



Opportunities and Challenges in Implementing Fiscal Federalism: A Case Study of Nepal's Local Governance

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Abstract

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Federalism enables power-sharing between central and regional administrations, with fiscal federalism focusing on resource allocation to improve governance. Nepal's 2015 Constitution established a federal system emphasizing decentralization and participatory governance. Despite advancements like Performance-Based Grant Systems, challenges in resource allocation, infrastructure, and coordination persist. This study explored fiscal federalism's challenges and opportunities to enhance governance and equitable development in Nepal. Using a descriptive cross-sectional design, data were collected from 384 local government officials involved in fiscal policy and management in Nepal. Data analysis, performed using SPSS version 20. The results highlight significant challenges, including insufficient funding (89.3%), political interference (89.6%), and lack of clear guidelines (85.9%). Opportunities identified include improved local economic growth (mean = 4.74), public service delivery (mean = 4.20), and accountability (mean = 4.17). However, the implementation of fiscal federalism is hindered by issues such as political instability (mean = 4.10) and resource allocation challenges (mean = 3.68). Despite these obstacles, respondents largely agree that fiscal federalism has contributed positively to local governance, with 94.3% agreeing that it has improved governance and 96% noting increased public participation. The study concludes that while fiscal federalism has shown promise in enhancing local autonomy and service delivery, addressing funding shortages, capacity deficits, and coordination challenges is crucial for maximizing its potential to foster equitable development and improve the quality of life in Nepal.

Keywords: Challenges, Fiscal Federalism, Governance, Implementation, Opportunities.

Declaration: *There is no conflict of interest, and I follow the research Ethics.*

Introduction

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Federalism is a governance system in which constitutional powers are divided between central and subnational governments, allowing each level to exercise authority within its jurisdiction while maintaining national unity amid territorial, socio-economic, cultural, and ethnic diversity (Acharya & Zafarullah, 2020; Brown et al., 2018). A central component of this system is fiscal federalism, which focuses on the assignment of taxation powers, expenditure responsibilities, and intergovernmental fiscal transfers across levels of government to promote efficient resource allocation, equitable income distribution, and macroeconomic stability (Akindele et al., 2001; Musgrave, 1959, 1961; Shah, 2016). Through mechanisms such as grants and revenue-sharing, lower tiers support service delivery while the central government primarily handles stabilization and redistribution functions. Nepal, declared a Federal Democratic Republic by the 2015 Constitution, has adopted decentralization to strengthen participation, local self-governance, equity, and service delivery (Shah, 2019). Although fiscal federalism enables context-sensitive planning, administrative efficiency, and intergovernmental competition, it also faces challenges related to accountability, institutional capacity, and infrastructure limitations at the provincial and local levels (Moges, 2013; Poudel, 2023; Pyakuryal, 2009). These dynamics make fiscal federalism a critical area for examining governance effectiveness and grassroots development in Nepal (Béland & Lecours, 2014).

After the 2015 Constitution, Nepal adopted federalism with fiscal decentralization to strengthen local governance, reduce regional disparities, and improve service delivery by assigning revenue and expenditure responsibilities across government tiers (Khadka, 2016; Poudel, 2023). Although the framework allows subnational governments to raise stable local taxes and non-tax revenues while the central government manages redistributive and stabilization taxes, implementation has faced persistent challenges, including unequal resource distribution, limited institutional and technical capacity at local levels, coordination complexities, and fiscal constraints that restrict autonomous decision-making. Performance-Based Grant Systems have improved transparency, accountability, and financial discipline while supporting capacity building and service delivery, yet structural and administrative barriers continue to hinder effective fiscal decentralization (Steffensen, 2016). These issues raise critical concerns about how fiscal federalism actually influences governance quality, public service delivery, and local economic development in Nepal, highlighting the need to examine both its opportunities and operational bottlenecks to strengthen the federal system (Poudel, 2023). Therefore, this study aimed to examine the opportunities and challenges in implementing fiscal federalism in Nepal with a focus on local governance.



Methodology

This study employed a descriptive cross-sectional design using a quantitative research approach to explore the challenges and opportunities of implementing fiscal federalism in Nepal. It focused on 384 local government staff members, including mayors, deputy mayors, chief administrative officers, section officers, finance officers, ward chairpersons, ward members, executive members, and ward secretaries, who are engaged in financial management, accounting, and policy implementation of fiscal federalism in Nepal. Participants were selected through purposive sampling. Data collection was conducted through Google Forms with structured questionnaires to gather demographic details, along with data on the challenges, opportunities, and participants' perceptions and understanding of fiscal federalism at the local level. The data were analyzed using SPSS version 20, employing descriptive statistics such as frequencies, percentages, means, and standard deviations to summarize participant characteristics.

Results and Discussion

Table 1: Respondents' Profile

Sociodemographic variables	Category	Frequency (N)	Percent (%)
Age of the respondents	0-30 years	10	2.6
	31-40 years	111	28.9
	41-50 years	190	49.5
	51 years and above	73	19.0
Gender of the respondents	Male	269	70.1
	Female	115	29.9
Educational level of the respondents	Basic level (1-8)	8	2.1
	Secondary level (9-12)	83	21.6
	Bachelor level	170	44.3
	Master level	123	32.0
Current position within the local government entity	Mayor	12	3.1
	Deputy Mayor	14	3.6
	Chief Administrative Officer	18	4.7
	Section Officer	174	45.3
	Finance Officer	3	0.8
	Ward Chairperson	91	23.7
	Ward Member	29	7.6
	Executive Member	11	2.9
	Ward Secretary	32	8.3
	Insufficient funding	343	89.3
	Lack of clear guidelines	330	85.9



Sociodemographic variables	Category	Frequency (N)	Percent (%)
Obstacles Faced While Executing Fiscal Federalism at the Local Level	Political interference	344	89.6
	Bureaucratic hurdles	300	78.1

Table 1 presents respondents' sociodemographic characteristics. Most respondents are aged 41-50 years (49.5%), with 28.9% in the 31-40 age group. The gender distribution shows a predominance of males (70.1%). In terms of education, 44.3% hold a bachelor's degree, and 32% have a master's degree. Regarding positions, 45.3% are Section Officers, 23.7% are Ward Chairpersons, and other roles, such as Mayor (3.1%) and Finance Officer (0.8%) are less common. This indicates a largely middle-aged, male, well-educated workforce in mid-level administrative positions. The table also highlights common obstacles faced in implementing fiscal federalism at the local level. Key challenges include insufficient funding (89.3%), political interference (89.6%), lack of clear guidelines (85.9%), and bureaucratic hurdles (78.1%). These obstacles are seen as significant barriers to effective fiscal federalism implementation in local governance.

Table 2: Opportunities of Fiscal Federalism

Opportunities of fiscal federalism		Frequency (N)	Percentage (%)	Mean	Std. Deviation
Impact on Local Economic Growth and Development	Strongly disagree	0	0.0	4.74	0.479
	Disagree	1	0.3		
	Neutral	4	1.0		
	Agree	89	23.2		
	Strongly agree	290	75.5		
Quality and accessibility of public services at the local level	Significantly not improved	0	0.0	4.20	0.446
	Not improved	2	0.5		
	Neutral	2	0.5		
	Improved	299	77.9		
	Significantly improved	81	21.1		
Promotion of Equitable Development across different local regions	Strongly disagree	5	1.3	4.13	0.592
	Disagree	4	1.0		
	Neutral	3	0.8		
	Agree	295	76.8		
	Strongly agree	77	20.1		
Accountability and Transparency in Local Government	Very Low Degree	0	0.0	4.17	0.553
	Low Degree	1	0.3		
	Moderate Degree	29	7.6		
	High Degree	259	67.4		

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	Very High Degree	95	24.7		
role of community participation in the success of fiscal federalism at the local level	Not Important	0	0.0	4.61	0.553
	Slightly Important	0	0.0		
	Moderately Important	13	3.4		
	Very Important	123	32.0		
	Extremely Important	248	64.6		
Efficiency of Local Government Operations	Strongly disagree	0	0.0	3.49	0.560
	Disagree	11	2.9		
	Neutral	175	45.6		
	Agree	197	51.3		
	Strongly agree	1	0.3		
Capacity to Generate and Manage Revenues	Strongly Disbelieve	0	0.0	4.23	0.585
	Disbelieve	2	0.5		
	Neutral	25	6.5		
	Believe	238	62.0		
	Strongly Believe	119	31.0		
Opportunities to Address Local Needs	Strongly disagree	0	0.0	4.16	0.665
	Disagree	7	1.8		
	Neutral	38	9.9		
	Agree	226	58.9		
	Strongly agree	113	29.4		
better utilization of local resources	Strongly disagree	7	1.8	3.96	0.527
	Disagree	0	0.0		
	Neutral	19	4.9		
	Agree	333	86.7		
	Strongly agree	25	6.5		
Improved the collaboration between local governments and local businesses	Significantly not improved	6	1.6	3.70	0.755
	Not improved	35	9.1		
	Neutral	43	11.2		
	Improved	284	74.0		
	Significantly improved	16	4.2		

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Table 2 presents the perceived opportunities of fiscal federalism, including the mean values. The impact on local economic growth (Mean = 4.74) was overwhelmingly positive, with 75.5% strongly agreeing. Similarly, the quality and accessibility of public services (Mean = 4.20) and equitable development (Mean = 4.13) were highly regarded, with 77.9% and 76.8% agreeing or strongly agreeing, respectively. Accountability and transparency were also rated positively (Mean = 4.17), with 67.4% indicating a high degree of agreement. Community participation was considered crucial (Mean = 4.61), with 96.6% of respondents highlighting its importance. The efficiency of local government operations (Mean = 3.49) had mixed responses, but 51.3% agreed or strongly agreed. Respondents also supported the capacity for revenue generation (Mean = 4.23), local needs addressing (Mean = 4.16), and better resource utilization (Mean = 3.96), with high agreement (62%, 58.9%, and 86.7%, respectively). Lastly, collaboration between local governments and businesses showed improvement (Mean = 3.70), with 74% agreeing or strongly agreeing. These results suggest strong confidence in the positive impacts of fiscal federalism.

Table 3: Challenges of Fiscal Federalism Implementation in Nepal

Challenges of Fiscal Federalism Implementation		Frequency (N)	Percentage (%)	Mean	Std. Deviation
Sufficiency of Rules and Laws for Fiscal Federalism	Strongly disagree	0	0.0	3.43	1.057
	Disagree	119	31.0		
	Neutral	29	7.6		
	Agree	188	49.0		
	Strongly agree	48	12.5		
Difficulty in Managing Tasks at the Local Level	Strongly disagree	8	2.1	3.90	0.790
	Disagree	22	5.7		
	Neutral	27	7.0		
	Agree	271	70.6		
	Strongly agree	56	14.6		
Impact of Insufficiently Trained Staff	Very Low impact	0	0.0	4.20	0.643
	Low impact	0	0.0		
	Moderate impact	48	12.5		
	High impact	210	54.7		
	Very High impact	126	32.8		
Difficulty in Allocating Budget and Resources	Not Challenging	8	2.1	3.68	0.719
	Slightly Challenging	6	1.6		
	Moderately Challenging	115	29.9		
	Very Challenging	228	59.4		
	Extremely Challenging	27	7.0		
Impact of Political Instability	Very Low Impact	0	0.0	4.10	0.779
	Low Impact	4	1.0		
	Moderate Impact	87	22.7		

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Challenges of Fiscal Federalism Implementation		Frequency (N)	Percentage (%)	Mean	Std. Deviation
	High Impact	160	41.7		
	Very High Impact	133	34.6		
Challenge of Working with Other Levels of Government	Not Challenging	7	1.8	3.49	0.693
	Slightly Challenging	15	3.9		
	Moderately Challenging	153	39.8		
	Very Challenging	201	52.3		
	Extremely Challenging	8	2.1		
Impact of Lack of Infrastructure	Very Low Extent	70	18.2	3.04	1.128
	Low Extent	19	4.9		
	Moderate Extent	130	33.9		
	High Extent	157	40.9		
	Very High Extent	8	2.1		
Effectiveness of Communication between Local and Central Governments	Very Ineffective	17	4.4	3.04	1.047
	Ineffective	147	38.3		
	Neutral	30	7.8		
	Effective	185	48.2		
	Very Effective	5	1.3		
Sufficiency of Local Government Autonomy	Strongly disagree	1	0.3	4.11	0.768
	Disagree	14	3.6		
	Neutral	46	12.0		
	Agree	203	52.9		
	Strongly agree	120	31.3		
Complex rules and procedures slow down or block local government financial and budget plans	Strongly disagree	2	0.5	4.26	0.685
	Disagree	9	2.3		
	Neutral	14	3.6		
	Agree	221	57.6		
	Strongly agree	138	35.9		

Table 3 outlines the challenges of fiscal federalism implementation in Nepal, highlighting various issues faced at the local level. The sufficiency of rules and laws for fiscal federalism is mostly agreed upon, with 49% agreeing and 12.5% strongly agreeing, yielding a mean of 3.43. Managing tasks at the local level is seen as a challenge, with 70.6% agreeing and 14.6% strongly agreeing, giving a mean of 3.90. Insufficient trained staff has a significant impact, with 54.7% reporting high impact and 32.8% indicating very high impact, reflected in a mean of 4.20. Allocating budgets and resources is considered very challenging, with 59.4% finding it very challenging and 7% extremely challenging, resulting in a mean of 3.68. Political instability is also a major challenge, with 41.7% indicating a high impact and 34.6% very high impact, with a mean of 4.10. The challenge of collaborating with other levels of government is seen as very challenging by 52.3%, with a mean of 3.49. Infrastructure deficits affect local governance, with 40.9% indicating high



impact, reflected in a mean of 3.04. Communication between local and central governments is perceived as ineffective, with 38.3% reporting it as ineffective, resulting in a mean of 3.04. Local government autonomy is generally viewed positively, with 52.9% agreeing and 31.3% strongly agreeing, yielding a mean of 4.11. Lastly, complex rules and procedures are seen as obstructing financial and budget plans, with 57.6% agreeing and 35.9% strongly agreeing, reflected by a mean of 4.26. These findings highlight the significant challenges faced in the implementation of fiscal federalism at the local level in Nepal.

Table 4: Perception on Challenges in Implementing Fiscal Federalism at the Local Level

Perception of challenges		Frequency (N)	Percentage (%)	Mean	Std. Deviation
Fiscal federalism faces challenges due to inadequate funding from the central government.	Strongly disagree	3	0.8	4.46	0.657
	Disagree	2	0.5		
	Neutral	11	2.9		
	Agree	168	43.8		
	Strongly agree	200	52.1		
Local government officials lack sufficient capacity and training to manage fiscal responsibilities effectively.	Strongly disagree	7	1.8	4.37	0.710
	Disagree	2	0.5		
	Neutral	4	1.0		
	Agree	201	52.3		
	Strongly agree	170	44.3		
There are significant coordination issues between different levels of government under fiscal federalism.	Strongly disagree	5	1.3	4.19	0.663
	Disagree	5	1.3		
	Neutral	10	2.6		
	Agree	257	66.9		
	Strongly agree	107	27.9		
Regulatory and legislative constraints hinder the effective implementation of fiscal federalism.	Strongly disagree	7	1.8	4.12	0.699
	Disagree	2	0.5		
	Neutral	25	6.5		
	Agree	253	65.9		
	Strongly agree	97	25.3		
There is a lack of public awareness and understanding of fiscal federalism and its benefits.	Strongly disagree	9	2.3	4.50	0.772
	Disagree	2	0.5		
	Neutral	6	1.6		
	Agree	138	35.9		
	Strongly agree	229	59.6		
Perception on opportunities					

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Perception of challenges		Frequency (N)	Percentage (%)	Mean	Std. Deviation
Fiscal federalism provides opportunities for enhanced local autonomy in decision-making.	Strongly disagree	9	2.3	4.22	0.757
	Disagree	4	1.0		
	Neutral	11	2.9		
	Agree	230	59.9		
	Strongly agree	130	33.9		
The implementation of fiscal federalism can lead to improved public service delivery.	Strongly disagree	11	2.9	4.27	0.775
	Disagree	0	0.0		
	Neutral	11	2.9		
	Agree	214	55.7		
	Strongly agree	148	38.5		
Fiscal federalism promotes local economic development by allowing regions to manage their resources.	Strongly disagree	10	2.6	4.16	0.842
	Disagree	6	1.6		
	Neutral	32	8.3		
	Agree	201	52.3		
	Strongly agree	135	35.2		
Local governments are more accountable to their citizens under fiscal federalism.	Strongly disagree	7	1.8	4.30	0.699
	Disagree	0	0.0		
	Neutral	11	2.9		
	Agree	217	56.5		
	Strongly agree	149	38.8		
Fiscal federalism has the potential to reduce regional disparities by ensuring equitable resource distribution.	Strongly disagree	8	2.1	3.39	1.105
	Disagree	106	27.6		
	Neutral	55	14.3		
	Agree	157	40.9		
	Strongly agree	58	15.1		

Table 4 presents both the challenges and opportunities perceived by the respondents in the implementation of fiscal federalism at the local level. Respondents overwhelmingly perceive funding as a major challenge, with 95.9% agreeing (52.1% strongly agreeing) that inadequate funding from the central government hinders effective implementation, reflected by a high mean score of 4.46. Capacity and training deficiencies among local government officials also pose a significant challenge, as 96.6% agreed (44.3% strongly agreed), with a mean of 4.37. Coordination issues between various levels of government are considered another obstacle, with 94.8% agreeing (27.9% strongly agreeing), resulting in a mean of 4.19. Regulatory and legislative constraints were highlighted by 91.2% (25.3% strongly agreeing) as impediments, with a mean of 4.12. Lastly, the lack of public awareness about fiscal federalism is seen as a barrier by 95.5% of respondents (59.6% strongly agreeing), with the highest mean of 4.50. On the opportunities side, fiscal federalism is seen as enabling enhanced local autonomy, with 93.8% agreeing (33.9% strongly agreeing),



yielding a mean of 4.22. It is also believed to improve public service delivery, with 94.2% agreeing (38.5% strongly agreeing), reflected by a mean of 4.27. Local economic development is another perceived benefit, with 87.5% agreeing (35.2% strongly agreeing), and a mean of 4.16. The accountability of local governments to citizens is seen as strengthened under fiscal federalism, with 95.3% agreeing (38.8% strongly agreeing), resulting in a mean of 4.30. However, the potential for reducing regional disparities is considered less strongly supported, with 68.1% agreeing (15.1% strongly agreeing), yielding a mean of 3.39. These findings illustrate a balanced perception, where challenges related to funding and coordination dominate, while fiscal federalism's potential for local empowerment, service improvement, and accountability is strongly acknowledged.

Table 5: Perception on the overall impact of fiscal federalism

Overall impact of fiscal federalism		Frequency (N)	Percentage (%)	Mean	Std. Deviation
Fiscal federalism has positively impacted overall governance in Nepal.	Strongly disagree	6	1.6	4.37	0.725
	Disagree	2	0.5		
	Neutral	14	3.6		
	Agree	185	48.2		
	Strongly agree	177	46.1		
The implementation of fiscal federalism has increased public participation in local governance.	Strongly disagree	5	1.3	4.34	0.682
	Disagree	3	0.8		
	Neutral	7	1.8		
	Agree	211	54.9		
	Strongly agree	158	41.1		
Fiscal federalism has led to more efficient public spending at the local level.	Strongly disagree	0	0.0	4.50	0.650
	Disagree	4	1.0		
	Neutral	21	5.5		
	Agree	139	36.2		
	Strongly agree	220	57.3		
There is greater transparency in government operations due to fiscal federalism.	Strongly disagree	3	0.8	4.22	0.654
	Disagree	9	2.3		
	Neutral	4	1.0		
	Agree	253	65.9		
	Strongly agree	115	29.9		
Fiscal federalism has improved the overall quality of life for residents in my region.	Strongly disagree	0	0.0	3.89	0.570
	Disagree	14	3.6		
	Neutral	43	11.2		
	Agree	297	77.3		
	Strongly agree	30	7.8		



Table 5 presents respondents' perceptions on the overall impact of fiscal federalism in Nepal. The majority agree that fiscal federalism has positively impacted governance (94.3% agreement, mean 4.37) and increased public participation in local governance (96% agreement, mean 4.34). Respondents also believe fiscal federalism has improved public spending efficiency at the local level (93.5% agreement, mean 4.50) and enhanced transparency in government operations (95.8% agreement, mean 4.22). However, the perception that fiscal federalism has significantly improved the quality of life for residents is less pronounced, with 85.1% agreement (mean 3.89).

Discussion

The socio-demographic findings of the present study revealed that a significant portion of the local government workforce is middle-aged, predominantly male, and highly educated, with the majority holding bachelor's or master's degrees. Most respondents occupy mid-level administrative roles, such as Section Officers and Ward Chairpersons, while higher leadership positions are less common. This demographic profile indicates a well-qualified and experienced workforce, with a clear emphasis on administrative functions, which may enhance the efficiency and effectiveness of governance processes at the local level. However, the underrepresentation of top leadership positions may limit the overall decision-making power and strategic direction in local governance. These findings align with similar observations in Ethiopia (Yimenu et al., 2021), where a well-educated and mid-level workforce shapes local governance but faces challenges due to limited leadership roles and centralized control.

Regarding the implementation of fiscal federalism, respondents highlighted several significant challenges that hinder its success. The most critical challenges include political interference, inadequate funding, and the lack of clear guidelines, which are seen as major obstacles in achieving effective fiscal federalism. Over 89% of respondents identified political interference and insufficient funding as particularly detrimental, reflecting a widespread concern that central government control limits local autonomy and hampers resource allocation. Bureaucratic hurdles and the need for more clear and comprehensive policy frameworks further complicate the implementation, creating delays and inefficiencies in local governance. These issues mirror the struggles observed in Ethiopia (Yimenu et al., 2021) and Nigeria (Arowolo, 2011; Salami, 2011), where fiscal decentralization efforts are undermined by centralization, political interference, and insufficient regional revenues.

Despite these challenges, fiscal federalism is largely viewed as a positive force for local governance. Respondents reported strong agreement that fiscal federalism has positively impacted local economic growth, public service delivery, and equitable development. The high levels of agreement on issues like accountability, transparency, and community participation demonstrate the perceived benefits of fiscal decentralization in empowering local governments. Additionally, respondents believe that fiscal federalism enhances local autonomy and improves the capacity for revenue generation and resource management, allowing local governments to better address their communities' needs. These findings align with the findings of Devkota (2021), who emphasizes that fiscal federalism can enhance decentralized governance



and empower local governments to make context-specific decisions. Similar positive outcomes were noted in Ethiopia (Yimenu et al., 2021) and Nigeria (Arowolo, 2011; Salami, 2011), where fiscal decentralization promoted local development despite facing challenges in implementation.

However, the study also highlights some limitations in the broader social impacts of fiscal federalism, particularly regarding improvements in residents' quality of life. While respondents agree that fiscal federalism has led to some positive changes, the direct effect on residents' living standards appears more moderate. This suggests that while fiscal federalism has enhanced governance processes and public service delivery, its impact on the social and economic well-being of residents may take more time to fully materialize. These findings are consistent with the global perspective shared by Peck (2014), who noted that political and economic constraints affect local governance and fiscal management, limiting the broader societal benefits of fiscal decentralization in the USA. Addressing key barriers such as funding shortages, capacity deficits, and coordination challenges will be essential for maximizing the potential of fiscal federalism in Nepal and achieving more significant improvements in the overall quality of life for local populations. Furthermore, Abdul et al. (2023) and Shankar (2015) study suggests that addressing these challenges through policy reforms, capacity building, and fiscal decentralization could unlock the full potential of fiscal federalism in Nepal, enhancing its social impact over time.

Conclusion

Thus, this study highlights both the positive impacts and the challenges of implementing fiscal federalism in Nepal. While fiscal federalism has contributed to local economic growth, improved public service delivery, and enhanced local governance, significant obstacles, including political interference, inadequate funding, and bureaucratic inefficiencies, continue to hinder its full potential. Although respondents perceive fiscal federalism as a positive force for local autonomy and development, the direct impact on residents' quality of life remains limited, suggesting that more time and effort are needed to achieve substantial social and economic benefits. To optimize the implementation of fiscal federalism and maximize its impact, it is essential for Nepal to address funding shortages, improve coordination among various government levels, and enhance the capacity of local governments. Policy reforms focused on decentralization, capacity building, and fiscal management will be crucial for unlocking the full potential of fiscal federalism in improving governance and the quality of life for local populations.

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