Fiscal Decentralization in the context of Federalisation in Nepal

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Government of Nepal
Background

- Nepal adopted Federal Constitution on September 20, 2015,
- Spheres of government: federal, provincial and local.
- The Constitution provides guidance regarding the functional responsibilities for each of the three government levels
- Five different lists of competencies, federal functions, provincial functions, local government functions, as well as concurrent federal-provincial and federal-provincial-local functions.
- National Natural Resource and Fiscal Commission will be responsible to design the mechanism for fiscal transfers among tiers.
Federalism

• Federalism: a system of government in which state power is divided and shared between central and sub-national governments.

• In federalism, constitutionally-distributed powers among different tiers of government may enhance political accountability and policy-making skills by bringing government closer to the people and politicians are more responsive to local needs and interests. It also helps to empower citizens and contributes to decision-making process.

• In a federalist government, the power is divided between the national government and other governmental units. In the case of Nepal, this means the power is divided between federal government, provincial government and local governments.
Collaborative federalism

It is a concept of federalism in which federal, provincial and local government interact cooperatively and collectively to solve common problems, rather than making policies separately but more or less equally or clashing over a policy in a system dominated by the national government.
Interrelationship between the Federal, Provincial and Local levels (Part 20, Constitution)

231. Legislative interrelationship between Federation and Province

232. Relations between the Federation, Provinces and local level (cooperative, coexistence and coordination type relations)

233. Relations among the Provinces

234. Inter-Provincial Council

There shall be an Inter-Provincial Council to settle disputes of political nature between the Federation and Province and among the Provinces, consisting of a Chairperson and members as follows:

(a) Prime Minister - Chairperson
(b) Home Minister of Government of Nepal - Member
(c) Finance Minister of Government of Nepal - Member
(d) Chief Minister of respective Province – Member

235. Coordination among the Federation, Provinces and local Levels
Aspects of Managing fiscal federalism

• Implementation of the constitution as per its spirit.
• Revenue assignment including revenue sharing
• Who will do what (lists)
• Functional analysis principles (policy and regulation, financing, provision, production and distribution of services)
• Provincial and local administration
• Transfer of functionaries (article 302)
• Transfer of fund (article 60)
• Finance follows the function (Linking functions, fund and functionaries)
• LBs restructuring (one size fits all—not possible)
• Expenditure needs of provincial and local levels (60)
• Fiscal equalization grant to province and local levels (60)
• New acts and laws (federal, provincial and local)
• Role of OPMCM (two committees formed) and others institutions.
• Political and economic factors that influence the design, adoption and implementation of federalism
Revenue sharing mechanism: Constitutional provision (article 60)

- The Government of Nepal shall make necessary arrangements to equitably distribute the revenue generated by it from its sources, between the federal, provincial and the local level entities.
- The Government of Nepal shall distribute fiscal equalization grants to province and local level entity on the basis of their expenditure need, their capacity in generating revenue and the efforts made by them.
- The distribution of revenue between the federal, provincial and the local level entity shall be transparent.
Institution: National Natural Resources and Fiscal Commission (part 26, article 250 & 251)

(a) Determine extensive grounds and measures, regarding the distribution of revenue from the federal consolidated fund to the federal, provincial and local level governments.

(b) Make recommendations, according to law, on distribution of the equalization grants to provincial and local governments from the federal consolidated fund.

(c) Conducting research and studies in regard to making a basis for distribution of conditional grants to provincial and local governments in compliance with national policy and program and standards, and the state of infrastructure there.

(d) Determine extensive grounds and measures regarding the distribution of revenue between provincial and local governments from the provincial consolidated fund.

(e) Making recommendations regarding the measures of reforms on responsibilities of expenditures and revenue generation between the federal, provincial and local governments.

(f) Making recommendations about the internal loans the federal, provincial and local governments may take, by analyzing the economic indexes in totality.

(g) Reviewing the bases of revenue distribution between the federal and provincial governments, and making recommendations for reform.

(h) Making recommendations about coordination and mitigation of disputes likely to arise between the federation and province, between the provinces, between a province and local level entity, or between local level entities.
# Vertical tax sharing of selected federal countries & details of Canada

<table>
<thead>
<tr>
<th>S.N.</th>
<th>Country</th>
<th>%</th>
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<tbody>
<tr>
<td>1</td>
<td>Australia</td>
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<tr>
<td></td>
<td>States</td>
<td>15.3</td>
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<tr>
<td></td>
<td>Local</td>
<td>3.4</td>
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<tr>
<td>2</td>
<td>Canada</td>
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<td>Provinces</td>
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<tr>
<td></td>
<td>Local</td>
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<td>Germany</td>
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<td></td>
<td>Länder</td>
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<td>Local</td>
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<td>4</td>
<td>Switzerland</td>
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<td></td>
<td>States</td>
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<td></td>
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<td>15.2</td>
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<td>5</td>
<td>United States</td>
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<td></td>
<td>States</td>
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<td>Local</td>
<td>15.9</td>
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<td>6</td>
<td>India</td>
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<td></td>
<td>States</td>
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<td>7</td>
<td>South Africa</td>
<td>29</td>
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<tr>
<td></td>
<td>Provinces</td>
<td>29</td>
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<td></td>
<td>Local</td>
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<table>
<thead>
<tr>
<th>Level of governments and tax items</th>
<th>Share in Revenue ( % )</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>F</td>
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<tr>
<td><strong>Federal</strong></td>
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<tr>
<td>Income tax</td>
<td>64.7</td>
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<tr>
<td>Consumption tax</td>
<td>45.3</td>
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<tr>
<td>Payroll tax</td>
<td>68.6</td>
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<tr>
<td><strong>State or provincial</strong></td>
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<tr>
<td>Income tax</td>
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<td>Consumption tax</td>
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<td>Resource tax</td>
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<td>Health premium</td>
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<td>Property tax</td>
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<tr>
<td><strong>Local</strong></td>
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<tr>
<td>Property tax</td>
<td>2.2</td>
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<tr>
<td>User fees</td>
<td>24.4</td>
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Implementation rule of fiscal decentralization

1. Fiscal decentralization should be viewed as a comprehensive system.
2. Finance follows function
3. There must be a strong central ability to monitor and evaluate decentralization
4. One Inter-governmental system does not fit the urban and rural sector
5. Fiscal decentralization requires significant local government taxing powers
6. Central governments must keep the fiscal decentralization rules that they make
7. Keep it simple
8. The design of the Inter-governmental transfer system should match the objectives of the decentralization reform
9. Fiscal decentralization should consider all the levels of government
10. Impose a hard budget constraint.
11. Recognize that Inter-governmental systems are always in transition and plan for this.
12. There must be a champion of fiscal decentralization.
Key issues

• Political will and orientation
• Provincial arrangement and designing all the system including administrative set-up.
• Jurisdictional clarity and concurrent list implementation.
• Transitional Management (Political, administrative and planning)
• Economics of scale and service delivery
• Sectoral coordination and ownership
Key issues

- Urban Management
- Support for restructuring
- Professional autonomy and acceptance
- Expenditure need and constitutional provisions
- Revenue adequacy
- Vertical and horizontal fiscal balance
- Institutions building and human resource management
- Economic growth, development and service delivery
- Fiscal/Financial discipline and fiduciary risk reduction
- Maintaining current gaps and governability.
Way forward

- **Political**
  - Political Leadership, will and consensus
  - Election of all tiers
  - Professional support and quick action
  - Facilitation and accountability
  - Conflict resolution mechanism and capacity

- **Fiscal**
  - Fiscal framework and legal infrastructure
  - Lead institution (NNRFC, OPMCM, MOF, MOFALD.....)
  - Common and level specific strategies
  - Revenue potentiality utilization
  - Balance between expenditure need and financial resources
  - Fiscal balance and accountability
Way forward

• Adequate resource for service delivery
• Fiscal governance and technical competency
• Judicious allocation of resources and expenditure capacity
• Vertical and horizontal fiscal balance (grant, equalization etc.)
• Institution building, credibility and proper functioning in an accountable manner.
• Rational economic behavior of all tiers (taxing, spending and debt.)
• Efficient, effective, more equitable and more stable fiscal relations across levels of government.
Way forward

- Administrative
  - Strong mandate and acceptance for change
  - Transition Management (HR, Services and institutions)
  - Human Resource Management at all tiers.
  - Capacity development
  - Transition Management of Plan, Program and Projects
  - Arranging functioning sub-national governments
  - Localizing resources, capacity and services
  - Compliance of implementation rules of FD.
Way forward

- Others
  - Provincial Infrastructures
  - Local Infrastructures and restructuring local bodies/levels
  - Reconstruction
  - Managing transition and federating is also handling uncertainty

There is no explicit or implicit constitution obligation for “good faith” behavior by either government. – Federal Financial Relation Act, 2009, Australia
Thank you
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