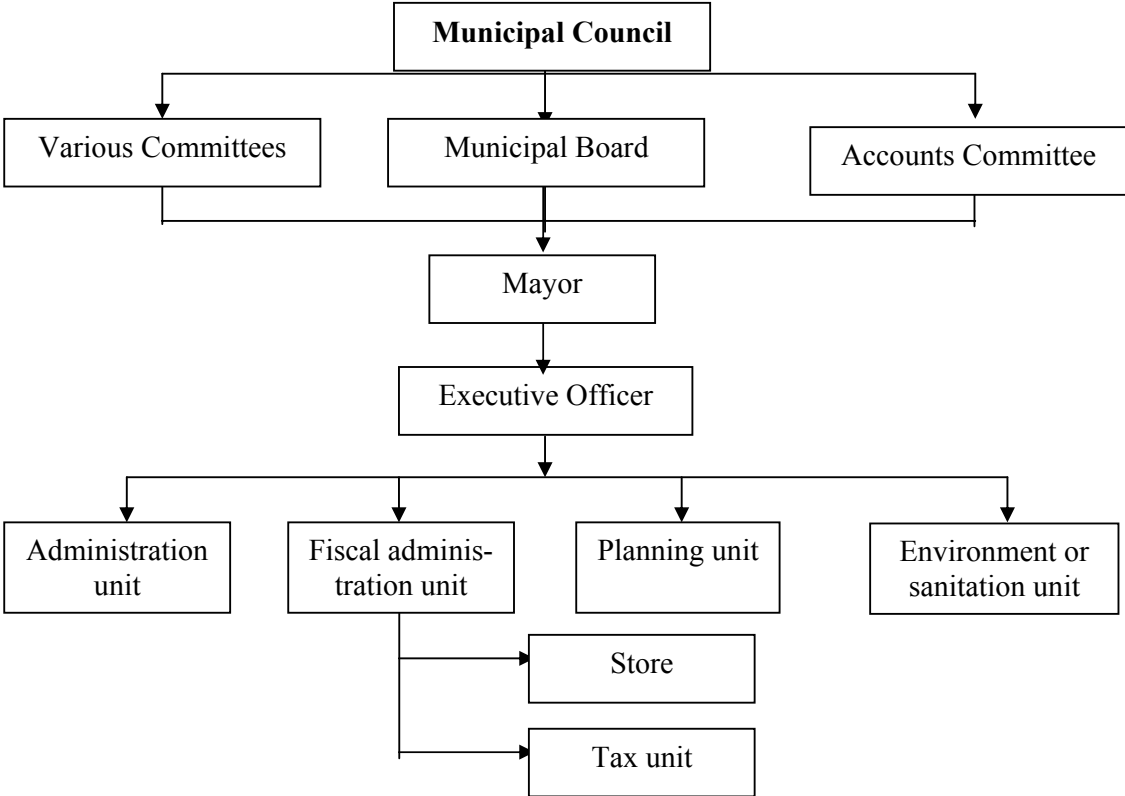
According to the Local Self-Governance Act, there are provisions of having VDC and Municipality Offices. In the Office there are personnel in accordance with the posts determined by their respective Councils. There is the provision that the administrative head of the Municipal Office is an Official of MHG. Other personnel of the municipality are under the administrative head. There is a provision that the VDC Secretary will be an official deputed by HMG. Other personnel are under the Secretary.

This component implements the decisions of the Council as directed by the executive body. In analyzing the present organizational structures of the local bodies, it is found that the organizational structure of Municipality is more up-to-date and has been prepared on the basis of load and nature of work. But in the case of VDCs, such an attempt is rarely seen.

The organizational structures of most municipalities and VDCs are presented in charts 3.2 and 3.3 respectively.

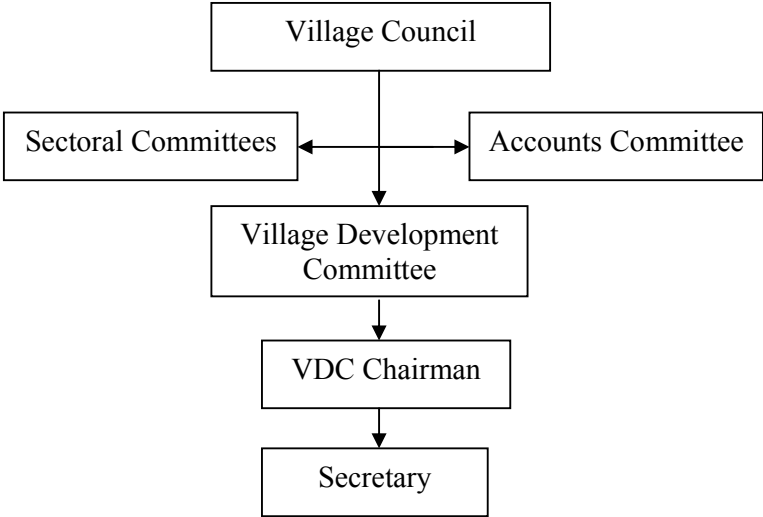
Chart 3.2

Organizational Structure of Municipality



Source: Based on UDLE Reports

Chart 3.3 Organizational Structure of VDC



Under the existing organization structure of municipality, separate section/unit has been created for tax administration. For collection of taxes, the municipality has created a process that for any city dweller visiting the municipality for a particular work, the municipality does that work only after payment of tax or arrears of such tax from the visitor. Likewise, for other taxes due from the citizens, tax teams are also mobilized in home visits for collection. Thus the Municipalities have made some progress in tax revenue collection through their efforts. But, as there is a trend to raise more indirect taxes than direct ones, such taxes are raised through contractors.

In most of the VDC Offices there is one Secretary and one Technical Assistant (not trained in technical skill). Although there are additional VDC personnel in some urban oriented VDCs with good resources, there is no such provision in others. Although the Local Self-Governance Act has provided several rights of raising taxes, there is as yet no effective collection of taxes. Most VDCs have no building of their own. Similarly, within the organizational structure, there is no unit for tax revenue. In the absence of such mechanism, it is not unnatural that tax collection is not effective. Such a tax administration has been felt necessary in the VDC organizational structure for collecting the tax revenue effectively.

3.4.3 Provision of Human Resources

Municipality

There is a provision that an HMG official is posted as the administrative chief of the Municipalities. This HMG official controls all the personnel in the Municipality. HMG determines the status of officials to be posted in the Municipalities on the basis of population and resources. Accordingly, HMG has posted III class gazetted officers in 45 Municipalities as executive chief, II class gazetted officers in 12 Municipalities, while a I class officer is posted as a chief and a III class officer as Assistant in the Metropolis.

Similarly, it is observed that, within the institutional structure, job tasks of the sections, sub-sections and unit are defined and work is progressing accordingly. For the function of tax administration, municipalities have appointed personnel according to respective work load. Although they might be lacking in skill, the present strength of municipal personnel appears municipally able to meet the demands of the tax administration.

VDC

The existing human resource management of VDCs is in a very delicate condition. In most of the VDCs only a Secretary and a Technical Assistant are functioning. In a true sense, the strength of two personnel is too small to cope with the demands of management and revenue collection. At present, the VDC Secretary works as secretary to the Village Council, the village executive body, administration chief, account and assistants all at once.

The existing institutional structure and the human resource management aspects are not capable. The VDCs have been created as a means of communication from the bottom to the centre and also a means of delivery of services to the people. But their institutional arrangement and human resources management have not changed suitable to meet the demands of. The tax and revenue resources granted by the Local Sub-Governance Act cannot be considered scant, but the mechanism for tax collection is completely lacking. It appears that the VDCs need additional personnel. Therefore, the following arrangements should be made in the case of the VDCs.

- a. Deminirtation of structure by reviewing needs and justification;
- b. In the case of personnel, raising the level of the Secretary and providing additional manpower for accounts, revenue and technical work; and
- c. Provision of a suitable VDC building and development of system of administration.

3.5 Review of the Provisions of Local Bodies

The Constitution of the Kingdom of Nepal, 1990 has recognized the provision of local bodies. For the organization and operation of the local bodies, the Local Self-Governance Act, 1999, the Local Self-Governance Regulation, 1999 and the Local Bodies (Fiscal Administration) Regulation, 1999 have provided strong legal basis. Similarly, the Ninth Plan (1998-2003) has also incorporated various policies and programmes for the consolidation of local bodies. Thus, review of the local bodies, which have been enabled constitutionally, legally and from policy perspectives, can be done regarding their positive aspects and from problem or challenge angle. These two aspects are mentioned below in respective order:

Positive Aspects

- The principle of decentralization has been mentioned clearly in the constitution and in long term policies;
- Local Self-Governance Act and related Regulation are in force. Under these legal provisions, 3913 VDCs, 58 municipalities and 75 DDCs are in operation.
- High Level Decentralization Implementation and Monitoring Committee having been formed, the Executive Committee is also acting under it;
- Continuous interaction and exercises are being made between HMG and donor agencies to provide dynamism to decentralization;
- An environment of cooperation and understanding is being created between the HMG and the Associations of Local Bodies;
- Decentralization has remained a main component in the policies of political parties;
- Local bodies have started planned development through periodic plans and enhancement of their capabilities.

Problems and Challenges

- In Nepal there has not yet been clarity in and implementation of such issues as what are the public services to be provided by the government, who is responsible for them, if the people have to uphold their rights, how can they do it etc. Similarly, due to overlap in the jurisdictions of HMG and the Local Bodies, the respective responsibilities and accountabilities have not been clearly specified. People have not been getting all the services mentioned in the legal form. Fiscal management is very weak. Audit reports are pointing to the fact of progressive irregularities in expenditure, and the increase in amounts of questionable utility.
- The powers given by the Local Self-Governance Act to the local bodies are in conflict with several other powers granted to HMG or other agencies by earlier laws and regulations. One study¹⁶ has shown several points of conflict contained in 23 laws (Annex-5) and indicated that only if there are amendments in those laws can the local bodies be more active. All central agencies are not active in transferring the powers that they have been given earlier, to the local bodies. The local bodies are also exercising authorities beyond their legal limits on the claim of having used them in the past. Thus it is not possible to specify sources/resources and identify the truly responsible agency for services. This has retarded the dynamism not only of local bodies but the very process of decentralization.

¹⁶ Study Report on the Improvements to be made in the prevailing Laws for the Effective Implementation of the Local Self-Governance Act, 2055; DANIDA/DASU, January 2000

- All structures, mechanisms and concepts have not yet been completely implemented in accordance with the principle of decentralization and as provided for in the law (Act). The Monitoring Committee that makes policy monitoring has just begun its functions. The agencies that monitor, supervise and assist the local bodies have not been active and effective. Although local bodies have powers to monitor locally based government agencies and NGOs, they are not complete because these powers are not mandatory. The agency responsible for the consolidation of local bodies is not clear by identified and the roles of the Associations of local bodies are also not clear. Government agencies have not assimilated the process of decentralization as being the decentralization of all the works of the government. Thus, the implementation aspect of decentralization is very weak (the clarity in policy notwithstanding).
- A trend is on the rise that the people's representatives of the local bodies take amenities/facilities. It is natural that the larger the number of representatives, the higher in the overhead expenditure. Such an expenditure is on the rise, but the existing facilities are not adequate for whole time involvement of capable representatives who can provide effective leadership. Thus, on the one hand, there is inadequate facility leading to decrease in motivation for efficiency, on the other the expenditure on allowances and facilities for the representatives is increasing because of the excessive number of representatives. The minimum annual amount of the regular legal expenditure on the executive boards of the local bodies alone has reached Rs. 22,53,28,000/- (Annex-6). This amount is equivalent to 8% of all the grants from the Ministry of Local Development to all the local bodies. As this is the minimum amount and it covers only the executives, the actual total expenditure is much more than this. Because of involvement of many persons in the decision making process, on many occasions, the decision has been impeded or suppressed. There are no two opinions on the fact that, if local bodies are given necessary facilities and incentives, they can surely be more efficient and effective. Likewise, in some countries, the number of local bodies has been reduced and the area and size increased with the objective of making the local bodies more effective from management point of view and financially viable and self-supporting. For example, in Denmark, there used to be, before 1970, 25 counties, 88 urban local bodies and 1300 rural local bodies, but now they have maintained only 14 counties, and 275 municipalities¹⁷. Therefore, in Nepal as well, it is felt the time has come to review the number of local bodies and the number of personnel¹⁸.
- In the context of planned development, some DDCs and Municipalities have started to formulate periodic (5-7 years) plans in the participatory process. If election for the local bodies takes place before such periodic plans are completed, the successive elected body should do the follow-up. Along with this, it is difficult to make an exact projection of capital investment as many plans remained incomplete because of faulty planning process; as the provision, that local priority projects should also get national priority, has not been fully implemented; and the process has not yet started that local services provided by sectoral ministries should be brought under the umbrella of the DDC.
- Because of the weakness of recruitment process in the past, qualified and skilled personnel were not attracted to the local bodies. If has not been possible to train old staff, who have been stuck to their present post for a monotonously long period. Personnel who were recruited over 20 years ago without intense competition have now been promoted to

¹⁷ Municipalities and Counties in Denmark: Tasks and Finance; Danish Ministry of Interior, January 1999, p.7

¹⁸ Report of the High Level Decentralization Coordination Commission, 1997, P. 59-61 and 73-77 mentions the impact of the number of representatives and that Report has been presented to HMG for implementation.

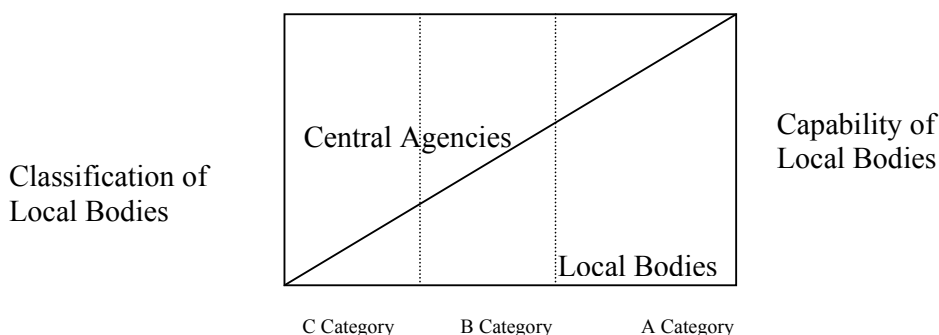
higher levels (up to non-grazetted class I), although their skills and qualifications were not enhanced. These personnel are not controlled under the administrative chain of command but are psychologically attached to the individuals who appointed them. There are examples admitted by office bearers of several DDCs and municipalities that, even if they wish, 60% of the personnel are not capable to assist the local bodies in discharging the present responsibilities properly. Therefore, all these factors must be considered while upgrading the capability of the existing personnel or recruiting new ones.

3.6 Recommendations and Suggestions

(a) Scope of Responsibility of Local Bodies

Considering the inequalities among the local bodies themselves, it appears necessary that the classification of local bodies should be more objective oriented in order to promote the cooperative process among them and solve the problem of widespread overlaps. Accordingly, it would be appropriate to give greater responsibilities of public service delivery to local bodies that fall in the higher category and reduce the central involvement in such areas. Conversely, in the case of local bodies falling in the lower category with less capability, lower responsibility should be given at the local level and centre should play bigger role in providing the public services. The conceptual framework of the process is presented in chart 3.4:

Chart 3.4
Inter relationship of Classification of Local Bodies,
Their Responsibility and Capability



Similarly the capital city should be placed in a special category and the sources, resources and responsibilities should be adjusted accordingly. In most of the countries, Capital City is given autonomy through a separate Act. In Nepal also, time has come to give autonomy and greater powers to Kathmandu Metropolis by a separate Act. After the division of responsibility in this manner, the responsibilities together with the revenue rights (service charge, fee or direct tax) should be allocated to the concerned local bodies, or the amount allocated in the central budget for such services should also be delegated and thus make adjustment between resources and functions. The government should provide assistance by playing the role of facilitator and evaluator.

For the sake of classification, in addition to the criteria mentioned in the Act, indicators like financial discipline, organizational capability and efficiency in performance should also be added. In the process of classification (from the stage of developing indicator to evaluation and actively placing the local bodies in respective category) the respective Association of Local Bodies should be involved.

For the sake of division of work according to the classification, a tradition should be started to form a task division committee which should decide the division of work with the concerned local body. This task division should be reviewed and renegotiated every three years, and the central budgeting system should also be developed accordingly. It would be appropriate to gradually decrease the administrative expenditure ratio by granting revenue rights on the basis of such classification, and the responsibility assumed by the local bodies gradually decreasing overlaps in work and making the local bodies totally responsible in the areas of present overlaps and making the administration small but efficient.

(b) Amendment of the Laws/Regulations in Conflict with the Local Self-Governance Act

Many current laws are in conflict with the Local Self-Governance Act. Among them 23 laws have been mentioned in Annex - 5. It is necessary to increase the effectiveness of the local bodies by appropriate amendment of those laws.

(c) Review of the Number of the Local Bodies and office Bearers

The following problems have surfaced because of the huge number of local bodies:

- Local bodies have not been able to grow as economically viable units;
- There is very little scope of decreasing administrative cost and the enhancement of the quality of the administrative and technical manpower is going to be very expensive;
- The expenditure on the facilities of the representatives being very high, the revenue is being spent more on unproductive overhead rather than on subjects of popular interest and development/construction works;
- There is lack of financial incentives to motivate capable leaders for whole time work;

Therefore it is necessary to review the number of the local bodies and the elected office bearers. For the solution of these problems, the following suggestions have been made:

- Areas or settlements with common social geographical and economic factors should be made single unit;
- Minimum population should be determined as the basis for ward division in the VDCs and Municipalities and the number of wards should be small. Posts without specified responsibilities after election should be cancelled;
- Determining the number of representatives from the view point of quality rather than quantity;
- It is desirable to review and reduce the number of districts from the presently run 75 administrative districts in view of the development of information technology, development of transportation and infrastructure and the fact that NGOs can share the burden of government responsibility.

This will reduce the number of DDCs and the administrative mechanism of HMG also becomes less burdensome.

While revising the number of local bodies, it is necessary to have a long term view. For example, the data of all the areas have to be updated on the new basis which is very expensive. Therefore, in works like revision of the number of local bodies and delineation etc, it is necessary to do them only with long term thinking (20-30 years) so that the data of the areas based on the political boundaries of the VDC (population, land, agriculture output, industrial stabilities and such other basic matters) are not distorted.

(d) Establishing Functions of Fiscal Enabling and Policing of Local Bodies

For this purpose, the following three permanent agencies should be established and operated:

(i) Local Bodies Fiscal Commission

There is a necessity of creating a permanent Local Bodies Fiscal Commission with professional experts in order to make the local bodies financially more capable, to monitor the fiscal management aspects, to disseminate the best practices in fiscal attempts of local bodies, to work as moderator among HMG local bodies and their respective Associations, to advise HMG on fiscal policies and revenue administration. It would be appropriate to create this Commission as an autonomous institution and full time experts (nominated from HMG, Local Bodies, Private Sector and Civil Societies) should be employed and put to work.

The scope of work of the Commission should be as follows:

- To conduct study/research on various aspects, the tax or non tax revenue of local bodies (data collection, tax determination, implementation) and work in a coordinated manner between HMG and local bodies to incorporate timely improvement;
- Advise HMG after conducting monitoring, evaluation and review of the tax and revenue mobilization rights of the local bodies;
- Look after functions like task division, grant management and administration;
- After undertaking fiscal analysis and projection of fiscal need, offer advice about alternate sources;
- Assist in the process of mobilizing donor support;
- Establishment of Data Bank and development and updating of indicators for monitoring and evaluation;
- Evaluating the fiscal behavior of local bodies, prepare list of reward and punishment recipients;
- Recommend various policies and programmes for improvement of fiscal management of local bodies; and
- Work as liaison agency between HMG, Local Bodies and Associations of Local Bodies.

(ii) Local Body Accounts and Audit Board

The auditing system of local bodies has not been effective and efficient (chapter 6). No independent or consolidated record is mentioned about the subjects pointed out in the internal and final audit of the VDCs. In this respect, the status of the audit of Municipalities and DDCs is also similar. The entire accounting system has not been taken into view in the context of improving, and control of repetition of accounting, auditing and problems of irregularities. There has been no full monitoring and evaluation of the accounting systems at each level of each local body. Even the inventory of goods and property has not been updated.

For this purpose it has become necessary to create and operationalize an independent, specialized board for accounting and auditing systems of the local bodies. This Board will have to do such important works as: conducting regular audit; removal of problems pointed by audits (reconciliation of irregularities, recovery or writing off); making the accounting system transparent; conducting studies, monitoring and evaluation of the policy wise, operational and processual aspects of the accounting systems of local bodies; and presenting necessary policies and recommendations to HMG. The scope work of the Board should be adjusted as being

supplementary to the Auditor General's office. It is desirable to form this Board on the advice of the Auditor General and to provide policywise and technical support from the Auditor General's office. In addition, it will be appropriate to include in this Board experts recommended by the local bodies. The audit report of the Board should be given to the chief of the Local Body, the Council and local office of the District Treasury & Control office and arrangement should be made for its public presentation.

(iii) Formation of Local Bodies Service

Act 255 of the Local Self-Governance Act has made provision of local bodies Service. It is necessary to form a Commission for developing parameters and processes regarding the recruitment, promotion, condition of service, facilities etc of the local bodies personnel. Unless such a service is formed, the future career of local bodies personnel will not be known and it is not likely that capable persons will be attracted to serve in the local bodies. There is a dearth of capable personnel in the tax, revenue and account management of local bodies. Decentralization can be effective and the fruits of development can reach the people only if service oriented and committed personnel are employed in the offices with direct popular contact. Therefore, qualified and skilled people will join the local bodies only if the local service is made attractive, drawing participation from highly qualified people in the competitive selection. Considering the need for improvement in the present manpower management and revenue management aspects of the local bodies, it appears that the concerned provisions of the Act must be implemented and the local service must be created as soon as possible.

(e) Conducting Programme of Organizational Consolidation of Local Bodies

There is the necessity of consolidating the entire organizational structure and the fiscal administration of the local bodies. For this, there is the necessity of creating a separate fiscal administration unit and enhancing the knowledge and skill of representatives and the employees. It is necessary to run the processes of fiscal policy and programmes formulation, implementation, monitoring and improvement in the local bodies as regular and dynamic processes. For this, the local bodies need expert service and other forms of central assistance.

There is a necessity to: make necessary manpower available on the basis of work responsibility for the entire structural consolidation; upgrade the efficiency and level of personnel in the local bodies; and making clear division of responsibility between the representatives and personnel. It is necessary to transfer one of the Local Development Training Centres as a centre for manpower development training of representatives and personnel of the VDCs as mentioned in the Ninth Plan. To get rid of old and skillless personnel of the Local Bodies who cannot be improved even by training, it is necessary to offer them specially attractive package, terminate their service and, in such vacancies, recruit new and efficient persons.

(f) Clarifying Mutual Attitude and Policy among Local Bodies, Private Sector and Civil Society

The state should mobilize four mechanisms - Central Administration, Private Sector, Civil Society and the Local Bodies - in a coordinated manner for the development of infrastructure and delivery of public service. The Ninth Plan mentions the policies and strategies of the central administration with the other three mechanisms. But the apex bodies of the other three mechanisms have not stated their attitude to each other clearly. This lack of clarity is impeding the development of a mutually coordinated and cooperative environment of defining their interrelationship for promotion of employment opportunities, local level income raising activities and involvement of citizens and the private sector in tax mobilization. Therefore, it is necessary that the apex organizations of the Local Bodies, the private sector and the civil societies (NOGs) should clearly state their policies and attitudes towards each other.

(g) Electoral Constituency Development Programme

The fact that elected Members of Parliament (MP) take interest in the development of their constituency is considered a good sign. Accordingly, it has been arranged that every MP gets a lump sum annual budget of one million Rupees for the development of his/her constituency. But, in this process of conducting separate development programmes by different agencies, there is the dual problem of overlaps in the development programmes of the local bodies and difficulty in launching planned development programmes by the local bodies.

Regarding the expenditure of the grants given to the DDCs guidelines and regulations have been made and implemented and there is also regular monitoring of such expenditure. But, although DDC has to maintain the account of this fund, there is no clear guideline or regulation about it. Thus an uneasiness is being felt in having to keep two different kinds of accounts by the same agency. Therefore it is necessary to run the electoral constituency development programme by a separate regulation. It appears that there should be an arrangement that such a fund should be spent within the district Development Plan through coordination between the DDC and the Concerned MP (ex-officio DDC member) in a systematic way. The reason is that there is a constant need for the active cooperation of the MPs in making decentralization meaningful, by not letting their own programme have adverse effect on the objective and substance of the Local Self-Governance Act, enacted by themselves. Therefore, there should be uniformity between the constituency development programme and other local development programmes with respect to plan formulation process, technical assistance, accounting system, audit and reconciliation of irregularities.

(h) Responsibility of DDC towards VDCs and Municipalities

The DDC is an intermediary local body and VDCs and the Municipalities are local bodies working directly at the people's level. Therefore, instead of indulging in public service delivery at the local level, the DDCs should be centred in aggregative works like inter agency coordination, policy formulation, preparation of periodic plans, search for new fiscal resources, monitoring, evaluation and maintenance of fiscal discipline. In addition, the DDC should mobilize tax and revenue in collaboration with lower bodies, and pay greater attention to developing appropriate organizational structure, manpower and method for this purpose.

Organized by the Local Self-Governance Act, the DDC, Municipality and VDC are local bodies with equal status and capacity. But the role of the DDC is made important and the process of running integrated district development programmes is mentioned. In this context it is not clear what impact the DDC will have on the two lower bodies in terms of directions, control and policies. For this there should be provision that the DDC should exert control according to given responsibilities, or the role of the DDC should be reviewed and adjusted with the other two bodies. Such a relationship is more important and sensitive. In the context of the lack of agency for monitoring, evaluating and assisting the excessive number of VDCs, it appears appropriate to give this responsibility to the DDC, and there appears a need for coordination with the Municipalities as well.

(i) All Ministries Should Directly Assist Local Bodies in their Specialized Sector

At present, Ministry of Local Development is considered the lead Ministry in relation to decentralization. But this is not true and decentralization should apply to the whole state machinery. Hence with regard to working with local bodies, other agencies should not regard the Local Development Ministry as the contact Ministry but proceed to work with the Local Bodies in accordance with clause (2) of Art 240 and clauses (1), (2) and (3) of Art 243. Therefore a tradition should be started for each Ministry to work directly with the local bodies with regard to their respective sectors.

Creating a Special, Independent Structure for Capital City

As the capital city has unique specialty and importance it is found that various countries have made provision for various laws and given the capital city greater responsibilities and different types of power. As the capital city has special types of resources, highly skilled manpower is easily available, private sector and civil societies can also actively participate, and all are sensitive to its specialties, it is necessary to make a special structure through an Act of Parliament, making it possible to harness all these resources and potentialities and to attain coordinated work. While making the Act, it would be appropriate to have cooperation and coordination with the central government with regard to some public areas, cultural and natural heritage and such other sensitive aspects.

Dissolution of Town Development Committee

Almost all the tasks performed by the Town Development Committees, formed by HMG according to the Town Development Act, 1989, are of local nature and they fall within the jurisdiction of local bodies (particularly Municipalities). Now there is overlap between the scope of work of these committees and the local bodies and coordination is not attained. Thus, on the one hand, there is difficulty to provide for their administrative cost and, on the other, development of settlements and infrastructure with popular participation and mobilization of the resources of Local Bodies has also not occurred. Therefore, in the context of the Local Self-Governance Act having given the kinds of functions that the Town Development Committee does to the local bodies, it would not be appropriate to retain the Town Development Committees. So they should be dissolved and the resources and technical assistance should be allocated to the local bodies themselves together with the responsibility (of the dissolved committee).

Chapter Four

Fiscal Status and Authority of Local Bodies

4.1 Historical Background of Fiscal Decentralization

In the context of giving fiscal authority to local bodies, the Town Panchayats were given the authority to impose household tax and house rent tax in 2019 (1963). In the same way, the Town Panchayats were also given the right to impose professional tax, upto 10 per cent on the land tax, upto 20 per cent entertainment tax on the admission fee and vehicle tax not exceeding Rs. 100 on the means of transport registered in the same town. As the mobilization of taxes did not gain momentum, it was reviewed in 1965-66. The household tax, professional tax and vehicle tax were simplified. The additional surcharge on land tax was cancelled. There was a provision of trade surcharge @ 0.3 per cent and a new tax - Panchayat Development Land Tax (PDLT) - was implemented. In the fiscal year 1975-76, there was a provision of imposing 0.50 per cent trade tax, but the Panchayat Development Tax, was suspended. In the year 1989, the trade tax was suspended and a provision was made to levy taxes at 1.00 per cent.

After the political change of 1990, the then Panchayat Acts were abrogated, and the VDC Act, 1992, Municipality Act, 1992 and DDC Act, 1992 were introduced with a view to consolidating the local bodies and making them powerful. In those Acts, there were powers for the local bodies to impose different taxes. The power to collect land revenue was handed over to the VDCs and the Municipalities from fiscal year 1997-98. Despite all these powers, local bodies could not collect taxes to their full potentials for different reasons. So, making timely improvements in the existing conditions, the Local Self-Governance Act and Regulation were introduced in 1999 with a view to granting more autonomy to the local bodies. From the Local Self-Governance Act, 1999, and Local Self-Governance Regulation, 1999 several fiscal powers are granted to the local bodies. The fiscal condition and fiscal powers of local bodies are analyzed in this chapter.

4.2 Fiscal Status of the DDCs

4.2.1 Internal Resources of DDCs

DDCs in Nepal are excessively dependent on external resources. In the internal resources of DDCs, local tax, income from the allocation of revenue and others (in come from land revenue) are the main ones. In the course of this study, details of internal resources were available from 34 districts. The study of those data showed that the total income from internal resources was Rs. 11,92,02,000 in fiscal year 1998-99 and it increased to Rs. 19,75,68,000 in 1999-2000 - an increase of about 66% (Annex-7). In this increase, the contribution of service charge, sales and income raising activities is deserves mention. In the fiscal year 1999-2000, the total income of all 75 districts from internal resources was Rs. 29,93,00,000¹⁹. Table 4.1 shows the composition of the internal resources of 34 districts.

¹⁹ The 37th Annual Report of the Auditor General Part 3, p-400.

Table 4.1
Composition of Internal Resources of DDCs

Resources	1997-98 Rs. in 000	Percentage of Internal Resources	1998-99 Rs. in 000	Percentage of Internal Resources
Tax	37097	31.10	41225	20.90
Service charge	2343	2.00	3780	3.70
Fee	9242	7.80	9695	4.90
Sales	44148	37.00	96620	48.90
Loan	1124	0.90	1442	0.70
Land Revenue	3744	6.20	4902	2.50
Other income raising programmes	17904	15.00	36304	18.40
Total	119202	100.00	197568	100.00

Source: Income Description of DDCs (Annex-7)

The resources of the DDC can still increase, because income from royalty and registration has just started to come and the amount from revenue allocation is likely to increase. No DDC has raised any income from source like capital, interest, dividend and bonus. This shows clearly that the fiscal management of the DDCs is highly dependent on the central grants and expenditure oriented as central agent. It appears that it will take some time for the DDCs to develop as self-directed, service oriented and financially self-supporting institution.

Thus, even if the internal resources are increasing, the total share of internal income is very small. This can be measured through the fiscal autonomy indicator of the DDCs. In measuring the indicator of fiscal autonomy, the ratio of internal resource with the total resources of the DDCs is examined. In the following table, the fiscal autonomy indicator of 34 districts is presented. (In this calculation, the salary of the VDC Secretaries is also included in the DDC grant. If the amount of salary of the VDC Secretaries is excluded, the indicator will show a little better fiscal autonomy status).

Table 4.2
DDCs Fiscal Autonomy Indicator

Average	8.00%
Range	0.005 - 55.00%
Geometric mean	2.40%
Median	2.00%

According to table 4.2, the fiscal autonomy of the DDC ranges from 0.005 to 55 per cent and the average autonomy is 8 per cent. But the median figure is only 2% indicating that the autonomy indicator for half of the DDC is less than 2% and the geometric mean shows the weighted average autonomy at 2.4%. In the table 4.3, a classification of districts, from which fiscal data were obtained, is made on the basis of fiscal autonomy.

Table 4.3
Classification of DDCs on the Basis of Fiscal Autonomy

Fiscal autonomy	Name of districts (1998-99)	Name of Districts (1999-2000)
0-4 per cent	Dolpa (0.005) Parbat, Rukum, Mugu, Bajhang, Okhaldhunga, Lamjung, Rasuwa, Baitadi, Rolpa, Achham, Siraha, Arghakhanchi, Bajura, Bhojpur, Gulmi, Myagdi, Sindhupalchok, Udayapur Palpa (2.85)	Dolpa (0.15), Bajhang, Rukum, Achham, Rasuwa, Okhaldhunga, Mugu, Siraha, Jumla, Lamjung, Bajura, Gulmi, Baitadi, Arghakhanchi, Udayapur, Bhojpur, Rolpa, Parbat, Myagdi, Dadeldhura, Palpa (3.85)
4-25 per cent	Dadeldhura (5.95), Parsa, Kabhre-palanchok, Kailali, Bardiya, Dhading, Rupandehi, Jhapa (22.65)	Dolkha (6.1), Bardiya, Sindhu-palchok, Kabhrepalanchok, Parsa, Lalitpur, Jhapa (17.2)
25-45 per cent	Kathmandu (32.3), Bhaktapur, Lalitpur, Kanchanpur (45)	Dhading, Rupandhi, Kanchanpur, Kailali, Bhaktapur (55.7)

4.2.2 Composition of Expenditure of DDC

In the context of this study, details of expenditure of internal resources have been received from 32 DDCs and the details of grant expenditure from 31 DDCs (Annex - 8). Table 4.4 shows the status of the expenditures from internal resources and from the grant-in-aid.

Table 4.4
Status of the Utilization of Internal Resources and Grant-in-aid

Expenditure head	Internal Resources (32 DDCs)				Grant (31 DDCs)			
	FY 1997-98	% of total exp.	FY 1998-99	% of total exp.	FY 1997-98	% of total exp.	FY 1998-99	% of total exp.
Office related	15725	12.8	16607.5	10.3	15600	2.6	15310	2.2
Personnel related	34826	28.3	41170	25.6	122272	20.1	202612	29.5
Rent related	6174	5.00	754.50	4.70	5766	0.90	5503	0.80
Fuel	4582	3.70	4083.5	2.5	3333	0.50	3265	0.50
Miscellaneous	7396	6.00	13913	8.7	4581	0.80	9876	1.40
Durable office equipment	3484	2.80	3119	1.90	4259	0.70	5308	0.80
Public works and improvement	36270	29.50	56963	35.50	136431	22.40	104751	15.30
Programme grant	3588	2.90	5182	3.20	254315	41.80	234206	34.10
Capital Grant	1165	0.90	1670	1.00	244	0.0	8525	1.2
Adm. Grant and contingencies	9836	8.00	10393	6.5	61978	10.2	96423	14.10
Total	123046	100	160639.5	100	608779	100	685978	100

Source: Expenditure details of DDCs.

Notes:

- Personnel head includes salary, wages, travel allowance and dress.
- Rent includes water supply, electricity, telephone and others services

- Office expenses includes repair/maintenance, office equipment, printing, news papers and other equipments/goods.
- Fuel includes vehicle fuel and other fuel.
- Miscellaneous includes tea, snacks, hospitality and other expenditure.
- Durable goods includes furniture, vehicles and machineries.

The above table shows that 77% and 80% (for FY 1998-99 and 1999-2000 respectively) of the internal revenue of the DDCs is spent on public construction and maintenance, personnel, office operation and miscellaneous expenses, while on the grant side, programme grant, public construction, personnel related, grant and contingency expenses take away 94 and 93 per cent for respective fiscal years. The expenditure summary of the DDCs is presented in Table 4.5 below:

Table 4.5
Summary of the Expenditure of DDCs

Types of Expenditure	Internal Resources (32 DDCs)				Grant (31 DDCs)			
	FY 1997-98	% of total exp.	FY 1998-99	% of total exp.	FY 1997-98	% of total exp.	FY 1998-99	% of total exp.
Administration (Personnel + office)	64791	53	72518	45	151230	25	232197	34
Miscellaneous and contingency	17232	14	24306	15	66559	11	106299	15
Development programmes	41023	33	63815	40	390990	64	347482	51

This table shows that administrative expenditure of DDC covers about fifty per cent from the internal resources and about one third of the grant expenditure as well. Similarly the miscellaneous and contingency expenses during the two financial years of review were 14 and 15 per cent respectively from internal resources and 11 and 15 per cent respectively from the grant fund, thus leaving for development work only 33 to 40 percent from internal resources and 51 to 64 per cent from the grant amount.

Viewed in totality, the administrative expenditure is too high, the programme expenditure is small and the miscellaneous (which includes allowance, donation, charity etc) expenditure also remarkable. Thus there is the challenging situation where in bulk of the income of the DDC should be diverted to development work and the expenditure on miscellaneous and contingency heads should be flown in the planned programmes.

Review of the Fiscal Status of the DDC

The DDCs are excessively dependent on external resources. Among the internal resources of DDC, the amount coming from lower bodies as allocation of revenue (land revenue) is the buoyant resource. The DDC should seriously ponder over this issue. It is only when the DDCs are actively oriented to maximally mobilize the allocated revenue resource from the lower local bodies will their revenue increase. For example, there is a provision that DDC will get 25% of the land revenue. If it is mobilized efficiently, the DDCs will be largely benefited.

In the present condition, natural resources export tax (like herbs, boulders, sand, animal hydes and bones) are the main internal resources of the DDCs.

The DDCs do not seem to have made expected progress in terms of extending public services and mobilizing resources therefrom. Even in terms of policies, the DDCs have yet to move ahead in a planned manner in mobilizing non-renewable natural resources like boulders, sand etc. and renewable natural resources like herbs. It is necessary that the DDCs be aware of the ill consequences of unlimited use of natural resources like soil erosion and depletion of geo diversity and adopt appropriate and sustainable policy.

In sum, the DDCs should enhance their fiscal capability. Under this, functions like review of existing resources, identification of new resources, and further consolidation of existing resources need to be done on a continuing basis. For this purpose, institutional improvement and human resource development are indispensable. Similarly, it is necessary to develop a process of formulating, implementing and monitoring policies and programmes for proper mobilization of sources of revenue. It is apparent that the DDCs can move confidently towards fiscal autonomy only if they adopt effective and practicable revenue policies and implement them impartially and efficiently.

4.3 Fiscal Status of Lower Local Bodies (VDC and Municipality)

4.3.1 Fiscal Status of Municipalities

Recently the Municipal Management Section of the Ministry of Local Development has published a Comparative Study Report of the Fiscal Status of all the Municipalities with assistance from the Urban Development through Local Efforts (UDLE) programme. Based on the data of that report, a comprehensive revenue and investment status of the municipalities is presented in Annexes 9 and 10. The composition of the income of the Municipalities is presented in table 4.6.

Table 4.6
Source of Income of the Municipalities

	<i>FY 1995-96</i>	%	<i>FY 1996-97</i>	%	<i>FY 1997-98</i>	%	<i>FY 1998-99</i>	%
Local Tax	658,022,276	64.2	686,095,292	65.6	984,344,399	62.0	869,286,295	56.3
Fees, fines	47,103,679	4.6	65,241,280	6.2	78,625,443	5.0	90,422,321	5.9
Rent from property	26,528,905	2.6	34,935,503	3.3	39,650,431	2.5	49,500,136	3.2
Other Income	10,535,153	1.0	19,929,774	1.9	23,139,249	1.5	33,293,690	2.2
Income/internal	742,190,013	72.4	806,201,849	77.0	1,125,759,522	71.0	1,042,502,442	67.5
Miscellaneous	11,642,980	1.1	18,430,736	1.8	15,600,340	1.0	16,211,141	1.0
Grant	68,962,188	6.7	84,943,539	8.1	261,802,174	16.5	246,775,645	16.0
Loan	98,695,378	9.6	22,208,050	2.1	19,556,012	1.2	52,517,934	3.4
Brought forward	103,429,363	10.1	114,736,565	11.0	163,704,797	10.3	186,969,494	12.1
Total revenue	1,024,919,922	100.0	1,046,520,739	100.0	1,586,422,845	100.0	1,544,976,656	100.0

Source: Income Details of Municipalities (Annex - 9)

The analysis of the above data presents the following status of internal resources:

Table 4.7
Analysis of Local Resources (in%)

	FY 1995-96	FY 1996-97	FY 1997-98	FY 1998-99
Local Tax	64	66	62	56
Fees and fines	5	6	5	6
Property rent	3	3	2	3
Others	1	2	1	2
Total	73	77	71	67
Ratio of kabadi and vehicle tax	61	62	58	53

Revenue Income

In the total revenue of the 58 Municipalities 67 to 77 per cent appears to have been generated through local resources (including octroi and occasional vehicle tax). The ratio of grant is 7 to 16 per cent. In other sources fall loan and the carryover from last year. In analyzing internal resources, 56 to 66 per cent has come from local taxes, 5 to 7 per cent from fines and fees, 2 to 3 per cent from rent and the rest from other minor sources. In the local tax, octroi and vehicle tax forms 78 to 85 per cent. Although, the average revenue of the municipalities from internal resources appears good, after the replacement of the octroi and vehicle tax by Local Development Fee, their capability for resource mobilization has decreased and they have become centre oriented. The local development fee has not been arranged under the Local Self-Governance Act and it cannot be considered a long term and reliable resource. Another reliable and permanent resource should be explored to replace it.

The Local Self-Governance Act has given the municipalities a scope of identifying other resources and improving their fiscal status. Most of the municipalities have not implemented measures like taxes on entertainment, advertisement, commercial video shows and integrated house and land tax. Municipalities have been given full power to impose tax on house and land from this fiscal year. Municipalities have started to use it. After the withdrawal of octroi, the government it self raises and distributes the Local Development Fee, but it is not a sustainable system. Although there is the provision for an occasional vehicle tax in the Act, there is no arrangement made to this day to implement it. In the average per capita revenue of Rs. 493, (with the inclusion of the Local Development Fee) 332 has been derived from local resources. But even in this, there is a great inequality among Municipalities. Among these, the lowest revenue, Rs. 30 per capita, is collected by the Dasharatha Chand, and the highest per capita @ 1336 per person, is collected by Dhulikhel Municipality. Birgunj and Bhaktpur have raised over Rs. 1000 while Tikapur, Narayan, Kamalamai and Bhimeshwar have raised less than 1000. The report has recommended that 55 municipalities should implement these taxes. That study has also recommended that attention should be paid to the fact that service fee can be mobilized from such services like street light, public lavatories, water supply, solid waste management etc. The study has drawn the conclusion that the municipalities should tie up a programme of allotting number to houses with the house tax.

Some Municipalities (7) are excerssively dependent on grant while some (18) have not taken effective steps towards mobilizing the vast potential resources like house rent, tenancy. Some

Municipalities like Dharan, Bhaktapur, Butwal, Nepalgunj, Pokhara, Kathmandu and Mechi Nagar have started mobilizing potential tax, service charge etc. rather well, but the number of such Municipalities is less than 10.

It has been found that if proper attention is paid in the process of monitoring, in the case of most of the Municipalities (41), the resource mobilization can be made more effective. There is a scope for wide spread improvement in the process of tax management in the Municipalities and this is one main means of enhancing their fiscal capability.

Some Municipalities have raised resources from sand and aggregates from the river banks although such sources fall outside their jurisdiction, while some others are bargaining with respective DDCs for sharing such resources.

Investment

Table 4.8 clearly shows the composition of the expenditures and investment of the municipalities. It shows that 36 to 44 per cent of the municipalities' budget is spent on regular, operational activities and the remainder is spent on loan repayment, social work, common goods and construction activities. Administrative cost is Rs. 197 per person on an average. The study conducted by the Ministry of Local Development has made recommendations for reduction of administrative cost in most of the Municipalities. The regulation limits the administrative expenditure at 25 to 40 per cent, but 36 Municipalities have exceeded that limit. Among the Municipalities with administrative expenditure of more than 60 per cent are Bidur (62%), Jaleshwar (63%), Janakpur (68%), Kalaiya (67%) and Kathmandu (64%). There is a tendency of spending high amounts in the form of donation and the number of Municipalities with such trend is at least 20. In the same way, in the case of the number of personnel, the average is 3 persons per 1000 population but 8 Municipalities exceed this limit. And about 3% budget is spent on office equipments.

Table 4.8
Composition of Investment and Expenditure of Municipalities

	FY 1995-96	%	FY 1996-97	%	FY 1997-98	%	FY 1998-99	%
Regular expenditure	325031283	36	363546300	40	574988148	42	619021824	44
Loan repayment	18152102	2	26352769	3	44241707	3	34883913	3
Social programmes	69320097	8	71221629	8	50038922	4	68082042	5
Non-durable office goods	20504361	2	11434508	1	72496742	5	37535116	3
Capital Investment	478063262	52	431345595	48	641690663	46	632085048	45
Total	911071105	100	903900801	100	1383456182	100	1391607943	100

Source: Expenditure details of Municipalities (Annex -10).

In the development expenditure of the Municipalities, only about 4 to 8 % has been spent on social programmes. In the remaining expenditure, 45 to 52 per cent has gone to capital investment and 2 to 3 % to loan repayment. Dhulikhel Municipality has made the highest capital investment @ Rs. 947 per person and Amargadhi has made the lowest investment @ Rs. 21 p.p. Those making higher than Rs. 500 investment include Banepa, Bhaktapur, Birgunj, Ilam, Mechi Nagar and Siddharthanagar, and those making lower than Rs. 100 investment include Triyuga, Tikapur, Prithvinarayan, Mahendranagar, Lekhanath, Lalitpur, Kirtipur, Janakpur, Gulariya and Bidur Municipalities.

It has been recommended that the municipalities should concentrate their budget in such social programmes like education, health, environment sector etc. Three municipalities - Mahendranagar, Putalibazar and Pokhara - are reported by the study to have made encouraging

investment in social programmes. In this manner, the Municipalities should be oriented towards reducing the regular, miscellaneous and contingency expenditures and the amount thus saved should be diverted towards planned development. They should increase investment in social programmes and expand services/facilities by increasing the involvement of the private sector.

Review of the Fiscal Status of Municipalities

The ratio of the internal revenue of the municipalities (including local development fee) is around 70%. This shows that the fiscal status of the municipalities is much better than that of the DDCs or the VDCs, but the termination of the octroi and the vehicle tax which stood around 80% of local resources (or almost 60% of total revenue) seems to have weakened their fiscal status.

Integrated property tax appears to be the basis of the best tax with satisfactory yield. Similarly, the house tax, professional tax and vehicle tax are also taxes worth great potentials. In the field of non-tax revenue, service charge also has an important place. But, as the cost of service delivery is also high, this cannot be a remarkable source of income. There are possibilities of resource mobilization by adopting a policy of providing services for the comfort of city dwellers on a participatory basis by involving the private sector. But sufficient attention does not seem to have gone to it.

Most of the Municipalities are found not to have made any attempt of mobilizing direct tax. But, in the context of the main indirect tax being terminated, the municipalities should take the direct taxes and service charge as the main local resource. In almost all the municipalities, institutional framework for revenue administration has been developed and attempt has been made to develop revenue information system. The present challenge is to make that framework and information system active and effective. Need has also been felt for clarity of policy and political commitment along with the consolidation of revenue administration.

4.3.2 Fiscal Status of VDCs

The VDCs in Nepal are excessively dependent on external resources. For studying the internal resources of the VDCs, data were requested from three VDCs with high, medium and low income from each district. The fiscal resources of the VDCs derived from the analysis of the data received about 75 VDCs from 30 districts are presented in table 4.9.

Table 4.9
Source of Income of VDCs

Rs. 000

	FY 1997-98	No. of VDCs	% of internal resource	% of total revenues	FY 1998-99	No. of VDCs	% of internal resource	% of total revenues
Local tax revenue	12671	74	56.8	14.6	12213	72	53.8	14.0
Service Charge	1899	19	8.5	2.2	2959	19	13.0	3.4
Fee	4228	50	19.0	4.9	5241	54	23.1	6.0
Sales	971	7	4.4	1.1	894	9	3.9	1.0
Others	2543	22	11.4	2.9	1397.4	23	6.2	1.6
Total internal revenue	22312	75	100.0	25.7	22706	75	100.0	26.0
Grant	64492	75	289.0	74.3	64609	75	284.6	74.0
Grand Total	86804			100.0	87315			100.0

Source: Details of Income of VDCs (Annex -11)

In analysing the above table, most of the VDCs seem to have collected taxes. This is because of the responsibility of collecting land revenue. The ratio of tax in the internal resources is 60%. Even then, as only 66 VDCs showed income from tax, it is apparent that some of them do not even collect the land revenue. The internal resources mainly include tax, service charge, and fee, and their total weightage is around 90 per cent.

Table 4.10 shows the level of fiscal autonomy of the VDCs.

Table 4.10
Indicators of Fiscal Autonomy of VDCs

	FY 1997-98	No. of VDCs	FY 1998-99	No. of VDCs
Geometric mean (%)	5.6	75	5.5	75
Range (%)	0.04 to 97.1		0.1 to 96.9	
Average (%)	25.7%		26.0%	
Median (%)	5.6		6.3	

The table shows the level of fiscal autonomy of VDCs to be 25 to 26%, but as the minimum is only 0.04 and the maximum goes upto 97, there is a vast difference among the VDCs. The medium figure is between 5.5 and 6 per cent, and the weighted average (geometric) mean is 5.5 per cent, the fiscal autonomy of the VDCs is very low. Table 4.11 shows the autonomy of the VDCs falling in the level of autonomy.

Table 4.11
Number of VDCs falling in the Level of Autonomy

Level of fiscal autonomy %	No. of VDCs	
	1997-98	1998-99
Over 50	9	7
25 to 50	9	9
6 to 25	21	23
Below 6	36	36

Expenditure details of VDCs are presented in table 4.12.

Table 4.12
Expenditure Details of VDCs

Rs. 000

<i>Expenditure heads</i>	<i>Total Expenditure</i>				<i>Expenditure from internal resources</i>			
	<i>1997-98 VDC-58</i>	<i>% of total</i>	<i>1998-99 VDC-47</i>	<i>% of total</i>	<i>1997-98 VDC-58</i>	<i>% of total</i>	<i>1998-99 VDC-47</i>	<i>% of total</i>
Personnel expenses	5845	20.6	4201	18.5	2206	18.2	1202	20.9
Rents	385	1.4	376	1.7	141	1.2	218	3.8
Office expenses	1476	5.2	654	2.9	665	5.5	324	5.6

<i>Expenditure heads</i>	<i>Total Expenditure</i>				<i>Expenditure from internal resources</i>			
	<i>1997-98 VDC -58</i>	<i>% of total</i>	<i>1998-99 VDC - 47</i>	<i>% of total</i>	<i>1997-98 VDC - 58</i>	<i>% of total</i>	<i>1998-99 VDC - 47</i>	<i>% of total</i>
Fuel	289	0.1	43	0.2	15	0.1	32	0.6
Miscellaneous	2404	8.5	1471	6.5	2110	17.4	674	11.7
Office goods (durable)	1741	6.1	1448	6.4	294	2.4	125	2.2
Financial assistance	2124	7.5	3238	14.3	977	8.1	167	2.9
Public work/maintenance	10122	35.7	7059	31.2	4952	40.9	2487	43.3
Programme grant	309	1.1	214	0.9	29	0.2	0	0.0
Capital grant	2953	10.4	2776	12.3	516	4.3	253	4.4
Social service	969	3.4	1116	4.9	162	1.3	200	3.5
Contingencies	26	0.1	60	0.3	26	0.2	60	1.0
Total	28381	100.0	22655	100.0	12093	100.0	5742	100.0

Source: VDC details (Annex - 12)

Notes:

- Personnel expenditure includes salary, allowance, travel cost and dress.
- Rent includes water supply, electricity, telephone and other services.
- Office expense includes repair & maintenance, office goods, printing, newspapers and others.
- Fuel includes fuel for vehicle and other purposes.
- Miscellaneous includes tea, hospitality and other expenses.
- Durable office goods includes furniture, vehicles and machineries.
- Financial assistance includes financial and other grants.

In analyzing the expenditure of VDCs, the following status is seen:

- Although the capital grant in itself is substantial, only a small portion of internal resource is spent on it.
- The amount spent on miscellaneous and financial grants from internal resources is remarkable.

In the total expenditure, the main headings are public work, personnel expenditure, miscellaneous, capital grant and financial assistance (83% in both the years of reviews). In the case of internal resources, public works, personnel expenses, miscellaneous and office related expenses took up 82%. This shows the trend of making insignificant capital investment from internal resources. Table 4.13 presents a summary of the VDC expenditure.

Table 4.13
Summary of Expenditure

Rs. 000

	Total expenditure				Internal resources			
	1997-98	%	1998-99	%	1997-98	%	1998-99	%
No. of VDCs	58		47		58		47	
Administrative (personnel and office)	9475	33	6721	30	3321	28	1901	33
Development programme	13384	47	10049	44	5497	45	2740	48
Miscellaneous, contingency and fina- ncial assistance	4554	16	4769	21	3113	26	901	16
Social Security	969	4	1116	5	162	1	200	3

The analysis of the above table shows that about 50% of the VDC expenditure is made in development work and the rest is spent on administration, social security, miscellaneous and contingencies. The expenditure on administrative heads has exceeded the prescribed limit.

Review of Fiscal Status of VDCs

A few VDCs are active in mobilizing internal resources only as an exception. In the resources of such VDCs, the main sources are vehicle clearance tax, and natural resources (like sales of sand and soil). In other words, the VDCs do not seem to have made internal resource mobilization. As the vehicle tax is terminated and the sand and soil are not permanent resources, the condition of even these VDCs will deteriorate. Thus, several alternatives should be explored to make the VDCs self-sufficient in resources and there is a distinct need for effective utilization of given powers.

The devolution of power for land tax and revenue has greatly assisted in the resource status of VDCs. Yet, the fact the total collection of land revenue/tax is less than what it was in the year of developing this power, indicates that mere transfer of power without the organizational capability does not increase the revenue. It has been experienced that the land revenue collection was not remarkable because of factors like: the VDCs were not prepared institutionally; inadequacy of the manpower (both in quantity and quality); the data were not up-to-date; lack of coordination among concerned agencies. As the DDCs get 25% of the land revenue collected by the VDCs, the DDCs should have a role in activating, assisting and monitoring the VDCs. But, in practice, most of the DDCs have been passive receivers of such revenue.

Most VDCs have not developed the capability to implement the given power. In fact, this should be done by joint endeavor of the government and the local bodies. Likewise, most VDCs have yet to think in terms of increasing services and drawing increased resources therefrom.

4.4 Review of the Tax and Revenue System of Local Bodies

It appears that, to benefit from the allocated resources, the recovery capability of local bodies should be improved. For this purpose, an effective mechanism should be created to collect revenue according to the given power.

In the local bodies of Nepal, the tax administration system does not seem efficient. Although the Municipalities have units to look after tax and revenue, effectiveness has not been attained in important revenue related tasks like assessment of potentials, revenue planning, attempts at collecting revenue, inspection, review etc. For example, there is no data in the Municipalities showing even revenue potentials. The status of the VDCs is still more serious. The VDCs lack manpower and planned programme for revenue is insignificant. In the DDCs too there is no unit for revenue and planned attempt has also not taken place. In sum, revenues that can be collected without solid attempt or planning are the main resources of the VDCs. There is lack of political commitment and neutrality in revenue mobilization.

Desired improvement in the status of tax and revenue mobilization cannot be achieved unless there is the formation of a tax and revenue system, supply and quality improvement of human resource, meaningful endeavour, monitoring and reviews. It is necessary that attention of local bodies, their apex associations and HMG must be paid towards this issue and different programmes should be carried out in joint endeavour.

Status of the Basis of Tax

If the present arrangement is compared with international assumptions, principles of taxation and convention, the powers given to local bodies in Nepal should be considered adequate.

In observing the customs of many developed and developing countries, house and land tax is found to be the largest resource of the lowest bodies. This power is given to the VDCs and the Municipalities in Nepal as well. Although the house and land tax is a constant source and is remarkable in terms of yield, there are no two opinions on the fact that from the point of flexibility and buoyancy, it is a weak source, because the valuation of land and house cannot be repeated and up-dated in short periods. Side by side, the tax administration machinery has to be very capable and efficient for this purpose. Nevertheless, the result of the yield of house and land tax reflects the endeavour of the local body. Seen from this parameter, the VDCs and Municipalities of Nepal are found lagging far behind the present potentials.

After house and land tax, professional tax and entertainment tax are also seem important from the view of the three indicators - flexibility, buoyancy and yield. There is a great potential for the local bodies of Nepal to mobilize ample revenue by using these taxes. This can be a great source specially for the Municipalities, and to some extent for the VDCs. But viewed in totality, these taxes have also not been mobilized satisfactorily compared to their potentials. The natural resources utilization tax has remained an important source of revenue at present, and, if properly managed, it can remain a good source. '

Under the utilization of natural resources, different policies should be made regarding non-regenerative resources like boulders, aggregates, sand and soil and regenerative resources like herbs, solvent extraction, hyde and skin, feather, and dry grass (Bankes). Otherwise, there will be imbalance in the environment, and the budget allocated for their improvement will be more than the revenue gained from them. Presently such powers are given to the intermediary body - the DDC. But, in the long run, the power to raise revenue from non-regenerative natural resources should be given to the lower local bodies and the power to raise revenue from regenerative natural resources should be given to the intermediary body - the DDC.

About Clarity in Tax and Revenue Power

Most of the powers developed by the present Act and Regulation were given in the past also. But there was limited endeavour to implement those powers. Local bodies were indifferent to mobilize revenue from local resources for various reasons such as : in some cases it was difficult

to implement (like, the house and land tax was not implemented because of record, valuation system and political reasons); in some cases, the yield was not attractive, and various other reasons; the local bodies had dependent mentality; fear of being unpopular, and inability to establish interrelationship between services and revenue; and the absence of environment to ask the citizens to pay revenue.

Under the circumstances, it is felt that sufficient study had not been done about the complexity and problems of collection, because the present Act and Regulation have provided nearly the same kinds of power, have provided no clear explanations and there are no additional guidelines regarding the collection of tax revenue. Therefore it is necessary to consider why the earlier powers for additional resources could not be implemented; what kinds of assistance from what agencies will be necessary for effective implementation and how it would be practical to implement (introducing all taxes simultaneously or implementing in phases).

It is also necessary to provide guidelines/directions regarding the definition, explanation, assessment, billing, collection, follow-up, planning and policy of taxation.

Problems Created by Exemption of Local Taxes

The existing taxation power given to the local bodies seems to have shrunk because of exemptions granted under various laws. There is a provision about tax exemption in transactions related to public utility institutions (water supply, electricity, telecommunication), educational institutions (universities), Pashupati Area Development Fund and Guthi Sansthan (Religious Endowment Corporation). In particular, the public utility institutions are profit oriented and they have been charging the local bodies the same tax or fee as other customers. So exemption of tax in their case does not look justified.

Problems of Local Bodies' Data Regarding Revenue Administration

Data is one important element of revenue administration. The data management of local bodies in Nepal appears very weak. No local body has a record and data about how much revenue would be mobilized from any source. After the transfer of land revenue from HMG to the local bodies, the records are not updated. There is no assessment of the potentiality of natural resources. Thus, instead of the identification of tax payers, their participation and monitoring, local bodies have been mobilizing revenue on the basis of traditional practices. There is a practice of assigning low importance to data regarding organizational structure and human resource management. The tradition of making policy and doing revenue mobilization after the analyses of data has not been developed yet.

Under such circumstances it is difficult to assess the fiscal capability and fiscal achievement of the local bodies. On the other side, the local bodies also have no knowledge about what aspect to be emphasized to attain higher success. Therefore it is necessary to develop a system of maintaining revenue related data in order to make the local bodies fiscally more capable.

Deciding Tax and Tax Rate after Assessing the Impact of Tax on Local Economy

Tax and fee directly affect the people (users). Tax also has an impact on the development of trade, market and in attracting or distracting industry.

It has been found that the local bodies have done some positive work in the context of improving tax and fee. Examples are found that some Municipalities have done interaction with some professional organizations and have involved those organizations in the collection of taxes as well.

Similarly some local bodies have adopted a process of collecting revenue in collaboration with industrialists or the concerned party. It will be useful to encourage this process. It is felt that this process has increased the cooperative feeling of the industrial/commercial class towards the local bodies.

It is necessary to consolidate such successful and innovative processes and try to use elsewhere as well. Side by side, it is necessary to develop the process of involving the concerned tax payers before taking the tax decision.

4.5 Power and Source of Tax Revenue of DDC

The Local Self-Governance Act has made provision for tax, fee and revenue resources for the DDC. The heads for allocation of revenue have been discussed in Chapter 5. In this section, mention is made about subjects related to mobilization of internal resources. Those sources of revenue are presented in table 4.14.

Table 4.14
Sources of Revenue of DDC

1.	Tax	Wool, solvent extraction, herbs dry grass (bankes) Kabadi (reusable solid waste) boulders, slate, sand, animal bone, horn, feather, hyde (export tax)
2.	Service charge (in services provided by DDC)	<ul style="list-style-type: none"> - Road, bridge, irrigation canal, pond - Guest house, library, medical centre, Inn, community hall - Canal, water source (irrigation), embankment - Local Development Fee
3.	Fee	<ul style="list-style-type: none"> - River rafting, boat, tuin, fishing permission and renewal - Registration and renewal fee for water bank - Recommendation fee - Others
4.	Sales	- River sand, aggregates, boulders, slate, soil, swept away wood
5.	Loan	- Borrowing from bank or other Institutions with or without collateral with approval from District Council and on guarantee from HMG

4.6 Power and Source of Revenue of Lower Local Bodies

The sources of revenue of the VDCs and Municipalities according to the present Act and Regulation are given in table 4.15.

Table 4.15
The Sources of Revenue of VDCs and Municipalities

Resource	VDCs	Municipalities
1. Tax	<ul style="list-style-type: none"> - House and land tax - Land revenue and tax - Haat bazaar tax - Vehicle tax - registration, renewal and lump sum 	<ul style="list-style-type: none"> - House and land tax - Land revenue and tax - Integrated property tax - Vehicle tax - registration, renewal and lump sum

<i>Resource</i>	<i>VDCs</i>	<i>Municipalities</i>
	<ul style="list-style-type: none"> - Entertainment tax - Bahal Bitauri (rent) - Advertisement tax - Professional tax - Commercial video tax - Natural resource utilization tax - Other - collection and saving tax 	<ul style="list-style-type: none"> - Entertainment tax - Bahal (rent) - Advertisement tax - Means of profession tax - Commercial video tax
2. Service Charge (in services provided by it)	<ul style="list-style-type: none"> - Sanitation - use of drainage - Tourist Site Entrance fee - Park, garden, view tower - Fee for entertainment like magics, circus etc. - For recovering dues for others 	<ul style="list-style-type: none"> - Parking fee - Water supply, electricity, tap, public telephone fee - Solid waste, sanitation, sewerage fee - Public lavatories, park, bath room, swimming pool, gymnasium, guest house, tourist site, hostel, haat bazaar, slaughter house, crematorium, use of washing space, street light, road, drainage maintenance. - valuation of real estate (fixed assets)
3. Fee	<ul style="list-style-type: none"> - Television, video and other equipment license fee - Approval fee - Recommendation fee 	<ul style="list-style-type: none"> - Approval and recommendation fee - Approval of building design fee - Attestation of maps fee
4. Sales	<ul style="list-style-type: none"> - Soil from fallow govt. land - Product from public pond - orchard - VDC property - Dry wood, fire wood, branches, roots - 'Khar' grass 	-
5. Loan	<ul style="list-style-type: none"> - Loans from bank or other institution with approval from Council, with or without collateral and on government guarantee 	<ul style="list-style-type: none"> - Loans from bank or other institution, with approval form Council, with or without collateral and on government guarantee

4.7 Rates of Tax Revenue

The Local Self-Governance Regulation makes mention about the rates of sources of revenue of the local bodies. In the Regulation there are sources for tax rates with minimum and maximum limits, fixed rates and rates to be determined by the local bodies. Those sources are presented in table 4.16.

Table 4.16

Powers of Local Bodies for Determining Tax Rates

Sources with fixed rates	Sources with minimum and maximum limits	Sources in which the Council can determine rates
DDC		
<ul style="list-style-type: none"> - Export of goods made in the district, unrestricted animal products, herbs, agro, by product, forest based and mine based products like sand, boulders, slate - Reuseable materials in domestic industries - Resueable solid waste; feathers of unrestricted birds; service charge on canal/embankment; licence and renewal on river rafting, tuin and fishing; and cable car operation 	<ul style="list-style-type: none"> - Natural resource utilization tax - Other recommendation fee 	<ul style="list-style-type: none"> - Unrestricted animal bones and horns export - Guest house, library, medical clinics, Inn, Community hall
Municipalities		
-	<ul style="list-style-type: none"> - House and land tax - Land revenue and tax - Vehicle tax - Entertainment tax - Rentals - Advertisement tax - Professional tax - Commercial video tax - Other recommendation fee - parking charge (Municipalities only) 	<ul style="list-style-type: none"> - Bus park with utilities if constructed by self
VDC		
	<ul style="list-style-type: none"> - Haat bazaar, shops (tax) (VDC only) - Local collection and storage (VDC only) - Utilization of natural resources (tax) (VDC only) - Other sources like the Municipalities (tax) 	<ul style="list-style-type: none"> - Service Charge

4.8 System of Revenue Collection of Local Bodies

DDC

It has been seen that from among the powers vested in them, most DDCs have been collecting tax on export of products, reuseable materials (Kabadi) tax through contractors. Similarly, some

DDCs have collected these taxes through their own manpower. The management of the revenue received either through contractors or through self effort is done by the fiscal administration section. In the Municipalities, a Tax Section has been started within the organizational structure for collecting revenue.

For the purpose of taxes, the Municipality has to form a valuation committee. That committee makes recommendations regarding the processes of valuation, determining the tax rate and collecting revenue. Thus, priority has been given to property tax and an institutional arrangement has been made, but most of the Municipalities have not moved very far.

In the present arrangement, if there is no satisfaction in the decision of the committee, there is a provision of complaint to the Mayor, and the decision of the Municipality (board) becomes final. In the practices of other countries, there is a separate agency to look into the complaints, and, if its decisions is not acceptable, the court can be moved. In the same way, regarding the provision that a given valuation and tax cannot be amended for five years, it looks reasonable to change the tax rate even if the valuation remains unchanged.

Although the Municipalities are more efficient than the DDCs and VDCs in terms of revenue collection, they have not been able to collect revenue from all sources. The process of tying tax with services has also not started.

VDCs

The system of tax - revenue collection of the VDC is the least developed. Except a few Municipality oriented VDCs, most VDCs have not done tax collection effectively under the present arrangement. The thought of providing higher services to the people by mobilizing increased resources has not been developed and the main source of revenue of the VDCs is the grant-in-aid.

4.9 Fiscal Powers and Status of Local Bodies : Problems and Challenges

- Many tax and revenue powers have been given to local bodies. Yet only some main taxes are important from the view of local resources - (adequacy, buoyancy, potentiality) - like property based tax, professional tax, entertainment tax, export tax and natural resource utilization tax. Even among them, for the sake of most of the VDCs in the hills, the property based tax is the most important one. Talking of the property based tax, in many hilly and mountainous VDCs, the administrative cost of collecting the tax and workload will be much higher than the revenue so collected. Similarly, in the case of other sources of tax as well, the capability of local bodies to determine fixed tax rates is very low, keeping in view the facilities/services provided, their tax policies and the fiscal and environmental factors. Thus, even after getting fiscal powers, there has been no special improvement in their previous economic condition due to the lack of organizational capability and the shrinkage of autonomy.
- Even though the fiscal resources of local bodies are scarce, delivery of public services can be done through other alternative means - like the mobilization of the private sector and NGOs. But in practice, there is very low involvement of the private sector and the NGOs in the government functions of service delivery. In the case of the local bodies, the real condition reflects lack of mutual contact and attitude among the local bodies, the private sector and the NGOs. Sometimes the mutual attitude appears to be that of competitors. Because of this, there is lack of coordination and cooperation and the assumption has not been established that they are complementary to each other.

- There is no capable and effective organization to invest loan to the local bodies. Though there is a Town Development Fund Board for the sake of the Municipalities, it is not in a position to fulfil the needs and demands of all the Municipalities. For the sake of the DDCs and VDCs, there is no such body. It has been necessary that the government mobilizes fiscal resources for long term investment. The Town Development Fund Board should be made capable to fulfil all the needs of the Municipalities.
- It did not become evident that by giving the power to mobilize fiscal resources, the revenue would be collected. Land revenue and the household tax can be cited as its example, and the situation still persists that much more effort should be made to collect house and land tax to the previous scale.
- The central government had collected Rs. 6,10,00,000/- as land revenue in FY 1994-95 while the local bodies could collect only 2,96,00,000/- including arrears in FY 1998-99. This collection has challenged the assumption that the local bodies can mobilize greater revenue. The local bodies, DDC and Municipalities, had collected Rs. 29,93,16,000/- and 1,04,25,02,000/- respectively as revenue (including octroi, miscellaneous taxes and fees), which form 0.79% and 2.76% (respectively) of the total revenue of HMG. Even in the tax actually collected the ratio of indirect tax is predominant. As the representatives prefer the indirect tax, it has been a challenge to attract the local bodies toward direct taxes.
- All local bodies have tried to collect taxes on the export of products. In giving such power to each local body, there will not only be impediment in the free flow of goods by the frequent road barriers in short distance, but it will also harass the business people. If local bodies are prevented from taking taxes on local products, there is no better alternative in the present circumstances. There is no provision for the government to impose tax on agricultural products at present, and, if the local bodies also do not impose tax on it (mainly cash crop and the cereals with mass production), the potentials for local taxation will be just left out. So, a simple but effective alternative way should be explored to systematize it.
- The Councils have the power to determine the taxes of the local bodies. The Council makes the tax decision without consulting the tax payers. This practice has resulted in a vast difference between the estimation and actual collection. Paying attention to the fact that involvement of the tax payers in determining taxes results in better revenue yield, effectiveness in revenue mobilization should be brought by making institutional arrangement for involving tax payers and concerned organizations in the process of tax determination.
- The Local Self-Governance Act, 1999 has given the local bodies the responsibility of protecting and utilizing the fallow land not owned by HMG or any one lese. But it has not transferred the ownership. It cannot be believed that the responsibility without ownership can guarantee protection and best utilization of such property.
- In Nepal there are various physical and natural heritages. There is great revenue potentiality in them. But such a work needs management capability and investment as well. Realizing this reality, there is a tendency that the local bodies give out natural sites of importance like lakes/pounds on long term lease.
- With respect to giving out such natural heritage on long term lease, the central government should assist the local bodies by providing policy and guidelines.

4.10 Areas of Improvement Needed in the Revenue Rights of Local Bodies

4.10.1 DDC

Improvement needed in the current sources

- (a) Although the sources of tax revenue given to the DDC appear appropriate, it would be expedient to make the following changes²⁰:
- Regarding the non-regenerative natural resources, the authority should be transferred from the DDC (presently holding) to lower local bodies, because the exploitation of such resources will have impact on local environment and VDCs and the Municipalities are responsible for soil conservation and other environmental protection. If there is a system of the VDC and Municipality sharing revenue from such resources with the DDC, it would be comparable with the provision of the lower local bodies sharing such revenue with the intermediary local bodies in other countries. If such natural resources are exported abroad as raw materials, it would be appropriate to devolve such right to the DDC.
- (b) The DDC has been given the right to levy tax on export from the district. The export tax mainly includes herbs, bones and horns, feather and raw materials from forestry products. It is good to export bones, hydes, horns and feathers of unrestricted, dead animals as much as possible, but special attention needs to be paid in the export of herbs. But realizing the fact that attention should be paid to the protection or conservation of endangered species of herbs, it would be appropriate to give the local bodies the right to identify the endangered species and determine these rates for the export of other herbs. Similarly, if there is a commercial farming of herbs for export, it would be good to levy less tax on its export and to share the revenue with the lower local bodies. Likewise, the DDCs are experiencing great difficulty that, in the case of raw materials from forestry and agricultural products, some species have been named with rates like wheat stalk, dry jungle grass, but there is none in the case of dry corn plants. Therefore there should be a provision that DDC itself should levy taxes on such items. Likewise, a better substitute for road barrier should be identified for the sake of export tax. Otherwise, it would be necessary to have barrier in each frontier and it would be improper. Levying taxes on the source itself in consultation with the tax payer would be proper.
- (c) Under the Kabadi, tax has been fixed on export of non-reuseable materials. If these materials are really non-reuseable, it would be better to encourage their export rather than tax them. But, if these so called non-reuseable materials are being exported inspite of the tax, the exporter must be making a profit (and it must be reusable), imposing tax on such export should be continued.
- (d) There is a provision of export tax on materials re-used by domestic industries. In such materials are included such items that can be re-used after washing, like soft drink bottles, reuseable after purification like pieces of polythene pipe, and used papers. Although taxing the re-useable materials is justified, taxing the materials which can be reused by the same industry alone is not justified because they have been paying professional and income taxes. Therefore it would be appropriate to waive taxes on materials carrying brand name, like soft drink bottles, that can be used only by the same company.

²⁰ The report of the High Level Decentralization Committee, which is presented to HMG, includes recommendation on various subjects. (Pages 84-93).

Viewed from another angle, re-useable materials can be taken as raw materials. Therefore, it would be more useful from a long term view to tax the unit of product rather than taxing the transportation of raw materials. But, viewing from the income aspect of the DDCs, it would be useful to have a gradual removal strategy in a few years.

- (e) Mentioning roads, track, bridge, pond and irrigation as tax base has helped to inflate the list of tax authority of the DDC. But it does not look like an independent source. There already being a provision that service charge can be collected from such facilities constructed from internal resources, and that natural ponds are under the ownership of VDC or Municipality, this is not a solid tax base.
- (f) It would be appropriate to hand over projects constructed in collaboration with HMG and donor agencies to the local bodies, make them responsible for operation and maintenance and be authorized to levy tax or service charge on such utilities.
- (g) After HMG started distribution of passports from the District Office, the DDCs have been making income as fee for recommendation. This source should be legitimatised.

Additional Sources of Taxes and Revenue to be Given to DDC

(a) Tourism Fee

In FY 1998-99 the amount raised as fee for mountaineering and trekking was Rs, 25,42,00,000/-. Tourism-trekking fee is not a good tax system. The pressure of services and facilities used by the tourists falls on the VDCs and Municipalities. As it is not possible to ascertain which VDC or Municipality shared what amount of pressure and as it is administratively not proper to have a transaction between HMG and the VDC or Municipality, the share of such fee should be realized by the service providing body as additional fee. But such additional fee rate should be fixed in the maximum.

(b) Registration and Renewal Fee

It would be proper to delegate the authority to the DDCs to register and renew the cooperatives. Kabadi and user groups and collect fee for such services.

(c) Agro Products District Export Tax

Instead of giving the DDC the right to collect export tax from agro-products (commercial and cash crops) and use barriers in several places, it would be more appropriate to realize the tax from the source or from a single place.

(d) Tax Authorities to be Transferred from Other Bodies

Cottage Industries Registration and Renewal Fee: At present, the central agency has been registering and renewing the cottage industries, but the central agency has not been making a good income from it. It is rather experiencing various administrative botherations. If this authority is given to the local bodies, the owner will find it easy to register and renew, the local bodies will find it easier to realize other taxes as well, and it will help the local bodies to increase their investment in the promotion and encouragement of such industries. Therefore, it will be appropriate to transfer this power to the DDCs after developing their organizational capability, data and information system.

4.10.2 Lower Level Bodies

Improvements Needed in the Present Sources

If the following arrangements are made regarding the source of revenue of the lower level local bodies, it will be more effective.

- (a) The nomenclature of Integrated Property Tax implies both the fixed property tax and wealth tax. But the intention of the law appears to be fixed property tax, that too, house and land tax. Therefore, it would be better to change the name from Integrated Property Tax to Integrated House Land Tax. As the fiscal administration of the Municipalities can be systematized by associating many other taxes and fees, the integrated property tax should be made compulsory rather than optional in future. Although a few Municipalities are moving ahead to impose integrated house-land tax, the capability of many others is not yet developed. Therefore, for the present, the option whether to implement the integrated house land tax or not should be kept open. In the present condition, the tradition of realizing property based tax can be started from the collection of the house land tax. It is necessary to have a thought that starting in this way, the tradition and capability can be gradually consolidated leading to full implementation of the integrated house land tax.

It would be appropriate for the VDCs also to have a provision of implementing the integrated property tax as far as possible, like that of the Municipalities described above. But, in the case of the VDCs, the value of the house should be based on the type or quality of the house, and the value of the land on which the house is constructed should be equal to the value of cultivated land used for land revenue purposes. Because of the lack of adequate physical facilities in the VDCs, a separate valuation for the house - land does not appear justifiable. Regarding the house and land tax, the household tax should be fixed as per the type of house and the house land tax should be at par with the rate of cultivated land revenue. The VDCs neighboring big cities and the VDCs along the highway should be given the authority to implement the same house and land tax policy as the Municipalities. While the tax presently being realized by the Tax Office will be implemented by the VDCs and Municipalities, changes should be made in the rates mentioned in the Regulation if necessary.

- (b) The entertainment tax and house land tax should belong to the VDC and the Municipality, and policy should be adopted to hand over these to the VDCs and Municipalities in the long run. This policy is reflected also in the Budget Speech of FY 2000-2001. These sources of tax will prove to be a great resource for the VDC and the Municipality in future. But, for the present, these taxes should be collected in the joint effort of the government and the local bodies and the revenue should be divided. Gradually, the full responsibility of collecting such tax should be transferred to the local bodies. The tax from commercial video using dish antenna should be included under this.
- (c) The commercial video tax should not be realized as a separate tax because if tickets are sold, it can go into entertainment tax and if video show is operated without tickets, it can be included in the professional tax.
- (d) There should be the provision that the vehicle taxes should be integrated, realized by the government and the VDCs and Municipalities should be given their share of tax. After the termination of the lump-sum tax on the highways (the provision of tax vide Means of Transportation Tax Act, 1974, Amended, Art 12), this provision should be implemented. A provision can be made that the revenue raised from this means should be invested in the construction and maintenance of road. It would be appropriate to give the power of identifying taxable vehicles and public means of transport (vehicles, roads, cable cars etc) and determining the rates of tax on them, to the local bodies, and if such facilities involve more area than a local body then there should be a provision of joint taxation.

- (e) It should be explained that the income from sale should be entered as income by selling products from government or public land, ponds and property under the ownership of the concerned local body. The present provision mentions dry grass, grass, branches of trees, firewood and there is a confusion if it applies in the case of government or community management forest products as well.
- (f) Only the VDCs have the power to get a share from other agencies for realizing their arrears or dues. Many governmental, non-governmental agencies and local bodies have to realize taxes, fees, fines, service charges and other dues from citidwellers in the Municipal areas. It will be very expensive for such agencies to collect these arrears by themselves. Therefore, such power should be given to all the lower bodies for which they should be given some commission. There is the possibility that such arrears can be realized together with the collection of their own tax, fee, charge etc.
- (g) The local body should be given the power to fix the rte of fee like Kanjihouse forestry cattle fees, approval fee, on the basis of cost involved.

Additional Tax Resources for Lower Level Bodies

Mention has been made here about the tax source of tax left out in the present Act and Regulation, long term policy direction or thought for resource mobilization by the local bodies:

(a) Registration Fee of House Land

According to the present provision, 5 to 90 per cent of the registration fee (for house and land) is given to the DDC. It looks appropriate that part of this money should be allocated to the VDC and Municipality for the development of their respective areas. In addition, in the case of municipalities where the consolidation and development of land has been implemented, and after the adjustment of units of land through measurement, it would be appropriate to adopt a long-term policy of transferring the power of registration to the local bodies, if they develop their capability to do this function in accordance with the prescribed legal process.

(b) Tax, Fee on Boulders, Sand, Aggregates

At present, the Municipalities have not been given this power, it is only partially given to the DDCs and the VDCs. In most of the Municipalities in Nepal, there is a predominance of rural areas rather than urban areas. In this context, this power should also be given to the municipalities. Because of the absence of this power (in the Municipalities), there has been confusion and tension between the VDCs, Municipalities and the DDCs regarding the export of sand, boulders, aggregates etc. In this respect, the natural resources utilization tax, particularly on non-regenerative natural resources, should be given to the VDCs and the Municipalities. In addition, in order to check the uncontrolled use of this power by the VDCs and Municipalities ,there should be the provision of constantly reminding them that such resources should be used without damaging the natural balance.

Therefore, there should be a provision that the power of taxation over the use of boulders, aggregates, sand and soil should be given to the VDCs and Municipalities, and that 25% of such revenue should be shared with the DDCs.

(c) Environmental Conservation Fee

India and some other states have levied environmental conservancy fee/tax. The Municipalities are found to be collecting this fee in unison with other universal tax. It appears appropriate that the VDCs and Municipalities in Nepal also should realize this fee together with the house land

tax, keep such revenue in a separate account, and use it in programmes of environmental conservation, improvement and awareness generation.

(d) Recommendation Fee for License to Sell Alcohol (Wine)

Presently there is a provision that the Value Added Tax office issues license for selling alcohol (wine). Local bodies have no power in it. But control of alcohol and management of alcohol sale is a matter affecting the local people. So, such a license should be issued only on the recommendation of the VDCs or the Municipalities. In issuing such recommendations, the local bodies can charge a fee and increase their revenue status.

(e) Community Forest

In the community forestry development programme, if local bodies provide assistance on demand from the forestry product users, and if they get a certain percentage of revenue, from export of the forest products for commercial purpose, it would create an atmosphere of complementary efforts and there will be continuity in the tax realization.

(f) Fee for Approval of House Design to the VDC

It appears appropriate that the VDCs should have a provision of approving the design of house in their bazaar areas. In future, after the development and expansion of settlements, the VDCs will gradually develop into Municipalities. Therefore, with the objective of starting the process of development of systematic settlements, it is necessary to determine the plan of development of settlement and the Bazar (market). It would be proper that the VDCs start the process and raise the revenue from the very beginning. Similarly, in the case of parking fee and other provisions in the Municipalities, the VDCs should be authorized to levy such fee if the basic facility and infrastructure are prepared.

(g) Tax Authorities to be Transferred from Other Agencies

Entertainment Tax: The central government is collecting an entertainment tax or movie development fee from the cinema halls and there is a provision for some additional tax by local bodies. The centre has not been able to collect a remarkable amount from this arrangement. So, ending this duality, the local bodies should be given the entire authority and there should be provision of choice between continuing the present practice of specifying tax on tickets or, after assessing total capacity, decide a fixed lump-sum tax amount.

Rent Tax: There is a provision that local bodies can raise additional fee, like entertainment fee, for letting their area be used or rent. In the present condition of the central body not being able to collect substantial amount from rent, it should also be handed over fully to the local bodies (like the entertainment tax). In the FY 1998-99, the Government had collected Rs. 20,04,00,000/- from Bahal tax. But a policy should be adopted that this power should be transferred only after verification that local bodies have the institutional capability and statistical basis to raise higher amount than this.

Water Tax: The provision of the central government realizing water tax in big projects has not been implemented effectively. If this power is given to the local body, the water tax can be realized along with the land revenue.

Sewerage Fee: The Nepal Water Supply Corporation adds 25% sewerage fee in its water supply bill. In the condition that the burden of operation of the sewerage is falling on the local bodies, this right should be transferred to the local bodies and, it would be best justified if such revenue is spent on the development of that concerned area. In addition, there should be a necessary provision that such revenue must be invested in repairing and maintaining the drainage pipes and in purification

or treatment of the polluted liquid from the sewerage. In transferring the responsibility of sewerage to the local bodies, the manpower, budget and other responsibility of the central agency should be reduced and additional revenue sources should be created for the local bodies.

Vital Statistics Registration: Income from vital statistics registration should be handed over to the local bodies.

Services and Service Charge: In the Form of Long Term Thinking - If the local bodies buy public utility services like electricity, water supply, telephone etc. in bulk and redistribute among the local dwellers, there is a possibility of increasing their income. Local bodies in India and Bangladesh are making remarkable income from this. In such bulk purchase and sale of such services, the local bodies can make profit on the basis of efficiency and, while collecting such service charge, they can realize other taxes or fees also from the users. If bulk purchase is not possible, local bodies can help realize the fee or charge from the users on commission basis and this will facilitate easy payment for the local users as well. It appears appropriate that complete responsibility of managing water supply should be gradually transferred to the local bodies.

Development and Utilization of Physical and Natural Resources, In the Form of Long Term Thinking:

(a) Mines:

Excavation of mines has been done in Nepal only to a limited extent. In a few places small coal mines, slate mines and other minor minerals have been exploited. In accordance with the discussion earlier done about boulders, sand and aggregates, the local bodies should be given the authority to levy taxes on semi-precious objects (stones) and professions based on non-metal minerals. The power to issue and renew license for excavating such mines should also be given to the local bodies. It looks possible to adopt long term policy that the VDC should be given the right to realize taxes on semi precious and other mineral resources and for allocation with central agency.

(b) River, ponds, stream, water:

There is a possibility of raising revenue from the traditional sources of water use like generating electricity, running small water mills, fishing and direct sale of water.

(c) Fallow-land, gorges and sandy river side:

Owing to the provision that fallow land, gorges and river sides not under any one's ownership, belong to the Govt, the local bodies are only looking after such lands and no attention has been paid towards their proper utilization. New ways of utilizing such sources are being explored: like golf course, adventure climbing, park and garden development, cultivation of herbs etc. Such activities help the local bodies to increase their income. Therefore, it would be appropriate to hand over such lands to local bodies.

(d) Lakes and ponds:

In Nepal there are different kinds of lakes and ponds in different locations. They have great touristic potentials and have a great contribution in maintaining bio-diversity. Income is also being made from fishing in the lakes/ponds. There is a possibility that the local bodies can make great income from the conservation, development and utilization of such lakes/ponds. If tourist travel routes, boating, hotel resorts etc. are created, such lakes and ponds can become source of best income. There should be a provision that the DDC also gets 25% of such revenue.

4.11 Improvement to be Made in the Rates of Tax - Revenue

Some policy wise difficulties have been experienced in the rates of tax : for example, the DDCs should be given the right to fix the rate of fee on facilities constructed by themselves or handed over to them. They should be authorized to determine service charge and fee in other areas. Tax rates fixed for valuable objects like herbs appear to be very low. Similarly, in the case of consolidated property tax, the highest limit is fixed at Rs. 15000, whereas, on the basis of valuation the house and land tax can be more than lakh rupees. The land revenue and tax is so low that in certain circumstances, the amount of revenue cannot afford even the paper cost of providing receipt and maintaining records. Because of these facts, revision of tax rates has been necessary.

Recommendations regarding rates of tax and utilization

The Act and Regulation have not given the local bodies an authority to independently determine the rates of taxes to be mobilized by them at the local level. There are provision of fixing minimum and maximum limits of rates of taxes, fixed rates and discretionary fixing the rates on the basis of international practices. Yet it would be appropriate to make the resources in those categories more flexible in favour of the local bodies. For this purpose, the following suggestions are made:

- (a) Keeping the present authority of self determination intact, the authority to fix rates of service charges and sources under sales should be given to the local bodies.
- (b) In the case of taxes and fees having impact beyond the boundary of the local bodies, the maximum and minimum limits should be fixed or their basis should be specified. The terminal figures of rates should be revised and should be fixed with widespread consultation, interaction and discussion.
- (c) In the case of activities like excavation, export and sale of natural and physical resources, authority should be given to the local bodies to determine rates of tax with the involvement of the concerned agencies/parties.
- (d) There should be a provision of creating an organizational mechanism (like local body tax consultation committee) at the local level for the sake of carrying on interaction with concerned agencies before activating the basis of tax and fixing tax rate.
- (e) It would be appropriate to start a tradition of involving representatives from local bodies in determining the rates of tax and fee to be shared with the local bodies and in the revenue consultation committee.
- (f) It would be appropriate to utilize the revenue in the development, conservation and consolidation of the same source from where it has come.
- (g) The tradition of taking service charge or fee from the professionals attracting or serving the tourists should be encouraged and the direct personal entry fee from tourists should be discouraged.
- (h) As the local bodies have to increase the job opportunities at the local level, they should hold, practical viewpoint with regard to the selection of the type of industry and provide them attractive incentives in the legally applicable tax..

4.12 Scope of Improvement in the System of Revenue Collection in the Local Bodies

Recommendations Regarding Revenue Collection System of DDC

With regard to the systems of tax and revenue collection, the DDCs use contractors or manage it themselves. The system of collection in the DDC is developed, but the determination of tax is not done in a scientific manner. The process of preparing the tax structure in consultation with the tax payers has not started. There is the predominance of the contract in the fiscal administration of the DDC, but there are legal obstacles and processual confusion in the ways of using the contractual practice in all the taxes and revenue. Therefore there is a need for an exit in this respect. Similarly, the DDCs should conduct a study about the potentialities of tax and revenue within their tax revenue jurisdiction, collect necessary data and formulate policy on this aspect.

There is a need that the DDCs should assist the VDCs specially in the function of tax - revenue collection. From this ratio of revenue that the DDCs get from allocation will increase. Therefore it is necessary that the revenue administration unit of the DDC provides support to the VDC as and when requested. It would be appropriate to keep a provision that for such purposes the DDC can have service contract with the private sector or the NGOs.

Recommendations Regarding Tax, Revenue Collection Systems of VDCs and Municipalities

The pattern of collection of some main tax sources of the VDCs and Municipalities are described in the following paragraphs.

(a) Property based tax

There is the need for a special provision for the implementation of the property based tax (house land tax, land revenue and land tax) in the local bodies. HMG had collected Rs. 12,33,27,000/- from the house land tax in 1998-99 FY. Under the circumstances, if the local bodies are to implement the house land tax seriously, the present pattern is inadequate. As the house land tax is more complex than other taxes, is more sensitive, and requires more effort than other taxes, the house land tax should be implemented only after detailed prior preparation. Therefore, the integrated house land tax should be implemented in phases. For this purpose, in the initial phase land revenue and tax and house land tax should be collected according to Art 136 of the Act, make other institutional preparations and implement the integrated house land tax according to Art 140 of the Act. Thus a separate system seems to be necessary regarding the house land tax and it is necessary to assist the local bodies in their function. Actual data is required for imposing property tax and its pre requisite is the house numbering. Some Municipalities have completed this work, this is ongoing in some, but the VDCs have not started the process of house numbering.

As HMG has stopped from FY 1999-2000 the collection of urban area house land tax, imposed as per the House Land Tax Act 1962, it has to be adjusted for the sake of realizing the arrears and changing the tax rate. The VDCs and specially the rural shaped municipalities have to drop the Household tax in order to start the house land tax. But there being exemption of tax upto the property value of Rs. 10,00,000/- (one million) most of the houses in such local bodies will not come within the boundary of the tax. Thus, keeping the needs of such local bodies also in view, it is necessary to revise the limit of tax exemption and inc case of house outside its ambit, imposition of the household tax should be kept open. But such tax should not exceed the minimum house land tax.

(b) Vehicle and Means of Transportation Tax

The present system is as follows:

- The registration and renewal fee is being collected by the Department of Transport Management.
- In the case of private and fare charging vehicles, both the vehicle fee and income tax are applicable;
- The occasional road permit fee is being collected by the Department of Transport Management; and
- Annual vehicle tax being collected by VDCs and Municipalities.

HMG had realized a total revenue of Rs. 31,50,00,000/- from the provisions of this tax authority, (the sub totals of Rs. 22, crore from the vehicle tax and Rs. 9.5 crore from the road permit tax). From a cursory view it appears possible that in the long run the local bodies collect all the transport taxes and pay the concerned agency of HMG the revenue accruing from the road permit tax and the vehicle income tax. But, in doing so, there will be difficulty for HMG in collecting necessary information concerning the data of vehicles throughout the country, assessment of imported fuel, for determining the vehicle import policy. Therefore, HMG should itself take this responsibility. In view of the present institutional capability of the local bodies also the allocation of this authority to them is not possible. Therefore, for the present, these taxes should be realized by the Department of Transport Management in an integrated manner, deposit 50% in the state treasury and, in the case of the remaining 50% send the proportional share on the basis of the residence of the vehicle owner to the concerned Municipality. The share of the VDC should be sent to the concerned DDC. It would be appropriate to adopt the policy that the Associations of the local bodies should be involved in this work and hand over the entire revenue to the concerned local bodies in phased manner.

The following sources of vehicles or transportation can also be mobilized:

- (1) Revenue should be raised also from means of transport like bullock cart, hand cart and bicycle by introducing a policy of registration and renewal. But in doing so, it is also necessary to provide additional facilities on account of their having paid the taxes. The additional facilities may be repair and maintenance of the roads, ownership certificate, parking space etc.
- (2) It would be justified to impose tax on vehicles carrying passengers or goods for passing through the local body's area, as they put additional pressure on the sanitation and other aspects of management. But because they would have already paid the road utilization tax to the Department of Transport, it would not be proper to put barrier at every local body frontier and collect taxes from each, and this provision has already been withdrawn too. Therefore, it would be appropriate to share part of such revenue with the concerned Municipalities.
- (3) It would be appropriate for the VDCs and Municipalities to take initiative towards developing parking facilities for such vehicles and charge appropriate fee for the use of such facilities. It has been seen in practice that vehicle trend to dodge such charge by parking elsewhere for which reason there is a high probability that it will not yield revenue. To alleviate this problem, the policy can be adopted to charge not the vehicles but the business establishments that spring around such facilities.

(c) Profession and Professional Tax

Local bodies have not been able to mobilize the professional tax effectively. For this purpose it is necessary that the local bodies have up-to-date record of the professions and professionals, an effective method of verifying if the tax has been paid or not, the process of action, the necessary documents, information, proof and receipt etc. Particularly in large Municipalities and town oriented VDCs, the system of management should be more capable and efficient. If this tax is in place, it will surely lead to remarkable increase in the revenue of the local bodies. Therefore, it is necessary to start a process of involving the professional organization of tax payers in the determination of taxes and associating the facilities to be provided to the taxpayers with the tax so decided. In the long run, after the development of institutional capability, this can be tied with the Value Added Tax.

In addition to the above, it appears that separate provisions can be made with regard to the professional and entertainment taxes for the VDCs and Municipalities on the basis of circumstances. The processions for other taxes and revenue seem to be all right. In the case of the DDC also, it would be appropriate to start a revenue mobilization unit and it should also help the VDCs in implementing the property based tax.

4.13 Recommendation and Suggestions

(a) Related to Tax-Revenue Authority

With regard to the tax - revenue authority of the local bodies, it has been recommended to review or improve in accordance with table 4.17

Table 4.17

Recommendations to improve the Tax-Revenue Authority of Local Bodies

	<i>DDC</i>	<i>VDC & Municipality</i>
Areas to be revised	<ul style="list-style-type: none"> - District export tax (by product from forest, livestock, agriculture) - Kabadi (re usable and non-reusable) 	<ul style="list-style-type: none"> - Consolidated property tax - Vehicle and transport tax : (unified collection system) - Income from sale
Recommendation for addition	<ul style="list-style-type: none"> - Registration and renewal fee (kabadi, user group cooperations), agricultural products (professional products and cash crop) export tax - Registration and renewal of cottage industries - Handing over new road, irrigation, water supply projects and authorization to raise service charge - Tourist, trekking fee (tied to the services they use). 	<ul style="list-style-type: none"> - Consolidated property tax and house-land tax in the VDC also - Entertainment and Bahal (rent) taxes to be totally transferred to local bodies - Entertainment tax from the show of video with dish antenna - Commission fee to the Municipalities for realizing arrears for others - Distribution of a fixed part of house-land registration fee from DDC - Sale of boulders, sand, aggregates and slate - Environmental conservation fee - Fee for permit of sale of alcohol - Income from community forest - House design approval of VDC - Water tax

	<i>DDC</i>	<i>VDC & Municipality</i>
		<ul style="list-style-type: none"> - Fee or sewerage - Income from vital registration
Others	<ul style="list-style-type: none"> - Redefining local development fee - Distribution of income from the sale of non-regenerative resources (boulders, and, aggregates slate) from the lower local bodies 	<ul style="list-style-type: none"> - Merger of commercial video tax in professional tax - Fixing of approval fee locally (as per circumstances) - Bulk purchase and sale of public service - Utilization of natural and physical resources

(b) Related to Tax-Revenue Rates

- Revision of tax-revenue rates: land revenue, house land tax, district export tax on cash crops and professional products etc.
- Identification of taxable objects from participatory method and authorizing local bodies to fix rate.

(c) Related to Fiscal Administration

- Developing a system in each local body of forming of Tax Fixing Advisory Committee together with the representation of private sector organizations and the civil society (NGOs) and fixing rates on the basis of its recommendation.
- Making a provision that the local body should spend bulk of the revenue from a sector in the improvement or development of the same sector.
- Make a legal provision that if, because of the failure to conduct a meeting of the Council, it is not possible to conduct basic services, pay bills of running projects, or the tax payers have difficulty paying tax, an all party meeting or some other method should be adopted to have continuity in fiscal operation.
- Develop data in each local body showing the potential and actual revenue collection.

(d) Encouraging Alternative Ways of Resource Mobilization

- For example by inviting the NGO, private sector or peoples participation.

(e) Granting Ownership Rights Over Properties like Fallow Govt. Land, Public Temples and Inns

- There is no proper protection and utilization of properties like public drainage, road, square, grazing land etc not belonging to HMG or any particular individual, because of lack of clear ownership rights of the local bodies. Making an inventory of such properties, a clear basis should be made by identifying the ownership of HMG of the local bodies. Provision should be made for the utilization of such properties by the local bodies for borrowing and income raising purposes without destroying their cultural importance and having no ill impact on the environment. In this context, action should be taken after reconsideration of recommendation form the High Level Decentralization Committee and the Task Force for the Alternative to Octroi.

(f) Loan and Foreign Grant

- Create an institution for providing credit (loan) to the DDCs and VDCs.
- Grant right to receive foreign assistance (grant or loan) by specifying condition and rationale).

(g) Preparing Policy and Procedure for Long Term Leasing

A beginning is made of the process of long term leasing of land, completed infrastructure and natural heritage for private sector investment and management. But because of the lack of a clear policy on long term leasing and the lack of technical capability, there have been questions regarding legality or regularity. It does not seem appropriate to allow leasing over 20 years as there is scant experience of the management of such lease, surety of service and the structure of the infrastructure, the capability and basis of assessing future potentiality and value is not developed and as such an action will narrow the rights and scope of office bearers to be elected afterwards. So, keeping the present process of leasing intact for 20 years, it is necessary to develop a separate policy for leasing beyond 20 years. So, HMG should prepare clear policy, procedures and processes about this and also provide technical assistance as needed.

Gradually Removing the Local Development Fee for Municipalities

The local development fee was imposed as a substitute for the octroi imposed by the Municipalities earlier. Presently this fee is collected and deposited by the customs offices. But, as this fee is not within the jurisdiction of the Municipalities, it is not a permanent solution. It does not seem appropriate to continue it long as it brings inaction in the Municipality's search for revenues. Therefore, assistance should be provided for effective implementation of the rights to tax revenue (house land, professional tax, entertainment tax, Bahal tax etc) and, as the capability grows, additional rights should be given. Along with the guarantee that additional revenue would be raised from other sources, the local development fee should be withdrawn on a fixed time table basis.

Financial Institution for Local Bodies

There has not been a provision for capital fund for fulfilling the responsibilities of the local bodies and for the sake of basic infrastructure. There is a need for capital among the local bodies to fulfil the growing aspirations of the people. In addition, local bodies have started preparing periodic plans for implementing which they need additional capital. But there is no financial institution to provide the needed capital to the local bodies. The reports of the Administration Reform Commission 1992 and Decentralization and Local Self-Governance Committee, 1997 have also mentioned the need for such an institution.

At present investment is flowing from the Town Development Fund, the Local Trust Fund and the fund of the local bodies. On the other side, savings are increasing in the local cooperative societies and community organizations. A need is seen for the creation of local bodies financial institution to assist all these efforts and provide the needed savings mobilization and credit flow to the local bodies. Similarly, the Town Development Fund should be strengthened to cope with the increased needs of all the Municipalities for credit flow.

Chapter Five

Provision for Central Grant and Revenue Allocation for the Local Bodies

In addition to the central grant for the local bodies, the Local Self-Governance Act (1999) and Regulation (1999) have, for the first time, made provision for the allocation of the central revenue. In this chapter, a description is given the central grant and the procedures of the allocation of the central revenue.

5.1 The Present Arrangement of Revenue Allocation

It has been mentioned in Art 236(1) of the Act that HMG will provide minimum grant to the local bodies and additional grants will be provided on the basis of population, level of development, capability and potentiality, status of income and expenditure and fiscal discipline etc. Although the tradition of central grant is old, there was no clear rationale or formula for distribution of grant. It is not even clear as to what extent those criteria have been followed. It has been experienced that, as the criteria of distribution have not been followed, the distribution has been haphazard, uncertain, unequal, unpredictable and vague.

The system of grant can be looked at from two angles. Those are: the grant to be given by the central Govt. from the allocation of revenue, and the lump sum central grant. In Nepal, the concept of grant from the allocation of revenue was initiated from the land revenue and house and land tax and recently the basis of this system of grant has been made broad and secure.

5.1.1 The Revenue Rights of the Local Bodies Provided by the Centre in the Form of Tax, Grants, and Allocation

According to the Local Self-Governance Act, 1999 and Regulation 1999, the provisions for allocation of revenue with the DDC are as follows:

- a. 5 to 90 per cent of the revenue raised from house and land registration fee;
- b. 50 per cent of the royalty from mines;
- c. 10 per cent of the income from forestry sector;
- d. 10 per cent of the income to HMG from electric power house; and
- e. 30 per cent of the income from tourist entrance.

Inter-Local Bodies Allocation of Revenue

The Act and Regulation have also made provision of allocation among the local bodies as well. Accordingly the VDCs and Municipalities have to share 25% of land revenue with the DDC. Similarly, the DDC also should share 35 to 50 per cent of the revenue raised from the sale of boulders, aggregates, sand with the concerned VDC or the Municipality. Likewise, 25% of the revenue from the cable car should be allocated to the concerned VDC.

5.2 Sources of Revenue to be allocated between the Centre and the DDC and Scope of Improvement in the Rates

House Land Registration Fee

The arrangement for the allocation of registration fee was started from FY 1999-2000. The percentage of its division does not appear progressive. According to the present arrangement to the DDC of the district, collecting up to Rs. one crore fees gets 60 lakh, and the DDC of district collecting 2 crore fees also gets 60 lakh only. Because it is unprogressive, it has caused difficulty in transferring the account on a trimester basis, as it is not certain whether the total revenue would be more or less than 2 crore. Taking the income of FY 1998-99 as the base, the estimated annual amount to be provided to the DDC was around 26 crore. But the cut in the rate of registration fee announced in FY 2000-2001 budget speech has had a great adverse effect on the income of the local bodies.

Royalty Raised from Mines

The royalty revenue appears to be available only to some DDCs as the mines are not distributed equally in all the areas. No system has yet been developed for allocation of revenue from this head to the DDCs. But the potentials are high. Viewed from the royalty collected in FY 1998-99, the estimated amount to be provided to the DDCs is Rs. 55 Lakh. It would be necessary to make the process of transferring the amount simple by requiring the collecting agency to make the amount available to the DDC.

Forestry Products, Royalty from Forest Sector

Because of the contradiction between the Local Self-Governance Act and the Forestry Act regarding the provision of royalty from the forestry sector and forestry products, there are confusions. There is a contradiction between the Local Self-Governance Regulation, and Forestry Act, the circular of the Ministry of Forest, regarding the basis of collection and the percentage of distribution. The DDCs have not been able to receive revenue from this sector. On the other side also, there is a contradiction between these two Acts regarding the ownership and disposal of boulders, aggregates and sand. Thus a problem exists between the DDC and the Forest office. It would be appropriate to make the DDCs also responsible for the conservation of forest, and provide 50 per cent of the revenue from this sector to the DDC. There should be a system of direct transfer of money from the revenue collector to the DDCs.

Royalty from the Amount Collected from Electric Power House

Regarding this source it is not clear from which royalty the DDC will get the share. Until the present no DDC has received this revenue. To get the revenue from this source, it looks desirable to make provision that the DDC should get a fixed portion of the electricity generated, or a fixed portion of the revenue that the Nepal Electricity Authority pays HMG, or a fixed portion of the royalty collected in the district concerned.

Tourist Entrance Fee

Although mentioned in the Act, this source is not yet clear. HMG realizes the passport fee and other fees from the tourists. Except the restricted areas (Gorkha, Mustang, Dolpa, Humla) there is no entrance free in other districts. In this situation, this source needs clarification. On the other side, it is not a respectable arrangement to directly collect money from the tourist in a discouraging manner. In this context it would be appropriate to allocate a certain portion of mountaineering fee, through the Ministry of Local Development, for distribution for the development of tourism infrastructure, its promotion and protection.

5.2.1 Proposed Rate of Allocation among Local Bodies

Limitation and Rate of Allocation Recommended for the DDC

- 50 per cent of the royalty from mines to the VDC/Municipality concerned;
- 50 per cent of revenue from forest sector to the VDC and Municipality concerned.
- 50 per cent of royalty from electricity to the VDC/Municipality;
- 50 per cent of revenue from tourism to the VDC/Municipality concerned.

It would be appropriate to put a condition that the revenue so received should be spent on the plans to develop and consolidate that sector.

Proposed Rate of Allocation by the Lower Local Bodies to the DDC

- In the context of the recommendation to transfer the power of selling boulders, aggregates and sand to the lower local bodies, they should send 25 per cent of such collection to the DDC.
- 25 per cent of the income from lakes and ponds earned by the VDC and Municipality should be sent to the DDC.

5.3 Central Grant to the Local Bodies

Though there is no fixed criterion or formula of grant yet there is a regular flow of grant to the local bodies.

5.3.1 Central Grant to DDC

The description of grant from HMG to the DDC is presented in table 5.1.

Table 5.1
Grant from HMG to DDCs

	FY 1997-98	%	FY 1998-99	%	FY 1999-2000	%
Towards Local Development Officer	31154	5.0	31154	4.9	31854	5.0
Towards VDC Secretarities	190085	30.4	190085	30.2	191335	29.8
Administrative Grant	78251	12.5	73766	11.7	83343	13.0
Personnel Welfare Fund	5625	0.9	6375	1.0	6440	1.0
Total Administration Grant	305115	48.7	301380	47.8	312972	48.7
Capital grant	139220	22.2	140315	22.3	141315	22.0
District Road	176300	28.2	176300	28.0	176300	27.4
Suspension Bridge	5525	0.9	12308	2.0	12308	1.9
Total Capital Grant	321045	51.3	328923	52.2	329923	51.3
Total Grant	626160		630303		642895	
Total National Development Budget	34038848		28531332		33291965	
% of total Development Budget in DDC Grant		1.8		2.2		1.9

(Based on the total development budget (actual) of 1997-98 and 1998-99 and proposed budget of 1999-2000).

The DDCs have been getting a very small part (about 2%) of the total development budget, in the form of grant. In the grant to the DDC, the proportion of administrative cost is very high. This trend seems to be increasing.

Under the administrative grant given to the DDCs, fall the expenses including the salary and allowances of personnel deputed by the centre in the DDC and the VDC Secretaries plus personnel recruited by DDC with this budget head. Similarly, the amount allocated by the centre for service terminal benefits of employees recruited by the DDC (personnel welfare fund) also falls under this head. The amount of administrative grant is over 48% of the grant to the DDC. Thus the capital grant to the DDC is just about 52%. There are examples that the districts with scanty internal resources and those in the mountain region incur administrative cost even by borrowing from the by capital grant.

The amount allocated as salary and allowance of the VDC Secretaries occupies a big portion of the DDC budget. In FY 1998-99, in the total administrative grant of Rs. 30,13,80,000/- the amount towards the VDC secretaries was 19,85,00,000/- (63%). In fact there should be a change that this amount is not shown in the DDC grant, because the VDC Secretaries are posted to the VDC and not to the DDC. As showing this amount in the DDC grant has an adverse effect in the fiscal autonomy indicator of DDCs, this account should be kept in a different manner.

The capital grants made to the DDCs are of two kinds: minimum lump sum grant and conditional grant. The DDCs can invest the minimum lump sum grant in every project of their choice and priority. The conditional grant is provided for investment in two sectors: construction and maintenance of district roads and suspension bridge. Although there are directives that the conditional grant must be spent on the specified sector alone, suspicions have been raised as to whether this is in fact being done so. Apart from this it is found that the capital grant is spent on administrative work. In addition, it is also seen that expenditures are made elsewhere by transferring the budget amount from the approved and prioritized programmes.

The criteria for making grants to the DDCs are not evident. The table 5.2 presents the comparative picture of the capital grants to DDCs on the basis of population, area, number of lower level local bodies and regional variation, after deducting the administrative grant to them.

Table 5.2
Comparative Distribution of Net Capital Grant

<i>Regional distribution of total capital grant</i>	<i>FY 1998-99</i>		<i>FY 1999-2000</i>	
	<i>Total Capital grant</i>	<i>% of total</i>	<i>Total capital grant</i>	<i>% of total</i>
Eastern Development Region	67550	20.50	68450	20.70
Minimum-Maximum amount to DDC	3100/5550		3100/5550	
District-16, VDC-893, Population-4446749, Area-28456 sq. km.				
Central Development Region	88919	27.00	89019	27.00
Minimum-Maximum amount to DDC	3010/6075		3010/6075	
District-19, VDC-1199, Population-543672, Area-27410 sq. km.				
Western Development Region	77832	23.70	77832	23.60
Minimum-Maximum amount to DDC	3010/6010		3010/6075	
District-16, VDC-863, Population-3770678, Area-29398 sq. km.				

<i>Regional distribution of total capital grant</i>	<i>FY 1998-99</i>		<i>FY 1999-2000</i>	
	<i>Total Capital grant</i>	<i>% of total</i>	<i>Total capital grant</i>	<i>% of total</i>
Mid-Western Development Region	59078	18.00	59078	17.90
Minimum-Maximum amount to DDC	3210/4450		3210/4450	
District-15, VDC-575, Population-2410414, Area-42378 sq. km.				
Far-Western Development Region	35545	10.80	35545	10.80
Minimum-Maximum amount to DDC	3200/5100		3200/5100	
District-9, VDC-383, Population-1679301, Area-19539 sq. km.				

According to this table, the lowest amount granted to a district is Rs. 30 lakh 10 thousand, while the maximum amount to a district is a little over its double i.e., Rs. 60 lakh 75 thousand. There is no justification of this difference. The districts have been receiving the grants on the basis of past record. Until now the distribution is not made on the common criteria of determining grants, i.e., area, population, geographical situation, level of development, attempt at local resource mobilization, fiscal need and fiscal discipline.

Lump-sum grant

Rs. 1,96,97,000/- has been provided in FY 1998-99 as lump-sum grant, which is 3.10 per cent of the total grant. On the one hand there is no concrete criterion of providing grant to the DDC, and on the other, the lump-sum grant has decreased the importance of the regular grant. Many DDCs are not in a position to account for the lump-sum grant because, lump-sum grant becomes the responsibility of the DDC office instead of the DDC as an institution. Such a grant can be a legal grant only if it is provided on the basis of the additional grant as per Art 236 of the Local Self-Governance Act, 1999.

Projects and Programmes Being Run by Different Ministries

The Ministry of Local Development is running some programmes by itself. As most of such programmes are being run through the VDC, and are of local nature, it would be appropriate to incorporate them under the DDC grant and give the responsibility of implementation to the DDC (in a situation when the Local Self-Governance Act is in force). Such programme and projects are: Local Development Construction Programme, Local Track and Suspension Bridge Programme, Rural Agricultural Road, Rural Infrastructure Development Programme, Labour Intensive Road Reconstruction and Rehabilitation Programme, Praja (Chepang) Development Programme, Depressed and Indigenous Peoples Development Programme and Special District Package Programme. In addition, the budget for programmes like Integrated Development Programmes, Remote Area Development Programme, Local Trust Fund also goes indirectly to the DDC and such programmes can be considered conditional grant. In a similar way, other Ministries are also running various types of local development programmes by themselves. But the programme budgets cannot be spent by the local bodies through their decision, and, therefore, cannot be classified as grant; the DDC appears to be working as an agency only.

In the same way, Rs. 1 million is being sent to the districts as constituency development programme per Member of Parliament. Although the DDC has to maintain its account, there is no separate mechanism for it, and there is no legal basis for the DDC to have special personnel for it. Hence, it comes as a special burden.

5.3.2 Central Grant to the VDCs and Municipalities

Municipality

The Centre has been providing administrative grant and capital grant to the Municipalities. The grant given to the Municipality is tied with its internal revenue according to which Municipalities with the income of Rs. one crore or more do not get it. This grant has not been encouraging in terms of internal resource mobilization, but it can be considered a proper step in the direction towards being self-supporting. Capital grant appears like an unconditional lump-sum grant and in addition, grant is also given for special programme or project which can be considered a conditional grant.

The description of grants received by the Municipalities is presented in table 5.3.

Table 5.3
Description of Grants Received by the Municipalities

Description	Rs. 000			
	FY 1998-99	%	FY 1999-2000	%
Administrative Grant	20000	14.2	25800	18.4
Capital Grant	85450	60.7	81500	58.1
Fire Brigade	4600	3.3	9000	6.4
Building			6100	4.4
Sanitation Equipment			4300	3.1
Matching Fund, Town Development Fund	13128	9.3	1837	1.3
Matching Fund, Training	643	0.5	438	0.3
Matching Fund, Learning Centre			500	0.4
Matching Fund, Youth Development			500	0.4
Counterpart Fund, Dumping Site			10225	7.3
Additional Lump-Sum Grant	13200	9.4		
Tractor Purchase	1500	1.1		
Town Planning Formulation	2200	1.6		
Total Capital Fund	120721	85.8	114400	81.6
Total Grant	<i>140721</i>		<i>140200</i>	
Total Development Budget (National)	28531332 ⁺		33291965 ⁺⁺	
Municipal Grant in Development Budget		0.5		0.4

(+Actual, ++ Estimate)

The Municipalities have received about 0.5 per cent of the total national development budget. Viewed from the point of population, and complexity of work and services, this amount is too small.

Bulk of the grant sent to the Municipalities is in the form of capital grant, which is about 85 per cent. One reason for this is that only one person - the executive officer - is deputed by HMG. Another reason is that the municipalities have mobilized their internal resources better than the DDCs and VDCs. In a similar manner, some conceptual experiment seems to have been done in the case of grants to the Municipalities in the form of matching fund - a third category. But in practice, this was not followed in action. For example, in the table 5.3, many heads have been

added in the subsequent years budget compared to the previous years budget. In the previous year also the additional grant amount is not classified into specific head. In the Municipalities also, lump-sum grant is sent as in the DDC. The volume of this grant was Rs. 77,00,000 in the previous year and it increased to Rs. 1,38,50,000/- in the subsequent year. Thus, the Municipality grant is also unscientific as there is no proper classification, the heads are not fully explained and additional lump-sum grants are made.

The VDC

The practice of sending direct grant from HMG to the VDC was started five years ago. Presently, HMG provides each VDC Rs. 5 lakh on equal basis. Thus, HMG makes available Rs. 1,95,65,00,000/- as common VDC grant which was 6.9% and 5.9% in the total national development budget in FY 1998-99 and 1999-2000 respectively. Thus, the grant to the VDC is bigger than the grants to the DDC and the Municipalities.

In the beginning this grant was provided as unconditional grant, but now 25% of this amount can be spent on administrative and manpower development work. This is often spent on allowances of the personnel and the office bearers of the VDC. The remaining 75% can be invested in the priority sector of the VDC.

The VDCs also get the salary and allowance of the Secretary as administrative grant. But this amount is incorporated in the DDC grant. As the VDC Secretaries are under the administrative control of the DDC, the amount is sent there. If this amount is transferred to the VDC grant, the VDC grant will increase by 9.7 per cent.

Municipalities and VDCs also get money for the social security programme. For this purpose, Rs. 40 crore and 53 crore had been sent in FYs 1998-99 and 1999-2000 respectively. But, as the Municipalities and the VDCs perform this work as agency of the Central Govt., this amount does not fall in the category of grant.

5.3.3 Grant from DDC to the VDC and Municipality

Generally, all the DDCs regularly provide some amount as capital grant to the VDCs. But only some DDCs occasionally provide grants to the Municipalities. Such grants from the DDCs also do not have fixed criteria or amount. Such grants are tied to some programmes rather than direct cash grant.

5.4 Joint Review of the Grants to the Local Bodies

The amount of money sent to the local bodies in the form of grant in FY 1998-99, is presented in table 5.4.

Table 5.4

Amount of Central Grant to the Local Bodies

	Total	Administrative	Capital
VDC Grant	1956500	489125	1467375
DDC Grant	630303	301380	328923
Municipality Grant	140721	20000	120721
Total Grant	2727524	810505	1917019
National Development Budget	28531332		
Total Revenue	37251000		

According to this table, in the FY 1998-99, the total amount of grant was Rs. 2,72,75,24,000 out of which the administrative grant was 81,05,5000 (or 29.71% of the grant - almost one third). In the same year, the ratio of grant in comparison to the development budget and the total revenue was as follows:

Proportion of grant in the development budget	9.56%
Proportion of grant in total revenue	7.32%
Proportion of capital grant in development budget	6.72%
Proportion of capital grant in total revenue	5.15%

The above table makes it clear that the grant amount is less than 10% of the development budget and less than 8% of total revenue, and, deducting the minor administrative grant, the net capital grant is only about 5%.

It is felt that there are the following weaknesses in the system of grants:

- a) There are no fixed criteria for determining the amount of grant;
- b) The grant is made on the basis of the amount in the previous year without considering the inflations or price rise factors, which shows the possibility of annual decrease in the volume of development work.
- c) There is increase in the administrative cost because of the annual increase in the pay scale and other administrative costs. As the administrative grant is incorporated into the total grant, the actual capital grant becomes still smaller.
- d) As there is no provision for the involvement of the local bodies in determining the grants, there is the probability of constant dissatisfaction of the local bodies in the process of grant.

Thus the amount of grant to the local bodies has remained small and there is no surety. The analysis in the following sections justifies the need for increase in the amount of grants:

1. In principle, the local bodies should get the grants in proportion to their responsibility. According to the analysis done in Chapter 3, it is not possible to assess to what extent the local bodies have been accomplishing their work responsibility because of widespread overlaps. Yet, the local bodies have got enormous responsibilities and the resources should also be commensurate to their work. Along with this, in the areas where there is overlap with central agencies, the entire responsibility should be merged with the local bodies along with the budget allocated to the central agency for such work.
2. In this context, the analysis of HMG, (Division of Work) Regulation (Manual), 2000 also provides the ground for determining the proportion of grants. The analysis of that Regulation shows the following picture (table 5.5):

Table 5.5

Number of Work Areas Tallying with the Local Bodies according to the Division of Work Regulation

	No. of Work Areas	No. of Work Areas Tallying with the Local Bodies	
		Full Tally	Partial Tally
Total Work Areas of Development Ministries	254	31	65
Total Work of other Ministries/Secretariats	138	–	–
Total	392	31	65

From the view of number, among a total of 392 work areas, the local bodies have been working fully in 31 areas and partially in 65 areas (Annex 13). Although these areas might carry little weight from the point of work load and seriousness of work, the three number of work areas given to the local bodies demand increase in the amount of grant.

3. From a practical point of view, there are large numbers of small works and the budget allocated for them is evidently inadequate. According to the data of the Ministry of Local Development, in the FY 1998-99 the DDCs, VDCs, and the Municipalities together conducted various small infrastructure projects to the tune of : 9700 water supply, 9814 roads, 7645 buildings, 2796 irrigation and 7931 miscellaneous. From this statistics, an average of over 500 projects has to be conducted per district for which additional revenue need is justified. In the present system, the local bodies have been getting about 9% of total development budget as grants. This needs to be increased. Instead of the unitary determination of the grant amount by the centre, it would be appropriate to have an interaction with the representatives of local bodies Associations and determine the amount jointly on the basis of work responsibility, and an appropriate mechanism should be developed for this purpose.

5.4.1 Grant Distribution Administration

The Ministry of Local Development has the responsibility of grant administration. This distributes part of the budget allocated as district level expenditure as grants to the DDCs, Municipalities and VDCs. From the remaining portion of the budget, the Ministry allocates some amount as HMG contribution in the collaborative projects with donor assistance which is again invested through the local bodies themselves. Similarly, the Ministry invests some portion in its own programmes like the Participation Based Development Work. It would be useful to transfer such programmes also to the local bodies with a fixed parameter and clear guidelines, as other grant programmes.

If the regional or field programmes of different Ministries are integrated and handed over to the DDCs in the form of grant, it would enhance the capability of the DDC to fulfil its onerous responsibilities.

5.5 Review of Grants and the System of Allocation

Different aspects of allocation of grants have been mentioned earlier. Its positive aspects and challenges are mentioned hereunder.

Positive aspects seen in the system of division of grants

- The concept of dividing tax and revenue has been initiated. It has strengthened the assumption that the local bodies are not only political units but also units of mobilization of public finance, and they are the subsidiary organs of HMG to share the burden of work in different sectors.
- There is consensus in the thinking that distribution of grants should be based on objective formula and it should be scientific.
- The assumption has also got a recognition that there should be a balance between the grant they get and their internal capability. In the context of Municipalities, some exercise has also been initiated in this direction. It has been evidenced that the local bodies have started making attempts at searching resources to fulfil their need and utilize their power.

Problems and Challenges seen in the system of Allocation of grants

- Although the criteria for the allocation of revenue have been identified, concrete work has not been done to determining the amount of allocation of revenue. There is no long term policy of grant distribution.
- There is continuity in sending grants to the local bodies. Yet the amount of such grant depends on the haphazard method or is based on the previous year's amount. The grant to the local bodies is not tied with the increase in the central income.
- The process of monitoring, supervision and action regarding the proper utilization of the amount received by the local bodies by way of grant and allocation of revenue, has not been implemented effectively.
- There is lack of clarity regarding the allocation of central revenue, and there is lack of coordination regarding how and by whom such an amount is to be made available. There is no inter-agency coordination to increase the amount to be collected from the specified sources. The procedure of collection and distribution of money to be allocated has not been developed. The procedure to be used for distribution of revenue among the local bodies is not yet clear.
- In the procedure for inter-local-body allocation also clarity and understanding have not been developed. Similarly, there is ambiguity regarding which head of divisible revenue belongs to which agency. For example, the Local Self-Governance Act has made a provision that the DDC should share 35-50% revenue from natural resources with the Municipality and the VDC respectively. The DDC alone gets the allocation of the house-land registration fee and it also raises revenue from the kabadi tax. The VDCs and the Municipalities have also started to claim shares from these revenue. Similarly, the DDCs and the VDCs are claiming shares in the local development fee which is going to the Municipalities until now.
- The grant has not been distributed on the basis of the work to be done and the quantity and quality of work accomplished.
- There is an important role of local bodies in the success of the protected areas. The local bodies have been providing assistance to such programme by: mobilizing people's participation, doing the work of providing relief to affected people, conducting work towards biodiversity, conservation of natural sources and resources and so on. In such

conditions, the claim of local bodies for share in the revenue is quite natural. At present, the management and resource mobilization of those areas is being done either by the Ministry of Forest or by Shree 5 Mahendra Nature Conservation Fund. In addition, about 30 to 50 per cent of the revenue from it is being spent on the development of the buffer zone through local user groups. Therefore, it would be useful to adopt a policy of tying this practice of buffer zone development to the regular process of local development through local bodies and spend the amount in a coordinated manner.

5.6 Recommendations and Suggestions

In accordance with the analysis done in this chapter, the following recommendation and suggestions are made with regard to central grant and allocation of central revenue:

a) Regarding the Heads and Rates of Division

1. In the present arrangement, some headings need further explanation, and some additional headings are also needed.

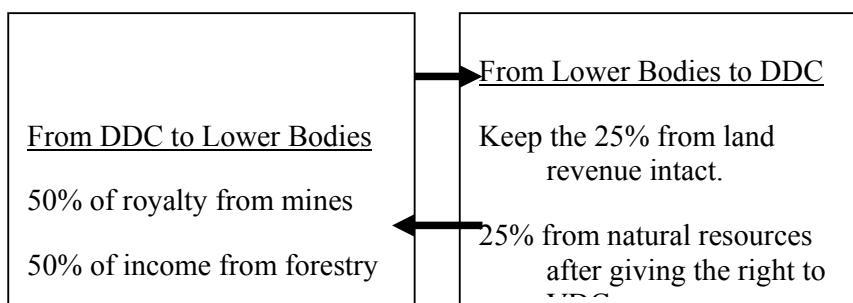
Such additions or improvements are as follows:

- **House land registration fee:** the rate of allocation should be made progressive.
- **Forestry products:** royalty from forestry sector; correct the legal provisions contradicting the Local Self-Governance Act.
- **Royalty from Electric Power House:** clarify and specify which revenue should be allocated.
- **Tourist entrance fee:** clarify and specify which revenue should be allocated.
- **Royalty from mines:** Differentiate between construction oriented, small and other types and clarify.

2. Additional headings for allocation of revenue

- Mountaineering and adventure tourism fee and vehicle tax to the DDC.

3. Regarding the allocation of revenue among the local bodies, the following recommendations are made:



(b) Regarding the Central Grant to the Local Bodies

There are no fixed criteria as to how much money has to be made available to the local bodies. This will create uncertainty in the local bodies and demands will continue to be made to the centre for increase. Therefore, it is necessary that the works of the local bodies be determined, the local bodies be classified and the quantity and procedures of grant be determined on that basis.

In the present system, local bodies have been receiving about 9 per cent of the total national development budget as grant. It is necessary to increase this amount. In stead of unitarily deciding the amount of grant from the centre, it would be appropriate to have interaction with the Associations of the local bodies, to develop a proper mechanism for it and the grant should be determined jointly. It would be appropriate to have the representation of expert from the local bodies in the Revenue Consultation Committee formed every year before the budget preparation.

(c) Kinds of Grants and Basis of Distribution

1. It is recommended that the grant money be classified into five groups in the following manner:

Administrative Grant: The heads of this expenditure are identified even now. The Local Self-Governance Regulation has mentioned that the administrative overhead should be between 25 and 40 per cent and the pattern of expenditure in the local bodies also shows the administrative expenditure around that limit. Therefore it is recommended that 25% of the total grant be allocated as administrative grant.

Unconditional Lump-Sum Grant: This grant is given in order to protect the fiscal autonomy of the local bodies. From the point of the present capability of the local bodies and their fiscal management, it is recommended that 35% of the total grant be allocated in this head. It looks appropriate to gradually increase the proportion of unconditional lump sum grant.

Conditional Lump Sum Grant: This grant should basically be provided to carry on the minimum services. The minimum service level should be decided and, the amount of grant should be determined on the basis of per unit cost or per individual investment.

Special Grant: This grant has been provided with a view to creating a ground for conducting special programmes in accordance with time and space. (like participatory programme, special area programme etc). It would be appropriate to decide the amount of this grant from the total grant on the basis of sensitive work or area, rehabilitation work or target group work etc.

Reimbursement Grant: If the local body takes over work responsibility from the centre, necessary amount should be made available under this head as a reimbursement of central expenditure to the local body for having accomplished the specified work.

For determining the grant to be received by the local body, criteria should be made including the area, population, level of development, fiscal discipline, fiscal endeavour, the work responsibility taken by the local body, development strategy and special needs. Proper weightage should be given to these criteria and a formula should be developed; it should be made transparent and be implemented while determining the grants.

2. Proposed Criteria for Each Grant

- **Administrative grant:** Area, No. of local bodies, with responsibilities entrusted to the local body.
- **Unconditional lump-sum grant:** Area, population and internal resource mobilization of the local body.
- **Conditional lump-sum grant:** Area, population and level of service or development.
- **Special grant:** To be determined every year in accordance with the central policy, programme, development strategy and circumstances.

d. Arrangement for Grant Administration

There is a need for an independent and permanent body for the sake of coordination in the allocation of recourses, discussion and negotiation with the centre regarding grants, management of revenue and grant and implementation of audit reports, and, for study, research, policy formulation and implementation. It would be proper to hand over these functions to the Local Bodies Fiscal Commission recommended in Chapter III.

Involvement of the Associations of Local Bodies in the Revenue Consultation Committee

It has been experienced that the changes made this financial year in the registration fee without interaction with the local bodies resulted in a great difference in the amount to be received from the allocation of revenue and affected the budget. Thus subjects like allocation of central revenue and central grant policy have been the issues of interest to the local bodies. Therefore it has been necessary to have the representation of professional expert from the Associations of local bodies in the Revenue Consultative Committee.

Chapter Six

Accounting System and Accountability of Local Bodies

6.1 Existing Provisions

The Act and Regulation mention the system of budget formulation, approval, implementation, accounting and auditing. It is not necessary to recount the provision of the Act and Regulation's so, only brief mention is made of the relevant aspects here.

6.1.1 Budget Preparation

The local bodies have been preparing budget for a long time, yet there are various weaknesses. As the accounting system of the local bodies is not transparent and the local leaders have not been sensitive to an expected degree, the process of formulation, implementation and evaluation of budget appears to be a regular formality only. In this background, the Local Bodies (Fiscal Administration) Regulation is now implemented. As sufficient time has not elapsed for getting feedback, the time is not ripe for making an all round evaluation. It might contain some improvements and also some weaknesses.

Viewed closely, one gets the feeling that the Regulation has not covered all aspects of local level fiscal operations. For example, the responsibility of preparing budget in the Municipality has been assigned to the Mayor and the Secretary, but in the case of DDC and VDC this is not even mentioned. It is specified that the DDC will prepare the budget and put it to the District Council for approval, while, in the case of the VDCs, the chairman alone is given this responsibility.

The format for budget preparation is specified. But, although the enforced Regulation contains budget heads with full explanations, the DDCs have not been able to develop budget in a systematic manner. Therefore, it has been difficult to study the entire fiscal management of all the local bodies, compare their accounts and assess the clarity and balance between the resources of the local bodies and the actual allocation in the budget heads. In the present condition, the capital investment and the annual service investment is mostly presented in a mixed form. There, again, is confusion between the budget heads of administrative and development expenditures. Although there is the provision that the development (capital) budget should pass through several committees from the VDC and the DDC, it is not fully applied in all the districts and the development budget proposal is also haphazard. In most of the local bodies, there is a practice of making plan proposals far beyond the available revenue inflating the size of the budget, and, in the implementation phase, there is a vast difference between the estimate and the actual revenue. In the same way, there is a practice of proposing higher administrative expenditure budget and give it legitimacy, also proposing unrealizable sources of revenue. The budget is proposed by the executive body and officially presented to the Council for final approval.

6.1.2 Budget Implementation, Accounting and Internal Control

After approval from the Council, the budget becomes official. Only after that the budget is implemented. With regard to the account keeping, there was a practice of following the accounting system of HMG, within the provision of the Act. But a separate fiscal regulation has been prepared and implemented recently for the local bodies.

The Act and Regulation mention such things as the responsible officer, limitation of authority, accounting process and formats. There is a provision that the local bodies should maintain double entry account. There is a provision that the internal audit of the VDC will be done by the DDC and the internal audits of the DDC and Municipalities will be done by their respective internal audit units. The final audit of the DDC will be done by the Auditor General. The audit of the VDC and Municipalities should be done by registered auditors. There is a provision that action on the audit report will be taken by the respective Council. Regarding the reconciliation of irregularities the Accounts Committee should study and present to the Council concerned.

6.1.3 Fulfillment of Accountability

It is found in the Act, Regulation the Polices that the local bodies should be people centred and should work responsibly. But it is not clearly mentioned to whom and for what the local bodies should be responsible. Yet, it is theoretically accepted that the local bodies should be accountable : to the citizens with respect to providing public services, to the central Govt. with respect to the public fiscal management, and to the concerned agency with respect to the different subject areas.

It is a universal assumption that every five years the people vote on the basis whether or not the accountability has been fulfilled, and, those who have not fulfilled their duties are defeated in the election. There is a provision of annual review of the usefulness of the resource through audit. It is expected that the accountability will be ensured because of the provision for the monitoring committee in the local bodies, and the provision that from the administrative and political point of view effectiveness of the local bodies and decentralization will be monitored. In addition to all these processes, the provision of ensuring public accountability by the prevailing rules and regulations is applicable in the case of the local bodies as well.

In practice, the local bodies themselves are found to have taken the initiative to find more effective ways than the legal and administrative provisions mentioned above. The local initiatives include such measures as : making the income expenditure and fiscal status public; code of conduct, regular interaction, entrusting the responsibility of determining and collecting tax to the concerned tax payers. The effectiveness of these measures is also felt to be increasing.

Provision Fund and Property of Local Bodies

The Act has made provision for incorporating the amounts shown in table 6.1 in the Local Bodies' Fund. In analyzing this table it is seen that there is lack of uniformity in terms of headings and language; there is lack of clarity in the process and there is difference in the headings of the Funds of the VDCs and Municipalities. Example :

- (a) Even after getting the right of taxation, in the case of the VDC, there is no word 'tax' and no phrase 'amount received from the allocation of revenue'.
- (b) In the case of the Municipality the words for credit are 'borrowing' and 'deposit' but the word 'loan' is missing, but, in the case of DDCs and VDCs, the term 'deposit' is not found.
- (c) In the case of the VDCs, mention has been made of the amount received 'for having assisted in controlling the clandestine export' and 'revenue received for having used water from the rivers'.

Similarly, the Local Self-Governance Act has specified that the local bodies will have full right over properties mentioned in Table 6.2 and it is the responsibility of these local bodies to supervise, repair and maintain such properties.

Table 6.1
Amount Incorporated in the Local Bodies Fund

DDC	Municipality	VDC
a. Amount received form HMG	a. HMG grant	a. Amount from HMG and DDC
b. Amount from tax, charge, fee	b. DDC grant	b. Charge, fee and rent
c. 25% of land revenue from VDC/Municipalities	c. Amount from tax, charge, service, fee, rent etc.	c. Amount from sale of property
d. Amount from rent and interest	d. Fixed % amount form land tax	d. From income raising programme
e. Amount from income raising programme	e. Sale/ auction of properly if used property	e. Charity/donation
f. Amount from individual/ agencies as gift, donation, grant	f. Resource mobilization	f. From fine/penalty
g. Amount from allocation of revenue	g. Loan investment	g. Institutional loan
h. Amount from fines/penalty	h. Income from contract	h. Amount from delegated authority
i. Institutional loan	i. Donation, gift, charity	i. Theft control of forestry products
j. Amount received from foreign donors	j. Amount from allocation of resources	j. From water use
k. Amount from other sources	k. From fines and penalty	
	l. Credit/deposit	
	m. From other agencies	
	n. Conditional HMG grant	

Table 6.2
Assets/Property Belonging to Local Bodies

DDC	Municipality	VDC
a. Property, purchased by DDC fund, or donated by some one will be DDC property and its maintenance will be DDC's responsibility.	a. Built or purchased by its fund, or donated property	a. Built, purchased, or donated property
	b. Public drainage, canal, bridge, pond, temples, inns, building, well, taps, grazing land, water bank, outlets, chowk, street, road, track and trees on both sides of road (not owned by HMG, DDC or individuals)	b. Public drainage canal, bridge, pond, temples, inns, building, well, taps, water bank, grazing land, outlet, and track (not owned by HMG, DDC or individual)
	c. Building, land, park, garden, bus park, owned by the Municipality	c. Forest given by existing law or HMG
	d. Forest given by existing law or HMG	d. Natural heritage
	e. Natural heritage	

The local bodies have no rights to sell or dispose of the property/assets in any way without the permission of HMG. But, except in the case of the property in (a) under the Municipality and VDC, which have been specified to be under their respective ownership, there is vagueness about granting right to ownership and use. This has created problems in updating the records and using such properties/assets.

6.2 Review of the Accounting System of Local Bodies and Accountability

Many weaknesses have appeared in the accounting system of the local bodies. After the implementation of the Local Bodies, (Fiscal Administration) Regulation, many improvements are expected in this process. The following review is made on the basis of their present practice

Positive Aspects

- On the basis of the need felt for a separate fiscal administration system a Regulation has been created which is enforced recently. Remarkable improvements are expected from its effective implementation in respect of fiscal management and accountability of the local bodies.
- No. of local bodies that are aware and active regarding transparency, clarity and correctness of accounts is increasing. On the other side, the process of interaction of the local bodies with pressure groups, interest groups, and related organizations is on the increase. The understanding and cooperation between the local bodies and other organization, institutions and groups is also increasing. Citizens and civil societies have started to take interest in the local bodies.
- There is growing recognition that the revenue of the local bodies should also be taken as public finance.
- Accounts committee and monitoring committee have been created in the local bodies.
- Professional accounting system is being started in the Municipalities.

Problems and Scope of Improvement

- There is no precision and efficiency in the accounting system of the local bodies. The accounts report is not prepared regularly and there is no process of presenting consolidated economic picture. The accounting system is ill affected by haphazard actions like frequent changes in budget allocation, incurring expenditure beyond budget limits and budget transfer.
- The budget system of local bodies is expenditure oriented and there is predominance of Govt. accounting system. The present accounting system cannot clearly show the sectoral expenses.
- Level of fiscal discipline is found to be low in the local bodies.
- The mechanism to make improvement on the weakness pointed out in the audit and maintain fiscal discipline appears to be weak. On the other side, there is also a trend that the office bearers of the local bodies ignore the rules and use autonomy in a wrong sense. There is policywise and processual weakness in the appointment of auditor from outside, and, action on its recommendation in the case of the VDCs and the Municipalities. Accordingly, they themselves appoint the auditor (Municipality) or make the recommendation themselves (VDC) and themselves keep the right to reconcile the irregularities pointed by the auditor, which does not seem morally justified.
- Auditing is done on the basis of documents, procedures, and budget. There has not yet been action oriented audit nor is there specific provision for it.
- User groups have made remarkable contribution in the cost of projects and programmes run at the local level. But the current accounting formats and the (audit) report do not incorporate the contribution of the user groups (cash, kind, or labour). There has not been assessment or audit of the resources mobilized locally. Even the expenses done by the user groups are not transparent.

- Need for improvement is seen also in the prescribed formats. New formats of accounting have been developed in accordance with to the new regulation. But they have not yet been fully implemented.
- Some weaknesses have been seen with regard to ensuring clean accounts and accountability. In the situation where the minimum standard of services is not determined, it is difficult to decide who is responsible to whom and for what action. Similarly, even in the subjects which are defined to some extent, the mechanism for ensuring accountability has not been developed and implemented effectively. There is no clear provision as to what would happen if the local bodies do not discharge their legal duty properly. There is scarcity of information flow and transparency. There is no fixed provision of involving the interest groups in the monitoring and evaluation and the audit has become just like a regular formality. Even the action that can be legally taken in case of irregularity, has not taken place.
- With regard to accountability the work responsibilities of local bodies and quality and quantity of public service have not been clearly specified, and there are wide spread overlaps. Therefore, it is not yet explained for which activities the local bodies hold full responsibility. Similarly, it is not clear which official or representative will bear what responsibility of the local body. For example, the power of decision given to the chief of the local body becomes active only when there is a tie in voting, else the chief has to follow the decision of the majority. Under a multiparty system, in the local bodies composed of multi-party representatives, it is not practical to assume unanimity in all decisions. It appears necessary that the chief of the local body should have power to attempt to mobilize new sources of resource, to control the unnecessary expenses and take action on financial irregularities.
- Because the Councils are not able and effective to fulfil their responsibilities and because of politicization in most of the activities, there is a past experience of inability to effectively mobilize fiscal resources. The committees, (like accounts committee) that have to provide support to the Council, are not active and practical. In some places, the Councils have been unable to conduct meetings and time is just passing on. In such circumstances, problems have arisen as to how to conduct the budget expenditure. It is necessary to have alternative solution for the unfinished work or the unpaid bills because of the failure of the Council to meet.
- Weaknesses have been seen with regard to the economic assistance and contingency expenses also. There is a practice in the local bodies of spending substantial amounts of money for the sake of different works just on the basis of application. The higher income a local body has, the higher is the amount thus spent. Under this head, the assistance is provided in the form of cash. It has become very necessary that this amount, which is spent in different forms or names like tea, snacks, hospitality, medical treatment, sports, constructional materials, aid for different clubs, expenses of delegations, necessary expenditure not included in the budget allocation and so on, should be utilized in the planned development work, making good use of the scarce resource in public welfare or priority sector. Such a practice of making arbitrary expenditure is not seen in any local body around the world. In the local bodies of Nepal these practices need to be immediately stopped: (like), spending beyond the legal limits, spending more than their fiscal capability, spending on unattainable objective, and spending in an uncontrolled manner in the form of financial assistance to such an extent as to affect the development work itself. In the same way, in the case of he regular expenses like tea, snacks, medical treatment and the expenses of the council, it is necessary to make improvement by incurring only very necessary expenses in minimum amount and by making these expenses transparent.

6.3 Recommendations and Suggestions

To make the accounting system of the local bodies efficient, regulated and accountable, the following suggestions are made:

(a) Relating to Budget Formulation

The following improvements are necessary in the preparation of budget in the local bodies:

1. Time and responsibility of budget preparation should be specified with respect to all the local bodies and make arrangements to conform to it.
2. Budget heads and their classification should be clearly explained. The system and format of accounts should be improved to reflect sectoral expenses.
3. The parameter of allocating budget according to the expenditure head should be clearly prepared and, before preparing the budget, pre conditions like study, design and the proportion of expenditure should be specified. There should be a clear provision that only the plans and programmes that meet the above preconditions can be incorporated in the budget.
4. The budget formats should be improved.
5. The tradition of showing unrealizable source of income to justify the expenditure should be ended.

(b) Fiscal Management and Accounting

1. The regulation that the budget for the new fiscal year should be approved as per the rules before making expenditure from it should be seriously implemented. If the council cannot meet in time, an alternate solution should be clearly laid out.
2. The right, responsibility and accountability of the official or office bearer making expenditure should be clearly mentioned, and provisions should be made that if such work is not done in a responsible manner, the concerned official/office bearer shall be held accountable.
3. The following improvements should be made in the present formats of accounting:

(i) Accounts and formats needing improvement:

- Income and expenditure account: cash transaction, sectoral expenditure; expenditure done through user groups or in construction work involving users; contract related; monthly report of income expenditure; classification of accounting format; format of cash receipt, daily income, headingwise tax collection account, inventory account and advance account.

(ii) Accounting formats to be removed

- Related to Municipality: Daily transaction details annex 30; General deposit account annex 73; four monthly (trimesterly) report of income expenditure annex 78; annual income expenditure statement annex 83.
- Related to DDC: Reporting format annex 127¹ reporting format annex 147.

(iii) Accounting formats to be added

- Related to VDC: Description of bank transaction and advance arrears; format for recording audit irregularities; record clearly showing irregularities and their reconciliation
- Related to Municipality: Deposit bank cash book; record of bills to be paid; daily tax and service charge billing account.

4. Tradition should be made to monitor the income and expenditure, and make necessary improvement in the middle of the fiscal year also; for this purpose, reporting formats of income and expenditure should be improved and implemented.
5. Formats should be developed in accounting reflecting the income source mobilized by the users groups.
6. Limitations should be determined in the amount transfer of budget heads and the expenditure in heads where there is no allocation.
7. The list of amounts incorporated in the fund of the local bodies should be revised.
8. In the remote areas without banks nearby, sending the collected revenue immediately to bank costs more than the revenue. So, there should be a special provision to make cash transaction in those areas.
9. In the remote and Himali VDCs in the north, the snow fall in the winter makes it difficult to do construction work and a suitable season for work falls around the end of the current fiscal year and the beginning of the next. The restriction on fiscal transaction at the end of the fiscal year has created problems in those areas. Such areas should be identified and special arrangement should be made to conduct the programme in those areas. Therefore, the time for construction being different in the Himali region, either the responsibility should be adjusted without freezing the budget or some other solution should be sought.
10. If, by the failure of Council meeting to take place, there is obstacle in making payment to ongoing projects or in running essential services or for the tax payers to pay taxes, there is necessity to solve this problem by making legal provision either for an all party meeting or other appropriate means.

11. Internal control and internal audit

- a. The accounts committees of the local bodies should be made capable and effective. Provision should be made to have the representation of interest groups and experts in the subject in such committees. The Accounts Committee should be made permanent and active throughout the year.
- b. The level of the accounts section and internal audit section of the DDC should be upgraded and it should conduct internal audit of the DDC and the VDCs.
- c. Regarding accountability, clear provisions should be made in the following aspects:
 - The process and guidelines of budget formulation and approval and the responsible person;
 - Projects to be managed by user groups;
 - The following areas of accounting : expenditure, income, inventory, forms to be used for deposit account; the need for records and reports; details like how many copies of the formats, who will prepare them, how much, where to send, who will send them, and what will happen if not complied with;
 - The amount coming from central budget and from various donor agencies under the partnership programme.

(d) Final Audit

1. Constituting the local bodies board (as mentioned in chapter #) and activating it. Regarding the final audit, make the following arrangements:
 - VDC: Taking the classification of auditors as the basis, appointment of auditors should be recommended in accordance with the amount to be audited. As there is no uniformity in the audit reports in the absence of the auditors opinion and points to be incorporated (like action on the last irregularities, auditors opinions on fiscal management), they should be added. After audit is completed, the VDC should send one copy of the report to the VDC, concerned DDC and the Ministry of Local Development through its concerned regional directorate. The date of the appointment of the auditor of the VDC and due date for the audit report should specified.
 - Municipality: Provision should be made that the final audit of the income and expenditure of the Municipality will be done by the Auditor General. The provision that the Council can write off audit objection (irregularities) should be made clear. The proposed Audit Board should make provision for a mechanism for monitoring and supervision of audit and irregularities.
 - Monitoring: The Accounts and Audit Board should be specified as the central agency for monitoring the realization of audit objections.
 - Legal provision should be made that if an elected representative of the local bodies stands can a candidate for any other elective post, such a person should present a certificate that there are no dues against him/her.

Advance

- Advance payment should be made only on the basis of justification of need and appropriateness.
- Provision should be made for monitoring, recovery and reconciliation of advances. Reconciliation of advances should be done in time so as not to let the advance continue with the office bearers of the local bodies. After a fixed time period, names (of advance holders) should be made public.

Transparency of Accounts

1. For the transparency of the economic transactions of the local bodies, legal provision should be made to make the following information and details public according to the following time and method:
 - The budget of income and expenditure of the local body with information as to how much money is allocated for which projects in the budget year: should be made public soon after the budget is approved.
 - When a local body conducts a public construction work with cost exceeding specified limit and involving also its own resources, by itself or through contractors or with participation from user groups, the details of the construction work like cost estimate, contracted amount, source of fund, date started, date of completion of the project person responsible for implementation etc should be visibly, notified in the construction site.
 - The status of the expenditure on completed and on-going projects in the particular year with the present status should be made public soon after the end of the fiscal year.

- After the audit reports and annual account reports have been endorsed by the Council, such reports should be made available if journalists the press or any other concerned person request for such information.
- After the completion of construction work done through user groups, there should be compulsory audit. There should be a provision to make the detailed information on the income, expenditure and report public. Provision should be made in the Regulation itself for the means and methods of making the programme and budget public.
- The financial assistance and contingency expenditure should be clearly explained in order to make them goal oriented transparent.

(e) Consolidation of Accounts

1. Training and orientation programmes should be conducted for members of the Accounts Committee, manual should be prepared and implemented.
2. Knowledge, skill and efficiency about accountancy should be increased among the accounts personnel and the peoples representatives. Regular monitoring and improvement programmes should be conducted by the proposed Local Bodies Fiscal Commission.