

## NEPAL

FEDERAL COUNTRY

## BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: LOW INCOME

LOCAL CURRENCY: NEPALESE RUPEE (NPR)

## POPULATION AND GEOGRAPHY

**Area:** 147 180 km<sup>2</sup>**Population:** 29.305 million inhabitants (2017), an increase of 1.2% per year (2010-2015)**Density:** 199 inhabitants / km<sup>2</sup>**Urban population:** 19.3 % of national population**Urban population growth:** 3.2 % (2017 vs 2016)**Capital city:** Kathmandu (4.5 % of national population)

## ECONOMIC DATA

**GDP:** 79 billion (current PPP international dollars), 2 697 dollars per inhabitant (2017)**Real GDP growth:** 7.5 % (2017 vs 2016)**Unemployment rate:** 2.7 % (2017)**Foreign direct investment, net inflows (FDI):** 196 (BoP, current USD millions, 2017)**Gross Fixed Capital Formation (GFCF):** 34% of GDP (2017)**HDI:** 0.574 (medium), ranking 149 (2017)**Poverty rate:** 15% (2010)

## MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

Following the end in 2006 of a decade-long civil war, Nepal's governance framework is currently in the transition from being a Monarchy to a multiparty democratic republic. With the promulgation of the new Constitution in 2015, Nepal moved from a unitary form of government to a federal one with a strong focus on decentralization based on "cooperative federalism". The new federation has three tiers of government, namely federal, state and local, whereby powers shall be exercised pursuant to the Constitution and the state laws. The Constitution has assigned both exclusive and concurrent powers, to be jointly exercised by the federal and the state levels or jointly by all three tiers of government.

The jurisdiction of the local governments is outlined under Schedule 8 of the Constitution, which establishes that local governments are responsible for development activities and for mobilizing the necessary resources to carry out such activities. As such, the new Constitution assigns local governments a larger functional and fiscal authority. The jurisdiction of the federal government is outlined under Schedule 5, to be exercised in accordance with the Constitution and the federal law. To date some of the laws that have been enacted include the Inter-Governmental Fiscal Management Act (2017), the Employees Integration Act (2017) and the Local Governance Operation Act (2017) along with a number of local and State Acts.

Local elections took place in 2017, following a 20-year gap. The National Assembly election took place in 2018, while the State Assembly and election for the House of Representatives took place on 26 November 2017 and 7 December 2017, in two phases. State creation is entirely new for Nepal and it is therefore too early to comment on the relationship between States and local governments for now.

## TERRITORIAL ORGANISATION

2016	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	276 urban municipalities ( <i>Nagarpalika</i> ) 460 rural municipalities ( <i>Gaunpalika</i> ) 6 metropolitan cities (Kathmandu, Pokhara, Biratnagar, Birgunj, Lalitpur, and Bharatpur) 11 sub-metropolitan cities Average municipal size: 7 450 inhabitants		7 provinces ( <i>Pradesh</i> )	
	753		7	760

**OVERALL DESCRIPTION.** As of 2014, prior to the administrative restructuring of Nepal, there were 75 districts, 3 914 village development committees, 6 metropolitan cities and 11 sub-metropolitan cities and 58 municipalities. During the course of 2015 and 2017, the number of municipalities increased according to the classification established by the Local Level Restructuring Commission. As a result, 7 provinces with 753 local government units were established. Any future change in the number and delimitation of local administrative units shall be made by a resolution passed by a two-thirds majority of the members of the municipality affected by the change. This change will be submitted to the state government, which will then recommend it to the Government of Nepal.

**STATE LEVEL.** The 7 provinces are divided into 77 districts for administrative purposes. Provinces' assemblies are still in the process of enacting budget laws and debating what their capitals and names will be. As of 2019, only two provinces had made decisions on these matters: the provinces of Karnali and Gandaki, whose capitals will be Birendranagar and Pokhara respectively.

**MUNICIPALITIES.** Local governments are subcategorized according to their population, resources and basic infrastructure: metropolitan cities, sub-metropolitan cities, urban and rural municipalities. The classification criteria are outlined in the Local Governance Operation Act and include minimum population and income requirements that depend on the geographical location of the local government, i.e. whether it is located in the mountains, hills or on the mainland. Municipalities must have an average annual domestic income of at least NPR 10 million (about USD 1 million) for the last five years in the Himalayan region and at least NPR 30 million (about USD 3 million) for other districts. Sub-metropolitan cities must have an average income of at least NPR 250 million (about US\$ 25 million) and metropolitan cities at least NPR 1 billion (about US\$ 100 million) over the past five years. For metropolitan cities, the

minimum infrastructure and facilities specified in the Local Governance Operations Act include requirements such as 75% of the total length of roads should be concrete, higher education institutions, and specialized service hospitals with at least 500 beds.

**INTER-MUNICIPAL CO OPERATION.** At national level, a Municipal Association of Nepal (MuAN) was established in 1994 after being contemplated by the 1961 National Directive Act. Following the 2017 local elections, in September 2018 MuAN completed its General Assembly and is undergoing a revision of its Strategy Plan in order to put forward revised plans and policies.

## SUBNATIONAL GOVERNMENT RESPONSIBILITIES

With the transformation to a federal system, the Constitution provided the three levels of government with five lists of powers: Three exclusive lists (Annexes 5, 6 and 7 of the Constitution), a concurrent federal-state list (Annex 8) and a concurrent federal-state-local government list (Annex 9). It is too early to compare the general principles and systems that may differ from one State to another, given that Nepal is currently in a transitional phase. States and local governments are currently drafting laws according to their areas of jurisdiction. The table below has been updated in accordance with the main areas of responsibilities delineated by the Constitution of Nepal, which are also reflected in the 2017 Local Governance Operation Act.

### MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

	PROVINCE LEVEL	MUNICIPAL LEVEL
<b>1. General public services</b>	State civil service and other government services; State level electricity, irrigation and water supply services; Navigation	Management of the local services; Local roads, rural roads, agro-roads; Irrigation
<b>2. Public order and safety</b>	State police administration and peace and order; State bureau of investigation	Town police
<b>3. Economic affairs /transports</b>	Intra-State trade; State highways; Exploration and management of mines; Agriculture and livestock development; Factories and industrialization	Agriculture and animal husbandry; Agro-products management; Animal health; Cooperatives and local markets management
<b>4. Environmental protection</b>	Use of forests and waters; Management of environment within the State	Environment protection and biodiversity
<b>5. Housing and community amenities</b>		Local level development plans and projects
<b>6. Health</b>	Health services	Basic health and sanitation
<b>7. Recreation, culture &amp; religion</b>	Protection and use of languages, scripts, cultures, fine arts and religions	Protection and development of languages, cultures and fine arts
<b>8. Education</b>	State universities; Higher education; Libraries; Museums	Basic and secondary education
<b>9. Social protection</b>	Management of trusts (Guthi)	Management of senior citizens, persons with disabilities and the incapacitated

## SUBNATIONAL, STATE AND LOCAL GOVERNMENT FINANCE

<b>Scope of fiscal data:</b> detailed financial data are not available.	Other	Availability of fiscal data: <b>Low</b>	Quality/reliability of fiscal data : <b>Low</b>
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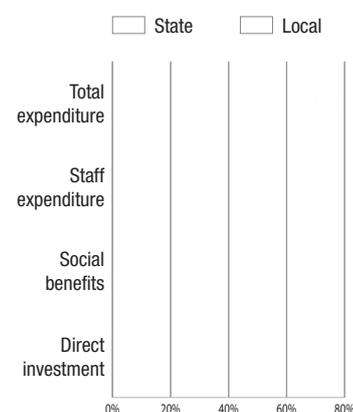
**GENERAL INTRODUCTION.** The Constitution has provisioned for exclusive as well as concurrent revenue assignments for all tiers of government. Article 60 defines the general principles of the distribution of sources of revenue across the three levels of governments, which are determined following the recommendations of the National Natural Resources and Fiscal Commission (NNRFC). It is also established that the federation, states and local governments have taxing power in their fiscal jurisdiction and collect revenue from such sources. In 2016, a National Urban Development Strategy (NUDS) was adopted as the framework for steering local development. In order to achieve the development objectives outlined in the NUDS, the municipal financing system was built on three components: Own Source Revenue (OSR), Inter Government Fiscal Transfers (IGFT) and the local borrowing framework, within which the Town Development Fund (TDF) plays a central role.

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## SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

	DOLLARS PPP / INH.			% GDP			% SUBNATIONAL, STATE AND LOCAL GOVERNMENT EXPENDITURE			% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)		
	SNG	State	Local	SNG	State	Local	SNG	State	Local	State	Local	
<b>Total expenditure</b>												
<b>Inc. current expenditure</b>												
Staff expenditure												
Intermediate consumption												
Social expenditure												
Subsidies and current transfers												
Financial charges												
Others												
<b>Incl. capital expenditure</b>												
Capital transfers												
Direct investment (or GFCF)												

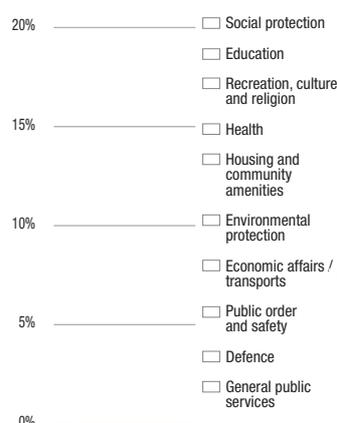


**EXPENDITURE.** In fiscal year 2013/14, local spending accounted for 8% of total public spending, with 72% of total local expenditure being capital expenditure and 28% being current expenditure. As a result of the vertical reallocation of public expenditure resulting from the change in the political-administrative system, at least 20% of public expenditure should be made at subnational level. Today, newly created subnational governments do not have sufficient resources to deliver the public services entrusted to them, particularly because of a lack of clarity about their authority to mobilize the necessary resources to implement their budgets.

**DIRECT INVESTMENT.** In FY2017/2018, relevant sectoral ministries provided support for projects and programs with budget up to Rs 5 million in rural municipalities (approximately 159 000 dollars PPP), up to Rs 10 million in municipalities (approximately 320 000 dollars PPP), and up to Rs 20 million in sub-metropolitan and metropolitan cities (approximately 640 000 dollars PPP).

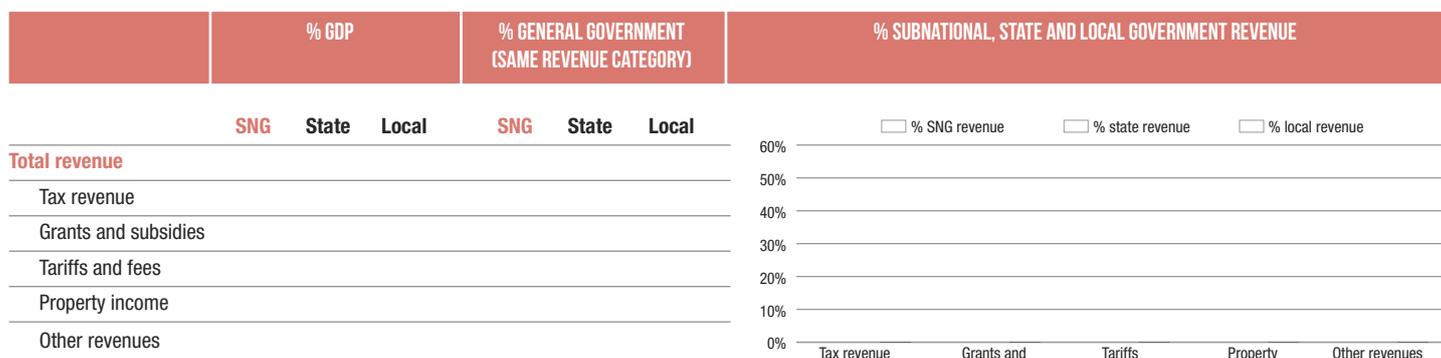
## SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

	% GDP			% SUBNATIONAL, STATE AND LOCAL GOVERNMENT			SNG EXPENDITURE AS A % GDP	% OF TOTAL SNG EXPENDITURE
	SNG	State	Local	SNG	State	Local		
<b>Total expenditure</b>								
1. General public services								
2. Defence								
3. Security and public order								
4. Economic affairs / transports								
5. Environmental protection								
6. Housing and community amenities								
7. Health								
8. Recreation, culture and religion								
9. Education								
10. Social protection								



As a result of the vertical re-allocation of public expenditure, a significant portion of the total expenditure on education, housing, community affairs and health is expected to take place at the local level, while expenditure on public services and economic affairs is expected to continue taking place at the national level.

## SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY



**OVERALL DESCRIPTION.** Local governments' own source revenues are insufficient to meet their expenditure needs and therefore they depend heavily on grants from the federal government. According to the Intergovernmental 2017 Finance Management Act, local governments receive four types of federal grants, namely the fiscal equalization, conditional, complementary (matching) and special grants. The grants are transferred by the federal government based on NNRFC's recommendation. Despite such provisions, there is a need for additional capacity to administer revenues at the local level and there is still no policy nor guidelines in place to regulate how to do so. Given that the new structures have only recently materialized, there is limited information on the revenue collection amounts and potentials. In the future, local governments may receive transfers from state governments, but they will likely be minimal since the states will also heavily depend on federal grants. Moreover, local governments have limited access to capital markets and private sector finance for their infrastructure investment needs.

**TAX REVENUE.** Over the period of 2008/09 to 2013/14, the own source revenue (OSR) of the 58 municipalities that existed at that time grew at an average annual rate of 13.8 per cent and, on average, the municipalities' OSR in the period only accounted for 27% of total revenue. Taxes and fees were the main sources of municipality OSR, with local tax as the highest (47.6%) contributor followed by service charges and fees (42.4%), and property rental (7.6%). Local governments' main sources of tax revenue are house and land tax (HALT), integrated property tax (IPT), land revenue tax, entertainment tax, advertisement tax, rent tax, business tax, vehicle tax commercial video tax. The Constitution of Nepal has given municipalities the right to raise their OSR for meeting responsibilities such as drinking water supply, small electricity generation, alternative energy, local roads, and irrigation, in addition to those provided under Local Self Governance Act (LSGA). Nevertheless, an inefficient tax administration system and poor collection efficiency remain the main challenges of local governments in increasing tax revenues. According to the 2017 Intergovernmental Fiscal Management Act, the federal government is to transfer 15% of the VAT and excise duty collected to local governments and 15% to the States, as well as 25% of royalties received from the use of natural resources to local governments and 25% to States. The NNRFC has currently devised a revenue-sharing formula based on the population and demographic structure, area, human development index, efforts on revenue collection, infrastructure development and expenditure requirements.

**GRANTS AND SUBSIDIES.** Intergovernmental Fiscal Transfer (IGTF), the main source of funding for most municipalities, grew by an average of 29% from 2006 to 2016. Currently, the types of grants municipalities receive are both conditional and unconditional, representing 52% and 48% of total grants respectively. The unconditional capital grant comprises two systems that are (a) basic (fixed) entitlements grants, and (b) a formula-based grant based on (i) population (50%), (ii) weighted poverty (25%), (iii) surface area (10%), and (iv) weighted tax effort (15%). Performances are assessed as per indicators set in the Minimum Conditions and Performance Measures (MCPM) system. The conditional grants are allocated to States and local governments to implement specific projects commissioned by federal and State governments in various sectors including health, education, social security, agriculture, forest and environment, irrigation, energy, infrastructure. Furthermore, the latest national budgets assign complementary grants to States and local governments for projects concerning the improvement of drinking water services and river control. The NNRFC has also fixed a minimum level of grants for local governments units to enhance the feeling of federalism and their right to choose their development priorities. In general, resource transfers are often irregular and unpredictable, making it difficult for municipalities to procure and implement planned and budgeted programs in an efficient and accountable manner.

## SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

	DOLLARS PPP/INH.			% GDP			% GENERAL GOVERNMENT DEBT			% SNG DEBT		
	SNG	State	Local	SNG	State	Local	SNG	State	Local	SNG	State	Local

### Total outstanding debt

Financial debt\*

\* Currency and deposits, loans and bonds

**DEBT.** The framework provided by the NUDS establishes that local governments may borrow funds from two main sources, the TDF and financial institutions, to meet the demand for infrastructure development. However, borrowing has not been a major source of municipal financing so far, as current borrowing represents, on average, only 0.85% of total municipal revenue (or 3% of municipal internal revenue). The TDF was set up by the 1997 Town Development Fund Act, which grants the TDF the autonomy to function as a financial intermediary institution for the development of urban infrastructure in Nepal. It is currently the only public sector organization to finance urban infrastructure and does so by applying long-term financing schemes. However, so far, the TDF has only been mobilized to finance a few urban infrastructure projects. Although there is an incentive mechanism in place to stimulate local borrowing for infrastructure development (namely, matching loans and grants), the municipal demand for TDF loans is still very low compared to the existing infrastructure financing gap. In order to achieve NUDS objectives, the 2016 Municipal Finance Framework calls for the restructuring of TDF as a full-fledged financial intermediary with a clearly defined mandate and responsibilities in funding infrastructure development.