



Opportunities and challenges in implementing fiscal federalism in Nepal: Perspective from local government officials

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Abstract: Federalism divides power among different government levels to address socio-economic and cultural diversity, with fiscal federalism focusing on the distribution of financial responsibilities. While Nepal's adoption of fiscal federalism aims to grant local government financial autonomy, challenges such as unequal resource distribution, limited capacity, and coordination issues hinder its full implementation and effectiveness. This study explored opportunities and challenges in the implementation of fiscal federalism in Nepal. A key informant interview was conducted with six local government officials, using thematic analysis for data interpretation. The study found that fiscal federalism has improved public service delivery, local economic opportunities, and civic engagement. However, resource mismanagement, political resistance, and administrative limitations remain significant obstacles. To maximize the benefits of fiscal federalism, the study recommends strategic planning, improved revenue management, and enhanced coordination among government levels. Strengthening legal frameworks and ensuring financial transparency are key to supporting local governments in fostering sustainable development.

Keywords: *Challenges, Fiscal federalism, Opportunities, Local government officials, Nepal*

Declaration: There is no conflict of interest, and the research was conducted following the research ethics.



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Introduction

Federalism is a governance system that divides power across multiple levels of government to accommodate diverse socio-economic and cultural groups, with fiscal federalism focusing on the distribution of financial responsibilities and resources among them (Acharya & Zafarullah, 2020; Brown et al., 2018). It involves revenue generation, taxation, and expenditure allocation, ensuring financial cooperation between central and subnational governments (Akindele et al., 2001; Musgrave, 1961). Nepal adopted fiscal federalism through its 2015 Constitution, granting local governments financial autonomy to manage resources according to local needs (Khadka, 2016). This includes tax-sharing mechanisms and Performance-Based Grant Systems (PBGSs), which improve fiscal management, encourage transparency, and foster infrastructure and service delivery improvements through collaboration with development partners (Shah, 2019; Steffensen, 2016).

Despite its advantages, Nepal faces significant challenges in fully implementing fiscal federalism. Unequal resource distribution, limited local government capacity, and financial constraints hinder independent decision-making at subnational levels (Poudel, 2023). Coordination complexities between government tiers further complicate effective resource allocation and governance. Moreover, fiscal federalism has lagged behind political federalism in grassroots development, impacting marginalized communities (Béland & Lecours, 2014). Addressing these challenges is crucial to maximizing fiscal federalism's potential in strengthening Nepal's governance framework, improving public service delivery, and driving economic development. Thus, this study aimed to assess the challenges and opportunities of fiscal federalism in Nepal to enhance governance and promote equitable development.

Methodology

A descriptive cross-sectional study with a qualitative research design was conducted to explore the implementation of fiscal federalism in Nepal. Six key informants, comprising local government officials with direct experience in fiscal governance, were purposively selected. Data was collected through in-depth Key Informant Interviews (KII) using a structured guideline. Thematic analysis was employed to interpret the data, beginning with transcription and translation from Nepali to English, followed by systematic coding and categorization of emerging themes. Further analysis of the qualitative data was done manually.

Results and Discussion

Role and responsibilities of local government official

Local government officials formulate policies, manage resources, deliver public services, oversee revenue collection, and ensure financial transparency. They engage with the community, coordinate with authorities, and uphold legal compliance to promote sustainable development. All six research participants shared similar responsibilities based on their positions, highlighting their role in governance and community well-being.



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The Participant 1 said,

P1: "In local level government, I facilitate and coordinate to formulate the annual budget policy, and program. Similarly, Formulation of budget, keeping record of the budget data, reporting the work, and helping to remove the unorganized reporting system. And doing work related to revenue and accounting that needs to be coordinated in the local level."

Participant 1 plays a crucial role in local government, primarily focusing on budget formulation, financial coordination, and revenue management. P1 facilitate the creation of annual budgets, ensure systematic financial planning, maintain accurate records, and report on budget utilization to enhance transparency. Additionally, P1 works to streamline inefficient reporting systems and oversees local revenue collection, contributing to fiscal accountability (Gyawali, 2015). P2's responsibilities align with Nepal's fiscal federalism framework, emphasizing decentralized governance and community participation (Acharya & Zafarullah, 2020). However, challenges such as resource centralization and unclear power distribution can impact local financial management, highlighting the need for effective coordination and autonomy in governance (Khanal, 2023; Sharma, 2020).

The participant 2 answered,

P2: "I am working as a ward secretary in Bardogaya Rural Municipality, Ward No. 2. According to the division of responsibilities of the municipality, my duties include tasks related to certification, social security, meeting management, revenue collection, and other daily administrative duties."

Participant 2, serving as a ward secretary in Bardogaya Rural Municipality, oversees administrative duties, including document certification, social security management, and organizing meetings to enhance local governance. P2 also facilitate revenue collection, ensuring efficient tax administration amid broader fiscal challenges (Khanal, 2023). Their role aligns with Nepal's federal aim of grassroots development but is hindered by hierarchical structures limiting citizen participation (Acharya & Zafarullah, 2020). Despite these challenges, P2 plays a crucial role in maintaining administrative and financial integrity, contributing to effective governance and service delivery at the local level (Gyawali, 2015).

Fiscal federalism foundation for local development

Fiscal federalism enables efficient resource allocation, promotes regional equity, and enhances local autonomy, improving economic growth, public services, and governance through decentralized control, transparency, and accountability (Bhul, 2024). Participants highlighted the role of fiscal federalism in local development, stressing the need for resource equity, inclusive community participation, and addressing marginalized groups. They noted the importance of financial transfers, careful budget management, and the impact of party politics on local governance, with federalism promoting equitable development, especially in remote areas.



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The participant 2 shared,

P2: "The constitution envisions a beautiful concept of long-term peace, development, prosperity, and good governance through a federal governance system. This has led to the recognition of fiscal federalism as a key component in achieving local development, where the role of fiscal federalism at the local level is considered extremely important."

P2 emphasizes the critical role of fiscal federalism in advancing local development, aligning with Nepal's constitutional vision for peace, prosperity, and good governance. Fiscal federalism is central to decentralizing authority, fostering local participation, and ensuring sustainable development at the local level. However, P2 highlights the challenges in its implementation, such as resource centralization and unclear power distribution, which hinder effective governance and resource allocation. The need for fiscal autonomy at the local level is crucial for addressing regional disparities, empowering local governments, and reducing inequalities. P2's perspective aligns with scholarly insights, stressing that overcoming centralization and coordination issues is essential for maximizing the potential of fiscal federalism to promote inclusive growth and development in Nepal (Acharya & Zafarullah, 2020; Khanal, 2023; Sharma, 2020).

Similarly, the participant 5 told,

P5: "In the context of Nepal, fiscal federalism plays a key role in local-level development. At the local level, there is a financial planning system in place, and it is evident that the federal government must carefully review and manage the budget for effective development."

P5 highlights the importance of fiscal federalism in Nepal's local-level development, emphasizing its role in effective financial management and resource distribution. P5 advocates for a structured financial planning system at the local level that aligns with development goals, enabling local governments to address community needs. However, challenges such as resource centralization and unclear power distribution, as noted by Khanal (2023), hinder effective implementation. P5 stresses the need for federal oversight to ensure efficient budget allocation and avoid inefficiencies, aligning with Khanal's (2023) views on balancing responsibilities and improving resource management. Overall, P5's perspective underscores the importance of collaboration between local and federal governments to maximize the impact of fiscal federalism, addressing key issues like poverty, regional disparities, and infrastructure deficits (Sharma, 2020).

Positive impact on public services delivery

Fiscal federalism enhances public service delivery by decentralizing resources and decision-making, allowing local governments to address specific community needs. It improves service accessibility, accountability, and promotes equitable development through public participation. All research participants agreed that fiscal federalism has positively impacted public service delivery, increasing access, responsiveness, and equity. However, challenges such as resource misallocation, infrastructure gaps, and policy weaknesses underline the need for better resource management, transparency, and strategic planning to fully realize its potential.

The participants P1 and P4 responded,



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P1: "In my experience, fiscal federalism has had a positive impact on public services and development. It has helped maintain equality in the distribution of resources and means at the local level. Additionally, poverty and unemployment have been reduced to some extent."

P4: "Fiscal federalism has impacted the delivery of public services at the local level. It has improved access to services, created variations in service quality, and enabled faster and more responsive service delivery."

Both P1 and P4 provide insights into how fiscal federalism has positively influenced public service delivery and local development in Nepal. P1 highlights that fiscal federalism has helped promote equality in resource distribution, which in turn has contributed to reducing poverty and unemployment. This reflects the broader objectives of Nepal's federal system, as laid out in the constitution, which aims to ensure equitable development at the grassroots level by enabling local communities to actively participate in decision-making (Gyawali, 2015). However, P1's response also underscores that challenges, such as the centralization of resources and unclear power distribution, continue to hinder effective resource allocation and cooperation among different levels of government, as observed by Khanal (2023).

P4, similarly, emphasizes the positive outcomes of fiscal federalism, noting improvements in access to public services, varying service quality, and increased responsiveness at the local level. This indicates that fiscal decentralization allows local governments to better cater to the specific needs of their communities, enhancing both service reach and efficiency. However, P4's view aligns with the perspectives of researchers such as Devkota (2021) and Sharma (2020), who stress that despite the positive impacts of fiscal federalism, challenges like capacity gaps, poor training, and coordination issues still impede its effectiveness. Additionally, issues like centralization and fiscal allocation difficulties, as highlighted by Abdul et al. (2023) and Shankar (2015), continue to prevent the full realization of fiscal federalism's potential, making it essential to address these barriers for sustainable and inclusive local development.

Fiscal federalism and economic empowerment

Fiscal federalism promotes local economic growth by decentralizing resources, enhancing governance, and encouraging targeted development investments. It fosters balanced, inclusive regional growth, reduces central government reliance, and supports long-term economic progress (Shah, 2016). All participants highlighted fiscal federalism's positive impact on local development, with improvements in healthcare, education, agriculture, and infrastructure. Economic initiatives, including agricultural projects and resource utilization like tourism, drive growth, while public participation and heritage preservation are emphasized in the process.

The participant 4 replied,

P4: "Fiscal federalism has significantly influenced economic development initiatives. It has led to improvements in the education sector, enhanced the delivery of healthcare services, promoted agricultural development, and accelerated infrastructure expansion."



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Participant P4 highlighted fiscal federalism's positive impact on local development, particularly in education, healthcare, agriculture, and infrastructure. By decentralizing resources, it has improved access to services and fostered economic empowerment. These advancements align with Nepal's goals of grassroots development (Gyawali, 2015). However, challenges such as limited fiscal autonomy and centralized resource control hinder full implementation (Acharya & Zafarullah, 2020; Khanal, 2023).. Addressing these barriers through policy reforms and decentralization could enhance fiscal federalism's impact, fostering inclusive development and improving local economic activity.

Enhanced public participation in local governance and decision making process

Fiscal federalism enhances public participation by decentralizing financial powers to local governments, enabling citizens to directly influence policies and projects. This system promotes transparency, accountability, and civic engagement, fostering a sense of ownership and responsibility (Adhikari, 2023). Participants highlighted increased public involvement in decision-making, with improvements in local governance structures, collaboration, and timely policy adjustments. While most participants noted positive changes, one participant observed limited impact, reflecting some variation in the perceived effectiveness of fiscal federalism in enhancing local governance.

The participant 2 shared,

P2: "Local levels have been granted sufficient authority for resource allocation. The governance structure has become more inclusive, and the decision-making process has become participatory. The participation of all groups is ensured. Key leaders, such as the chairperson, vice-chairperson, executive officers, ward committees, youth committees, revenue advisory committees, and other committees, have all become more collaborative and participatory. This change has allowed fiscal federalism to play a leadership role in local-level governance."

P2 highlights that fiscal federalism has enhanced local governance by granting local governments more autonomy in resource allocation, promoting inclusive decision-making, and encouraging participation from diverse groups. This shift aligns with Nepal's constitutional goals for equitable development (Gyawali, 2015). However, challenges such as hierarchical governance, centralized resource control, and limited fiscal autonomy, as noted by Acharya & Zafarullah (2020), hinder full citizen engagement. Despite these issues, the participatory governance model, supported by various committees, fosters democratic values and can address regional imbalances. To fully realize fiscal federalism's potential, Nepal must focus on capacity-building, intergovernmental coordination, and enhancing local revenue-generation.

Increased autonomy, accountability, and efficiency of officials

Fiscal federalism has strengthened local governance by granting greater autonomy to local governments, enabling independent decision-making and resource allocation. This decentralization has improved accountability, as officials are directly responsible for policy



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outcomes, reducing corruption and enhancing public service delivery (Khanal, 2023). Participants emphasized increased efficiency, with better coordination among officials leading to more transparent financial processes and timely implementation of initiatives. By fostering a more responsive and accountable system, fiscal federalism has enhanced governance performance, ensuring that local needs are effectively addressed.

The participant 4 shared,

P4: "The roles and responsibilities of local government officials since the introduction of fiscal federalism include increased autonomy and decision-making power, budget management and financial planning, coordination with elected representatives, improvements in service delivery, public hearings, and accountability."

P4 highlights that fiscal federalism has increased the autonomy and decision-making power of local government officials, allowing them to manage resources more effectively and align budgets with local priorities (Gyawali, 2015). This shift has improved governance by enhancing fiscal accountability and reducing inefficiencies (Khanal, 2023). P4 also emphasizes improved budget management, financial planning, and coordination with elected representatives, fostering a more collaborative governance structure. Additionally, fiscal federalism has strengthened service delivery, transparency through public hearings, and overall accountability. These changes have empowered local officials to make informed decisions while ensuring efficient governance and community-driven development.

Challenges in implementing fiscal federalism in municipal level

The implementation of fiscal federalism at the municipal level faces challenges such as unequal resource distribution, weak financial management, and coordination issues with higher government levels (Bhul, 2024). Many municipalities struggle with inadequate financial resources, inefficient use of grants, and reliance on external funding, leading to disparities in service delivery. Participants also noted issues like poor revenue generation, administrative inequalities, and political interference, which hinder effective governance. Additionally, weak accountability and transparency mechanisms further complicate implementation. Addressing these challenges requires stronger financial oversight, improved resource allocation, and enhanced coordination to ensure effective fiscal decentralization.

The participant 2 replied,

P2: "Focus has been placed solely on securing grants from higher levels of government, while neglecting efforts to expand and diversify local revenue sources. Complaints about citizens bearing double taxation have not been adequately addressed. There is a perceived weakness in local-level financial management, and concerns have occasionally been raised about the lack of objective-oriented utilization of grants. Additionally, lower-tier governments face challenges due to weak planning and operational efficiency. A significant reason for this is the lack of comprehensive plans."

P2 highlights key challenges in implementing fiscal federalism, particularly in financial management, revenue generation, and planning. Local governments rely heavily on grants from



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higher authorities, neglecting sustainable local revenue sources, which undermines their financial autonomy as discussed by Khanal (2023). Additionally, issues like double taxation and inefficient use of grants reflect weak financial oversight and dissatisfaction among citizens. The absence of clear business plans and strategic frameworks further weakens operational efficiency, making resource allocation ineffective. To address these gaps, there is a need for improved financial management, revenue diversification, and comprehensive planning to enhance the effectiveness of fiscal federalism at the local level.

Similarly, Participant 4 told,

P4: "Implementing fiscal federalism has come with several challenges, including disparities in resources, insufficient coordination, administrative inequalities, technical and legal complexities, and difficulties in revenue collection and distribution."

P4 identifies key challenges in implementing fiscal federalism, including resource disparities, insufficient coordination, administrative inequalities, and technical and legal complexities. Unequal resource distribution limits local governments' ability to deliver services effectively, while weak intergovernmental coordination causes inefficiencies, as argued by Khanal (2023). Administrative imbalances and unclear power structures further complicate governance, reflecting broader operational challenges as noted by Acharya & Zafarullah (2020), where communication and collaboration across different government levels are weak, leading to inefficiencies in policy implementation. Additionally, technical and legal barriers hinder smooth policy execution, and difficulties in revenue collection and distribution undermine fiscal autonomy. Addressing these issues requires policy reforms, improved coordination, and capacity building to enhance the effectiveness of fiscal federalism at the local level.

P5: "In my experience, it is evident that there is a lack of balance in the distribution of resources and funds at the local level, even though adequate financial resources are available. This indicates a significant issue with the allocation."

P5 expresses concern over the imbalanced distribution of resources at the local level, despite the availability of adequate funds. This misallocation creates disparities among regions, limiting the effectiveness of fiscal federalism. Khanal (2023) and Gyawali (2015) highlight the centralization of resources and poor allocation systems as key barriers, hindering local governments' ability to meet development goals. P5's observations align with Sharma (2020), emphasizing the need for a fairer and more transparent resource distribution to ensure the success of fiscal federalism.

Essence of Legal and institutional frameworks for fiscal efficiency

Legal and institutional frameworks for fiscal efficiency ensure effective public resource management through structured laws and regulations. The legal framework establishes rules for taxation, spending, and fiscal discipline, preventing misuse and ensuring accountability. The institutional framework, comprising relevant agencies and organizations, ensures the implementation and monitoring of fiscal policies. Together, these frameworks foster transparency, coordination, and effective governance, promoting economic stability and efficient service delivery.



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Participants 4 and 6 recommended that,

P4: "In my experience, to optimize the benefits of fiscal federalism, a clear legal and institutional framework is necessary"

P6: "I recommend the creation of comprehensive laws and ensuring that all activities are carried out in accordance with these laws to mitigate the challenges associated with fiscal federalism and optimize its benefits."

Both P4 and P6 highlight the critical role of a well-defined legal and institutional framework in ensuring the success of fiscal federalism. P4 stresses that having a clear legal and institutional structure is essential to maximizing the benefits of fiscal federalism. This suggests that for fiscal decentralization to be effective, there must be established laws and regulations that provide clarity on how resources are allocated, managed, and distributed at the local level. Without such a framework, there may be inefficiencies and confusion, undermining the potential of fiscal federalism. Ensuring clarity in legal responsibilities and the capability of institutions to enforce these laws will ultimately enhance governance, foster economic growth, and reduce regional disparities, in line with the goals of Nepal's federal system (Gyawali, 2015).

P6 further elaborates on this idea by recommending the creation of comprehensive laws and the strict adherence to them. According to P6, the challenges associated with fiscal federalism, such as resource misallocation or inefficiencies, can be mitigated if activities are aligned with well-structured legal guidelines. Ensuring that all operations are carried out according to these laws will not only provide accountability but also improve the fairness and effectiveness of fiscal policies at the local level. This approach is also critical for overcoming challenges such as low state-level revenue, excessive current expenditure, and poor fiscal accountability, as noted by Khanal (2023). Essentially, both participants emphasize that a strong legal foundation is indispensable for achieving fiscal efficiency and addressing the challenges faced in implementing fiscal federalism.

Transparent resource distribution and accountability

Transparent resource distribution and accountability in fiscal federalism ensure fair allocation and efficient use of public resources. Transparency prevents corruption and builds public trust, while accountability ensures responsible management and effective use of funds. Together, they promote equity, development, and financial integrity, contributing to national stability and progress (Khanal, 2024).

The participant 4 shared,

P4: "In my experience, to optimize the benefits of fiscal federalism, transparency in resource distribution is needed, the creation of equality, inclusion in local planning, and the introduction of motivational rewards and incentives."

P4 stresses the importance of transparency, equality, and inclusivity for effective fiscal federalism. Transparent resource distribution prevents misallocation and promotes fairness, addressing challenges like centralization (Khanal, 2023). Inclusive local planning ensures equal access to resources, aligning with Nepal's constitutional goals (Gyawali, 2015). P4 also suggests using



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rewards and incentives to encourage responsible resource management, fostering accountability. These factors transparency, fairness, participation, and motivation are key to optimizing fiscal federalism and ensuring equitable regional benefits.

Coordination for sustainable local development

Coordination for sustainable local development involves aligning efforts and resources from various stakeholders to achieve long-term, environmentally, socially, and economically balanced growth. It ensures efficient use of resources, addresses local challenges, and promotes shared responsibility, ultimately fostering resilient and thriving communities.

The participant 1 informed that,

P1: “At the local level, it is important to prioritize development while ensuring effective coordination between the federal and provincial governments in the allocation of funds.”

P1 emphasizes the importance of effective coordination between federal and provincial governments to ensure efficient resource allocation and sustainable local development in Nepal. This coordination is crucial to overcome inefficiencies and conflicts from competing policies and address gaps in under-prioritized sectors (Thapa et al., 2019). Aligning resources with local needs supports equitable development, as seen in other countries like Ethiopia and Nigeria (Arowolo, 2011; Salami, 2011; Yimenu et al., 2021). Addressing these coordination issues can enhance fiscal federalism’s impact on local development and reduce regional disparities.

Conclusions

The research highlights the positive impact of fiscal federalism on local governance and community development in Nepal, demonstrating improvements in public service delivery, local economic opportunities, and civic engagement. However, challenges such as resource mismanagement, political resistance, and limited administrative capacity hinder its full potential. Addressing these challenges through strategic planning, better revenue management, and stronger coordination between different government levels is crucial for maximizing the benefits of fiscal federalism. By enhancing legal frameworks and financial transparency, local governments can better serve their communities and foster long-term sustainable development, particularly in sectors like education, health, and agriculture.

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