

Fiscal Federalism and Economic Growth in Nepal: A Critical Examination

The introduction of fiscal federalism in Nepal's constitution of 2015 was a landmark step aimed at fostering economic growth and ensuring equitable distribution of resources across the diverse regions of the country. However, the effective implementation of this fiscal federalism model has faced numerous challenges, leading to concerns about its impact on economic development. Now, examining the relationship between fiscal federalism and economic growth in different regions of Nepal, shedding light on the implementation issues, controversies, and administrative challenges that have arisen.

Despite the constitutional provisions for fiscal federalism, evidence suggests it is not effectively enforced in Nepal. One of the key challenges lies in the uneven distribution of resources, with disparities between provinces. While certain areas such as Lumbini Pradesh continue to show high development other states such as Madesh Pradesh GDP is lower than the national rate. In the financial year 2023 provinces have budgeted a higher fiscal deficit of 0.9 % of national GDP. The mismatch between the spending responsibilities and revenue-generating power in different levels of government has created intense fiscal gaps in Nepal. According to the Ministry of Finance, Nepal's debt-to-GDP ratio for FY 2022-23 is 41.3%. Fiscal federalism has also contributed to this increasing debt since all of the provinces have exceeded their budgeted expenditure in FY 2022-23. The overall fiscal deficit is expected to reach 4.5% of GDP of 2022-23. A deficit beyond 3% of GDP is not considered a good symptom. Additionally, irregularities in public spending have reached Rs 487.32 billion in 2023, which is an alarming figure.

Fiscal federalism has decentralized public funds across the country, making it easier for people to access local services. It has also given some financial room to provincial governments for regional development projects. Moreover, it has somewhat reduced the problem of concentrating funds. However, with the decentralization of funds, there has also been the decentralization of corruption, increasing at both provincial and local levels. Rather than contributing to economic development, fiscal federalism in Nepal has, in some instances, worsened issues such as corruption and a lack of funds. Administrative shortcomings and mismanagement have overshadowed the intended objectives of balanced development and resource distribution. CIAA in its 33rd Annual report provided that corruption cases were filed against 766 individuals in 162 cases in the fiscal year 2022/23 and 20,905 complaints were received through different channels and 35.95% of all complaints accounted for local-level corruption. The highest level of corruption was found in planning and implementation processes with engineers, employees and executive officers.

A report on the Study on Corruption at the Local level by CIAA showed that more than 50% of survey respondents said that corruption at the local level is thriving. 27.3 % of the respondents

had increased after the local election. 14.9 % were forced to pay bribes to receive services from their local units. In a case of corruption while awarding construction contracts in 2021-22 in Sudur Paschim. A revenue loss of Rs 54 million to the state. This is only an example and these types of cases are seen at most of the local and provincial levels.

The mismatch between the spending responsibilities and revenue-generating power in different levels of government has created intense fiscal gaps, prompting intergovernmental fiscal transfer to be an integral part of fiscal federalism in Nepal. The implementation of fiscal federalism in Nepal has not been without controversies. Disputes over resource allocation, taxation powers, and revenue-sharing mechanisms have strained the relationship between the federal and provincial governments. The lack of a clear framework for resolving such disputes has led to administrative impasse and delays in the implementation of key policies.

The World Bank has put forth various recommendations for both the short and medium term to improve Nepal's fiscal federalism system. In the short term, suggestions involve developing a fiscal federalism roadmap by entities like the National Natural Resources and Fiscal Commission (NNRFC), the Ministry of Finance (MoF), and the National Planning Commission (NPC). This roadmap aims to enhance the Inter-Governmental Fiscal Transfer system, making it more flexible, transparent, and timely. The World Bank also recommends implementing a performance-based transfer system and creating a consolidated public financial management performance database at the federal level to better monitor and evaluate the overall performance of provinces and local governments. For the medium term, recommendations extend to the Office of the Prime Minister and Council of Ministers, MoF, Ministry of Federal Affairs and General Administration (MoFAGA), and various government levels. These include amending the legal framework to clarify concurrent and shared responsibilities among the three tiers of government, enhancing the capacity of human resources involved in public financial management, and reinforcing systems to improve budget credibility and service delivery across different government tiers. Overall, the goal is to bring about greater clarity, efficiency, and effectiveness in Nepal's fiscal federalism structure. Without the implementation of these recommendations, fiscal federalism is expected to impact negatively rather than positively in GDP.

In conclusion, the incorporation of fiscal federalism into Nepal's constitution in 2015 aimed at fostering economic growth and ensuring equitable resource distribution; however, its successful implementation has encountered substantial challenges. Despite constitutional provisions, evidence indicates that fiscal federalism is not effectively enforced, leading to uneven resource distribution among provinces and manifesting in fiscal deficits, escalating debt-to-GDP ratios, and irregularities in public spending. While fiscal federalism has provided financial autonomy for provincial development, it has also inadvertently facilitated the decentralization of corruption, impeding the desired benefits of balanced development. Ongoing controversies and

disputes over resource allocation and taxation powers strain federal-provincial relations, emphasizing the pressing need for comprehensive reforms. The World Bank's recommendations, emphasizing a flexible fiscal federalism roadmap and performance-based transfer systems, underscore the critical importance of effective implementation to prevent adverse impacts on GDP. Resolving issues related to resource distribution, corruption, and administrative challenges is paramount to realizing the positive contributions of fiscal federalism to Nepal's economic growth.