

Practices and Challenges of Fiscal Decentralization at the Local Government in Nepal

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Abstract

Introduction: This study explores the practices and challenges of fiscal decentralization at the local government level in Nepal. Fiscal decentralization primarily focuses on the transfer of fiscal powers, taxation, and spending to subnational governments. **Methods:** Qualitative content analysis was adopted to examine fiscal decentralization at the local government level through key informant interviews. The elected leaders from two local governments were the key informants who discussed financial resources, spending, and challenges. Additionally, an observation was conducted to examine the operation of local government. Similarly, a systematic review of the constitution, laws, and literature related to local government's power and authority was performed. Descriptive statistics using Excel were used for numerical summaries of responses. **Results:** The findings indicate that local governments in Nepal are struggling to effectively manage their financial resources, as they receive 78 percent of their total budget from the central government. The current spending situation is also not very satisfactory, emphasizing the necessity of institutional capacity building to sustainably generate tax revenue. Key challenges include limited grants, a low spending situation, imbalances in the allocation of resource responsibilities between subnational governments, poor coordination, weak fiscal discipline, and the politicization of budgets. **Conclusion:** Fiscal matters are crucial for implementing local development and ensuring effective service delivery. The current constitution assigns taxation powers, along with autonomy in revenue generation and spending, to local governments. Nevertheless, local authorities have encountered numerous challenges, making capacity building essential.

Keywords: Challenges; Decentralization; Fiscal Power, Grants; Local Government

Introduction

The least centralized approach that can effectively address the current issue is devolution of power, which is associated with the idea of fiscal decentralization. It is also connected to the degree of responsibility and financial autonomy given to subnational governments. It focuses on how governments strike a balance between their expenditures and income (Rodden, 2024). The duties of collecting taxes

and carrying out spending plans are divided between the central and local levels in fiscal decentralization (International Monetary Fund, 2017). Expenditure allocations, revenue allocations, intergovernmental fiscal transfers, and borrowings are key features of fiscal decentralization. Expenditure allocation is crucial to fulfilling performance allocation, and local governments can decide the expenditure allocation themselves under fiscal decentralization. In Nepal, responsibility for spending is asymmetrical based on population size and resource capacity criteria under the federal system. Equally important is the question of how to manage resources for spending. Spending responsibility depends on revenue sources. Intergovernmental transfers are a major source of revenue for local governments in Nepal.

However, Nepal has a long history of self-local governance and decentralization (Khanal, 2004), but it was limited to small areas and territories, as there were many small principalities. The practice of centralized governance was adopted following Nepal's unification in 1768. For tax purposes, a number of administrative units were set up, though the task of tax collection was entrusted to the local elites. Following the 1950 revolution and the emergence of democracy, the nation adopted contemporary ideas of decentralization in terms of local development, with programs to develop rural areas. The 3rd Plan period (1965–70) introduced numerous decentralization-related laws, policies, and acts to engage the community in local development. In 1962, the nation formally adopted a regional development strategy with decentralization, allocating 75 districts and 14 zones. Later, these were further subdivided into five development regions, which were then further subdivided into macro-political entities (Whelpton, 2005). Administrative decentralization was implemented during the Panchayat era (1960–1990), but local levels did not have fiscal authority, and local resource mobilization was less successful. However, Nepal embraced a multiparty democracy with a monarchy following the return to democracy in 1990. Consequently, the Local Self-Government Act (LSGA) 1999 established self-local governance with provisions for tax collection authorities and emphasized gender equality in order to strengthen decentralization; however, fiscal matters were given less priority. The decentralization was bureaucratic in nature. Most municipalities lacked proper planning, infrastructure, and human resources. After the people's second movement in 2006, the country engaged in constitutional reform by the Constituent Assembly, implementing a federal system.

In 2015, Nepal adopted a federal governance system in which the local governments were given more fiscal powers, ranging from the collection of taxes (local taxes, tourism fees, entertainment tax, land revenue tax, etc.) to local planning and resource mobilization. The Constitution of Nepal (2015) has a provision for a framework for fiscal decentralization under federalism. Fiscal federalism involves relationships between governments at multiple levels (Weingast, 2009). It includes resource distribution, fiscal transfers, bailouts, grants, and borrowings to subnational governments. Expenditure allocation, revenue allocation, fiscal transfers, and local borrowing are the four pillars of fiscal decentralization. Applied to Nepal, this principle emphasizes that local governments are often best suited to identifying and meeting the needs of their communities (Acharya, 2018; Oates, 1999). However, putting this theoretical model into practical use has proven difficult, as numerous obstacles have arisen in the implementation of fiscal decentralization.

Currently, Nepal has 753 local governments (including six metropolitan areas, 11 sub-metropolitan areas, 276 municipalities, and 460 rural municipalities). Rural municipalities are the lower tier of government. The Constitution mentions its executive, financial, and judicial (semi) powers (Bhusal & Breen, 2023). The responsibilities of local governments are to deliver public services to the local community and implement the socio-economic development of local people with the efficient use of resources. Rural areas in Nepal are rich in natural and cultural/religious resources, and their utilization can play an important role in fiscal decentralization. Utilizing the abundant natural and cultural/religious resources (for tourism purposes) found in local areas can be crucial to fiscal decentralization. There may be a lot of possibilities for local tourism to contribute to revenue generation. According to the World Bank (2022), travel and tourism accounted for roughly 6.6% of Nepal's GDP in 2019 and created 1.19 million jobs in 2023 (DailyExcelsior, 2024).

However, fiscal decentralization at local governments in Nepal is constitutionally empowered to receive grants based on the principle of devolution of power sharing. Nevertheless, the local level faces challenges in terms of heavy dependency on the center for fiscal resources (Devkota, 2020). According to the Ministry of Finance of the Government of Nepal, there are some gaps in the institutional structure and its enabling regulations in the federal system to improve services to citizens; these are critical capacity, the intergovernmental fiscal system, and coordination between sub-national governments (Bhusal, 2023; Ministry of Finance, 2021). This study explores the gap by exploring challenges regarding fiscal decentralization in terms of revenue generation, spending capacity, and other issues.

Methodology

This study adopted a comparative qualitative case study design to explore the practices and challenges of fiscal decentralization at the local government levels in Nepal. A comparative qualitative case study design is used to examine the practices of local governance in context for studying complex social and administrative phenomena (Creswell & Creswell, 2018). The use of multiple sources of data and methods of evidence enables methodological triangulation, which strengthens internal validity and credibility in qualitative inquiry (Yin, 2018).

The major objective of the study is to explore the practices and challenges of fiscal decentralization at the local government level in Nepal. Fiscal decentralization focuses particularly on fiscal resource management, autonomy, and expenditure. This study reviews literature, such as the constitution, laws, guidelines, and available empirical literature related to fiscal decentralization and local levels.

A comparative case study approach was employed to explore local governance practices and the complex social and administrative processes associated with decentralized governance in the context. Dhanpalthan and Bethanchok rural municipalities were purposively selected as comparative case studies, considering geographical and socio-economic variations: Bethanchok represents hilly terrain, and Dhanpalthan represents plain terrain. All elected local-level leaders (24 in total) as the key informants in the rural municipalities were interviewed in-depth to explore fiscal practices and their challenges. Documentary evidence and interview data were systematically examined through qualitative content analysis to identify and interpret recurring themes and patterns.

Additionally, structured observations of these two local government offices were conducted to have a better understanding of administrative operations and constraints, which triangulated interview responses during the analysis of qualitative data. In order to elaborate on the empirical context, descriptive statistics were used to create numerical summaries of the response patterns. In Excel 2021, frequency counts and percentages were computed to determine how many themes or replies appeared in the data. The study only looks at two rural municipalities because of resource and scope limitations. The findings provide an in-depth understanding of fiscal decentralization practices in the selected cases rather than statistical generalization.

Legislative, Executive, and Fiscal Provisions on Fiscal Decentralization

Constitutional Framework

As per the Constitution (Article 56, Clause 1), Nepal has three main levels of structure: federal, state/provincial, and local. The local level includes the village and municipal council. Article 50 emphasizes the 'autonomy' of the local level, which implies that local levels are important for local service delivery and development. Similarly, Article 59, Clause (1), states that federal, provincial, and local entities shall enact the law, make an annual budget, make necessary decisions, formulate policies and plans, and implement them regarding the subjects related to the fiscal powers mentioned in their respective lists of powers. Schedule 8 of the Constitution mentions the local government's power and authority, ranging from taxes to developmental plans to basic health and education to resource management. Similarly, the local levels can create plans and policies for villages and towns. Similarly, this constitution ensures equal and easy access to services and facilities at the local level. However, Schedule 9 mentions the concurrent powers for the federal, state, and local levels, such as service fees,

charges, penalties, royalties from natural resources, and tourism fees. However, education, health, and land overlap, which need to be clarified.

Executive and Legislative Powers

The Local Government Operation Act (Government of Nepal, 2017) details the authorities, duties, and responsibilities of the local government, assembly meetings and working systems, judicial functions, financial jurisdictions, and administrative functions. Local legislative powers are vested in the village council. Village and town councils have the power to issue laws, policies, and general directives. Article 215 provides for the Head of Village executive in every Village Council, and the Village executive is formed under the Chief's chairpersonship. All yearly plans, programs, and budgets should be proposed in the assembly, and the assembly should approve them on a majority or consensus basis (Article 20). After the approval, the Head or Chairperson of RM/M approves it within 15 days, and it becomes the 'legislative act'. Therefore, it is a powerful legislative body at the local level. Only the approved budget can be proposed and implemented. The present village/town assembly represents decentralization at the local level. The formation of planning, implementation, and monitoring in terms of decision-making is the responsibility of the local level.

Inter-Governmental Fiscal Arrangement (IGFA)

According to Article 228, Clauses 1 and 2 of the Act, the local level imposes a tax on areas within its jurisdiction. The local level has two sources of finance: one from the tax imposed in areas within its jurisdiction and another through grants or loans from the center or province. Article 54 of the Act provides for the collection of tax or revenue as per law in various sectors, such as the integrity of the house, land tax, housing rent, service tax, electricity, drinking water, waste management, bus parks, and herbs. To manage the finance sector systematically, there is a provision for a committee consisting of six members under the head or chairperson of the local government. The local governments can take a loan from the center based on the suggestions of the Financial Committee of the Government of Nepal. Similarly, Article 229 of the Constitution provides for the "Local Consolidated Fund" in every Village Council and Municipality. All revenues and budgets received are deposited in such funds. Similarly, all income obtained by the Government of Nepal, Province, and Local Level must be deposited in their own consolidated funds.

Likewise, Article 33(1) makes a provision for the "Intergovernmental Finance Council," consisting of the Federal and Provincial Finance Ministries, some heads of local governments, and a Finance Secretary under the Chairmanship of the Finance Ministry. Nominated members of the Treasury may expel members at any time for failure to fulfill their official duties. According to Subedi (2013), the MoF dominates financial affairs. The IGFA Act has provisions for revenue rights, revenue sharing, grants, loans, and fiscal discipline at the state and local levels of the Nepalese government. It describes the sharing of power and the scope of revenue generation in various ways. The types of transfers include fiscal equalization grants, conditional grants, complementary (matching) grants, and special grants. The first two types are the most prominent. The matching grant is complementary, and special grants are subject to programs and projects. However, the local level cannot take foreign assistance or grants directly. In the case of an internal loan, the local government should submit a proposal to the ministry, along with details of the full plan for which loans have been sought (Article 14 of the Act). In the case of a state or local level that fails to repay loans, the government of Nepal may recover such loans from grants to be provided to the local level. Table 1 shows that the local level receives 25% of the total revenue from each resource.

Table 1: The Provisions of the Distribution of Royalty of Natural Resources (In percentage)

SI No	Topic of Royalty	Government of Nepal	Concerned State	Concerned Local Level
1	Mountaineering	50	25	25
2	Electricity	50	25	25
3	Forest	50	25	25
4	Mines and Minerals	50	25	25
5	Water/other Natural Resources	50	25	25

Source: National Natural Resources and Fiscal Commission (2023)

Article 250 of the Constitution of Nepal has a provision for the National Natural Resources and Fiscal Commission (NNRFC) to make national-level development plans and recommend additional grants and loans. NNRFC determines the amount of equalization grant based on the following weights: human development index (10%), socio-economic inequality (5%), infrastructure development (10%), revenue collection (10%), and necessity of expenditure (70%). The commission consisted of a maximum of five members, including the chairperson. However, the central government is dominated by the NNRFC.

Patterns of Budget Distribution (grants) of the Local Governments

Local-level governments in Nepal are heavily dependent on the center for financial resources. They receive more than two-thirds of their total budget from grants, especially equalization grants. A total of 78 percent of the budget comes from grants (Asian Development Bank, 2022). The Constitution guarantees grants to the sub-national governments. According to the local leaders, the allocated budget was not enough to meet local needs. The grants are fixed based on NNRFC recommendations. Table 2 shows that NNRFC recommended an average of 92.71 percent of the budget from the federal government between fiscal years 2019 and 2023, although the disbursed budget was 88.56 percent in the same period. The provincial government made a small part of the budget (an average of 5%) available to the local level.

Table 2: Practices of Grants from Federal and Provincial to local levels between 2019 and 2023, %

Budgets	FY 19	FY20	FY21	FY22	FY23
<u>Recommended by NNRFC:</u>					
Federal to Local	85.2	89.9	93.7	94.6	100.2
Province to Local	4.4	6.2	6.3	7	7.6
<u>Disbursed:</u>					
Federal to Local	85.3	89.9	90	84.6	93
Province to Local	4	6.3	6.3	N/A	N/A

Source: Wagle, 2023

Results

The Bethandchok (Kavrepalanchok district of Bagmati Province) and Dhanpalthan (Morang district of Koshi Province) local governments were selected to examine the budget resources and expenditure patterns. In the case of revenue sharing, many leaders were dissatisfied with the distribution of the royalties for natural resources. Table 3 shows that a large amount of the budget was provided through fiscal transfers from the federal government in Dhanpalthan and Bethanchok rural municipalities, which mainly include fiscal equalization grants. In the last three fiscal years (2019-2022), federal transfers contributed to 64.50 percent (average) of the total budget at Dhanpalthan. The provincial government contributed only 9.7 percent (average). Similarly, 61.12 percent (on average) of the budget came from the federal government as grants in Bethanchok rural municipality in the last three fiscal years, between 2019 and 2022. The provincial government provided around 9.67 percent, which is higher than in

Dhanpalthan. The internal sources are steadily increasing, as they were 23.90 percent in 2019/20 and reached 35.70 percent in the 2021/22 fiscal year in Dhanpalthan, while in Bethanchok Rural Municipality, they increased from 28.1 percent to 28.98 percent (Table 3). However, the internal sources also include funds deposited in the consolidated fund for the cumulative prior years.

Table 3: Budget Sources Pattern at Bethanchok and Dhanpalthan Local Governments, %

Sources of Finance	Dhanpalthan			Bethanchok		
	Fiscal Years			Fiscal Years		
	2021/22	2020/21	2019/20	2021/22	2020/21	2019/20
Federal Government	61.01	64.78	67.83	61.75	59.02	62.59
Provincial Government	3.29	2.83	8.27	9.27	10.44	9.31
Internal Source	35.7	32.39	23.9	28.98	30.54	28.1
Total	100	100	100	100	100	100

Source: Field Survey, 2021

Note: Internal sources also include funds deposited in the consolidated fund

All leaders demanded that the budget allocation should be based on production and income generation. For example, dozens of industries continue to exist in Dhanpalthan, but they receive nominal revenue. This local government is also rich in agricultural land, but it cannot generate sufficient financial resources. Bethanchok is rich in natural and agricultural resources. Numerous individuals travel to Bethanchok from Kathmandu (a two-hour journey) for the purposes of mountain exploration and trekking, which is associated with the advancement of tourism. Therefore, generating employment and fostering local entrepreneurship requires more investment and a favorable environment. In the absence of sufficient fiscal resources, local governments have not been able to mobilize resources efficiently.

Table 4: Budget Expenditures (both capital and recurrent), %

Rural Municipalities	Fiscal Years		
	2019/20	2020/21	2021/22
Dhanpalthan	76.53	85.43	84.89
Bethanchok	59.1	63.94	71.63

Source: Field Survey, 2021

Likewise, the expenditure situation in Dhanpalthan rural municipality was represented by 76.53 percent in 2019/20, and it reached 84.89 percent in the 2021/22 fiscal year. These expenditures include both recurrent and capital expenditures. Table 4 showed that Bethanchok rural municipality was able to make expenditures of 59.1 percent in 2019 but improved in the 2021/22 fiscal year, reaching 71.63 percent. This suggests that Dhanpalthan has a more effective resource mobilization than Bethanchok. The average expenditure of both local governments was 73.6 percent, including capital and recurrent.

The capital expenditure seems to be around 30-40% only. From this point, capital expenditure may be around 30%. It implies a poor expenditure pattern, which hints that there is still a problem in revenue generation and effective resource mobilization. The result suggests that both local levels have minimal spending capacity, which requires improvement.

The population of Dhanpalthan (39394) was more than double that of Bethanchok (16777), despite Bethanchok having a hilly terrain with a richness of forests and minerals. Budgets depend on both population and terrain. Dhanpalthan has many areas for agriculture, but social development is lacking. This unequal distribution of resources leads to unequal development, with some local governments better positioned to provide services.

Furthermore, the lack of a well-structured compensation formula for intergovernmental transfers exacerbates the regional disparities. Consequently, marginalized regions and communities continue to be underserved, even though fiscal decentralization was intended to address such inequalities.

An overwhelming number of leaders (88.3%; both agree and strongly agree) agreed that the structure of the current local level is "paramount" in the context of local people-centeredness. Local governments are free to prepare local development plans and policies within the framework of existing laws and regulations. The village council should approve the budget and programs with a majority of council members before their implementation, which indicates a participatory approach. The Council is considered a local-level mini-parliament that can create its own legislation and policies. The elected chief of local government led the process. The present structure at the local level reflects the practice of high-level power exercise by enabling local planning with its decision-making; hence, it can be said that the local levels are more autonomous. The local government's role in achieving the national Sustainable Development Goals (SDG) agenda is vital, though sustainable fiscal decentralization is a prerequisite in this regard.

According to the Chief of Dhanpalthan Rural Municipality, Hari Lal Singh, "Despite a satisfactory structure in terms of planning and decision-making at the local level, local levels face budget deficits, leaving us unable to invest in technology and other infrastructure to provide resourceful service delivery efficiently. Online services are ineffective due to a lack of resources. There is also a shortage of skilled workers in the rural municipalities. Confusion regarding the concurrent powers needs 'Confusion regarding the concurrent powers needs clarification'" (based on personal conversations, April 22, 2022).

Discussion

Based on the legal, executive, and financial aspects and the case study, the following critical elements are important in raising financial resource richness:

Institutional Capacity and Governance Issues

The poor expenditure and revenue collection of local governments posed a major constraint on institutional capacity. All leaders of the two rural municipalities agreed that the allocation of equalization grants was insufficient. Most equalization grants go towards office work and staff salaries. However, the capital budget is limited. However, the expenditure situation is not satisfactory, as it was 73.6 percent (both recurrent and capital), though it is acceptable compared to the national average expenditure pattern. At the local level of Nepal, the average share of recurrent and capital expenditure was found to be 60.5% and 39.5%, respectively, between the fiscal years of 2019 and 2022 (Bhattarai, 2024). Similarly, Wagle (2023) mentions that only 62.8% of the allocated capital budget was spent, and the share of current expenditure and capital expenditure was only 71% and 29%, respectively, between financial years 2010/11 and 2019/20.

The current federal political system provides sufficient power and authority for tax generation, though local governments are unable to generate sufficient income for various reasons. The economy of society at the municipal level does not support the idea of raising taxes unilaterally; it may ignite resistance from local people. Local governments require a supportive approach from the central government to generate local resources without placing a burden on their communities. This suggests the need for pragmatic policies and strategies that create a conducive business and entrepreneurial environment at the local level, allowing investors to easily register their businesses and operate with confidence. Various incentives should promote the agriculture sector, as Dhanpalthan holds enormous potential for sustainable agricultural development. Agriculture is still a form of subsistence farming, and youth are reluctant to engage in it. Another challenge is a shortage of human resources.

Many local governments lack the expertise and resources to handle their financial responsibilities effectively. Acharya and Scott (2022) point out that a major challenge for local government is capacity building to generate its own financial resources to meet local development needs. This implies a need for an effective strategy to generate sufficient internal resources. Acharya (2018) further argued that local governance at the bottom level in the past was more centralized, and the Nepali local government still faced challenges regarding the capacity for resource mobilization. Acharya and Bhusal (2024) also

observed that local governments often operate with insufficient staff and that their personnel frequently lack the necessary training in financial management.

This shortage of capacity not only hampers revenue collection but also affects the efficient allocation of resources, leading to gaps in service delivery. In addition, governance challenges, including accountability, corruption, and poor transparency, comprise these issues. Inadequate accountability mechanisms at the local level often result in the misuse of resources and poor fiscal discipline (World Bank, 2024). Fukuyama (2005) argues that federalism signifies that the government is more accessible and apparent to the citizens it is intended to serve, which, in theory, should enhance accountability. The capacity of local governments in Nepal is found to be at a moderate level (Adhikari & Kurdi, 2025). Wealthier local governments, which possess stronger own-source revenue-generating capacities, are better positioned to finance local development initiatives, whereas fiscally weaker local governments remain more dependent on intergovernmental transfers from the federal government (Acharya & Bhusal, 2024). Therefore, a major challenge to fiscal decentralization in Nepal is the issue of the institutional capacity of local governments to manage financial resources.

Mismatch Between Responsibilities, Intergovernmental Transfer, Coordination, and Disputes

Another major challenge in Nepal's fiscal decentralization process is the mismatch between the financial responsibilities regarding resources assigned to local governments. Although local governments are constitutionally empowered to manage sectors such as health, education, and infrastructure development, they often lack sufficient revenue sources to finance these activities (Acharya & Zafarullah, 2020). However, these authorities fall under the local, provincial, and federal governments. Khanal (2026) explores that local governments in Nepal heavily depend on federal transfers, generating only 21% of their revenue (average) internally, which constrains real fiscal autonomy. This fiscal imbalance is worsened by the limited capacity of local governments, particularly in rural areas, to generate revenue owing to a smaller tax base. Although intergovernmental transfers from the federal government are intended to fill this financial gap, these funds often come too late and are inadequate, leaving local governments unable to manage their expenditures. In many cases, local governments have become overly dependent on these transfers, undermining their fiscal autonomy (Ghimire, 2023).

The concurrent powers of education and health services are allocated at the local, provincial, and federal levels. The authorities over land and forests have still not been transferred to the local level from the center and the province. Despite sufficient power and authority at the local level based on devolution under federalism, local levels face challenges, such as the inadequacy of laws and policies to implement their powers and authorities, a lack of coordination between local levels and central provinces, and poor resource mobilization. A crucial prerequisite for the success of fiscal decentralization is clear coordination between the different levels of government to avoid redundancies and optimize the use of resources. In Nepal, the division of fiscal responsibilities between federal, provincial, and local governments is often unclear, leading to frequent disputes and overlaps.

Both provincial and local governments claim revenue sources, such as land taxes and vehicle registration fees, causing confusion and reducing the overall efficiency of revenue collection. These disputes extend beyond revenue collection to include the distribution of budgetary resources. The federal government has been accused of maintaining excessive control over financial resources, undermining the autonomy of local governments, and creating tensions between different levels of government (Poudel & Ghantaghar, 2023). This lack of intergovernmental coordination delayed key development projects and weakened the effectiveness of fiscal decentralization. Some major issues, such as weak coordination between multiple layers of government, insufficient legislation, and limited financial transfers/subsidies, are needed to reform the capacity building of the local government. Nepal's fiscal decentralization efforts have been significantly challenged by the lack of a comprehensive legal and regulatory framework. The coordination mechanism between subnational governments is essential for maintaining the involvement of key stakeholders in shaping interdependent roles.

While the Constitution outlines provisions for fiscal decentralization, the actual enactment of laws and regulations that would provide structure and clarity to this process has been slow and uneven (Abdillahi, 2025). This gap in legal frameworks creates ambiguity in key areas, such as revenue distribution, budget creation, and expenditure obligations, leading to confusion among local governments and hampering their ability to efficiently manage finances. Furthermore, frequent alterations in fiscal policies, including changes in tax structures and budget allocations, introduce uncertainty, making it difficult for local governments to engage in consistent long-term planning. Indeed, this unpredictability in policy implementation highlights the issue of institutional instability in Nepal's broader governance practices (Bahl *et al.*, 2022). In Malaysia, local governments are largely autonomous, though mismatches regarding some service authorities are still issues in the context of local governance and decentralization (Flores, 2017).

Fiscal Discipline

Another problem is fiscal discipline. Fiscal discipline is more important in fiscal management. However, local levels have largely faced 'irregular amount' cases (in Nepali, it is called 'Beruju'—the trend of doing business without complying with the law, spending irregularly, or unreasonably). According to the Auditor General's Fifty-Seventh Annual Report 2020, in fiscal year 2019/20, the total outstanding "irregular amount" reached Rs. 418.32 billion after deducting settlements and adding the annual irregular amount of Rs. 40.84 billion (Office of the Auditor General, 2020). The accountability mechanism, processes, and practices should be given greater attention to strengthen fiscal discipline. Furthermore, digitalization of the tax system needs to be enhanced, as it may improve tax collection transparency and contribute to maintaining fiscal discipline.

Politicization of Budgets

Political factors also pose challenges to the implementation of fiscal decentralization in Nepal. Since the federal system introduced by the 2015 Constitution is relatively new, tensions between central and local governments often influence fiscal decisions. The decentralization process is slowed down when political parties oppose giving subnational governments fiscal authority to maintain control (Bhurtel, 2009). Further, political instability at both federal and provincial levels leads to frequent leadership changes, disrupting long-term fiscal planning and management. Although the federal government provides grants to local governments, the allocation of these funds faces challenges related to transparency, institutional capacity, and the application of objective criteria for addressing variations in population, poverty, and development needs (World Bank, 2021). Often, local governments remain influenced by broader political dynamics, with fiscal decisions sometimes reflecting political priorities rather than solely the service delivery needs of local communities. This politicization of fiscal decentralization may reduce its effectiveness, limiting its ability to strengthen local autonomy and improve public service delivery.

According to the Chief of the Bethanchok rural municipality,

"The politicization at the local level based on political parties poses a challenge, as its impact is visible in the budgets. For example, Behanchok faces discrimination in budget allocation as we represent the opposition party. Local governments of the ruling political parties receive adequate budgets and development programs. In my opinion, budget and development programs in Bethanchok are less of a priority for the Center. The discriminatory practice of budget priority, in the name of political parties, is not good for democracy and development. The budget should be allocated based on needs" (based on personal conversation, April 29, 2022).

Limitations

Although this study has certain limitations, it provides insightful information. Because only two local units are selected, the generalizability to different contexts may be limited. The role of tourism in fiscal decentralization is not well understood due to a lack of local tourism statistics. Local units vary greatly in their technological and administrative capabilities.

Future Scope

Future research could look at fiscal decentralization in the framework of federalism, using a larger sample size of local entities. Future research may potentially use a longitudinal strategy, as the cross-sectional technique limits the ability to conclude causality. Additionally, this study suggests that elected officials and legislators set up local levels for effective public service delivery. Along with this, local leaders need training and other support for planning, auditing, and budgeting. The need for more cooperation, as well as regulations on income and expenditure assignments, is highlighted by the gaps in fiscal autonomy.

Conclusion

Fiscal transfers under the current budgetary decentralization system need adjustment, as the existing grant ceilings may not adequately address the diverse needs of all local levels. Enhancing the capacity for resource mobilization is crucial for generating financial resources. It's essential to build the capacity of elected officials to effectively manage local resources. Moreover, improving the office environment—particularly by integrating technology—should be prioritized to make services more accessible and user-friendly. Despite the provision of fiscal autonomy in budgeting and development planning, local governments in Nepal continue to face significant challenges related to income generation and expenditure capacity. Decentralized decision-making in a federal system is more in line with information from local sources, which speeds up the process and increases institutional capacity. While decentralization based on federalism has provided local governments with more roles and responsibilities, many lack comprehensive institutional, administrative, or technical capabilities to manage efficiently.

Fiscal transfers under the current budgetary decentralization system need adjustment, as the existing grant ceilings may not adequately address the diverse needs of all local levels. Enhancing the capacity for resource mobilization is crucial for generating financial resources. It's essential to build the capacity of elected officials to effectively manage local resources. Moreover, improving the office environment—particularly by integrating technology—should be prioritized to make services more accessible and user-friendly. Despite the provision of fiscal autonomy in budgeting and development planning, local governments in Nepal continue to face significant challenges related to income generation and expenditure capacity. Decentralized decision-making in a federal system is more in line with information from local sources, which speeds up the process and increases institutional capacity. While decentralization based on federalism has provided local governments with more roles and responsibilities, many lack comprehensive institutional, administrative, or technical capabilities to manage efficiently.

COVID-19 has shown lessons on the need for stronger local government capacity to cope with local problems. Only local governments understand the needs and preferences of local people. The present fiscal decentralization system offers significant opportunities in the context of local development to strengthen local governance and support equitable development. Local governments can increase tourism as their main source of revenue thanks to the present decentralization policy. It might provide nearby resources that could lessen the center's reliance. For instance, Bethanchok Rural Municipality used to be a popular destination for hikers from Kathmandu. It makes sense to suggest that bolstering local revenue structures (such as trekking permits, local tourist levies, homestay licenses, and local service taxes) might raise the proportion of tourism-related benefits that are collected locally. The sustainable agricultural development approach can enhance local resources in both rural municipalities.

However, there are several obstacles standing in the way of their success. These include limited grants and poor resource mobilization, imbalances between assigned responsibilities, unclear legal frameworks, and party politics. Overcoming these challenges requires continued political commitment, capacity development, effective coordination between different levels of government, and appropriate utilization of fiscal resources. To accomplish successful fiscal decentralization, local governments need to have more institutional capability in the areas of planning and implementation.

CRediT Authorship Contribution Statement

D.C: Conceptualization, Methodology, Investigation, Data Collection, Formal Analysis, and Writing – Original, **M.S.B:** Supervision and Review, **S.K.O:** Review and Feedback, **M.S:** Review and Feedback

AI Assistance Declaration

During the writing process, AI and AI-assisted technologies were not used. The author is fully responsible for writing and editing the content.

Conflict of Interest

The authors declare that they have no conflict of interests.

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