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FINANCING RURAL LOCAL PANCHAYATS
IN NEPAL

LARRY SCHROEDER AND JAMES WOZNY

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PREFACE

Nepal, like many other Third World countries, has recently put greater emphasis on the development role of its local governments (panchayats). Furthermore, there has been a growing recognition on the part of both His Majesty's Government of Nepal (HMG) and the foreign assistance donor community that there is a need to meet the costs of operating and maintaining development projects and that local governments might play an important role in mobilizing the resources necessary to cover these costs. Yet, little is known about the financial affairs of rural local governments. This report is designed to begin to fill that knowledge gap by describing and analyzing the financial activities of district and village panchayats and to suggest some policies and programs which might improve the fiscal health of these rural local governments.

The report addresses the role local governments are to play in the planning and implementation of rural development projects in Nepal and analyzes the set of tax and nontax revenues mobilized by these local bodies. Attention is also given to the Land Tax revenues which local governments currently share with the central government and the grants provided by the central government. Particular attention is paid to the village-level project implementation process used in the country and the process by which nonmonetary resources are mobilized to carry out this process.

The report is based on two short-term visits to Nepal by the authors and, therefore, is limited in both its breadth and depth of coverage.

These limitations are, however, mitigated by the efforts of the Language Culture Training and Research Centre (LCRC) of Kathmandu which contributed significantly to the analysis reported here. Personnel of LCRC gathered much of the detailed financial information, conducted a set of detailed case studies and spent time conferring with each of the authors.

The plan of the study resulted from my January 1987 visit to Nepal during which I consulted with persons in the Ministry of Panchayats and Local Development (MPLD), two district panchayats, the Kathmandu mission of the United States Agency for International Development (USAID), particularly Dr. Carl Dutton, and several other experts, especially Mr. Duane Kissick of Planning and Development Collaborative International (PADCO). An advisory committee, consisting of Dr. Dutton, Mr. Kissick, Secretary S.B. Rai of the Ministry of Panchayats and Local Development, Secretary M.P. Kafle of the Ministry of Works and Transport and Mr. S.P. Shrestha of the Decentralization Committee, was established to oversee the study. The committee selected a sample of ten district panchayats and LCRC initiated its field work in April 1987. James Wozny, Research Associate in the Metropolitan Studies Program, Syracuse University, then spent five weeks in the country during May and June supervising the data processing, gathering additional data, interviewing HMG and local government officials, and visiting several local governments.

A study such as this one cannot be successfully completed without the full cooperation and assistance of many persons. At the risk of omitting certain individuals, Mr. Wozny and I wish to express our deep gratitude to

Messrs. J.N. Jha, H. Kharel, T.B. Manandhar, T.N. Shrestha and K.N. Pradhan, all of the LCRC, for their data gathering, translation and tabulation efforts as well as for their insights regarding the workings of local governments in Nepal. Special thanks are due Mr. B.R. Marhatta, Director of LCRC for his assistance in arranging interviews and meetings, extracting information from Government agencies and supervising the work of his team. Although the final version of this paper was completed after Wozny returned to Syracuse, both its content and form were greatly influenced by the efforts of LCRC.

We would also like to acknowledge the fine assistance provided by the afore-named members of the advisory committee. The authors are particularly grateful to Mr. Dutto and Mr. Kissick for the useful guidance and generous logistical support they provided. While we cannot acknowledge each individual, we are especially thankful for the fine cooperation, generous time and useful insights we obtained from the many HMG and local panchayat officials we interviewed. Mr. Nepali, Director of the Department of Land Revenue, should be singled out for generously sharing his time on several occasions and supplying a substantial amount of departmental data.

Mr. Ashok Poudyal and Mr. Harsha Bajracharya of USAID/PADCO served as invaluable guides to Wozny during his field trip to the Rapti Zone; Mr. C.P. Shrestha played a similar roll during my stay in the country. Mr. Poudyal and Mr. Heller of USAID/Kathmandu entered and processed much of the data with Mr. Vijay Rao providing similar research support in Syracuse. Ms. Martha Bonney and Ms. Esther Gray did their usual fine job typing this

report and Administrative Assistant, Ms. Carol Swan Babcock, provided us excellent administrative support. Any errors in the report are, of course, our own responsibility.

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Larry Schroeder
Syracuse, July 1987

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FINANCING RURAL LOCAL PANCHAYATS IN NEPAL

Larry Schroeder and James Wozny
with
Research Support Provided by the
Language Culture Training and Research Centre

Executive Summary

1. The Decentralization Act, 1982 of His Majesty's Government of Nepal (HMG) had several basic objectives including the promotion of popular participation in the planning of village, town and district-level development works, the achievement of intersectoral coordination and balanced development throughout the country, the strengthening of local institutions responsible for development and the maximization of local resource mobilization to carry out development works. While local panchayats (governments) in the rural areas of Nepal are now actively involved in this decentralized planning process, the goal of increased local resource mobilization has probably been emphasized less than the achievement of the other objectives. Indeed, apparently very little is currently known by HMG about the resource mobilization and administration activities of district and village panchayats. There is no attempt to collect nor to analyze financial data at the center. At the same time, there does appear to be the recognition that, given the financial difficulties faced by HMG, efforts to improve the fiscal health of local governments can have the dual benefits of providing resources to operate and maintain local development projects while also helping to ease the fiscal stress felt at the center.

2. The objectives of this report are three-fold. One is to describe generally the structure of rural local governments in Nepal and their resources and activities. A second is to document empirically the extent of these activities, at least for a small sample of panchayats. The third objective is to suggest, albeit on the basis of a relatively short-term analysis, policies that might be undertaken to improve the fiscal conditions and strength of these local bodies. Here we attempt to summarize very briefly the findings with respect to the second and third objectives of the research effort. Paragraphs (3)-(13) of this Executive Summary highlight our primary findings; paragraphs (14)-(29) summarize the primary recommendations made in the report.

3. The Rules promulgated in 1984 under the Decentralization Act prescribe an unrealistically long set of functions and powers to village and district panchayats. The fiscal health of these local governments is, however, so weak that very few of the prescribed functions are actually performed. Instead, the bulk of the public services that are provided in rural areas are produced by HMG line ministries.

4. While local panchayats do participate in the decentralized planning process, administration at the district level is complicated by the potentially divisive situation encountered by HMG employees at the district level. On the one hand, they are a part of the line ministries which employ them; on the other hand, they are expected to comply with local preferences as envisioned in the Decentralization Act.

5. Own-source revenues (excluding the local share of the HMG Land Tax) of district panchayats are extremely small on a per capita basis, averaging only about Rs. 0.81 in nine sample districts in 1985/86. Furthermore, while the list of revenue sources potentially available to district panchayats is a rather long one, nearly all of the potential sources suffer from a narrow base, restricted statutory rates and revenue yields which do not automatically grow in the face of inflation or economic growth. In fact, in only two districts of nine examined did per capita revenues increase in real terms during the period 1981/82 - 1985/86. Local resource mobilization is also impeded by weak administration, particularly poor record-keeping.

6. A land-based tax similar to the Land Tax, currently imposed by HMG with district panchayats sharing the revenues, constitutes a reasonable tax base for rural local governments in Nepal. The tax base is available in all districts and cannot be moved to escape taxation. At present, however, the tax structure is not conducive to revenue growth without explicit increases in tax rates; the rates, which when originally set may have been reasonable, are currently quite low; and the method of tax collection fails to make obvious any link between tax payment and benefits accruing from resultant expenditures thereby probably contributing significantly to tax delinquencies.

7. Intergovernmental grants to district panchayats consist of an Administrative Grant used to supplement local resources to hire additional employees, a Development Grant to be used for development projects, and at least two special grants programs--one to be used for development projects chosen by national panchayat representatives and another based on donor-financed integrated rural development projects (IRDP). While the size of the Development Grant increased substantially in 1981/82, since then the total amounts allocated have remained nearly constant.

8. The grant system, particularly the Development Grant, allows considerable autonomy to district panchayats in deciding how the grant proceeds are to be spent. Some mandates have recently been instituted to insure minimum district allocations to both the health and education sectors and also to insure that money is set aside for maintenance and for emergency use. Individual projects do not, however, require central approval prior to use of the funds.

9. Allocations are made across districts primarily on the basis of population, economic conditions as approximated by the location of the district and with recognition of the amounts of other monies flowing to the district from other sources. The political influence of members of the National Panchayat probably is a primary determinant of the allocation of that special grant program. The grants do little, however, to encourage local government resource mobilization.

10. The accounting methods used by local panchayats make a full assessment of the effects of spending difficult. Sectoral allocations are not traceable and the general state of the accounts is such that it is extremely hard to determine the relative importance of administrative support spending vis-a-vis development and maintenance efforts.

11. Employees in district panchayats are both direct hires and HMG employees posted to the district. Although the latter group can be transferred to other areas in the country, they have greater job security and, as such, appear to be more satisfied with their positions than are the direct-hires. Furthermore, a greater proportion of the HMG contingent have received training and may be more productive employees.

12. Development projects undertaken at the village level use a unique combination of monetary resources transferred from district panchayats and monetary and nonmonetary resources mobilized from the beneficiaries of the project. We determined that the resources mobilized through village level contributions generally exceed the amounts generated from local fees and taxes. While there is little uniformity across projects in different sectors or in different districts regarding the proportion of total costs supported from voluntary contributions, the results suggest that in the terai districts local contributions are at least two times the amount of total monetary resources mobilized through formal district panchayat taxes and fees excluding the Land Tax; local contributions in the sample hill districts are from nearly 2 to over 70 times the amounts earned from formal taxes and fees. This finding is particularly important when an assessment is made of rural local resource mobilization capabilities.

13. Problems in planning and implementation of village projects identified from a set of case studies include insufficient planning and supervision of the project; local disputes; late release of funds; and poor local leadership, particularly in choosing or designing projects that do not correspond with the demands of the villagers. Project choice is also affected by the political decision made in many districts to allocate equal amounts to each village in the district. One major result of these problems is a low project completion rate; in none of the ten districts examined did the annual project completion rate exceed 50 percent.

14. In a short-term study such as this it is difficult to justify the recommendation of a large number of highly specific policy actions that

should be undertaken to improve the fiscal situation of local panchayats. Additional study using more comprehensive data in a number of areas is needed. There is, however, little doubt that improved accounting, record-keeping, auditing and overall revenue administration practices are needed. A training program in these areas is, therefore, recommended as is a complete review and rethinking of the structure of the financial records maintained at the local level. A donor-assisted project to conduct the additional studies and to design and implement the necessary training programs would be appropriate.

15. Statutory tax rates held constant in nominal terms in the face of increased prices lead to declines in the purchasing power of revenues mobilized. Consideration should be given to increasing these rates, e.g., the rates of the house tax, mill and turbine tax and Land Tax.

16. Franchises issued for the operation of local public facilities such as roads, bridges and ferries should be encouraged wherever feasible. With certain policy changes the auction system used to allocate these franchises could generate additional revenues. Participation in these auctions should be encouraged, information concerning potential revenues should be made available to bidders and district panchayats should be allowed to reserve the right to hold a subsequent auction in the event it finds bids to be unreasonably low.

17. Policies allowing local business establishments in addition to mills and water turbines to be added to the business tax rolls should be implemented. For example, district panchayats should be given the right to tax brickyards operating in the district. Likewise, upon further study, consideration should be given to allowing district panchayats the right to impose taxes on certain goods produced in a district but consumed in other parts of the country.

18. With improved accounting procedures, districts might be encouraged to enter into economic activities such as cold storage facilities or small electric power plants. Thorough feasibility studies should be performed prior to undertaking such initiatives. It is important, however, that these initiatives not supplant private enterprise pursuits of the same activities.

19. While basic administration of the Land Tax should remain with HMG, we recommend greater participation in the collection process by village panchayats with direct sharing of locally-collected revenues. Such a policy would improve tax compliance by linking payments to locally-observable benefits and would provide village panchayats with a source of continuing recurrent revenues to meet local revenue operating and maintenance needs.

20. In the spirit of decentralization, district panchayats should be given the power to impose a limited surtax on the centrally-imposed Land

Tax. As a result of this policy the current Local Development Fee (which is really just an inferior alternative to this proposed surtax) could be abolished.

21. Consideration should be given to altering the structure of the Land Tax to result in a land value based tax. This would improve the revenue growth potential of the tax and, given the current land classification scheme, would not be unduly difficult to implement. It would, however, require that the land survey process currently underway in Nepal be completed. Again, this is a potential area for financial assistance by donors.

22. Consideration should be given to lowering the current one-hectare exemption level in the Land tax. Not only would it widen the tax net, it would discourage uneconomic subdividing of land undertaken purely to avoid the tax. Study should be given, however, to the equity implications of such a policy change.

23. The system of allocating Development Grants to district panchayats should be altered to provide increased incentives to local government resource mobilization. Analysis using more complete data could yield a system that, while continuing the current policy of ensuring larger grant flows to those districts with smaller potential local tax bases, would reward performance.

24. While political considerations probably require continuation of the special grant program supporting projects identified by members of the National Panchayat, development project and fiscal planning can be hindered greatly by this somewhat ad hoc program. For those reasons the program should not be expanded; instead primary emphasis should be given to the formal Development Grant program.

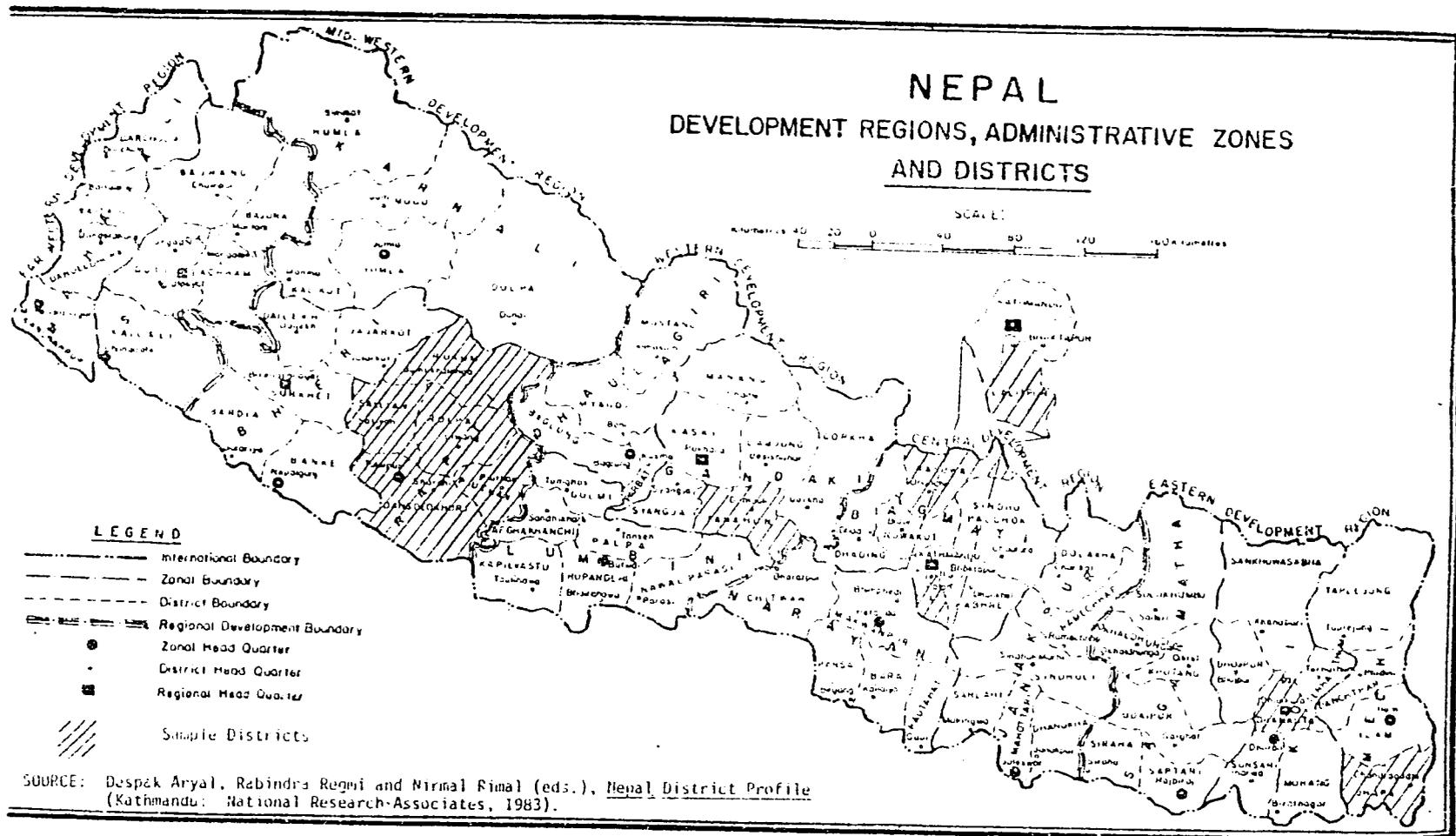
25. While increased technical skills at the district level are obviously desirable and would lead to better designed and implemented development projects, this may not be feasible in the shorter run. District panchayats should be encouraged to consider funding fewer but somewhat larger village-level projects to ensure that the necessary technical inputs are available to oversee the process. While this might mean that not every village panchayat would be allocated an annual project, fewer, but higher quality projects could result.

26. In order to improve project completion rates, district panchayats must insure that interjurisdictional disputes, such as those involved in at least some drinking water projects, are resolved prior to project approval.

27. Timely release of funds to development projects is another important determinant of project completion. While fiscal accountability is imperative, it may be possible to alter the fund-release process to

avoid untimely delays in project implementation by putting greater reliance on making village panchayat and user committee chairmen responsible for fund release.

28. Local leadership is still probably the single most important determinant of development project success, particularly in planning a project that will yield benefits to members of the users group and in insuring a sufficient flow of local contributions. Leadership workshops designed to transfer information as to techniques which have succeeded in other villages and districts may be an effective way to improve these abilities. Again, this should be an integral part of a follow-on project.



FINANCING RURAL LOCAL PANCHAYATS IN NEPAL

Introduction

The Seventh Plan, initiated in July 1985, has reaffirmed decentralized participation for rural development as a key domestic policy of His Majesty's Government of Nepal (HMG). Under this policy local panchayats (governments) are expected to be actively involved in the planning and implementation process. There are several good theoretical reasons for such decentralization. Those in the locality should have a better idea of the special needs faced locally and, therefore, should allocate resources in a manner most closely reflecting these needs. As such, decisions made locally are more likely to draw the support and participation of the local people, thereby leading to more successful project design and implementation. While such increased decision-making power can increase the likelihood of successfully implemented rural development projects, some costs also accompany these benefits. Resources are necessary to construct such projects; likewise, operating and maintaining such projects also require recurring mobilization of resources. A primary issue that arises is how such resources might be mobilized.

Most observers recognize that increased resource mobilization is necessary in Nepal. The budget of HMG is being squeezed by a poor performance in mobilizing revenues internally and an extremely heavy debt service burden. Few options are available. Additional external resources can be sought; however, this source is limited and, indeed, could contract.

Expenditures can be cut, but political and social realities will limit this option. Finally, additional resources may be mobilized internally. Given the relatively low ratio of taxes to GDP of only about 8 percent, this option will likely be pursued. Nevertheless, there are also limits to this alternative, particularly in the short-run.

A final option is to rely more heavily upon local governments to mobilize resources. Just as decentralization can have the effect of increasing local participation in project planning and implementation, mobilizing resources locally can be enhanced by the knowledge that the resources will be used to support local projects. Furthermore, it can be argued that those enjoying the increased decision-making power associated with decentralization should also be asked to bear increased responsibilities in the form of greater resource mobilization.

That HMG recognizes the potential importance of local governments in the resource mobilization process is verified by the fact that it is currently supporting the Management Support for Town Panchayats project (MSTP) which has improved revenue performance by urban local governments as one of its objectives. During that project's brief history much has been learned about the current financial status of town panchayats and progress has already been made in strengthening that status. But, at present, little is known about the resource mobilization problems and potentials among rural local governments in the country. With over 90 percent of Nepal's population living in rural areas additional attention to district and village panchayats is certainly in order. Hence, one objective of this

report is to provide some preliminary evidence regarding the current roles of rural local governments in the development process and the extent to which these local bodies engage in resource mobilization activities. While the evidence documented here is sketchy and based upon only a few observations, some conclusions can be reached and recommendations can be made. Thus, another objective of the report is to suggest steps that might be taken to strengthen the rural governments.

Rural local governments (the village and district panchayats) play important roles in the decentralized development planning and implementation process used in the country. To understand these roles a familiarity with the structure of these self-governing institutions and how they are linked to HMG is necessary. Hence, the next section briefly describes these linkages as well as the planning and budgeting processes used by local panchayats.

As noted above, the focus of this report is on the resources available to rural local governments of Nepal. Presently, there is a fairly long list of potential resource mobilization instruments available to district panchayats. The second section of the report describes these various own revenue sources of districts and documents the extent to which they are used to mobilize district panchayat revenues in nine districts located in different geographic sections of the country. Based on this analysis, together with a series of interviews conducted with local government officials and personnel, suggestions are made concerning how this resource mobilization process might be improved.

One current source of local government revenues is a land-based tax imposed by the central government but shared with the districts. Since a tax on land probably holds the greatest potential as a productive revenue source available to all localities throughout the country, the focus of the third section is on a description and analysis of the land tax. Again, suggestions for improvements in this tax source are drawn from that analysis.

At present district panchayats derive the bulk of their resources from the central government through a set of intergovernmental transfers. The fourth section of the report briefly describes and analyzes these grant programs. While stronger local governments may have decreased reliance on fiscal flows from the center, it is unrealistic to think that district and village panchayats will ever be totally self-sufficient. Some form of intergovernmental transfers are both necessary and desirable. Nevertheless, it is suggested that the form of the grants can be altered so as to assist in strengthening local governments.

The fifth section of the report focuses on the expenditure side of the district budget. One role the district panchayat plays in financing rural development in Nepal is through its direct support of development activities taking place in the district using its own personnel. A second aspect of district financial activities is as a conduit through which money passes to the village level where certain development projects are implemented.

Project implementation at the village level is the topic of the sixth section. While the bulk of the monetary resources supporting these village

projects flow from the district, a significant portion of the total cost of projects is expected to be derived directly from project beneficiaries. A set of case studies of village projects have been conducted in order to derive reasons for successes and failures of such activities and to suggest changes in the process.

The concluding section summarizes this rather preliminary study of rural local government finance in Nepal and makes specific recommendations for policy changes and follow-up activities. With sufficient commitment from HMG and some financial support by the donor community there is good reason to think that the fiscal health of local governments in the rural areas of Nepal can be improved.

The Role of Local Governments in Nepal's Decentralization Program

So as to understand the role of local government in Nepal, it is necessary to review the decentralized planning process. The current format for decentralized development in Nepal is based on the Decentralization Act of 1982 and its by-laws which became operational at the end of 1984. Nationwide implementation of the decentralization program was marked by the inception of the Seventh Plan in July 1985. The basic objectives of the program are to promote popular participation in the planning of village, town and district-level development works, to maximize local resource mobilization for these works, to achieve intersectoral coordination and balanced development throughout the country, and to strengthen local institutions responsible for development.

Local Government Structure

Nepal is divided administratively into five development regions, which in turn are divided into 14 zones and 75 districts.¹ The district panchayats are the largest units of local government and play the key role in the new decentralized planning system. Each district is divided into village panchayat and town panchayat areas, which in turn are normally subdivided into nine wards each; there are 4,022 village panchayats and 29 town panchayats in the country.

The representative process begins at the ward level where the adult residents elect a ward representative to the village panchayat, the governing body of the village. The chairman and vice-chairman of the village panchayat are elected at large by all adult residents of the village. Each ward also elects four representatives to the village assembly; members of the panchayat are also members of the assembly. The village and town assemblies within a district elect the chairman, vice-chairman and nine other members of the district panchayat. The district assembly comprises a) the members of the district panchayat, b) the chairman and vice-chairman of each village and town panchayat within the district, and c) representatives elected by town assemblies (one per every three wards within a town).

¹ Two good sources of information regarding the history and current status of district administration are T.N. Shrestha, Nepalese Administration an Image (Kathmandu: Sajha Prakashan, 1981) and District Administration in Nepal: Issues and Ideas, ed. T.N. Shrestha (Kathmandu Nepal Administration Staff College, 1985).

The panchayats are responsible for the day-to-day governance and plan formulation within the villages, towns and districts, while the assemblies issue directives and approve or reject proposals developed by the panchayats.² Village panchayats have been assigned a broad portfolio of administrative and developmental responsibilities, ranging from arresting criminals living within their jurisdictions to conducting literacy campaigns. The 112 duties of the village panchayats specifically enumerated in the Decentralization (Working Arrangements) Rules are summarized in Appendix A. But financial and personnel constraints preclude most village panchayats from fulfilling more than a fraction of these numerous responsibilities. District panchayats are entrusted with an equally daunting list of responsibilities (also summarized in Appendix A), many of which overlap the duties assigned to the villages. The development works undertaken by the village and district panchayats are coordinated with HMG's development efforts via a relatively complex planning and budgeting process.

Local Development Planning and Budgeting

The Decentralization Act requires each district to prepare annual District Development Plans (DDP) and five-year plans which are to integrate local plans formulated by the village and town panchayats with the spending

²A comprehensive study of town panchayat finances has already been made; thus, focus here is limited to the financial responsibilities and capabilities of village and district panchayats. See Town Panchayat Finances in Nepal (Kathmandu: Language Culture Training and Research Center and Bhaktapur Development Project, August 1985).

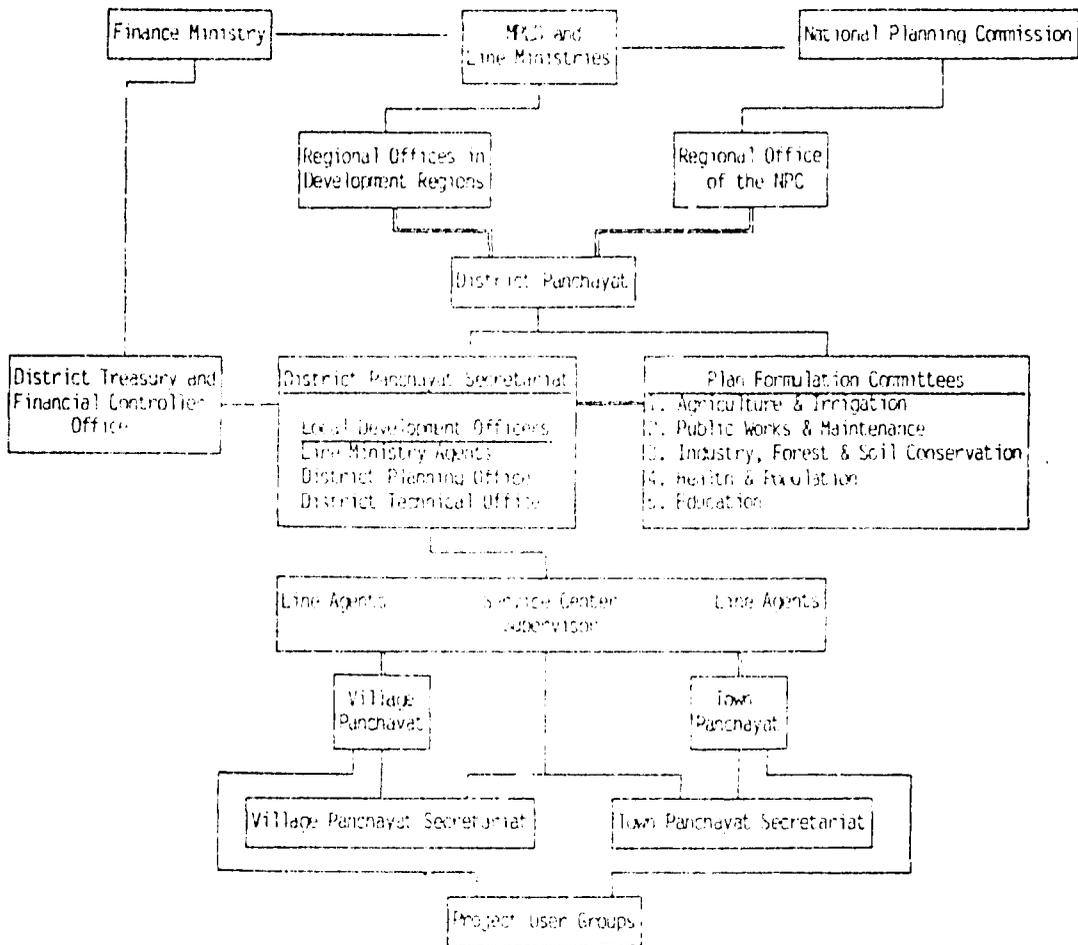
programs of HMG's line ministries operating in the district. The focal point of this planning effort is the district panchayat secretariat headed by the Local Development Officer (LDO) who is directly responsible to both HMG, as an employee of the Ministry of Panchayat and Local Development (MPLD), and the district assembly, where he serves as district panchayat secretary. The hierarchical structure of governmental units participating in the planning and implementation exercise is diagrammed in Figure 1.

The planning process begins in the September preceding the fiscal year (July through June) during which the plan is to be implemented. The MPLD initiates the action by providing each district with an estimate of the development grant that it can expect to receive for the plan period. Around this time the line ministries also estimate their district-wise budget allocations and the district, village and town panchayats estimate the resources that they will be able to mobilize locally. By mid-November, when the district panchayat has an estimate of the total resources at its disposal, each village and town panchayat is given an initial estimate of the grant allocation and is informed of the HMG expenditures that are likely to be undertaken in its area so that it can prepare its own plan.

Each ward committee within a village or town prepares a list of development works or programs (including maintenance of existing projects) after consultation with the residents of the ward. The ward plans are reviewed by the village panchayats and integrated into annual and five-year village plans. By mid-December the village and town assemblies should approve their annual plans and forward them to the district panchayat.

FIGURE 1

DECENTRALIZED PLANNING AND IMPLEMENTATION STRUCTURE



Legend

— Planning linkage

- Administrative linkage

SOURCE: Adapted from David R. Agrawal, *Decentralization for Rural Development in Nepal* (Kathmandu: Centre for Economic Development and Administration, Tribhuvan University, April 1986), p. 33.

The District Planning Office (DPO) within the panchayat secretariat collects the plans submitted by the villages and towns. Each district panchayat has five sectoral plan formulation committees, consisting of representatives from the panchayat, local class organizations, and the line ministries. These committees review the local projects that fall within their respective sectors and prepare sectoral plans.

By the end of January the LDO chairs a joint meeting of the plan formulation committees to work out the overall DDP. Although the district-level officials of the various line ministries have been integrated into the district panchayat secretariat under the leadership of the LDO, they remain responsible to their parent ministries and the panchayat has no allocative authority over the resources of the line ministries; the individual ministries have final say over where and how their money is to be spent. The district panchayat does, however, decide how to allocate the various grants received from HMG (although the central government sets sectoral guidelines for integrated rural development project grants) and locally mobilized resources. The purpose of the planning process is to coordinate centrally operated development works with locally formulated projects to avoid overlapping projects or major deficiencies in public works. The DDP must be approved by the district assembly in March; it is then forwarded to the MPLD and National Planning Commission (NPC) for their approval. These central agencies cannot cut anything from the DDP but they can prescribe additional projects.

The District Technical Office (DTO) must perform cost estimates for all local projects but it is unclear when the estimates are completed.

Some districts try to do the estimates before the projects are put before their district assemblies for approval; other districts perform the estimates only after the projects have been approved. All districts have trouble completing cost estimates in a timely fashion due to shortages of technical staff.

Once the plan has received final HMG approval, responsibility for implementing the various projects is assumed by the line ministries for HMG projects, the district panchayat for district-level projects and village and town panchayats via their appointed "consumers'" or "users'" committees for village and town projects. For each local project the local panchayat appoints a committee of five to seven members from among the beneficiaries of the ward in which the project is to be located. The ward chairman is supposed to chair the users' committee which has responsibility for mobilizing the local contribution for the project and maintaining the project (collecting fees for this purpose if necessary) once it is completed.

The Seventh Plan calls for up to nine service centers per district to be established to provide technical assistance to the local panchayats for planning and project design and to facilitate the flow of materials to users' groups. As of this date very few of these centers have come into operation. A technician from the DTO is supposed to visit each project at least once during its implementation to monitor its progress. Each trimester the village/town panchayat reports on the progress of its projects to the district panchayat and on the basis of these reports the

district decides whether to continue disbursing funds or not. An Inspection and Approval Committee is to be formed in each district to inspect completed projects and reports its satisfaction or dissatisfaction with each project to the district panchayat.

Summary

While this brief review of the planning process currently used in Nepal cannot do justice to its complexity, it does reveal that locally-chosen representatives of the people in villages and towns are actively involved, at least theoretically, in the process. Districts play dual roles as centers for the service delivery departments of central government ministries and as the highest tier of local government (although political representatives at the district level are only indirectly chosen by the voters). With both central government ministries and local governments involved in providing services, a principle objective of the planning and budgeting process is coordination of these activities. The coordination process is complicated by the fact that line personnel are directly responsible to their independent central ministries whereas local representatives are likely to have a much narrower scope of interest.³ It is the task of the local development officer to insure that the necessary degree of coordination occurs among these groups with competing goals and incentives. The task is obviously a difficult one.

³This situation is not unique to Nepal. The authors have observed similar problems arising in local governments in Bangladesh and Pakistan where line ministry decisions may conflict with local preferences.

District Panchayat Own-Source Revenues

The bulk of public sector-supported activities within districts are provided directly by central government ministries.⁴ While quantitatively less important, resources directly under the control of district panchayats should not be ignored particularly if, in the spirit of decentralization, local governments are to take on more responsibility for the development process in Nepal.

In the current section we focus primarily upon the revenues which district panchayats can mobilize through their own efforts; however, in order to provide some perspective, we begin the discussion by presenting a brief overview of the financial situation found in a sample of districts in the country. This is followed by a description of the own-source revenues available to district panchayats as well as an analysis of the performance of these revenue instruments. The section closes with a discussion of how these instruments might be improved and how additional resources might be made available to district governments.

Overview

⁴A complete study of resources available in rural areas would include analysis of line ministry spending. The current study is, however, limited to the direct role of local governments and policies that might be implemented to strengthen these institutions. For a more complete analysis of all resources available within one region of the country see Rapti Zone Regional Assessment, Report prepared by Planning and Development Collaborative International (PADCO) for USAID and His Majesty's Government of Nepal, September 1985.

It is common in analyses of local government revenues to distinguish between revenues mobilized directly by the local government itself, termed own-source revenues, and those resources mobilized through the efforts of a higher level of government. At least two types of resources constitute this latter flow of revenues--grants made directly from the higher level of government and revenues collected by the higher government but shared with the local governments in the area from which the taxes were collected. In Nepal, district panchayats receive both direct grants and a share of the land tax collected within the district.

As with many developing countries, the HMG makes no effort to collect extensive data on local resources available to district and village panchayats.⁵ For that reason, we must rely on information collected from a relatively small number of districts rather than analyze centrally collected and verified data for the entire population or even a large sample of districts. Although the nine districts were chosen nonrandomly, they represent a variety of geographic and economic areas (see the map displayed above). Two terai districts were included, one located in the far eastern portion of the country and the other from the Rapti region; six hill districts were a part of the sample including one each from the eastern and western development regions; and one mountain district was

⁵Indeed, one primary reason for this limited study is to document the extent of these resources.

included.⁶ In general, the sample represents slightly more than 10 percent of the population, land area and villages in the country. Appendix B discusses this sample in more detail including the problems associated with the quality of data collected.

As shown in Table 1, own-source revenues generally account for only a small fraction of the total resources available to district panchayats. In six of the nine sample districts this category contributed less than 5 percent of total current revenues in fiscal year 1985/86. In no instance did revenues collected directly by the district panchayats account for even 15 percent of the total. Shared taxes, which are mobilized in the local community, are relatively important in the two terai districts (Dang and Jhapa) where revenues exceed Rs. 4 per person. Various grants from the central government accounted for from 37 to 99 percent of total district panchayat income with the single mountain district (Rasuwa) almost entirely dependent upon these transfers. The data suggest an explicit policy of providing a greater flow of grants to the hill districts than in the terai and an extremely large per capita amount (Rs. 73) transferred to the

⁶For readers unfamiliar with Nepal, the country is divided topologically into three types of areas. The terai is the basically flat land that extends throughout much of the southern tier of the country bordering on India; the hill areas lie to the north of the terai and, while agriculturally less productive than the terai, is experiencing large population pressures in spite of the major difficulties associated with transportation of goods into and from the area; the mountains extend throughout the northern boarder of the country and contain relatively few residents.

TABLE 1

LEVEL AND COMPOSITION OF TOTAL DISTRICT PANCHAYAT
REVENUES IN SAMPLE DISTRICTS, 1985/86

District	Own-Source		Shared Tax		Grants ^a		Resources Available ^b	
	Per Capita	Percent of Total ^c	Per Capita	Percent of Total ^d	Per Capita	Percent of Total ^d	Per Capita	Total
Dang	1.90	13.9	4.51	33.7	7.19	52.4	14.57	4,666,080
Jhapa	0.24	3.2	4.43	59.6	2.80	37.2	9.51	5,950,514
Dhankuta	1.15	8.6	0.22	1.7	11.93	89.7	14.81	2,225,692
Pyuthan	0.75	4.5	0.71	4.3	15.08	91.2	16.54 ^d	2,760,834 ^d
Rolpa	0.53	3.2	0.04	0.2	17.64	96.6	26.70	4,593,951
Rukum	0.34	2.7 ^e	NA	NA	12.48	97.3 ^e	12.82 ^e	1,925,911 ^e
Salyan	0.77	4.2	2.00	10.8	15.83	85.1	18.74	2,919,471
Tanahun	1.38	12.7	2.89	26.7	6.55	60.6	14.18	3,661,884
Rasuwa	0.22	0.3	0.69	0.9	71.95	98.8	73.08	2,688,435

^aIncludes IRDP grants.

^bIncluding opening balance unless noted otherwise.

^cIn rupees; based on total (urban plus rural) district population as estimated for 1985.

^dExcludes opening balance.

^eExcludes shared tax and opening balance.

SOURCE: Accounts of the individual district panchayats, records maintained at local Land Tax Offices, and population figures from Table 8.1.

mountainous district with its very small population (see the section on grants below).⁷

Table 1 also suggests that in at least some districts there is a relatively large amount of funds carried over as unspent balances from the previous year. For example the Rolpa District Panchayat had Rs. 8.44 per capita in its opening balance in 1985/86, accounting for nearly one-third of the total resources available to the district in that year. Large carryover of unspent balances can indicate that local governments are experiencing difficulty in finishing projects. We return to this issue in the section devoted to development project administration.

In summary, this overview of the financial situation of district panchayats is not particularly promising. While one might hope that flows of direct grants from HMG would improve this situation, improved own-source and shared revenue performance ought to receive greatest attention due to the budgetary problems faced by the central government.

Potential Own-Source Revenues

As is often the case in developing countries, the list of revenue sources which district panchayats in Nepal can and do tap is an extremely long one, yet the revenues generated from each source is generally very small. As is shown at the bottom of Table 2, own-source revenues per capita ranged from only Rs. 0.22 to Rs. 1.90 in 1985/86. The nine-district average (unweighted) of Rs. 0.81 per person (approximately US\$ 0.04)

⁷The section of the Report on land taxation suggests that there is some uncertainty regarding the land revenue figures reported in Table 1.

TABLE 2
COMPOSITION OF OWN-SOURCE REVENUES, SAMPLE DISTRICTS, 1985/86
(percent of own-source revenue)

Revenue Source	Districts								
	Terai		Hill						Mountain
	Dang	Jhapa	Dhankuta	Pyuthan	Rolpa	Rukum	Sallyan	Tarahun	Rasuwa
House Tax	0.0	0.0	0.0	1.5	63.0	62.4	1.2	0.0	0.0
Road Tax	79.7	1.1	0.0	0.0	0.0	0.0	13.9	0.0	0.0
Bridge/Ferry Tax	0.0	11.9	54.9	0.0	0.0	10.1	3.4	0.0	0.0
Water Turbine Tax	0.0	0.0	0.0	0.0	4.2	9.5	1.3	0.0	0.0
Stone and Sand Tax	0.4	11.3	7.0	0.0	2.0	0.0	0.0	5.6	0.0
Taxes	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fish	0.0	0.0	0.0	0.0	0.0	1.2	0.0	0.0	0.0
Fines	0.1	0.2	0.0	0.2	0.4	0.0	0.5	0.1	1.3
Mill Establishment Fee	2.5	40.0	0.0	2.0	0.0	0.0	0.5	0.0	0.0
Radio License	2.8	6.8	5.4	3.0	4.2	12.9	3.3	1.6	11.7
Application Fee	0.2	0.4	0.0	0.3	0.3	0.4	0.1	1.1	0.0
Citizenship Fee	0.0	14.2	6.1	0.0	0.0	0.0	0.0	0.0	0.0
Sales of Forms	0.0	0.0	0.0	3.5	19.9	0.3	5.6	3.4	0.0
Other Sales	0.0	0.0	0.6	0.0	1.1	0.0	0.0	72.6	0.0
Rents	0.4	6.0	0.0	0.0	0.8	2.5	0.3	6.7	87.1
Arrears---PDLT	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
---Other	0.0	2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Specified Revenue	11.5	5.2	20.6	89.2	0.0	0.6	69.2	4.3	0.0
Other Nonspecified Revenue	2.1	0.0	5.5	0.3	3.6	0.2	0.8	4.7	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total Own-Source Revenue (Rupees)	609,877	150,332	172,578	125,370	99,692	51,771	120,685	356,227	8,105
Per Capita Own-Source Revenue	1.90	0.24	1.15	0.75	0.58	0.34	0.77	1.38	0.22

SOURCE: Accounts of the individual district panchayats and population figures from Table B.1.

amounts to only 0.02 percent of average annual incomes assuming income levels average Rs. 3360 per person (US\$160). The data in the table also indicate that the house tax is relatively important in two of the hill districts. The road tax dominates own-source revenue collections in Dang with a bridge/ferry tax most important in one of the hill districts. The mill establishment fee is particularly important in Jhapa district.

The structure of each of these revenue sources is discussed in more detail below. Before turning to that description, however, it is useful to consider the extent to which total own-source revenues have grown during the first half of the 1980s. Only if revenues grow more rapidly than do prices and population can real per capita spending increase. Table 3 shows the overall percentage growth in total own-source revenues for the period 1981/82-1985/86 as well as the implied annual average increases in nominal revenues. Two of the district panchayats experienced declines in own-source revenues with only two districts enjoying annual average revenue growth rates in excess of 4 percent. The third and fourth lines of the table are even more sobering. When the effects of inflation, as measured by the consumer price index, are factored into the growth rate estimates, only two districts experienced increases in the total purchasing power of resources which they mobilized locally. And in only one of these two districts (Pyuthan) did the real increase in revenues exceed the estimated rate of increase in population. In all other districts own-source revenues per capita could purchase fewer goods and services by 1986 than they could five years earlier.

TABLE 3
OWN-SOURCE REVENUE GROWTH IN SELECTED DISTRICT
PANCHAYATS, 1981/82-1985/86

<u>Districts</u>	<u>Percentage Growth</u>	<u>Average Annual Nominal Growth</u>	<u>Average Annual Real Growth</u>	<u>Population Growth</u>
Dang	21.08	3.90	- 5.91	4.72
Jhapa	10.76	2.06	- 7.58	6.84
Dhankuta	47.78	8.12	1.44	1.79
Pyuthan	98.16	14.66	4.52	1.40
Rolpa	-16.43	-3.54	-12.07	0.39
Rukum	- 3.72	-0.75 ^a	- 9.53 ^a	3.23
Sallyan	27.84 ^a	5.03 ^a	- 4.26 ^a	0.69
Tanahun	20.96	3.88	- 0.05	3.57
Rasuwa	10.23	1.97	- 7.05	5.44

^aExcludes other specific revenue.

SOURCE: Revenue figures are from the accounts of the individual district panchayats; the rate of inflation is based on the consumer price index presented in HMG, Ministry of Finance, Economic Survey, Fiscal Year 1985-86 (Kathmandu, 1986); and population growth rates are from Nepal: Contraceptive Prevalence Survey Report, 1981 (Kathmandu: Ministry of Health, NFP/MCH Project and Westinghouse Health Systems, 1983), Appendix 1, pp. 173-175.

If this performance is to be improved, changes will have to be made in the revenue structure. Prime candidates for such improvement are likely to be those revenue sources already being utilized by the district panchayats. We therefore begin this review of own-source revenues by describing briefly several of the most common revenue instruments currently being used by local governments in rural Nepal.

House Tax. The district panchayats are authorized to impose taxes on houses situated outside of urban areas at rates not exceeding Rs. 10 per year. Of the ten sample districts only the four hill districts of the Rapti Zone levy this tax. The districts normally graduate the rates of tax according to the size or quality of houses and they commonly contract the tax out to the village panchayats to collect in return for a share of the revenue. The exact division of responsibilities and revenue between the district and villages is negotiated then written into a directive that is passed by the district assembly. The basic characteristics of the house taxes levied in the Rapti Zone are presented in Table 4.

The administration of this tax appears to be very lax. In Salyan the village panchayats are supposed to submit complete lists of households, indicating which have or have not paid, but the district does not compile this information and has no record of the total amount of arrears outstanding. The district panchayat simply encourages the villages to collect arrears as soon as possible. There is apparently a public perception that a sizeable portion of the tax which is collected is siphoned off by village officials while district officials lack the records and desire necessary to ensure proper administration of the tax.

TABLE 4
 BASIC CHARACTERISTICS OF THE HOUSE TAXES LEVIED
 IN THE RAPTI ZONE

<u>District Panchayat</u>	<u>Rates of Tax</u>	<u>Division of Revenue</u>	
Pyuthan	House with ground floor only	Rs. 5	75 percent to village panchayats 25 percent to district panchayat
	One story house	Rs. 7	
	Two story house	Rs. 9	
	Three story house	Rs. 10	
Rolpa	Building with an area not exceeding 1890 square feet	Rs. 3	50 percent to village panchayats 50 percent to district panchayat
	Building with an area exceeding 1890 square feet	Rs. 5	
Rukum	"Ordinary" House	Rs. 3	Unknown
	House with two or more stories	Rs. 4	
	"Big" building	Rs. 6	
Salyan	Varies between Rs. 1 and Rs. 5 according to the number of stories and type of roofing of the house		Originally the district collected the tax and the split was 50/50 since 1984/85 the village pancha have collected the tax and have received 85 percent.

SOURCE: Interviews with district panchayat officials.

Transportation Tolls. The district panchayats may impose charges on persons, animals or vehicles that travel the roads, bridges and ferries under their control; they cannot levy charges on the major roads and bridges built and maintained by HMG. Four of the nine sample districts for which we have financial accounts collected tolls in at least one year between 1981/82 and 1985/86. The districts establish the rates for the tolls, which are normally graduated according to type of animal or vehicle (see Table 5), and then invite tenders from independent contractors who bid to collect the tolls. The individual submitting the highest bid is supposed to receive the contract and is then committed to pay the district the amount bid by the end of the fiscal year. The contractor keeps the difference between the amount collected and the amount originally bid. The districts enforce the conditions of the contract but do not know how much the contractors collect over the course of the year. The contractors also have an incentive to keep potential competing bidders ignorant of this amount.

Several of the sample districts have had tolls on their books but have failed to attract contractors in some years when the condition of their roads restricted traffic and diminished the willingness of transporters to pay the toll to such an extent that operating a toll post was not worthwhile. Dang District Panchayat relies very heavily upon its road tolls which have accounted for about 80 percent of the district's own-source revenue. Dang had also collected a ferry toll up until 1982/83 at which time it transferred this revenue source to two village panchayats. Dhankuta District Panchayat relies heavily upon revenue from a toll bridge.

TABLE 5
RATES OF TOLLS IMPOSED IN SOME SAMPLE DISTRICTS

I. Dang Road Toll	
A. Lamahi to Ghorahi Section (paid each way; Vehicles travelling between Lamahi and Koilabas pay half of these tolls)	
--jeep	Rs. 6.50
--minibus not exceeding 20 seats	Rs. 6.50
--tractor not exceeding 4 h.p.	Rs. 12.50
--tractor exceeding 4 h.p.	Rs. 21.00
--bus exceeding 20 seats	Rs. 25.50
--truck	Rs. 37.50
B. Ghorahi to Tulsipur Section (paid each way)	
--jeep	Rs. 7.00
--minibus not exceeding 20 seats	Rs. 7.00
--tractor not exceeding 4 h.p.	Rs. 7.00
--tractor exceeding 4 h.p.	Rs. 12.00
--bus exceeding 20 seats	Rs. 12.50
--truck	Rs. 25.00
C. Ghorahi to Hurnak Section (paid one direction only)	
--jeep	Rs. 7.00
--minibus not exceeding 20 seats	Rs. 7.00
--tractor not exceeding 4 h.p.	Rs. 7.00
--tractor exceeding 4 h.p.	Rs. 12.00
--bus exceeding 20 seats	Rs. 12.50
--truck	Rs. 25.00
II. Sallyan Road Toll	
--minibus	Rs. 100.00 per trip between Sallyan and Dang
--tractor	Rs. 100.00 per trip between Sallyan and Dang
--truck	Rs. 100.00 per trip between Sallyan and Dang
III. Rolpa Road Toll	
--horse	Rs. 1.00 per trip on main road
--mule	Rs. 1.00 per trip on main road
--tractor	Rs. 10.00 per trip on main road
(No contractors have bid for this toll in the past five years)	
IV. Rukum Suspension Bridge Toll	
--sheep	Rs. .25 per head per crossing
--unloaded horses, mules or donkeys	Rs. 1.00 per head per crossing
--loaded horses, mules or donkeys	Rs. 2.00 per head per crossing
--buffaloes	Rs. 10.00 per head per crossing

SOURCE: Interviews with district panchayat officials.

Water Turbine Tax. Districts may tax mills or water turbines located within their jurisdictions. Normally an approval fee is charged when a mill is first established and then an annual charge is levied, often graduated according to the size of the mill or the number of months the mill operates during the year. In Dang the approval fee is Rs. 160 and the annual tax is Rs. 20 per horse power. These taxes are collected by contractors in some places; in other districts they are collected by district panchayat staff and in a number of districts the village panchayats collect and retain shares of the taxes (in Dang the villages keep all of the annual charge). Jhapa, the most economically advanced of the sample districts, collected Rs. 60,000 from its mill establishment fee in 1985/86; no other sample district collected more than a quarter of this amount from mills.

Contracts to Exploit District Resources. Districts may grant contracts for the collection of bones, shells, feathers and other animal parts that are used for medicinal or ritual purposes. They may also grant contracts to catch fish and to collect stones, sand, timber and other materials that are borne by rivers within their boundaries. Town panchayats have also been given authority to sell stones and sand from river beds lying within town borders and conflicts have sometimes arisen when both towns and districts have attempted to exploit the same resources.

Other Prescribed Revenue Sources. The District Panchayat Act also empowers the districts to levy cesses on water used for irrigation, to impose fines and penalties for late payment of taxes, to collect rents from

persons using district guest houses, libraries, dispensaries and other public buildings, to purchase and dispose of assets at a profit, and to appropriate up to 5 percent of the incomes of village and town panchayats. The Decentralization Act further authorizes the districts to collect fees for licensing radios, tape-recorders and video sets and to elicit "contributions" from individuals or businesses for specific projects. None of the sample districts has imposed a water cess during the past five years and no district has demanded a share of its local panchayats' income during the past four years. The radio license fee is the only revenue source that has been used by every sample district over the past few years. Most of the sample districts have been able to earn some income from the rental or sale of their assets. The Sallian District Panchayat is proud of the gross income it has earned by renting a tractor it had purchased several years ago, but no one in the accountant's office had a clear picture of the net income earned from this enterprise. Tanahun has collected considerable sums in recent years from the sale of some of its land for housing plots. Dhankuta has earned some revenue by contracting out the operation of its mango garden and press.

Nonprescribed Revenue Sources. The sample districts have imposed some taxes and fees which are not specifically prescribed in either the District Panchayat Act or the Decentralization Act. The nonprescribed charges imposed by sample district panchayats include a tax on house sales, a "commodity" tax and a sales tax on exported animals and timber. It should be noted, however, that Section 50 of the District Panchayat Rules

specifically prohibits districts from imposing import or export customs duties or surcharges on central excise duties.

The Panchayat Development and Land Tax (PDLT). Chapter 4 of the Decentralization Act makes provisions for village and town panchayats to levy the PDLT but HMG has informally suspended this taxing authority since 1981. The PDLT was enacted in 1965 and first introduced on a trial basis in a score of village panchayats in the terai. The primary objectives of the experiment were to increase local resource mobilization and to strengthen the financial standing of the local panchayats.

While the basic concept and objectives of the PDLT were sound, the specific design of the tax was overly complicated for many local authorities. In order to gain the required approval from the district panchayat to levy the tax, a village panchayat had to prepare a plan and budget for the projects on which the tax revenue was to be spent. Priority was to be given to projects that increased agricultural output. The tax was imposed on both landlords and tenants as percentages of the primary annual crop produced on the land. The village panchayats were permitted to keep 85 percent of the tax proceeds while yielding 10 percent of the revenue to the district panchayat and 5 percent to HMG. The central government Land Tax was suspended in village panchayats where the PDLT was levied.

In the 1970s an attempt was made to implement the PDLT on a nationwide basis.⁸ In many areas the local authorities simply could not handle this administratively difficult tax; in other areas tax revenues were misused and this led to public dissatisfaction. Popular reaction against the PDLT in some districts contributed to the political disturbances of 1979 and led the Government to suspend the tax in 1981, before it ever became operational in many districts. Despite the nationwide failure of the PDLT the large majority of the village panchayat officials from the terai districts interviewed by the study team were in favor of reintroducing the tax and claimed that their constituents shared their sentiments. These officials said the people preferred being able to pay the tax in their own villages rather than travelling to regional collection sites and they preferred having the revenue kept in the village, unlike in the case of the Land Tax which was popularly perceived to flow out of the villages, never to return.

Evaluation of Alternative Own Source Revenues

The own-source revenue performance of district panchayats has generally been poor. Improving this performance will require a variety of actions regarding both the structure and administration of these revenue instruments. At the same time, policy changes should be implemented only

⁸Two case studies of the PDLT are Bhavani Dhungana, Narendra Kayastha and Bal Rai, "A Study on Panchayat Development and Land Tax," processed (Kathmandu: Centre for Economic Development Administration, 1976) and Vijaya Shrestha, "A Study of Panchayat Development and Land Tax in Some Selected Village Panchayats of Jhapa District," processed (Kathmandu: HMG Home Panchayat Ministry, 1972).

after considering the equity and economic effects of the alternative instruments. Here we evaluate these aspects of the major own-source revenues currently collected by district panchayats as well as several different revenue sources which were recommended by local government officials interviewed during the field work.

The house tax, as currently imposed, suffers from poor administration and a low rate structure which does not lend itself to automatic revenue growth in response to inflation or economic growth. While the rates in some jurisdictions are graduated according to the size or value of the house, revenues will grow primarily in response to increased numbers of taxed structures rather than to enhanced values of the existing stock of houses.

Some consideration can be given to increasing the maximum allowable rates of the house tax. The current rates, ranging from Rs. 3-10 per structure as shown in Table 4, are extremely low even given the economic conditions of the rural areas of Nepal. Doubling the maximum allowable rates but maintaining their graduated structure would seem reasonable.

Still, simply increasing rates is not sufficient to improving the performance of this levy. One necessary condition is improved tax administration, particularly better record-keeping. This objective should be one portion of an overall strengthening in financial administration practices at the district level. Even then, however, it cannot be overemphasized that such revenue enhancements, including those discussed below, must also be accompanied by service benefits received by house tax

payers. The entries in Tables 4 and 5 reflect this fact. Users of the services of a road or bridge are willing and able to pay rates equal or above the annual amounts due on the house tax for which no direct benefits are seen.

Tolls on roads, bridges and ferries as currently administered in Nepal have considerable merit and should be encouraged.⁹ At the same time, with constant rate structures, strong revenue growth cannot be anticipated from this source since only the level of traffic will lead to enhanced revenues. Periodic review of rates should occur so that they reflect the additional costs of maintaining and repairing the infrastructure.

Probably the most important administrative aspect of the toll system is ensuring a competitive franchising environment. If few bidders participate or if collusion among bidders occurs, the amounts obtained from this revenue source will be limited. Several policies can be used to maximize the revenues earned. Auctions must be publicly announced in advance so as to attract the maximum number of potential bidders. Information regarding approximate traffic levels should be collected on a small sample basis and made public so as to allow bidders to make good estimates of gross revenues that might be expected. This will also allow district panchayat officials to determine whether bidder collusion is

⁹For a case study of toll roads in Bangladesh including a discussion of pricing policies, see Larry Schroeder, "Toll Roads as a Zilla Parishad Revenue Source: A Case Study," Metropolitan Studies Program Occasional Paper No. 62, The Maxwell School (Syracuse, NY: Syracuse University, November 1982 [revised May 1984]).

occurring. Open auctions should be used to insure that price information is available to all bidders and to reduce the likelihood of collusion between officials and franchise bidders. And, in the event that one auction yields unreasonably low bids, the district panchayat might reserve the right to hold a subsequent auction with the franchise given to the highest bidder in either of the auctions. Finally, as was mentioned above, the district must ensure that the infrastructure on which tolls are being imposed is maintained if it wishes to continue to derive revenues from the facility.

Districts might consider operating the toll systems themselves. The primary revenue advantage of self operation is that it would allow the districts to derive the profits currently accruing to the winning private enterprise operators. A second possible reason for self-operation is that it would help to insure that franchise operators do not use their toll collection authority to extract tolls greater than those allowed in the toll schedules. Offsetting these possible advantages is that if the district panchayats were to operate the facilities there would be a need for increased staffing levels and greater administrative costs. Also, under the current system the bidding mechanism allows the price system to reveal, at least indirectly, the willingness of users to pay for the facility (witness the lack of bidders on certain roads in Rolpa and Salyan). We would not recommend conversion to self-operation.

The mill and turning tax is one form of local business tax which, due to the ease of identifying the business, keeps costs of administering the

tax relatively low. Consideration might be given to expanding the base of this type of tax to other larger business operations found in at least some districts, e.g., brickyards. Again, the administrative and record-keeping costs could be kept low since relatively few establishments would be added to the roll. Such taxes are not truly benefit based since they are only indirectly tied to the services provided by the district panchayat to the business establishments. For that reason, and the fact that excessive rates can have detrimental economic development effects, the rates imposed on mills and other establishments should be limited. Whether or not the current rates should be altered cannot be determined without further study.

It was noted above that the Panchayat Development and Land Tax is theoretically sound; its weaknesses lie in its administrative complexity. Essentially the tax is a form of agricultural income taxation, a form of taxation which has encountered administrative difficulties wherever it has been attempted in the developing world. With low rates the tax does not have major production disincentives; however, equal yield taxes based on the potential value of land have preferable incentive effects. Tying the tax to a specific project provides a benefit basis for the tax instrument, but it greatly complicates tax administration. Furthermore, local governments require a productive revenue source that yields revenues on a continuing basis and can be used for a variety of needs, especially the recurrent costs of operating and maintaining local governments service facilities. As currently structured the PDLT does not achieve that objective. As is discussed below, there are good reasons to prefer the Land Tax to the PDLT.

In addition to these local revenue sources our interviews elicited several suggestions for new possible local revenue sources. One type of revenue source mentioned by local government officials are various economic activities to be undertaken by local governments. In addition to the tractor purchase-leasing arrangement in Sallyan District mentioned above, other interviewees suggested operating cold storage facilities, operating currently idle mines, collecting and selling herbs, building and operating mills and small electric power plants, or even establishing cottage industries. While local panchayats might mobilize resources through these or other economic activities, there are several factors that should be kept in mind before recommending a widescale entrance of local governments into these ventures. First, all of the suggested activities could be operated as private enterprises. If these activities are, in fact, potentially profitable, one wonders why private entrepreneurs are not engaging in them. Since there is little reason to believe that local governments can operate these businesses more efficiently than the private sector, the revenue-generating viability of these activities must be questioned. One exception could arise if private sector investors cannot obtain credit necessary for large capital investments associated with activities such as tractors, mills and cold storage plants whereas local governments could obtain such credit. Even then, however, the economic feasibility of such activities should be studied carefully. Finally, if local governments were to enter into more economic activities, accounting systems must be improved to ensure that these undertakings do not drain revenues needed for other public sector services.

Several new taxes were also recommended by local officials contacted. Many suggested that particular goods produced in the district but used elsewhere should be taxed upon removal from the district. Among the products mentioned were roofing slate, ghee, herbs, ginger, goats or other animals and resin. Such "export" taxes should be considered carefully and certainly deserve greater study. They can be productive producers of revenue.¹⁰ They do, however, have questionable economic effects. When the taxed products are produced under competitive conditions and are widely available from many districts, as would appear to be the case for the products mentioned above, owners of capital (producers) would bear the burden of the tax. If, on the other hand, the products are produced by only a handful of producers in a single district, consumers would bear the bulk of the tax burden. In either instance, if rates are kept low, the efficiency losses associated with the tax should not be severe. A potentially more important efficiency loss to Nepal's economy which might arise are those associated with tax administration. Local 'export' taxes are similar to the octroi and each increases the costs of transporting goods since loads must be stopped and inspected prior to paying the tax. Even more detrimental is the possibility that the taxes be allowed to cascade as the load passes through districts enroute to its final destination; but ensuring that goods in transit are not taxed also adds to the administrative costs (particularly the compliance costs) associated

¹⁰ Similar taxes are used by rural local governments in Pakistan and are commonly the most important local revenue source.

with the levy. Hence, while we provisionally recommend that consideration be given to the imposition of new taxes on specific goods, we feel that additional study should be made before such policies are implemented.

Summary

There are some policy actions that can be undertaken to improve own-source revenues of district panchayats. Rates of several of the revenue instruments might be increased and some additional revenue sources might be tapped. Still, it is extremely important that any of these policies be accompanied by improvements in revenue administration. Record keeping at the local government level is especially weak; training and some revision in the types of records that should be maintained at the local level are called for. Analysis should be undertaken of a possible tax on goods produced in rural districts and consumed in other parts of the country. Still, probably the greatest potential for sustained, improved revenue performance is the land tax. It is to that source we now turn.

Land Taxation

Given the extreme relative importance of agriculture in the economy of Nepal it is reasonable to expect land to play an important role in resource mobilization efforts of the country. At present there is a land tax imposed; however, it accounted for less than 2.5 percent of total HMG tax revenues in 1984/85. There are good reasons to think that this ratio can be increased through more active participation of local governments in the Land Tax process so as to create a more obvious link between tax payments

and benefits received. Here we review the structure and record of land taxation in Nepal and make several suggestions for improving its resource mobilization capabilities.

The Current Taxation of Rural Land in Nepal

Land revenue is currently being collected under two distinct systems in Nepal based on whether or not formal surveys have been conducted according to the Land Survey Act. In the 24 districts that have not yet been surveyed assessment records are not formalized; instead land revenue continues to be collected by traditional agents--Mukhiyas and Zimmawals--and tax yields are extremely low (the sample districts Pyuthan, Rolpa and Rukum fall into this category). In the remaining 51 districts the Land Survey Department has classified all land outside of the town panchayat areas into four types and four grades within each type (see table 6). The Land Survey Department is responsible for adjusting the grade of land when it is improved such as when irrigation is introduced or when it deteriorates due to soil erosion.

In each surveyed district the Department of Land Revenue operates offices that collect three taxes on land: the basic Land Tax, which consists of specific rates graduated according to type and grade of land; the Local Development Fee, which is equal to 10 percent of each landowner's basic Land Tax payment; and the Land Registration Fee applied to transfers of land.¹¹ Revenue from the Land Tax enters into HMG's fiscal accounts and

¹¹The same three taxes are collected in the nonsurveyed districts but the rate of the Land Tax is lower and is not graduated.

TABLE 6

STATUTORY LAND TAX RATES AND TAX AS A PERCENTAGE OF LAND VALUE FOR
SURVEYED LANDHOLDINGS IN EXCESS OF 1.5 BIGHAS OR 20 ROPANI

Type and Grade of Land	Primary Characteristics of Grade	Statutory Tax Rate on a Per Hectare Basis ^d	Roughly Estimated Per Hectare Land Values ^b	Tax as a Percentage of Land Value
I. Lands in Terai Region				
A. Dhananar Lands ^c				
(i) Abal	best quality soil; year-round irrigation; paddy can be grown; yields at least two crops per year	Rs. 76.5	Rs. 110,000	.07
(ii) Doyan	good quality; irrigated only part of the year; yields two crops per year	Rs. 64.5	Rs. 88,000	.07
(iii) Sim	not irrigated; yields only one crop per year	Rs. 51.5	Rs. 66,000	.08
(iv) Chahar	dry soil containing gravel or sand; yields crops only in intermittent years	Rs. 39.5	Rs. 44,000	.09
B. Bhit Lands				
(i) Abal	Soil can support dry rice, wheat, maize, millet and similar commercial crops	Rs. 19.5 ^d	n.a.	n.a.
(ii) Doyan	inferior, sandy soil that can support maize, millet and similar commercial crops	Rs. 14.5	n.a.	n.a.
(iii) Sim	sandy or gravelly soil that cannot support crops in consecutive years	Rs. 10.0	n.a.	n.a.
(iv) Chahar	lands that are not level and whose soil contains sand or gravel	Rs. 5.0	n.a.	n.a.

TABLE 6 (CONT.), Page 2

<u>Type and Grade of Land</u>	<u>Primary Characteristics of Grade</u>	<u>Statutory Tax Rate on a Per hectare Basis^a</u>	<u>Roughly Estimated Per Hectare Land Values^b</u>	<u>Tax as a Percentage of Land Value</u>
II. Lands in Other Regions				
A. Khet Lands				
(i) Abai	good soils on somewhat level terrain at altitudes below 3,000 feet; irrigated; year-round; paddy can be grown	Rs. 39.5	Rs. 70,000	.06
(ii) Doyan	good soil; part-year irrigation at altitudes below 3,000 feet or year-round irrigation at altitudes between 3,000 and 4,000 feet	Rs. 34.5	Rs. 51,000	.07
(iii) Sim	sandy or gravelly soil and short-period irrigation below 3,000 feet or better soils and irrigation at higher altitudes	Rs. 29.5	Rs. 34,000	.09
(iv) Chahar	lands that contain poor soil or are steeply sloped or at very high elevations	Rs. 19.5	Rs. 20,000	.1
B. Pakho Lands				
(i) Abai	soils unsuitable for paddy but otherwise of good quality; located in villages below 2,000 feet, gradient moderate enough for plowing	Rs. 19.5	Rs. 39,000	.05
(ii) Doyan	moderate gradient permits plowing but soil is inferior or land is situated between 2,000 and 4,000 feet	Rs. 14.5	Rs. 25,000	.06

TABLE 6 (CONT.), Page 3

Type and Grade of Land	Primary Characteristics of Grade	Statutory Tax Rate or a Per Hectare Basis ^a	Roughly Estimated Per Hectare Land Values ^b	Tax as a Percentage of Land Value
(iii) Sim	land with poor soil or steep grading at low altitude or better quality land at high elevations	Rs. 10.0	Rs. 16,000	.06
(iv) Chahar	lands slightly worse than Sim grade	Rs. 5.0	Rs. 10,000	.05

^aIn the terai region land is measured in bighas; 1 bigha = .68 ha. In the other regions land is measured in ropani; 1 ropani = .051 ha. The tax rates have been rounded to the nearest Rs. .5.

^bThe values for dhanhar lands are based on average sale prices recorded by the Land Tax Office in Dang District. Values for similar land are likely to be higher in the eastern terai and much higher in the Kathmandu Valley. The values for bhut and pakho lands are based on minimum transfer prices for such land set by officials in Salyan District. We have tried to err on the low side of our land value estimates.

^cDhanhar lands that are located outside of the terai region but are situated in Kathmandu Valley, Pokhara Valley, Surket Valley or Dang Valley are graded and taxed in the same manner as dhanhar lands in the Terai.

^dThe table of tax rates used by the Department of Land Revenue does not contain separate rates for bhut lands in the terai but Department officials said that this land classification is equivalent to the pakho classification in other regions.

SOURCE: The Land Survey Act and information provided by the Department of Land Revenue.

then 50 percent of the collections in each district is turned over to the district panchayat as a supplement to the Development Grants, a portion of which is to be distributed to village panchayats. (If less than Rs. 100,000 is collected in a district, the entire amount is turned over to the district.) The Local Development Fee is never recorded as HMG revenues, rather it is supposed to flow directly into the district's account and can be used in a manner similar to any of the district's own-source revenue. Districts receive no portion of the tax on land transfers. In some districts the Land Tax Offices are still collecting arrears from the PDLT; the district panchayats receive all such arrears collected.

District panchayats appear to use different methods to account for the revenue flows from the Land Tax Offices to the districts. Among the six districts for which we have actual accounts, only Dang shows a clear record for both the Local Development Fee and the share of the Land Tax it receives. In Dang's accounts the Fee appears in the District Assembly Fund while the Land Tax share flows into the Development Grant Account. Salyan keeps a separate Local Development Fee account but shows no accounting of the Land Tax share (the principal accountant was not available to explain the accounts). The accounts for Tanahun, Rasuwa and Rolpa contain no reference to any revenue received from the Land Tax Department. Most of the panchayat accountants could locate records for this revenue item but in some cases the LCRC field researchers had to obtain this information from the district-level Land Tax Offices.

In five of the nine sample districts the locally reported land revenue figures are largely consistent with records kept by the central office of

the Land Tax Department. In Dhankuta District, however, the local account of land revenue is much below the amount implied by the central office records, while the converse is true for Pyuthan and Tanahun Districts. In Salyan District the Local Development Fee account is ambiguous and appears to overstate the amount collected from the Local Development Fee. Obviously, there is a need for improved accounting and record-keeping at the district level.

In Table 1 we relied upon revenue figures collected by the field researchers. If we were to replace the locally reported land revenue figures with ones that were consistent with the central records, there would exist a more consistent pattern of reliance upon land revenue among the hill districts in our sample. The revised figures would show the three nonsurveyed hill districts--Pyuthan, Rolpa and Rukum--receiving less than 1 percent of their total current revenue from land taxation (the combination of the 50 percent Land Tax share and the Local Development Fee). The three surveyed hill districts would be shown to receive between 4 and 8 percent of their total current revenue from land taxation.

Optional bases for Land Taxation

Land taxation is implemented in a variety of forms in both developed and developing countries and each approach has its virtues and drawbacks. The crudest form of land tax is one based simply on the area of landholdings, such as the Land Development Tax in Bangladesh. This type of tax is certainly the easiest to administer but it is deficient in terms of equity. Even when the rates of the tax are graduated according to the size

of a taxpayer's landholdings, the tax is not equitable because holdings of equal size can vary considerably in productivity. Furthermore, the nominal revenue of a crude area-based tax will remain stagnant (declining in real terms) unless the rates are periodically adjusted.

Taxes are sometimes imposed on the product or income generated by both land and other factors employed on the land. The PGLT falls into this category of land taxes which are more equitable and provide for greater revenue growth than do simple area-based taxes. The problem with these taxes is that an extensive and well-trained complement of tax administrators is required to estimate accurately the annual product or income of each landowner. In addition, income and production taxes decrease the incentive to utilize land productively. Some governments avoid the administrative and incentive drawbacks of taxes on actual agricultural production or income by taxing "presumptive" agricultural income. Under this type of tax regime land is normally classified according to its productivity and then an estimate is made of the average annual income earned from one unit, e.g., one hectare, of each class of land within the taxing jurisdiction. Each taxpayer's presumptive or potential income is then determined by multiplying the number of land units he owns by the appropriate per-unit average income. Finally, the tax is applied as a percentage of presumed income. The presumptive income tax is equitable in terms of the "ability to pay" criteria if ability to pay is measured in terms of ability to earn income rather than in terms of actual income. Furthermore, since the tax is based on potential rather than

actual production, a landowner cannot reduce his tax liability by curtailing his production so the tax encourages the most productive use of the land.

Many countries impose taxes on the estimated market value of agricultural land. Since the price that an individual is willing to pay for a piece of land should be approximately equal to the discounted value of the stream of income he expects to earn from the land in the future, tax rates that are stated as a percentage of land value may be restated as a percentage of expected annual income. As an example, take the case of a land tax whose rate is equal to 1 percent of the market value of land. A unit of land valued at Rs. 100,000 would bear an annual tax of Rs. 1,000. If the normal net rate of return on a unit of land is 5 percent, a producer is not likely to pay Rs. 100,000 for a piece of land unless he can reasonably expect to earn approximately Rs. 5,000 net income per year from it. In this case the land tax represents 20 percent of the expected annual income from the land. Since the land value tax can be reinterpreted as a tax on expected income from land, it shares the same equity and incentive characteristics as the presumptive agricultural income tax.

Nepal's current Land Tax is a sophisticated version of an area-based tax since it accounts for differences in the productive potential of various types of land. Nepal's tax, however, falls short of being either a presumptive income tax or a land value tax. To convert the Land Tax into a presumptive income tax one would have to estimate the average net income earned per hectare of each grade of land in a locality and set the tax rate as a percentage of each landowner's estimated total net income earned from

land. To convert the Land Tax into a land value tax one would have to estimate the average market price per hectare of each grade of land within a locality and then apply the tax as a percent of the value of a landholding.

The Rate Structure of the Land Tax

When the rates of the Land Tax were last determined twenty or more years ago, the Government must have (at least implicitly) based them upon some estimate of the income that could reasonably be generated by a unit of each grade of land. At that time the rates were deemed to be an acceptable percentage of expected income from land. Over the past two decades the nominal tax rates per hectare of land have remained unchanged while nominal incomes from land have risen due to both economic growth and price inflation. The Land Tax rates, stated as percentages of real income from land, have therefore fallen below what was considered an acceptable burden twenty years ago.

In two of the sample districts, Dang and Sallyan, the study team collected data concerning the transfer prices of various grades of land. The estimated land values for different grades of land that are reported in Table 6 are based on these data; they represent conservative estimates of the average market values of land.¹² The data in Table 6 indicate that the

¹²In Dang District the data were based on the sale prices of land reported to the Land Tax Office. Since these reported prices are likely to considerably understate the true value of the lands transferred, we raised the prices by 10 percent in order to obtain the estimated land values for Dhanabar land presented in Table 6. In Sallyan District the data consisted of the minimum prices that were permitted to be reported for transfer tax purposes. These minimum prices were set by a committee of local and HMG officials and are said to be slightly below true market prices. These prices were set on a village-by-village basis and we report the average values in Table 6.

current Land Tax rates range between 0.05-0.1 percent of land value (the minor variations across grades are within the margin of error of our estimates). The rate of 0.1 percent is roughly equivalent to the average rate of the Land Development Tax in Bangladesh. In contrast the average rate of land value taxes on rural lands in Latin America and the Caribbean is about 0.4 percent and the combined rate of rural property taxes in the Philippines is 0.6 percent.¹³

One might also examine Nepal's Land Tax rates as percentages of expected income from land. Since the tax represents somewhat less than 0.1 percent of land value, if the annual net rate of return on land is 5 percent, the tax would be slightly less than 2 percent of annual income; if the rate of return were only 1 percent, the tax would equal about 10 percent of annual income. By combining recorded data on net returns per hectare in Nepal with our data on per hectare land values, we estimate that the average net rate of return on agricultural land in Nepal falls roughly

¹³In order to compare these disparately designed tax systems we have redefined each country's tax rate as the statutory tax liability as a percent of the market value of land. For more detail on each of the taxes cited see James Alm and Larry Schroeder, "The Land Development Tax in Bangladesh," Metropolitan Studies Program Occasional paper No. 84, The Maxwell School (Syracuse: Syracuse University, May 1984); Hernando R. Garzon, "A Quantitative Evaluation of the Revenue Determinants of the Property Tax System in Peru and an International Comparison with Other Property Tax Systems Applied in Latin America and the Caribbean" (Syracuse: Doctoral Dissertation, forthcoming); and Roy Bahl and Larry Schroeder, "The Real Property Tax," in Roy Bahl and Barbara D. Miller (eds.) Local Government Finance in the Third World: A Case Study of the Philippines (New York: Praeger Publishers, 1985), pp. 46-81.

between 3 and 5 percent.¹⁴ If this estimate is accurate, the current Land Tax is roughly equivalent to a tax on agricultural income at a rate of 2 to 3 percent. Not only are these tax rates relatively low, but a substantial portion of the tax base (13.4 percent in 1984/85) is exempted by the provision under which any landholding less than 1.5 bighas or 20 ropani in size (each ceiling is roughly equal to 1 hectare) bears a tax of only Rs. 1.

The Government has some leeway to raise the rates and lower the exemption level of the Land Tax without making the tax overly burdensome in comparison to either world standards or its own standard of twenty years ago. The amount of revenue to be raised via land taxation should be determined by the demand for local public expenditures. We suggest below that this determination can best be made when some responsibility for rate setting and tax collection is devolved to local authorities.

Current Yield of the Land Tax

At current rates the average district-wide tax assessment before the "poor farmer" exemption is about Rs. 1.5 million. The terai districts on average possess tax bases that are 6.5 times the average tax base of surveyed hill districts and over 20 times that of surveyed mountain districts or any of the nonsurveyed districts (see the first column of Table 7). The "poor farmer" exemption reduces the nation-wide tax base by

¹⁴For data on net returns see Rapti Zone Regional Assessment, Appendix Table A.III.18, p. 221. The returns presented in that study have been converted to 1986-rupee equivalent for the purposes of our analysis.

TABLE 7

AVERAGE LAND TAX ASSESSMENTS, EXEMPTIONS AND COLLECTIONS
FOR TERAI, HILL AND MOUNTAIN DISTRICTS, 1984/85

	Pre-exemption Assessments	Amount of Tax Exempted	Post-exemption Assessments	Actual Collections ^b	Exemptions as a Percent of Pre-Exemption ^b Assessments	Collections as a Percent of Post-Exemption ^b Assessments
I. Surveyed Districts^c						
18 Terai Districts ^d	4,143,461	477,995	2,665,466	2,225,651	11.5	60.7
24 Hill Districts ^d	602,622	97,656	504,967	276,946	16.2	54.8
2 Mountain Districts	236,673	37,077	203,401	160,794	14.1	79.1
44 Surveyed Districts	2,074,513	250,324	1,784,191	1,060,664	12.3	59.9
II. Nonsurveyed Districts^e						
9 Hill Districts	125,664	97,585	28,079	7,146	77.7	25.5
8 Mountain Districts	45,532	35,059	10,463	6,558	77.0	62.7
17 Nonsurveyed Districts	87,955	60,166	19,812	6,869	77.5	34.6
61 Districts	1,492,030	199,558	1,292,484	772,890	13.4	59.8

^a The actual collections figures include collections of arrears from previous years as well as penalties for late payment.

^b Averages for the last two columns are weighted averages.

^c Complete data were not available for four surveyed districts. For the purposes of this table a district is defined as a terai district if at least one-third of its registered land is classified as terai land; distinctions between mountain and hill districts were made on the basis of geographic location.

^d Including the four Kathmandu Valley districts.

^e Data were not available for ten nonsurveyed districts.

SOURCE: Data provided by the Planning Section of the Department of Land Revenue.

13.4 percent; this provision cuts the tax base in the nonsurveyed districts by over 75 percent.

The terai districts contain over 80 percent of the country's post-exemption Land Tax base and account for over 85 percent of actual collections. Since the figures for actual collections shown in Table 7 include collections of arrears from previous years as well as penalties for late payment of tax, the collection percentages shown in the last column of the table overstate the efficiency of Land Tax administration in Nepal. If data from Dang and Salyan Districts are representative of districts in general, then between 20 and 30 percent of collections in any year consist of arrears and penalties and one should reduce the collection percentages accordingly. The adjusted data imply that in the surveyed districts a little less than one-half of the current year's tax due is actually collected each year. In the nonsurveyed districts less than 30 percent of the tax due is collected on time.

The local Land Tax offices establish several regional collection sites within their districts for periods of one to three months each year; they do not have sufficient staff or funds to maintain these posts for longer periods. In the hill districts, where seasonal migration is common, landowners are often out of their districts at collection time and then have difficulty travelling to the district headquarters to pay their tax. The tax offices have neither the will nor the resources to pursue delinquents aggressively. Officials readily impose the prescribed 15 percent penalty on payments made after June 29th but this usually occurs

only when delinquent taxpayers come in on their own volition to settle their accounts. No interest is charged on arrears so once a landowner has failed to meet the payment deadline he has no incentive to clear off his arrears, unless he wishes to sell or transfer his land, in which case all taxes due on the land must be paid.¹⁵ The provisions in the Land Tax Act that authorize tax officials to sequester or auction off land on which arrears are due are almost never applied.

Summary and Suggestions

This review of the Land Tax in Nepal has documented the previously-noted weaknesses in the record-keeping and accounting activities in district panchayats and has indicated that the level of land taxation in the country is low on a statutory basis and is even lower when tax delinquency is taken into account. Additional technical assistance is certainly in order to improve the record-keeping and accounting skills at the district level. In addition, changes in the structure and administration of the tax could lead to improved revenue performance of the levy. Of primary importance in this regard is greater involvement of local governments in tax administration. Thus, we suggest (1) that village panchayats be given a role in the collection of the tax with a larger proportion of the taxes collected remaining at the village level; (2) that in the short-run the Local Development Fee be abolished, the basic rate of the Land Tax be raised, and the district assemblies be given limited

¹⁵ Landowners who pay their taxes early receive a 5 percent remission but early payments are extremely rare.

authority to impose a surcharge; and (3) that in the longer run the tax structure be altered to enable taxes to reflect current land values.

The collection efficiency of any tax increases both with the will to collect of the tax collector and the willingness to pay of the taxpayers. Both of these factors can be increased by means of a greater localization of the tax which means giving local authorities a role in tax collection while at the same time giving them a greater share of the take and making them rely more heavily on this locally mobilized resource and less heavily on the HMG grants for local development works. Of course, those districts with severely restricted land tax bases will continue to remain largely dependent upon funds from the center.

A strong argument can be made for giving village panchayat authorities a role in collecting the Land Tax and its arrears and, as an incentive, earmarking a share of the tax collected within their panchayat areas to the village panchayats. We have heard complaints from both taxpayers and tax officials regarding the latter's inability to maintain a presence outside of the district headquarters to facilitate tax payments. A possible solution would be to have the land tax offices continue to establish their temporary regional collection sites but give the village panchayats responsibility for pursuing the tax delinquents and collecting arrears. One would like to keep as little cash as possible flowing through the panchayat offices. This should not be too much of a problem since the higher tax rates will make the 15 percent penalty on late payments a more formidable incentive to landowners to pay on time at the collection site.

Village panchayat officials can be very effective collectors of arrears if they are given the incentive that a significant share of the tax take will be made available to them for projects within their panchayats. Similarly, landowners should be more willing to pay the tax if they can see a more direct link between their payments and the benefits of local development works. Public pressure will also be more easily mobilized against tax delinquents who will be viewed as not pulling their weight for the village. Lists of delinquents should be posted at panchayat offices and read at the village assemblies when people's awareness of their public finance constraints is at its peak.

As we noted earlier, the amount of revenue to be raised from the land tax should be determined by the demand for development expenditures. If the demand for local development works exceeds the amount that HMG can support financially, the districts should be enabled to meet the excess demand by raising their own Land Tax collections. One suggestion would be for HMG to set a basic rate for the Land Tax, say one that approximates 0.4 percent of land value, in order to ensure a minimum contribution from each district toward the support of local services and permit each district assembly to impose a surtax of up to an additional 0.4 percent. The current Local Development Fee could then be abolished since it is really just an inferior alternative to the proposed surtax.

In order to provide local communities a sufficient incentive to rely more heavily on local resources, all of the surtax revenue and 70 to 80 percent of the basic Land Tax revenue should remain in the districts with

at least half of this local share being allotted to the villages in which the revenues were raised so as to maintain the closest possible link between contributions and benefits. (A 20 to 30 percent share of the higher-yield basic tax should amount to at least as much as HMG's current share of the Land tax and should be sufficient to cover its administrative costs.) The grant allocation system should also be redesigned to induce heavier reliance on the land tax base. As will be explained more fully below, each district's grant allocation should be inversely related to some measure of its land tax base, such as the amount of tax due under the basic 0.4 percent rate set by HMG.

In the short-run the suggested basic rate, which we state as a percentage of land value, can be approximated by raising each of the existing rates four-fold. The resulting rates could also be used as ceilings for the district surtaxes. In the longer run the Government should give serious consideration to shifting to a land value based tax since such a tax would permit revenues to grow in step with the general price level and would permit local authorities to keep up with the rising cost of providing public services without having to vote on rate increases every few years. A land value tax would be easier to implement than a presumptive income tax because information on actual land sales is available to tax assessors and provides them with some evidence concerning the actual value of lands of various qualities in various locations.

Since a system for grading land is already in place throughout most of the country, the remaining task to be accomplished is the assignment of

values to specific grades of land in each locality. This task should be performed by a committee consisting of HMG land survey and land tax officials as well as local authorities knowledgeable of land prices in their jurisdictions. The values could be based on a survey of transaction prices of land with recognition given to the fact that transfer prices recorded at the Land Tax Offices probably understate the true market value of land. The HMG representatives on the committee must have the final say in determining land values and tax assessments since the local representatives would have an incentive to understate the tax bases in their districts, thereby gaining larger grants from the central government. One suggestion would be for the Land Revenue Officer in each district to serve as the final assessment authority with the other members of the committee serving in a consultative capacity.

Land assessments will have to be updated periodically to reflect changes in market values. Ideally reassessments should be performed annually but, since each assessment involves a considerable administrative effort, it is more reasonable to aim for assessing land values every three to five years.

Consideration should also be given to lowering the one-hectare exemption level so as to bring a larger percentage of the landholding population into the tax net. Although the exemption may improve the apparent progressivity of the tax, previous experience in Nepal and other developing nations has demonstrated that it is extremely difficult to administer fairly a land tax whose rate structure is graduated according to

size of holdings or which provides for a substantial exemption. The higher the exemption level is the easier it is for landowners to divide their holdings artificially purely for the purpose of tax avoidance. A relatively low exemption level would make this tactic infeasible for all but the smallest landholders.

Intergovernmental Transfers

The data in Table 1 make it very clear that intergovernmental grants are, by far, the most important source of revenue to many district panchayats. Here we describe and evaluate the several different ways in which HMG transfers funds from the center to the districts. The section closes with several suggestions regarding how this system could be improved.

Types of Transfer Programs

There are two primary grants programs used by HMG to transfer money to the districts--an Administrative Grant and a Development Grant. In addition, there are several other smaller grants programs which transfer funds to districts as well as a loan program that can be used to supplement local resources.

Administrative Grants. Administrative Grants are subsidies allocated by HMG to pay the salaries and allowances of approved district panchayat personnel. The professional staff of the district panchayats, including the LDO, planning officers, accountants, engineers and supervisors in the district panchayat secretariats, are direct employees of the HMG and enjoy

full civil service benefits. Additional personnel can be hired directly by the district panchayat, but if their salaries and allowances are subsidized by Administrative Grants, the Ministry of Panchayats and Local Development (MPLD) must approve the hiring. Due to their special employment status, these employees are not members of the civil service and have no assurance of being funded from one year to the next. The Administrative Grant is to pay salaries and allowances; however, financial records in at least one district indicated that the Administrative Grant was used for a wide variety of recurrent cost expenditures including expenditures for fuel, building maintenance, etc.

The size of the total Administrative Grant pool is determined annually; it is contained in the regular portion of the HMG budget. The MPLD allocates the grant among the recipient panchayats on the basis of the perceived needs of the 75 districts. There does not appear to be a single, fully specified formula to determine these allocations; instead, judgmental allocations are used. Three different criteria are supposedly used in making this allocation: geographical location (terai, hill or mountain); population size; and the access by a particular district to other development resources. The underlying objective of this system appears to be redistributive in nature with those districts perceived to have lower levels of economic activity and higher costs for providing services given greater amounts of grants. For these reasons terai districts generally receive the smallest per capita allocations with the largest per capita Administrative Grants provided to mountain districts.

Development Grants. Development Grants are provided by HMG to the districts for local construction works. While these are essentially block grants, sectoral allocations of a portion of the funds have recently been mandated. There is to be Rs. 100,000 set aside for each of two sectors-- education and health--with an additional Rs. 100,000 reserved for natural calamities and another Rs. 100,000 devoted to maintenance. Finally, as is the case with total spending of district panchayats, no more than 15 percent of the grant is to be spent directly on administration. Some districts have interpreted this to mean that 15 percent of the grant should be set aside to employ additional workers. According to the Decentralization Act Working Rules (Section 72) one-half of district revenues, including HMG grants, are to be allocated to village panchayats based on the population, geographic location, efficiency and local resources of the village. This provision has, however, apparently never been seriously enforced.

Since these block grants are meant for development purposes, they are a part of the HMG development budget. The approximate size of the grant pool is determined in the national five-year plan. According to the Seventh Plan, a total of Rs. 1 billion are to be disbursed to local panchayats (rural and urban) over the five-year period 1985-1990. In 1985/86 total disbursements of rural panchayat grants amounted to Rs. 117 million with the 1986/87 allocations approximately the same at Rs. 116 million.

Allocation of the amounts across the 75 district panchayats is still linked to decisions made during the formulation of the previous (Sixth)

five-year plan. At that time officials of the MPLD and the National Planning Commission (NPC) determined what share of the total grant fund was to be allocated to each district. As with the case of the Administrative Grants, the three factors used to determine the allocations included the location of the district, its population and access to other resources for development. This last factor allows the Government to take into account development works to be undertaken directly by HMG as well as the "other grants" (described below). The resulting shares have apparently remained nearly unchanged since the early 1980s; since most members of the National Panchayat appear satisfied with the allocation, HMG is reluctant to propose major revisions in the system. Instead, it is the other grants that are used by the MPLD and the NPC to meet special needs which they perceive in particular districts.

Other Grants. Two grant programs are included in this category--Special Program Grants and Integrated Rural Development Program (IRDP) Grants. The former grants are allocated by MPLD to members of the National Panchayat (primarily on the basis of the member's political influence) for use in their home districts. While the money flows through the district panchayats, the national representatives control the project selection process. The grants tend to be used for projects similar to those financed from the development grant program but provide a method whereby National Panchayat members, who are frequently political rivals of district panchayat chairmen, can distribute benefits to their constituencies to weigh against the substantial patronage systems that district chairmen control.

The IRDP grants are funded primarily by foreign donors with at least a portion of the money flowing through district panchayats. Sectoral guidelines for the use of these grants are jointly determined by the donors, the MPLD, NPC and line ministries. That is, districts are told how much of the grant is to be spent in the health sector, the education sector, etc. The districts can then choose individual projects within these guidelines.

Loans. For the past four years HMG has permitted the Ministry of Finance to guarantee loans by commercial banks (most of which are government-owned) to district panchayats for productive projects. Over the period Jhapa has been the only district in the country to have negotiated such a loan. Apparently, banks are disinclined to lend to district panchayats because of inherent risks perceived in such loans as well as the large administrative costs which the banks must bear.

Analysis and Evaluation of Transfer Programs

As with the case of local resource mobilization instruments there are several different criteria against which one can evaluate intergovernmental grant systems. Among these are the size and growth of the transfers, the equity implications of the system, the effect of the system on local government spending, resource mobilization and planning and the fiscal accountability built into the grant scheme.

Size and Growth of the Grants. Table 8 shows the per capita distributions of the Administrative, Development and other grants to each of the sample districts for each fiscal year 1983/84-1985/86 as well as the

TABLE 6
PER CAPITA ALLOCATION AND RELATIVE IMPORTANCE OF
INTERGOVERNMENTAL GRANTS, SELECTED DISTRICT
PANCHAYATS, 1983/84-1985/86

Year	District Panchayats ^d								
	Udaipur	Jodhpur	Chambuda	Pyritman	Kolpa	Rukun	Sallyan	Tanarun	Kaswa
1983/84:									
Administrative	0.42	0.22	0.97	0.86	0.84	0.97	0.87	0.55	4.17
Development	3.54	1.55	13.90	1.14	11.23	12.45	7.41	8.40	74.79
Other	0.51	0.89	3.02	4.12	1.19	0.48	1.25	0.00	7.98
All Grants	4.47	2.65	17.88	6.12	13.26	13.90	9.53	8.94	86.94
(As Percent of Total Revenue)	(35.78)	(28.42)	(74.43)	(86.26) ^b	(53.05)	(98.50) ^c	(92.14) ^d	(78.89)	(79.78)
1984/85:									
Administrative	0.40	0.20	1.36	0.81	0.82	0.96	0.93	0.79	3.96
Development	2.92	1.45	11.77	9.70	9.65	10.35	10.31	6.99	65.66
Other	7.97	1.89	10.53	9.77	5.16	6.23	8.67	0.80	25.58
All Grants	11.29	3.54	23.65	20.28	15.65	17.54	19.92	8.58	95.40
(As Percent of Total Revenue)	(60.49)	(36.33)	(82.31)	(92.49) ^b	(59.98)	(98.20) ^c	(90.45) ^d	(52.85)	(97.77)
1985/86:									
Administrative	0.57	0.28	1.28	1.26	1.24	1.40	1.28	0.77	5.35
Development	2.79	1.36	10.66	9.56	9.62	10.03	6.85	5.79	59.34
Other	3.81	1.16	0.00	5.32	6.78	1.05	7.71	0.00	7.27
All Grants	7.18	2.80	11.93	16.08	17.64	12.48	15.83	6.55	71.95
(As Percent of Total Revenue)	(49.26)	(29.44)	(91.56)	(91.18) ^b	(66.07)	(97.31) ^c	(84.47) ^d	(46.22)	(98.48)

^aEntries are in Rs. per capita; amounts in parentheses are as percent of total district panchayat revenues from all sources, including opening balance.

^bExcluding opening balance.

^cExcluding opening balance and share of land revenue.

^dExcludes other special revenue and share of land revenue.

SOURCE: District panchayat records and population data cited above.

proportion of total district panchayat revenues accounted for by this flow of resources from the center. As had been stated above, the relative importance of these grants in the overall revenue structure of these rural local governments is quite large. The data also verify that, generally, hill districts received a larger per capita allocation of both the Administrative Grant and the Development Grant than did the terai districts and that the mountain district (Rasuwa) received, by far, the largest per capita allocation of Administrative Grants.

Several patterns are observed in the year-to-year changes in allocations within districts. Generally, per capita Administrative Grants increased, particularly between 1984/85 and 1985/86. Less stable patterns of changes were observed in the Development Grants and the special grant allocations; especially dramatic per capita changes were observed in the latter. For example, in Dang District, the per capita allocations increased from Rs. 0.51 in 1983/84 to Rs. 7.97 in 1984/85 and fell again to Rs. 3.81 in 1985/86. Similarly large changes, though with slightly different patterns, are observed in the bulk of the other districts represented here. This is not particularly surprising given the ad hoc nature of these grant programs. In part, the variability might be attributed to the political nature of the Special Grant Program where projects may be undertaken even though they are not fully integrated into the district panchayat planning and budgeting process. The problem with such major variability is that it can add greatly to the fiscal planning problems encountered in local governments.

The data in Table 8 suggest that per capita development grants generally declined during the period 1983/84-1985/86 but that the decreases were not uniform for all districts. In part, this is due to the growth in district populations; but it also can be attributed to discretionary changes made by HMG in the allocation of funds. Table 9 displays the year-to-year percentage changes over the five year period 1981/82 through 1985/86 by district. While in 1982/83 six of eight districts exhibited increases in Development Grant allocations over their 1981/82 levels, by the middle of the decade seven of the eight had experienced declines relative to the 1981/82. Since nominal data were used to compute the entries in Table 9, the obvious implication is that HMG was decreasing its support of development spending through district panchayats, at least for the several districts represented here. Such decreases run counter to the supposed interest in decentralized development commonly attributed to the Government.

In order to investigate longer term trends in HMG support for local government development efforts we have constructed Table 10 which shows the proportion of aggregate development spending by HMG allocated specifically to panchayats and local development expenditures (both urban and rural). The Table also displays the ratio of this spending to GDP and total HMG tax revenues. The data suggest that there was a pronounced increase in the relative importance of such spending in 1981/82 relative to the prior two years but that subsequently the ratios have slowly declined (as was found for the sample districts shown in Table 9). The implication is that,

TABLE 9
 PERCENTAGE CHANGES IN DEVELOPMENT GRANT REVENUES,
 SELECTED DISTRICT PANCHAYATS, 1981/82-1985/86

<u>District</u>	<u>1981/82- 1982/83</u>	<u>1982/83- 1983/84</u>	<u>1983/84- 1984/85</u>	<u>1984/85- 1985/86</u>	<u>1981/82- 1985/86</u>
Dang	34.70	-27.35	-13.54	0.00	-15.39
Jhapa	-13.12	-14.50	0.00	0.12	-25.63
Dhankuta	14.50	-13.06	-13.78	0.25	-13.95
Pyuthan	- 9.89	-38.64	761.77	0.00	-11.77
Rolpa	44.37	-36.35	-13.77	0.12	-20.66
Rukum	a	-21.86	-14.19	0.00	a
Salyan	74.08	-47.45	40.22	-33.19	-14.29
Tanahun	36.28	- 1.61	-13.75	-14.30	- 0.89
Rasuwa	51.29	-22.28	- 7.15	- 5.00	3.71

^a Cannot be computed due to lack of data.

SOURCE: District panchayat records.

TABLE 10
 PANCHAYAT AND LOCAL DEVELOPMENT EXPENDITURES
 (in percents)

Fiscal Year	Panchayat and Local Development Expenditures (Development Budget)		
	As Percent of Total HMG Development Spending	As Percent of GDP	As Percent of Tax Revenues
1979/80	1.69	0.17	2.56
1980/81	3.29	0.33	4.42
1981/82	7.25	0.87	12.22
1982/83	6.73	0.99	13.84
1983/84	6.48	0.88	12.22
1984/85	6.18	0.81	10.77

SOURCE: HMG, Ministry of Finance, Economic Survey, Fiscal Year 1985-86 (Kathmandu: HMG, 1986).

whereas the Government dramatically increased its support of local panchayats at the time there was a significant increase in interest in decentralization, this support has slowly declined in the face of other pressing needs.

Equity Implications. Since there are no good district-level income or economic base data, it is not possible to analyze statistically the extent to which the grant system allocations are correlated with local incomes. Still, there is good reason to believe that, in fact, incomes in the hill districts are lower than those in the terai and greater than in the mountains. In general, the allocations as shown in Table 8 are in conformity with the general goal that greater per capita allocations of development grants be made to those districts with weaker economic bases.

Implications for Local Government Behavior. Grants have several different potential effects on local government planning and fiscal behavior. Grant systems may alter spending decisions made locally; they may affect local resource mobilization efforts; and they may interfere with the fiscal planning process.

In general, the structure of the grant mechanisms used in Nepal suggest that they have relatively little reallocation effect on spending decisions. The Development Grants carry mandates that particular amounts (not percentages) of the total district panchayat allocation is to be spent on health and education and that additional amounts are to be set aside for maintenance and calamities. Such mandates can affect local government spending decisions if they do not coincide with local needs. For many of

the districts, this is probably not a problem since the total Development Grant allocation is commonly in excess of Rs. 1 million. For some districts, however, the mandates may act as a constraint on local government budgeting. For example, in 1985/86 Chapa District received an allocation of Rs. 850,000. The mandates effectively determine how nearly one-half of the grant is to be spent. This might constitute an effective constraint on budgetary flexibility; it could be avoided by changing the mandate into a percentage rather than specifying it in terms of absolute amounts, e.g., specify that at least 10 percent of the allocation is to be spent in one sector.

The Administrative Grant which subsidizes labor spending by district panchayats could provide an incentive for districts to try to augment their labor force since they are not required to bear these costs from their own resources. The incentive is dampened, however, by the requirement that such new employees be hired with HMG approval.

None of the grant schemes provides any direct positive incentive for district panchayats to mobilize resources of their own. There is no matching nor revenue effort provision in the grant allocation formula. While the system provides generally smaller grants to terai districts with healthier economic bases and greater resource mobilization potential, there is nothing in the system to reward districts which do a better job at mobilizing resources on their own.

In some developing countries intergovernmental grants are promised to local governments but then, due to other circumstances, the money is not transferred. Such interruptions in the flow of funds can greatly impede the development process since it results in the need to curtail or postpone

projects. Apparently this problem arose during one recent fiscal year in Nepal; however, certainty of grant flows does not appear to be a significant problem with the grant system.

The mandate to set aside funds from the development grant for the purpose of maintenance is obviously desirable from the standpoint of helping to ensure that efforts are undertaken to maintain development projects in the districts. One practical problem faced in many developing countries that have attempted to use a similar requirement is that commonly it is very difficult to distinguish between actual maintenance and reconstruction activities.¹⁶ Unless the recipient government is technically capable of undertaking a true maintenance program and is audited to insure that the funds are spent in this manner, the requirement has no actual effect.

Specifying that grant funds are to be used to finance maintenance activities can create an undesirable incentive in the grant system in that localities begin to rely on the central government for such money rather than mobilizing the resources themselves. Ideally, the localities would see it in their best interest to maintain development projects from their own resources so as to derive the greatest long-term benefits from the

¹⁶For example, in Indonesia some projects are simply termed maintenance projects even though they are similar to other development projects. This is done in order to comply with the requirements promulgated by the central government. See Larry Schroeder, Rural Development Grants to Local Governments in Asia, Metropolitan Studies Program Monograph No. 19, The Maxwell School (Syracuse, NY: Syracuse University, March 1987).

centrally funded projects. But this will require both the political will and technical know-how at the local level to mobilize the necessary resources and undertake the maintenance activities.

Summary

Local panchayats will likely have to continue to rely heavily on the flow of transfers from HMG for some time in the future. At the same time, it is not likely that the size of the grant allocations will increase significantly in the face of severe central government resource constraints. Instead, the very slow growth patterns as observed over the past couple of years are likely to extend into the future.

While the grant system, at least the Development Grant portion, is generally in keeping with the decentralization policies of HMG in that it interferes very little in local decision-making, it also does nothing to encourage local governments to mobilize resources of their own. We do not have adequate data to suggest a fully specified development grant system here; however, with some additional study and more extensive data one could be constructed which would do more to encourage local revenue efforts while still allocating relatively greater resources to those areas of the country with fewer local resources available to tap. In addition to population and location of the district (as purportedly used in the current allocation system) local revenue collection efforts, including collections of current and past-due Land Taxes, should be included in the formula to encourage local governments to mobilize greater amounts of resources from this source. With improved financial administration practices implemented at

the district level, the grant system could become a potent force in encouraging district panchayats to strengthen their financial health through their own efforts.

In the longer run there may be good opportunities to use credit to finance some investment opportunities in rural areas. Until the financial health and administrative capabilities of district panchayats are strengthened, however, extensive loan financing is probably not warranted.

District Panchayat Expenditures and Employment

Given the paucity of revenues documented above, it is unrealistic to expect that district or village panchayats are able to perform the extremely long list of functional responsibilities assigned to them outlined in Appendix A. It is, however, useful to examine the expenditure activities of these governments while recognizing that only a longer term study might ascertain the effectiveness of this spending. Since the quality of services are closely tied to the quality of labor inputs used, we also briefly examine employment conditions and attitudes in district panchayats.

Expenditures

The nature of the financial records maintained by district panchayats do not facilitate an in-depth analysis of activities of these local governments. In part the difficulty stems from the fact that several different accounts or funds are maintained by district panchayats, but the methods generally employed in accounting for these funds are quite crude

and do not permit a thorough analysis of spending patterns. It is also not possible to construct a distribution of a district's spending according to the type of service provided, e.g., for roads, health or water resources. Instead, the accounts are maintained only on the basis of the object of spending, e.g., for labor, rent, etc.

In addition to these conceptual issues, the data available for several of the sample districts contain no information concerning the amounts spent from IRGP and Special Programs Grants and there are only two districts for which detailed accountings of expenditures financed by Development Grants were recorded. Data relating to District Assembly Fund expenditures were collected and are presented in Table 11, but these expenditures represent only a small fraction of the total expenditures channelled through the district panchayats and, when examined in isolation of other expenditures, they reveal very little. Since the financial resources recorded in the various accounts maintained at the district level are quite fungible (for example, furniture and supplies for the district panchayat may be purchased out of either the District Assembly Fund or the Development Grant Account), it really only makes sense to look at functional breakdowns of consolidated expenditures.

Chapter 6 of the Decentralization Act imposes two restrictions on the consolidated expenditures of the district panchayats. Section 67 stipulates that, except when HMG grants specific permission, the panchayats may not spend more than 15 percent of their consolidated financial resources for administrative purposes. The definition of administrative expenses is imprecise:

TABLE 11
 DISTRICT ASSEMBLY FUND EXPENDITURES: 1985/86
 (in percents)

District Assembly Fund	Districts							
	Danu	Dhapa	Dhankuta	Roipa	Rukun	Sallyan	Tanahun	Rasuwa
Salaries and Allowances	31.3	30.5	62.5	64.9	51.5	19.9	11.3	78.0
Maintenance and Repair	0.4	1.8	2.3	0.0	0.4	0.3	3.1	0.0
Rent	3	0.0	2.7	0.0	0.0	0.6	0.0	0.0
Furniture and Supplies	8	5.9	5.8	0.0	3.2	2.3	5.5	19.4
Vehicles and Fuel	0.2	4.7	a	0.0	0.6	0.1	1.4	0.0
Services	6.2	3.5	2.9	0.0	0.3	0.5	1.9	0.0
Financial Assistance	35.2	8.9	2.4	3.2	33.3	14.7	36.0	2.6
Development Works	1.1	na	0.0	0.0	0.0	0.7	37.4	0.0
Miscellaneous	14.6	3.8	21.4 ^a	1.9	10.6	61.0	3.5	0.0
Total District Assembly Fund	711,057	1,714,562	417,732	84,662	187,883	444,925	1,139,499	11,702

^aIn the case of Dhankuta the miscellaneous category includes an undeterminable amount spent on fuel.

SOURCE: Data collected by LCRC field researchers.

Amounts spent on salaries, allowances, fuel, transportation, furniture, etc., of local panchayats and branch offices...shall be treated as administrative expenses. Provided that the amounts to be spent on employees who reside at the project site itself shall be treated as project expenses.

This imprecision, combined with the lack of detail in even the best kept of the districts' accounts, makes it extremely difficult for HMG to verify that the restriction on administrative expenditures is being met. Officials of several of the hill districts said that HMG realized that they could not stay within the 15 percent limit and, therefore, did not pressure them to do so. Section 72 of the Act requires that at least 50 percent of the consolidated resources of the district panchayats be transferred to the village panchayats. The sample districts appeared to have less trouble meeting this expenditure constraint than they have complying with the restriction on administrative expenses.

Detailed breakdowns of Development Grant expenditures by object were available for Dang District Panchayat for 1985/86 and for Rasuwa District Panchayat for 1982/83. The combination of these data with data concerning expenditures from the District Assembly Funds and Administrative Grants for the two panchayats provides a more comprehensive picture of district-level expenditures than is possible for any of the other sample districts. The consolidated accounts presented in Tables 12 and 13 are, nevertheless, still incomplete since they contain no breakdown of expenditures financed from other grants. These other grants accounted for 28.4 percent of the

TABLE 12
 CONSOLIDATED EXPENDITURE ACCOUNTS OF DANG DISTRICT, 1985/86
 (all figures except percentages are in rupees)

	District Assembly Fund	Development Grant Account	Administrative Grant Account	Other Grants	Total Excluding Other Grants	
					Amount	Percent of Total
Salaries and Allowances	222,627	118,752	183,000 ^d	NA	524,579	17.0
Maintenance and Repairs	2,864	116,709	---	NA	119,573	3.9
rent	21,072	---	---	NA	21,072	0.7
Furniture and Supplies	56,787	26,684	---	NA	83,471	2.7
Vehicles and Fuel	1,178	10,777	---	NA	11,955	0.4
Services	43,992	3,000	---	NA	46,992	1.5
Contingency	88,843	---	---	NA	88,843	2.9
Financial Assistance	250,644	---	---	NA	250,644	8.1
Tools and Equipment	---	27,503	---	NA	27,503	0.9
Construction	---	241,868	---	NA	241,868	7.9
Development Works	8,125	1,654,991	---	NA	1,663,116	54.0
Miscellaneous	2,418	---	---	NA	2,418	0.1
Total Current Expenditure	698,750	2,200,284	183,000	1,221,376	3,082,034	100.1
Balance Carried Forward	12,307	392,426	---	NA	404,735	

^dDetails of the 1985/86 Administrative Grant Account were not available but, on the basis of practice observed in prior years, it is assumed that the entire grant was spent on salaries and allowances.

^bIn the Development Grant Account funds allocated to the villages for projects are labelled "Financial Assistance," however, since this same term has a different meaning in the District Assembly Fund, we place the project funds on the Development Works line.

SOURCE: Accounts furnished by the Dang District Panchayat.

TABLE 13

CONSOLIDATED EXPENDITURE ACCOUNTS OF RASUWA DISTRICT, 1982/83
(all figures except percentages are in rupees)

	District Assembly Fund	Development Grant Account	Administrative Grant Account	Other Grants	Total Excluding Other Grants	
					Amount	Percent of Total
Salaries and Allowances	4,500	239,675	111,812 ^d	NA	355,987	8.9
Maintenance and Repairs	---	4,659	---	NA	4,659	0.1
Rent	---	1,350	---	NA	1,350	---
Furniture and Supplies	---	90,099	---	NA	90,099	2.3
Vehicles and Fuel	---	10,660	---	NA	10,660	0.3
Services	---	9,273	---	NA	9,273	0.2
Contingency	---	10,615	---	NA	10,615	0.3
Financial Assistance	600	1,426	---	NA	2,026	0.1
Tools and Equipment	---	5,000	---	NA	5,000	0.1
Construction	---	3,504,265	---	NA	3,504,265	87.7
Miscellaneous	---	---	---	NA	---	---
Total Current Expenditure	5,100	3,877,022	111,812	4,163,532	3,993,934	100.1
Balance Carried Forward	---	---	---	NA		

^d Details of the 1982/83 Administrative Grant Account were not available. For the purposes of this table we have assumed that the entire grant was spent on salaries and allowances since this is how the grant is supposed to be spent. One district (not in the sample) was, however, found to spend its administrative grant on a broad range of items.

SOURCE: Accounts furnished by the Rasuwa District Panchayat.

funds channelled through the Dang District Panchayat and 51 percent of the funds flowing through the Rasuwa District Panchayat.

In fiscal year 1985/86, 17 percent of the expenditures financed by the Development Grant, Administrative Grant and own-source revenues available to the Dang District Panchayat was devoted to salaries and allowances. The Administrative Grant was spent on the salaries and allowances of 15 nongazetted staff in the panchayat office. (The principal employees of the district and village panchayats, such as the LDO, the district planning officer, administrative assistant and accountant, the engineers and several supervisors in the District Technical Office, as well as the town and village panchayat secretaries were all paid directly by the MPLD.) Nearly 32 percent of the District Assembly Fund was spent on the salaries and allowances of the district, town and village panchayat chairmen and vice-chairmen, allowances paid to district, town and village Assembly members and a few nongazetted staff of the district panchayat. Approximately 5 percent of the Development Grant funds was used to hire eight project supervisors and a peon. In addition, approximately Rs. 12,000 of the "financial assistance" heading of the District Assembly Fund was distributed as administrative stipends to the village panchayats for the purpose of hiring office peons. If one were to assume that the salaries and allowances funded from the Development Grant qualified as project expenses (there is no way of telling from the accounts), then administrative salaries and expenses consumed 13.6 percent of the district's consolidated resources, excluding other grants.

Expenditures on rent, furniture and supplies, vehicles and fuel and services purchased by the panchayat would all appear to qualify as administrative expenses. The contingency category in the District Assembly Fund represents a sum that was not specifically allocated in the budget and which can be spent at the discretion of the panchayat during the fiscal year. If only one-third of this contingency fund were spent on administration, then roughly 20 percent of the identifiable expenditures of the panchayat went toward administration. We have no way of determining what percentage of other grants was spent on administration. If HMG is intent on enforcing the 15 percent limit, it will have to provide a more precise definition of administrative expenses and design a standard panchayat accounting nomenclature that permits the identification of each rupee spent as either an administrative or nonadministrative expenditure.

The Dang District Panchayat fulfilled the HMG requirement that at least Rs. 100,000 from the development grant be spent on maintenance and repairs. The district devoted very little of its own resources for these purposes, however, and the total amount spent for maintenance represented less than 4 percent of consolidated expenditures.

Slightly over 8 percent of the District Assembly Fund expenditures went to "financial assistance," a category which comprises both the administrative stipends to the village panchayats (approximately Rs. 12,000) and donations to needy individuals or people suffering calamities (the remaining Rs. 238,000). In several of the sample districts the field researchers heard allegations that the panchayats' authority to distribute

assistance was being abused and that much of the money distributed went to relatives or friends of panchayat members. The financial assistance arrangement certainly appears to hold great potential for abuse and the popular concern over this item suggests that a full public disclosure of all aid allocations be made on a regular basis.

Over 50 percent of the current revenue accruing to the Dang District Panchayat is passed on to the village panchayats for development works, even before the other grants are taken into consideration. If the latter funds were included, the villages' percentage share would be considerably higher. Furthermore, nearly all of the Rs. 392,428 Development Grant balance that was carried forward into fiscal year 1986/87 were allocations for development projects that could not be spent by the villages before the end of 1985/86.

The expenditure accounts for Rasuwa District Panchayat for 1982/83 (Table 13) predate the two restrictions imposed by the Decentralization Act but would easily have satisfied both restrictions. Salaries and allowances, including those of personnel working on development projects, comprised less than 9 percent of total district expenditures, excluding other grants. While this figure is much lower than the 17 percent share of expenditures in Dang that was devoted to salaries and allowances, this superficial comparison is misleading. Dang's expenditures on salaries and allowances amount to Rs. 1.6 on a per capita basis while the per capita figure for Rasuwa is Rs. 11.3. This per capita comparison suggests that a crude spending restriction such as the 15 percent ceiling on administrative

expenditures may be much more constraining on districts with very low total expenditures per capita than on those with high per capita expenditures.

Rasuwa District Panchayat spent a very high proportion of its financial resources in 1982/83 on development projects (labeled as "construction" in the accounts). In contrast, the district allocated a miniscule fraction of its funds for maintenance and repairs. Rasuwa's accounts show no balance of unspent funds being carried forward into 1983/84 but project lists maintained by the district panchayat clearly indicate that not all projects were completed by the end of the fiscal year.

There is an obvious need to bring some order to the financial accounts maintained by district panchayats. There are at least three different aspects to such an effort--account design, accounting skills and audits. No one of these should be expected to lead to improvements by itself. As currently structured the accounts do not give any indication of the types of services provided by district panchayats. And while there are good reasons to question the desirability of the limit on administrative spending, auditing this limitation is nearly impossible.

In this brief study it is not possible to document the adequacy of accounting skills in these local governments. There is reason to suspect, however, that these skills need to be improved through additional training (but only after the accounts have been rationalized).

Audits are the third prong of a well-administered and accountable financial administration system. No audits of any district accounts have

been undertaken in the past seven years. The MPLD has plans to establish separate audit units within each district panchayat secretariat. Once these units are able to complete internal audits, the districts will be required to hire auditors registered with the Auditor General's Office to conduct final audits. At present district funds are quite vulnerable to misappropriation. It is not possible to gauge the extent of actual abuse, but the popular perception that such abuse exists seriously weakens the confidence of the people in local government and undermines revenue mobilization efforts. While property audited accounts are absolutely necessary, we would caution against concentrating solely in this area of financial administration. Account structure and accounting/bookkeeping skills are also necessary ingredients to improvements.

Employment

It was noted above that there are two types of labor employed at the district panchayat level--HMG civil service employees posted in the district panchayat and direct hire district panchayat employees. As HMG employees the former group can be transferred to other jobs in other locations at the discretion of the center; however, their continued employment is much more certain than that of the latter group. Such a two-tier employment composition can certainly affect overall employee morale, particularly if civil service employees have benefits, e.g., pension rights, not enjoyed by direct hires of the local panchayat.

This issue of employment satisfaction is borne out in a survey conducted by the LCRC in ten districts. A total of 130 district-level workers were surveyed; 77 of the respondents (59.2 percent) were direct hires of the district panchayat with the remaining 53 (40.8 percent) being

HMG employees. When asked whether they were satisfied with their jobs, nearly one-half (48.5 percent) of all respondents indicated that they were. But there is a significant difference in the proportions satisfied with their jobs when the two types of employees are differentiated. Only 36.4 percent of all direct hire district panchayat employees surveyed said they were satisfied with their jobs while 66.0 percent of the HMG employees were satisfied.

Another major difference in the two sets of employees concerns their training. In the same survey it was found that while slightly more than one-half of all respondents had received training of some form, only 37.7 percent of district panchayat direct hires had been trained whereas 73.6 percent of the HMG employees had received special training.

While personnel administration issues are somewhat outside the domain of this study, these data do suggest that future efforts to strengthen local panchayats in Nepal should encompass efforts to learn more about the subject and include training efforts. One policy issue that should be included in such an initiative is creation of a local government service. The LLLCRC survey found, not unexpectedly, that 83 percent of the responding district panchayat direct hires supported the idea of such a service. Although there are major drawbacks of local government services, the idea does deserve additional study in follow-up analysis.

Financing and Administering Local Development Projects

Obviously, one primary objective of local governments in a developing

country is economic development. A means to this end is the development project. Many aspects of administering and financing development projects in Nepal are unique; and while there are certain weaknesses associated with the process that should be altered, there are also features that could be utilized in other developing countries.

In this section we review the primary features of the district and village project implementation process concentrating on the financing mechanisms used. We then analyze some unique data regarding the set of village development projects being financed in six sample districts. We close by discussing some of the major issues regarding project administration and finance as raised during the course of our interviews and from the analysis of the available data.

Financing Projects

Development projects are undertaken by both the district panchayat and village panchayats. While there is no clearcut differentiation between district and village projects, commonly the former will involve more than a single village whereas village projects tend to be small projects with a relatively small number of beneficiaries. In the latter instance user groups are formed to carry out the project and to mobilize a share of its financing.

Village projects tend to be technologically quite simple. Local drinking water projects, small irrigation systems, school and local panchayat buildings, roads, bridges and culverts are, apparently, the principle types of projects undertaken at the village level. To carry out

a project a local users' committee is formed to represent the households who will be direct beneficiaries of the scheme. The five to seven person committee is appointed by the village panchat and is chaired by the chairman of the ward in which the project is located. Not only does the committee oversee the construction of the project, it is also to be responsible for project repair and maintenance. There is, however, some question as to whether any sustained maintenance program is ever considered at the outset of project design. Instead, maintenance appears to be an afterthought with needed repairs made to a project only when it becomes obvious that repairs are necessary. This is one area in which additional study and technical assistance is needed so as to improve the long-term productivity of projects and sustain the flow of project benefits.

Nearly all of the village projects undertaken are financed through a combination of monetary inputs provided from the district panchayat and other resources mobilized at the village level. Although village panchayats have the authority to mobilize resources through formal taxes and fees, the resources used to meet project costs are most commonly mobilized "voluntarily".¹⁷ While these contributions may be in the form of

¹⁷ Village panchayats are authorized to levy a trade or occupation tax on shops, mills, theaters, markets, commercial sites, etc.; they may impose fees for the registration of vehicles and firearms and for the annual renewal of radio licenses. In those districts which do not impose and share the house tax with the village panchayats the latter have extremely restricted revenue bases. Two village panchayats which were visited collected only radio, rifle and water turbine license fees; their annual own-source revenues were less than Rs. 5,000, all of which were spent on panchayat office expenses. A third village panchayat, which encompassed a small town, earned slightly greater revenue by imposing a tax on shopkeepers and was thereby able to hire street cleaners. Even those village panchayats that have access to house tax raise very little formal revenue; one such panchayat raised Rs. 25,000 in 1985/86.

cash, most commonly they are nonmonetary resources particularly labor and, at times, locally available materials.

In estimating project costs it is necessary to value the amount of labor and nonlabor inputs contributed locally. Each district uses an estimate of the current price of labor, sometimes differentiating between the going wages of skilled and unskilled labor. For example, in 1986/87 Salyan District used Rs. 18 per day for unskilled labor and Rs. 35 for skilled labor; in Dang District Rs. 20 per day was used; in Bhaktipur District, which is more urbanized and lies adjacent to Kathmandu, the wages were estimated to be Rs. 30 and 55 for unskilled and skilled labor, respectively. The data suggest that there is an attempt to use reasonable estimates of the opportunity costs of the voluntarily mobilized labor.

While the transfer of funds from the district to villages is equivalent to an intergovernmental grant with a local match, there is no well-defined matching system used by districts. That is, the local contribution as a proportion of the total project costs may vary greatly from project to project and from village to village. In some districts the district panchayats distribute grant monies among villages on approximately an equal per village basis. Since total project costs differ considerably, equal village allocations result in significant differences in the relative importance of local contributions from project to project.

Equal allocation of grants among all villages precludes the need for the district panchayat to attempt to evaluate the relative merits of the numerous schemes presented from each village. While politically preferable

and possibly necessary due to the shortage of technical skills at the district level, this lack of hard evaluation probably results in some technically inferior projects being undertaken.

Different villages have shown unique approaches to the issue of raising voluntary resources. In some projects all beneficiary families are expected to contribute equal labor shares towards the completion of the project; for other projects, particularly irrigation projects, landowners are expected to contribute towards the project in proportion to the amount of land to be irrigated by the project. Salyan District has authorized small annual fees, amounting to Rs. 5 per benefitting household, to be collected by the committee to operate and maintain of drinking water projects. Finally, although it was not financed through the Development Grant, a communal forest project in one village uses collections of in-kind contributions of grain to provide the resources necessary to hire a watchman to ensure that nonparticipants in the project do not take wood from the forest.

Empirical Analysis of Projects

Each district panchayat is to maintain a project book containing information on the village-level projects partially financed from its funds. We have obtained summary information from ten districts regarding such projects undertaken during the past several years. Table 14 shows the sectoral allocation of these projects, both by number of projects and their total cost (the aggregate of district funds and locally-mobilized contributions). To aid in the interpretation of the data, the percent of

TABLE 14
SECTORAL ALLOCATION OF PROJECTS FOR SELECTED DISTRICTS

District	Year	Sector					
		Water		Irrigation		Buildings	
		Number Projects ^d	Total Cost ^b	Number Projects ^a	Total Cost ^b	Number Projects ^a	Total Cost ^b
Dang	1985/86	8 (20)	409,230 (17)	23 (58)	1,407,351 (58)	6 (15)	440,404 (18)
Dhapa	1985/86	3 (12)	52,313 (11)	8 (31)	124,314 (26)	4 (15)	56,824 (12)
Dhankuta	1985/86	16 (36)	525,185 (25)	8 (18)	208,130 (10)	18 (40)	1,221,001 (59)
Pyuthan	1984/85	15 (33)	na	5 (11)	na	14 (30)	na
Rolpa	1984/85	na	1,368,641 (70)	na	219,758 (8)	na	507,052 (19)
Rukum	1985/86	---	---	11 (21)	535,782 (11)	26 (49)	3,423,801 (73)
Salyan	1985/86	3 (7)	1,126,188 (27)	12 (27)	661,811 (16)	27 (60)	1,886,313 (46)
Tanahun	1985/86	64 (93)	1,778,746 (94)	4 (6)	63,683 (3)	---	---
Lalitpur	1985/86	8 (18)	105,244 (9)	7 (16)	93,674 (8)	19 (42)	831,177 (73)
Rasuwa	1983/84	14 (19)	1,356,716 (25)	9 (12)	631,356 (13)	19 (26)	1,675,962 (35)

TABLE 14 (CONT.), Page 2

District	Year	Sector					
		Roads		Bridges		Other	
		Number Projects ^a	Total Cost ^b	Number Projects ^a	Total Cost ^b	Number Projects ^a	Total Cost ^b
Dang	1985/86	---	---	---	---	3 (8)	147,757 (6)
Jhapa	1985/86	1 (4)	5,145 (1)	8 (31)	223,653 (46)	2 (8)	18,032 (4)
Dhankuta	1985/86	---	---	---	---	3 (7)	116,553 (6)
Pyuthan	1984/85	---	---	12 (26)	na	---	---
Rolpa	1984/85	na	78,382 (3)	---	---	---	---
Rukum	1985/86	---	---	16 (30)	754,055 (16)	---	---
Sallyan	1985/86	---	---	---	---	3 (7)	462,678 (11)
Tanahun	1985/86	---	---	---	---	1 (1)	42,392 (2)
Lalitpur	1985/86	3 (7)	46,189 (4)	---	---	8 (18)	62,363 (5)
Rasuwa	1983/84	13 (18)	921,043 (19)	14 (19)	164,321 (3)	4 (5)	66,989 (1)

^aNumber in parenthesis is percent of total number of all village panchayat projects financed in that year.

^bNumber in parenthesis is percent of total costs of all village panchayat projects financed in that year.

SOURCE: District panchayat records.

the district totals are also shown.

No single conclusion can be reached from these data other than to suggest that, as should occur under decentralization, each district allocates the funds quite differently, preferably in accord with the needs perceived locally. For example, irrigation projects dominated the allocation in the terai district of Dang whereas drinking water projects were apparently deemed most crucial in several of the hill districts, e.g., Tanahum and Rolpa.

Large differences in the sectoral percentage allocations of projects and costs suggest significant project size differences. For example, in Dhankuta 36 percent of all projects undertaken were drinking water projects but they used only 25 percent of the funds while buildings accounted for 40 percent of the projects and 59 percent of the funds. Hence, water projects were considerably smaller, on average, than were the building schemes.

While local contributions are commonly advocated as a desirable resource mobilization technique for low-income developing countries, there is a dearth of information available on the topic. Thus the data in Table 15, which show, by sector, the proportions of actual or budgeted project costs raised through contributions, are especially interesting.¹⁸ It is difficult from these data to reach any firm conclusions regarding those

¹⁸ It should be noted that there is no ex post auditing of the actual amount of local contributions made towards the completion of a project. For the entries indicated as budgeted amounts, contributions are the difference between estimated project costs and the grant from the district; 'actual' entries are village panchayat estimates of local contributions. In either instance the ratios shown very well may be biased.

TABLE 15

LOCAL COST SHARING RATIOS BY SECTOR FOR SELECTED DISTRICTS
(amounts shown are percentages of shared costs to total project costs)

<u>District</u>	<u>Water</u>	<u>Irrigation</u>	<u>Buildings</u>	<u>Roads</u>	<u>Bridges</u>	<u>Other</u>
Dang ^a	43.19	54.29	60.15	---	---	52.65
Jhapa ^a	75.23	71.04	68.32	12.54	84.06	50.09
Dhankuta ^a	22.28	23.49	63.54	---	---	37.71
Pyuthan	na	na	na	na	na	na
Rolpa ^b	95.50	---	33.14	23.45	48.91	---
Rukum	66.63	---	87.33	---	60.51	---
Salyan ^d	10.29	61.07	74.19	---	---	56.67
Tanahun ^a	32.61	50.00	---	---	---	54.31
Lalitpur ^b	12.43	25.41	12.82 ^c	33.02	---	15.36
Rasuwa ^a	5.27	3.74	14.19	23.93	16.12	14.99

^aActuals according to records.

^bEstimated.

^cLocal sharing ratio is 46.08 if the one district panchayat building with no cost sharing is omitted.

SOURCE: District panchayat records.

sectors in which local sharing is likely to be more or less successful. At the same time, one can conclude that the local nonmonetary matches are quite high. In the terai districts of Dang and Jhapa local matches in excess of 50 percent were generally the rule. The hill districts exhibited generally lower local matches, nevertheless local contributions commonly amounted to more than one-third of the total costs of the projects. In great part this outcome may be due to the previously noted policy to transfer larger development grants to the hill districts. This conclusion is strengthened when observing the data from the one mountain district represented here--Rasuwa. There the local match ratios are even lower, again possibly because of the very large per capita Development Grants provided to the mountain districts.

While one might anticipate some sectoral bias in the levels of local contribution, e.g., higher local contributions to more labor intensive projects such as drinking water systems and lower ratios for building projects, the data do not support this expectation. Instead, the ratios within a sector vary greatly across districts.

The large local contribution ratios shown in Table 15 suggest that these voluntarily mobilized resources are significant in the overall activities of local governments in Nepal. To examine this, Table 16 shows the ratio of total local project contributions relative to the monetary resources mobilized by the district through its own-source revenues as well from the total of own-source revenues plus the shared land taxes (which are also raised locally). The results are quite interesting as they suggest

TABLE 16
RELATIVE IMPORTANCE OF PROJECT CONTRIBUTIONS,
SELECTED DISTRICTS

District	Year	Own-Source Revenues	Own-Source Plus Shared Taxes	Project Contributions	Contributions Relative to	
					Own-Source Revenues	Own-Source Plus Shared Taxes
Dang	1985/86	607,877	2,065,703	1,266,182 ^a	2.08	0.61
Jhapa	1985/86	150,332	2,353,820	364,169 ^a	2.42	0.12
Dhankota	1985/86	172,175	755,578	985,693 ^b	5.71	4.79
Pyuthan	1984/85	138,618	271,092	NA	NA	NA
Rolpa	1984/85	96,411	192,349	2,078,550 ^b	20.91	19.54
Rukum	1985/86	51,771	NA	2,803,224 ^b	73.46	NA
Sillyan	1985/86	120,685	432,496	2,344,378 ^a	19.42	5.42
Janahun	1985/86	356,337	1,102,980	634,969 ^a	1.78	0.57
Lalitpur	1985/86	55,802	129,691	174,844 ^b	2.06	1.35
Rasuwa	1983/84	1,639	1,639	562,348 ^a	343.10	343.10

^aActuals according to records.

^bEstimated

SOURCE: District panchayat records.

that local nonmonetary contributions tend to dominate the amounts mobilized through the more formal taxation techniques.¹⁹ In all instances contributions are considerably greater than the amounts derived from own-source revenue instruments. In the terai districts, where the land tax is very productive, contributions take on relatively less significance in the overall resource package of districts; however, in the less prosperous hill and mountain districts the project-related contributions generally dominate the formal, monetary-based resource mobilization instruments. The conclusion that must be drawn from these estimates is that the resource mobilization effort in the rural areas of Nepal are certainly greater than a simple review of district panchayat accounts would suggest.

While the previous discussion suggests that the project implementation effort in Nepal is quite successful, the record is not uniformly positive. One major problem is project completion. One indicator of the problem is the large closing fund balances mentioned above. The data in Table 17 specifically address the project completion problem. In only a very few instances could the district panchayat report that projects were fully completed by the end of the fiscal year in which they were initiated. In fact, in no instance among the six districts were even one-half of the projects undertaken completed by the end of year. Unfortunately, the

¹⁹We again caution that the contribution values may be overstated since in three instances they were drawn from budgets rather than from actual expenditure data. On the other hand, since the actual (albeit unaudited) contribution data represent only those contributions made by the end of the fiscal year, further contributions should be forthcoming in order to finish many of the projects (see below).

TABLE 17
 PERCENTAGE OF PROJECTS COMPLETED AT END OF FISCAL
 YEAR BY SECTOR, SELECTED DISTRICTS

District	Year	Sector						Total
		Water	Irrigation	Buildings	Roads	Bridges	Other	
Dang	1985/86	25.0	34.8	33.3	---	---	33.3	32.5
Jhapa	1985/86	0.0	75.0	75.0	100.0	0.0	100.0	44.4
Dhankuta	1985/86	0.0	25.0	0.0	---	---	0.0	4.4
Pyuthan	1984/85	na	na	na	na	na	na	na
Rolpa	1981/86	na	na	na	na	na	na	na
Rukum	1985/86	na	na	na	na	na	na	na
Salyan	1985/86	66.7	75.0	25.9	---	---	66.7	44.4
Tanahun	1985/86	12.5	0.0	---	---	---	0.0	5.8
Lalitpur	1985/86	0.0	14.3	10.5	0.0	---	22.2	10.9
Rasawa	1983/84	14.3	44.4	31.6	69.2	78.6	na	na

SOURCE: District panchayat records.

problem also cannot be traced to a single sector nor to one region of the country. Only with more thorough and in-depth analyses of individual projects can one determine the possible weaknesses in the process to determine how the situation might be altered. Several case studies provide some of this needed insight.

Case Studies

Personnel of the LCRC conducted 13 case studies of individual development projects located in six different districts. The sample chosen was not random; instead a purposeful sampling technique was used. Information was desired about both "successful" and "unsuccessful" projects so, in conjunction with local officials, projects representing both outcomes were chosen. The resulting set of projects represent four different sectoral allocation of funds: seven drinking water projects, two buildings (one village panchayat office building and one local school building), three irrigation projects (two irrigation distribution schemes and one dam) and one road (a mule track). Summary information on these schemes is shown in Table 18.

As might be anticipated from the nature of the sample chosen, it is again difficult to reach definitive conclusions regarding the factors which lead to successful completion of village projects. Of the seven drinking water projects only two were deemed successful; the bulk of the failures were attributable to disputes regarding the source of water. This is a classic example of allocating a limited resource which, on the basis of the social benefits received, should be made available outside the area in

TABLE 18
SUMMARY OF DEVELOPMENT PROJECT OUTCOMES, SELECTED PROJECTS

District	Type Project	Persons Benefited	Project Costs	Local Share	Contribution Per Person	Year Project Began	Completion Date	Comments
Tananun	Water	250	Rps. 22,424	20%	Rps. 18	1985	1986	Successful small project
Tananun	Water	400	16,144	22	9	1985	Incomplete	Water source dispute
Tananun	Water	500	34,279	35	24	1985	Incomplete	Management problems and late grant; excessive labor share
Sallyan	Water	500	157,583	20	64	1983	1987	Problems in supervision and participation
Sallyan	Village Building	Entire Village	67,781	70	na	1985	1986	Regular supervision and good local participation
Rolpa	Mule track (road)	1,200	15,000 (district)	na	na	1985	1987	High local interest
Rolpa	Water	1,000	217,745	35	80	na	na	Disputes at water source led to problems
Dhankuta	Water	600	54,125	8	8	na	na	Good supervision and timely release of funds
Dhankuta	Irrigation	500 ^a	23,333	14	na	na	na	Political conflicts and lack supervision
Rasuwa	Irrigation	30 ^a	18,621	20	na	1982	1983	Good participation and timely fund release
Rasuwa	Water	150	85,403	5	28	1982	Incomplete	Dispute over water source
Jhapa	Dam	800	27,285	83	28	1985	1986	Strong leadership of user's group
Jhapa	School building	200 ^b	29,674	85	126 ^c	1985	Incomplete	Political controversy and alleged misuse of funds

^a Ropani land, not number of beneficiaries.

^b Number of school children.

^c Per student.

SOURCE: LCRC survey.

which the resource is located.²⁰ In such instances it will be absolutely necessary for the higher level of government, in this instance the district panchayat to assist in resolving the dispute. Perhaps some sort of compensation will have to be made to the village holding the resource in question; this is particularly true if there are alternative uses of the same resource in the source village. In any event, prior to district approval of a project, there should be assurance that the supply problem is already resolved or can be resolved in a timely manner lest funds be committed to projects which cannot be completed due to such disputes.

The proportion of local share does not appear to be a significant factor in determining the success or failure of a project. One successful project, the village panchayat building project in Sallyan District was successfully completed in spite of the fact that 70 percent of total costs were to be raised locally whereas the much lower 35 percent local share on the drinking water project in Tanahun was deemed excessive. Similarly, the 83 percent local share on the dam in Jhapa district was raised while the 14 percent share for the irrigation project in Dhankuta did not lead to a successful outcome. Interestingly, at least some persons interviewed suggested that no more than a 20 percent matching rate should be required; the data here, however, do not necessarily support this contention.

Economic theory would suggest that smaller scale projects are more likely to be successful when local contributions are necessary. There is

²⁰ Similar problems are faced in the western states of the United States where water is quite plentiful in some areas but scarce in other locations.

some slight evidence of this in these data. The relatively small (30 ropani) irrigation project in Rasuwa was successful whereas the 500 ropani irrigation scheme in Dhankuta was not successful.

Two items over which districts have at least some control should be noted as important constraints to the success of development projects. One of these is the timely release of grant funds. Without such funds purchases of necessary inputs cannot be made at the point in time when local labor will be forthcoming. Efforts should be made to overcome this constraint. Also problematic is the lack of sufficient technical supervision. The drinking water project in Dhankuta received such supervision from the district technical officer (DTO) and was successful whereas the considerably larger water project in Salyan was not successful, in part because of the lack of adequate technical supervision.

Strong local leadership emerges as probably the single most important determinant of the success of these local development projects. It obviously is necessary if local participation is to occur and if disputes within the user group are to be avoided. It may be possible to conduct leadership workshops in various communities to help foster these leadership characteristics. Attempts should be made to have past successful project chairmen attend these workshops so that they may pass on to others the techniques they have found useful in encouraging local participation.

Summary and Policy Issues

The village project implementation process used in Nepal is particularly interesting, especially regarding the techniques used to

mobilize resources through nonformal mechanisms even though the monetized portion of the projects flows through local governments. Based upon the case studies and the aggregate data analyzed above together with personal interviews conducted with village and district officials, it is apparent that several issues need to be addressed if the development project process is to be improved.

Among the issues identified are: allocation of funds across projects; carryover and accumulation of funds; planning and supervision of projects; release of funds; mobilization of contributions; and maintenance of projects. We consider each in turn.

Allocation of Funds. One potential cost of decentralization is that political factors are likely to play an important role in the allocation of funds. This is probably the case when district panchayats determine the distribution of funds across villages. Whereas economic efficiency would dictate that the limited district funds be allocated across villages in a way to maximize the overall social benefits of the projects, such an allocation mechanism is not only unlikely to be feasible, political realities preclude it. Still, simply dividing the total available funds equally among all villages, as is the practice in at least some districts, is unlikely to lead to the most effective use of limited district panchayat funds. There should be some attempt to scrutinize projects prior to their approval at the district level. Particularly important, if resources permit, is consideration of the technical feasibility of the projects as well as possibility that the pledged local contributions can realistically be mobilized.

A related issue concerns project choice at the local level. Some village officials say that they realize that at least some of the projects undertaken are not high quality schemes. They argue, however, that the incentives of the system discourage undertaking higher quality projects.²¹ The monetary grants provided to villages are seen as being too small to do much with them; however, the villages feel that if even this small amount of money is not used, it will be lost in succeeding years. Local officials argue that they should be allowed to accumulate the funds until a sufficient amount is available to fund a higher quality project.

While there may be some merit to this argument, a better solution that would permit higher quality projects and would also avoid uneconomic accumulating of funds would be to alter the allocation of funds at the district level. Rather than opting for the politically preferable allocation of a small amount of funds to every village (which may further subdivide the amounts among several different projects in different wards), it would probably be better to fund a smaller number of projects. In this way, greater supervision could be provided by the technical officers at the district level and higher quality projects might result. To mandate such allocations would, however, defeat the idea of decentralization and take away some local political discretion. This is a policy choice that only HMG can make.

²¹The assumption here is, of course, that the necessary technical competence is available to complete successfully higher quality projects.

Unspent Balances. Problems associated with project delays have been mentioned at several points throughout this review of local resources mobilization in Nepal. It was observed that at least several of the sample districts had accumulated relatively large closing balances. Such balances will accumulate if projects are unduly delayed such that budgeted funds are not spent. Unless these funds are productively invested, they constitute a drain to the overall development efforts of the country. At present, apparently, excess fund balances do not yield interest earnings for the district panchayats. This situation should be altered; technical assistance in financial administration provided to districts should include consideration of cash management techniques.

Project Planning and Supervision. The case studies show that lack of proper project planning and supervision is one cause of project failure. During our fieldwork we observed a small dam that had been partially washed away during the rainy season due to poor design and workmanship. No engineer had been available to help design the dam and an overseer had visited the worksite only twice during its construction. In another village a small drinking water system had been constructed without any technical assistance; however, because a pipe had not been placed sufficiently deep in the ground, a tractor had collapsed the pipe thereby reducing the number of working taps from six to five. Again, overcoming these obstacles will require additional technical manpower and/or technical training. The alternative will be to undertake fewer projects at the village level, at least until greater technical assistance is available.

A second, related issue concerns the previously mentioned problems associated with projects, particularly water projects, that affect more than a single village. District level officials must act to avoid these interjurisdictional problems if projects are to be completed successfully.

Release of Funds. Timely release of funds is another problem that apparently has contributed to project failure. Again a difficult dilemma faces district officials. On the one hand, fiscal accountability requires that funds not be wasted, hence funds should not be released unless it is known that they are being spent correctly. On the other hand, delays in the release of funds may mean that crucial inputs cannot be made available when they are needed. A policy introduced during the past year requires that when a village project is not completed on schedule funds for subsequent projects in that village be withheld by the district. While some form of sanction is required current practice penalizes villagers who are likely to have had no involvement in the failed project. It is also not clear how long a village will be punished if one of its projects is never completed.

One obvious remedy to the project completion problem is a larger number of overseers and/or fewer projects. Lacking the resources for this alternative, it may be possible to put greater responsibility in the hands of the village panchayat chairman and, simultaneously make them liable for misappropriation of funds. Release of funds could occur upon submittal to the LDO of papers jointly submitted by the village panchayat chairman and the user group chairman; as soon as possible, inspection of the project

site and records would occur. Any improper use of funds should result in penalties lodged against these two individuals.

Mobilization of Contributions. Some projects have failed due to insufficient local contributions. While local leadership capabilities may have been at fault, such failure is also an indicator of a poor match between local preferences and project selection and design. In fact, one major advantage of mobilizing resources through local contributions is that the technique provides a good indicator of the demand for a project. If the local match is so great that the costs of participating outweigh the benefits expected from the project, contributions will not occur and the project is likely to fail. As experience is gained and shared among villages it may be possible to improve the planning and budgeting process so that projects chosen will also elicit the local cost sharing necessary to complete the project.

Project Maintenance. The fieldwork undertaken here showed that project maintenance is not a high priority item in the mobilization or utilization of funds. While Nepal is certainly not unique in this respect, greater attention should be paid to the issue. Mandating that a portion of the development grant be spent on maintenance may help overcome some of the problems, however, localities will have to anticipate taking on a significant portion of the maintenance responsibility.

Users groups can and, apparently, do use informal means to mobilize voluntary contributions to repair projects. Yet some repairs require monetary resources not readily accessible from project beneficiaries.

Greater reliance upon the land tax, as discussed above, is still the most reasonable approach to insuring a continuing flow of resources to be made available for project operation and maintenance.

Summary and Recommendations

While limited in scope and depth, the analysis allows us to draw several conclusions regarding the finances of rural local panchayats and to make some recommendations regarding policies and programs that might be used to strengthen these local bodies. Still, we caution that, since the data analyzed here were generally limited to only a handful of districts and villages, additional study of most of the recommended policies is certainly appropriate.

The 75 district and 4,022 village panchayats are expected to play an active role in the development process in Nepal. Their participation is crucial to the decentralized planning process as well as to aspects of project implementation. Still, only with greater resource mobilization at the local level will these rural governments be able to supplement the development activities currently dominated by HMG and, as importantly, be able to operate and maintain development projects.

Our analysis of the finances of nine district panchayats show that only a small fraction of their financial resources are earned from own-source revenues. The Land Tax, which is administered by HMG and shared with district governments, is particularly important in terai districts; hill and mountain districts rely most heavily on direct grants from the

center. Still, the overall per capita amount of revenues available to district panchayats is extremely small and the recent record of revenue growth suggests that few districts have experienced any increase in the per capita purchasing power of own-source revenues. Likewise, while the size of development grants increased substantially upon implementation of the decentralization policy, recent growth in these transfers has been stagnant.

Taxes currently available to district panchayats generally have narrow bases and structures which are not conducive to revenue growth; furthermore, they suffer from poor administration. Other local revenue sources, particularly tolls and other user fees, have considerable merit and should be encouraged. Still, as suggested below, there is room for greater resource mobilization at the local level.

The shared Land Tax appears to hold the greatest potential for improved revenue performance for all districts in the nation. As currently structured, however, it is not conducive to strong revenue growth, its effective rates are low and its revenue performance could probably be improved through a more direct involvement of local authorities in its administration.

The system of HMG grants to district panchayats is generally in keeping with Nepal's decentralization policy and does not appear to interfere greatly with local decision making. The system does little, however, to encourage local resource mobilization. Furthermore, political influences on the flow of grants to specific localities may interfere with systematic development objectives intended for the transfer system.

The analysis here has concentrated on local government resource mobilization and administration, therefore, less attention is given to the spending side of local budgets. An examination of limited spending data does, however, indicate that record-keeping, accounting and audit practices deserve improvements. Still, there was no way in this brief study to draw conclusions regarding the effectiveness of the spending undertaken by local panchayats.

One unique feature of the study is its examination of the project implementation process at the village level in Nepal, particularly locally-mobilized contributions used to supplement monetary transfers from district to village panchayats. While the quality of data available is limited, there is strong evidence to suggest that the value of these nontraditional resources generally exceed the amounts of locally-mobilized, formal tax and other own-source revenues. Examination of individual projects suggests that a variety of factors can impede the project implementation process but that the keys to success are careful choice of projects which are in accord with the needs of beneficiaries together with strong local leadership and at least minimal technical advice in planning and implementing the scheme.

Recommendations

While we have couched many of these recommendations in rather absolute terms, we recognize that at least a portion of them deserve considerably more study, preferably aided by supplemental economic data. This is most particularly the case for the several suggested changes in revenue structures where more complete data could yield more accurate estimates of

revenue, incentive and equity implications of the policies.

1. There is little doubt that improved accounting, record-keeping, auditing and revenue administration, including cash management skills are needed at the local level. A training program in these areas, possibly in conjunction with further analysis of potential policies is, therefore recommended. A donor-assisted project, not unlike that currently being implemented in town panchayats, is particularly appropriate. It should, however, be accompanied by a more thorough study of local resource policy by considering further the policy recommendations made below.
2. Statutory tax rates held constant in nominal terms in the face of increased prices lead to declines in the purchasing power of revenues mobilized. Consideration should be given to increasing these rates, e.g., the rates of the house tax, mill and turbine tax and Land Tax.
3. Franchises issued for the operation of local public facilities such as roads, bridges and ferries should be undertaken whenever feasible. The auction system used to allocate these franchises should, however, be examined carefully to ensure that maximum revenues are generated. Participation in these auctions should be encouraged; information concerning potential revenues should be made available to bidders; and district panchayats should be allowed to reserve the right to hold a subsequent auction in the event it feels bids are unreasonably low.
4. Business establishments in addition to mills and water turbines should be added to the business tax rolls. For example, district panchayats should be given the right to tax brickyards operating in the district. Likewise, upon further study, consideration should be given to allowing district panchayats the right to impose taxes on certain goods produced in a district but consumed in other parts of the country.
5. With implementation of better accounting procedures, districts might be encouraged to enter into some economic activities, but only after thorough feasibility studies have been performed. Particularly important in this regard is that these initiatives do not supplant private enterprise pursuits of the same activities.

6. While basic administration of the Land Tax should remain with HMG, greater participation in the collection process by village panchayats with direct sharing of locally-collected revenues is recommended. Such a policy should improve tax compliance by linking payments to locally-observable benefits and would provide village panchayats with a source of continuing recurrent revenues to meet local revenue operating and maintenance needs.
7. In the spirit of decentralization, district panchayats should be given the power to impose a limited surtax on the centrally-imposed Land Tax. At the same time, the current Local Development Fee could be abolished since it is really just an inferior alternative to this proposed surtax.
8. In the longer run, the current structure of the Land Tax should be altered to result in a land value based tax. This would improve the revenue growth potential of the tax and, given the current land classification scheme, would not be unduly difficult to implement. It would, however, require that the land survey process currently underway in Nepal be completed. Again, this is a potential area whereby donors might provide financial support.
9. Consideration should be given to lowering or even abolishing the current one-hectare exemption level in the Land Tax. Not only would it widen the tax net, it would discourage uneconomic subdividing of land undertaken purely to avoid the tax. Study should be given, however, to the equity implications of such a policy change.
10. The system of allocating Development Grants to district panchayats should be altered to provide increased incentives to local government resource mobilization. With some additional study using more complete data it would be possible to design such a system while continuing the current policy of ensuring larger grant flows to those districts with smaller potential local tax bases.
11. While political considerations probably require that the special grant program to members of the National Panchayat be maintained, development project and fiscal planning can be hindered greatly by this somewhat ad hoc program. For those reasons the program certainly should not be expanded; instead primary emphasis should be given to the formal Development Grant program.

12. While increased technical skills at the district level are obviously desirable and should be sought so as to lead to better designed and implemented development projects, this may not be feasible in the shorter run. District panchayats should be encouraged to consider funding fewer but somewhat larger village-level projects to ensure that the necessary technical inputs can be available to oversee the process. While this might mean that not every village panchayat would be allocated an annual project, they could plan to implement higher quality projects.
13. In order to improve project completion rates, district panchayats must insure that interjurisdictional disputes such as those involved in at least some drinking water projects are resolved prior to project approval.
14. Timely release of funds to development projects are another important determinant of project completion. While fiscal accountability is imperative, it may be possible to alter the fund-release process to avoid untimely delays in project implementation by putting greater reliance upon village panchayat and user committee chairmen in taking responsibility for fund release.
15. Local leadership is still probably the single most important determinant of development project success, particularly in planning a project that will yield benefits to members of the users group and in insuring a sufficient flow of local contributions. Leadership workshops designed to transfer information regarding what techniques have succeeded in other villages and districts may be an effective way to improve these abilities.

In summary, the analysis here has revealed much heretofore unknown information regarding the current fiscal roles of rural local governments in Nepal. While the financial health of these bodies is not strong, there appear to be areas where significant improvements can be made with some policy changes and additional technical assistance.

APPENDIX A

FUNCTIONS, DUTIES AND POWERS OF VILLAGE AND DISTRICT
PANCHAYATS UNDER THE DECENTRALIZATION
(WORKING ARRANGEMENTS) RULES, 1984

Given the extremely long list of functions, we have opted to conserve space by simply listing a sampling of the functions that are to be performed by village panchayats and district panchayats within several different development sectors. We note in parentheses the total number of detailed functions that are specified in the Rules.

Village Panchayats

Education and Culture (10)

The functions include: operate adult literacy classes; conduct literacy campaigns; operate primary schools; operate libraries; sponsor sports competitions; build stadiums; sponsor drama, painting, music and other competitions; and maintain records of places of archaeological, religion and social importance.

Health and Population (13)

The functions include: prescribe garbage dumping sites; remove any material which is injurious to public health; arrange for cremation grounds; arrange for vaccinations of children; direct the cleaning of ponds, wells, and ditches; arrange for prevention of epidemics and treat them in the event of an outbreak; operate and manage health posts and health centers; maintain population records; arrange for midwives; and clean roads, tracks, bridges, culverts, drains, lanes and other public places.

Agriculture, Irrigation and Land Reforms (16)

The functions include: encourage farmers to grow particular crops and to breed particular animals and to plant fruit trees; to arrange for seeds, fertilizers, insecticides and credit for farmers; to make arrangements for pasture lands and seasonal markets; to arrange for construction, repair and maintenance of embankments, canals, aqueducts, ponds, wells etc.; to make arrangements for prevention and

treatment of animal and bird diseases; and to maintain records concerning lands, tenant farmers, birds and animals in the village. The panchayat may also establish a grain fund into which grain is to be deposited at a rate not exceeding 5 percent of the annual production of lands within the area during the first year of the funds operation and at a 2 percent rate in succeeding years. The fund will be managed and used as the Panchayat sees fit.

Works and Transport (7)

The functions include: construct, repair and maintain dirt or mule tracks, motorable roads, fair-weather roads, all-weather roads, bridges, culverts, drains, parks, gardens, gymnasiums, etc.; to construct markets and arrange for their operation; and to register all vehicles that need not be registered with HMG.

Water-Supply and Hydro-Electricity (6)

The functions include: formulate and implement plans and programs to supply pure drinking water; construct, repair and maintain water-taps, tanks, ponds, wells, hand-pumps, etc. in public places; and make necessary arrangements to provide drinking water for cattle and for washing tanks. Also provide for electric lights on roads or tracks in the village, as far as possible.

Forest, Soil Conservation and Ecology (10)

The functions include: plant and protect trees and encourage villagers to plant trees; form consumers committees to conserve and manage forests; prevent unauthorized felling or destruction of forest products and poaching of wildlife; undertake river control works to prevent soil erosion; and conduct publicity about importance of forests.

Industry, Trade and Tourism (6)

The functions include: recommend to appropriate institution for supply of credit to cottage industries; teach skills relating to cottage and rural industries; arrange for sale of foodgrains and agricultural inputs at fair prices; check accuracy of weights and measures being used in village; construct rest-houses; and protect tourists.

Energy (3)

The functions include: publicize utility of bio-gas; recommend to district panchayat for issue of firewood permits; and prepare estimates regarding requirements for kerosene, gasoline, diesel etc.

Social Welfare (5)

The functions include: arrange to take helpless persons and orphans to hospital or healthpost if necessary; maintain records of disabled persons; arrange for relief of victims of natural disasters; and arrange for cremation of any helpless person or person without relatives who dies in village.

Powers of Panchayats (6)

The functions include: maintain records and maps of panchayat area; operate programs of class organizations; inspect activities of ward committees; and incorporate in village development plan programs of class organizations.

Administration and Miscellaneous Matters (29)

The functions include: evict persons encroaching on village land; renew radio licenses; fill ditches and demolish buildings that might endanger lives; control gambling and liquor consumption; maintain records; arrest absconding criminals; celebrate national days and festivals; publicize importance of national language, heroes, dress and emblems; eliminate communal or caste discriminations; present to village assembly particulars of approved program, progress made in the plan, financial accounts and audit report; comply with directives issued by the district panchayat or by His Majesty's Government. Item (16) gives village panchayat right to enlist volunteer labor of villagers and "In case any villager refuses to contribute volunteer labor the Village Panchayat may direct him to hand over to it money or goods equivalent to the value of volunteer labor."

District PanchayatsEducation and Culture (9)

The functions include: supervise adult education; grant permission for pre-primary schools; establish, operate and manage vocational schools and libraries; arrange to train teachers up to lower secondary level; distribute educational materials; and arrange availability of textbooks up to secondary school level.

Health and Population (14)

The functions include: establish and operate health posts, health centers and Ayurvedic and Homeopathic hospitals; operate programs relating to family planning, maternity and child welfare and

population control; operate malaria eradication programs; arrange for midwives in all village panchayats; and maintain up-to-date population, birth, death, marriage and migration records.

Agriculture, Irrigation and Land Reforms (15)

The functions include: determine district targets in foodgrain production; evaluate input requirements and arrange for their procurement and distribution; arrange for soil-testing; protect and maintain pasture lands; maintain records of lands; construct, repair and maintain dams, canals, ponds, etc. covering more than one village and arrange for irrigation in the district; construct, repair and manage godowns; and bring virgin lands under the plow.

Works and Transport (7)

The functions include: construct, repair and maintain trails, mule tracks, dirt or metalled roads located in more than one village or, if a village is unable to do so, the district should carry out the functions assigned to the village; construct, maintain and repair bridges, culverts, causeways, bridges, guest houses, hostels, theaters, stadiums, gardens, libraries, etc.; operate and control boats, ferries and rope bridges on rivers; and prescribe fares for buses, taxis, rickshaws, horse-carts, and other vehicles.

Drinking Water and Hydro-electricity (2)

The functions include: formulate water supply schemes benefitting more than one village and distribute hand-pumps, tanks and water-taps for supply of pure drinking water.

Forests, Soil Conservation and Ecology (14)

The functions include: formulate an affore station program in the district and make arrangements to supply saplings; protect and utilize panchayat forests; conserve forests, forest products and wildlife; issue permits for building timber and firewood; supply timber required for development purposes; prevent uprooting of plants and trees; ensure that industrial establishments do not pollute rivers and air; and prepare land-use maps.

Industry, Trade and Tourism (9)

The functions include: arrange for training to develop local skills such as weaving, wickerwork, carpet-making, knitting and tailoring so as to develop and expand cottage industries; license establishment of rice, dal, oil, flour and other mills not exceeding 15 hp; conduct feasibility surveys for cottage industries; register and renew

Licenses of cottage industries; protect slate and stone quarries; construct, repair and manage tourist spots and rest-houses; and grant permission for hotels, lodges, restaurants and tourist accommodations and inspect them.

Energy (3)

The functions include: publicize utility of bio-gas and arrange for supply of credit to farmers to install bio-gas plants; select sites for energy depots; and prepare estimates of annual requirements of kerosene, gasoline, diesel and other energy resources and arrange for their sale and distribution.

Social Welfare (4)

The functions include: prescribe minimum daily wages other than those employed in industrial establishments; manage orphanages, old people's homes and hostels; compile records of destitutes in district; and arrange for relief and aid to victims of natural disasters.

Panchayats (14)

The functions include: demarcate wards in villages and towns; settle disputes regarding village and town boundaries; prescribe location of the center of a newly created village panchayat; maintain records of panchayat and class organization workers; inspect movable and immovable assets of town and village assemblies and panchayats; insure that accurate accounts, registers, records and documents are maintained by town and village panchayats; operate programs of class organizations; if necessary, procure the records, accounts, minute-books, and other necessary documents possessed by town or village panchayats; and, if necessary, issue orders to forestall any action of a town or village assembly or panchayat or its committees or sub-committees that are likely to harm the public or endanger the life of any person or which might lead to disturbances anywhere.

Administration and Miscellaneous Matters (19)

The functions include: register radios, video sets and tape-recorders in the district and license them; discourage consumption of narcotics; arrange for celebration of national days; arrange for food, accommodation and entry into temples to pilgrims on religious festivals; present before the district assembly the district development plan, budget and other programs and proposals for collecting taxes, fees, charges, contributions etc.; present the audit report before the district assembly; formulate policies and programs for improving the condition of women; name roads or streets built by the district panchayat; publish statistics on different matters; and

to perform any other function entrusted by His Majesty's Government
but comply with the directives of His Majesty's Government.

APPENDIX B
DATA AND METHODOLOGY

Much of the analysis presented in this report is based on financial data collected for a nonrandom sample of ten districts selected by the Advisory Committee of the project. Due to USAID's special interest in the Rapti Zone all five districts in this zone were included in the sample. The remaining five sample districts were chosen by HMG's representatives on the committee with the intention of making the sample as representative as possible of all 75 districts in the country. The geographic locations of the sample districts are indicated on the map above.

Selected characteristics of the sample districts are presented in Table B.1. The ten districts represent 13.3 percent of the 75 districts, contain 13.5 percent of the country's population and 10.6 percent of its land area, possess approximately 12.5 percent of the country's assessed land tax base, and received 13.2 percent of the MPLD's total development grant allocation in 1985/86. Thirty percent of the sample districts have yet to be surveyed for the land tax, compared to 32 percent of the districts nationwide. All of these indications lead us to believe that the sample is reasonably representative of Nepal's districts as a whole.

The five districts of the Rapti Zone comprise one of the poorest economic regions of the country. The arable land of the zone is concentrated in Dang district. The four other districts, Rukum, Rolpa, Pyuthan and Salyan face food deficits every year. While Dang has agricultural surpluses, it faces the problem of extreme concentration of

TABLE B.1
SELECTED CHARACTERISTICS OF SAMPLE DISTRICTS

District Panchayat	Geographical Classification	Estimated 1986 Population	Total Area (in thousands of hectares)	Number of Village Panchayats	Town Panchayats within the District	Land Tax Assessments (in thousands of rupees)	Development Grant Received (in thousands of rupees)
Dang	Terai	335,299	299.5	39	Tribhuvannagar	3,488.1	1,000
Jhapa	Terai	668,284	144.2	49	Bhadrapur, Damak	7,120.3	1,000
Lalitpur	Hill	199,598	39.5	40	Lalitpur	444.1	1,500
Dhankuta	Hill	157,383	89.8	35	Dhankuta	416.4	1,600
Tanahun	Hill	267,548	149.8	45		414.9	1,750
Pyuthan	Hill	169,227	132.9	49		121.5*	1,600
Palpa	Hill	172,708	170.4	51		68.4	1,655
Rukum	Hill	155,953	183.7	43		13.1	1,506
Salyan	Hill	156,871	187.6	47		412.7	1,600
Rasuwa	Mountain	38,791	124.0	18		64.9	2,298
Sample Total							
As Percentage of Nationwide Total		13.5%	10.6%	10.3%	17.2%	12.5%	13.2%

SOURCE: Population and area figures are from Nepal: Contraceptive Prevalence Survey Report, 1981 (Kathmandu: Ministry of Health, NFP/MCH Project and Westinghouse Health Systems, 1983), Appendix 1, pp. 173-175; Land Tax data were provided the Planning Section of the Department of Land Revenue; Grant data were provided by MPLD; the remaining information is from the LCRC survey.

land ownership. Education and health facilities are less developed in this zone. The primary long secondary, and secondary enrollment ratios in this zone are much lower than national averages. Farming is mainly of subsistence nature. The inception of the Rapti Integrated Rural Development Project has greatly benefitted the zone. The project provides assistance in areas of agriculture, health, education, rural roads, conservation and rural industry.

Jhapa district is agriculturally prosperous, and has been the venue of several socioeconomic experiments and demonstration projects. It also has above-average transport access to other districts. This district should be in a strong position to raise local resources, since the standard of living of its population is well above the national norm. Dhankuta district is one of the more prosperous hill districts of Nepal. The implementation of the Koshi Hill Area Rural Development Project (KHARDEP) has especially benefitted the district's road linkages with other districts opening it up to the outside world. Lalitpur district has the advantage of proximity to the capital city and has recently become a very popular residential area. The district does have several underdeveloped areas without access to transport or other public facilities. Tanahum district is a hill district having the attendant problems of transportation and provision of social services. The district, however, has the advantage of being on the main road between Kathmandu and Pokhara, making it a favored location for studies, surveys, and experimental programs. Rasuwa district lies in the country's mountainous, making it the poorest and least accessible district in the sample.

Most of the financial accounts data for the sample districts were collected from Panchayat officials and district land tax offices by field researchers employed by the Language Culture Training and Research Centre (LCRC). Problems in the analysis of some portions of the data have arisen primarily due to the lack of standardization, detail, completeness and accuracy of the accounts kept in district offices and partly due to the absence of some details in the questionnaire format employed by the field researchers. There exists an official accounting format that is supposed to be followed by every district Panchayat but few of them comply with this regulation. The LCRC collected budget documents produced by some of the districts but these documents were rarely comprehensive in that revenue from the land tax and from some types of grants were frequently left out. Most of the Panchayat offices could dig out figures for these last two revenue items but in some cases the researchers had to rely upon land revenue figures supplied by the district-level Land Tax Offices. Some of these locally reported figures are inconsistent with records kept by the central office of the Land Tax Department; these discrepancies are described in the text.

Our data concerning the districts' own-source revenues are reasonably comprehensive and accurate, except in the case of Lalitpur whose accounts were incomprehensible to the field researchers. For this reason we have had to drop Lalitpur district from our analysis of financial accounts. We also should have a fairly accurate accounting of the various grant funds received by each district, although there are a few discrepancies between

the amounts of development grants that the MPLD reported disbursing in 1985/86 and the amounts that the districts claimed to have received. We rely upon the amounts reported by the districts, except in Table B.1. where we need to rely upon MPLD figures for the nationwide development grant allocation.

The principal problem with our expenditure data is that for many districts we lack the amounts spent from IRDP and Special Programs Grants and for all but two districts (for one year each) we lack a detailed accounting of expenditures financed by Development Grants. In one of the Development Grant Accounts that we do have there is a large summation error, leading us to believe that a major expenditure item was omitted or drastically understated.

In addition to collecting financial accounts data the LCRC researchers collected lists of local development works undertaken within the districts and some data regarding District Panchayat personnel. The LCRC staff also interviewed district officials involved in revenue administration and conducted brief case studies of 13 local development projects. The Syracuse University researchers interviewed government officials at the central, district and village levels, conducted case studies of an additional five projects, and collected detailed data regarding land taxation from the Land Tax Department's central office and from the district offices in Dang and Sallyan.