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Empirical Review on Intergovernmental FiscalTransfer in Nepal

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Abstract

Financial transfers are usually provided by the central government to the local-level government on a layered basis and in special cases, it also flows in parallel. Therefore, intergovernmental financial transfers are also economic coordinators promoting coordination and cooperation between governments. Nepal's new federal constitution provides equal state power to each level of federal unit (i.e., federal, provincial, and local governments). These governments' functional responsibilities are enshrined in the schedules of the constitution, with expenditure responsibilities devolved to the sub-federal units while revenue-raising rights remain highly centralized. To bridge the gap between revenue rights and expenditure needs, the constitution mandates fiscal transfers; sub-federal units receive four grant types (fiscal equalization, conditional, special, and matching). The largest category of grant is fiscal equalization, which constitutionally must be distributed based on the expenditure need and revenue potential of the sub-federal units, as processed by the independent National Natural Resources and Fiscal Commission (NNRFC), the body charged to make the fiscal transfer process balanced and transparent. In the short time since the implementation of federalism started in 2017, Nepal has done well with the fiscal transfers system. However, the horizontal distribution of fiscal equalization grants has not been as successful, featuring an allocation formula and methodology that many consider unfair and meriting closer study. Accordingly, this paper examines current approaches and proposes alternate allocation formulae and methodologies, including recommendations for coordination and cooperation between the government and NNRFC on fiscal transfer issues.

Keywords: *Empirical, Review, Intergovernmental, Fiscal, Transfer, Goverment, Local, Federal, Central, Equal, justifiable, distribution, revenue, grant, Empower, national, natural resources, commission, constitution, institution, distribute, central resources*

Introduction

1. Context

Local government in general comprises the lowest level of government. Different terminologies have been used to denote local government as 'council' used in Australia and New Zealand, 'district administration' used in Malaysia and Nepal, and 'Panchyat' used in India. Intergovernmental fiscal transfer has begun since the starting of state governance system. It is necessary to be an effective governance. Since, welfare state to current new public governance, fiscal transfer is needed and important part of governance. Each country either unitary system or federal political system, there is also intergovernmental fiscal transfer system but there is different in quantity of fiscal transfer according to situation of autonomy. Fiscal transfer also based on some decentralization's principles which are: principle of efficiency and subsidiary, economic scale, externalities, or spillover, inclusion and equity, overall economic stability, accountability, national interest, and goal. And fiscal transfer also based on participation, possession strategic vision, and sustainability. Constitution has been determining of level of governments and fiscal decentralization.

In Nepal, local bodies have started to working effectively gradually with the restoration of democracy in 1990. The population size, income, and area coverage play a determining role in categorizing the local government as wards, municipals, and district. The history of Nepal's development of local self-government can be described as pre-historical period, Kirat period,Lichhavi period, Malla period, unification period, Rana period, Panchayet period, and democratic period. Fiscal transfer system has not been effective until the period of panchayat as central government had planned for development for local bodies. Fiscal has not been transferred directly to the local bodies, but central government had allocated budget based on development planning (Kharel, 2019).

In the past, Nagar panchayat and Gram Panchayat collected some revenue within their area like POT. After re-establishing of democracy local self-governance act was promulgated which has removed the CHUGI Tax and has provisioned the local development revenue. There was no system of sending revenue to central government that collected by local bodies. Central government started to provide some grants for local bodies with the restoration of democracy in 1990. Now, the 2015 constitution has declared Nepal as a “Federal Democratic Republic “system. Nepal’s federalism is based on a three tiers system of government including the federal, provincial, and local levels. The constitution has clearly delineated the power, functions, authority, and limitation of each tier of government while devising mechanism for fiscal transfer and interrelationship between three tiers of government.

Intergovernmental fiscal transfer is an important instrument of fiscal federalism, which setups the methods of sharing of resources among the three types of government. it envisages that the provincial and local government and receive various kinds of transfer.

Constitution has incorporated the political and fiscal rights among the three tiers of government. Fiscal transfer is a main pillar of federalism. People at local level get the resources for their social and economic development. Because of fiscal transfer Provincialand local government might be independent from federal government in development in their own place. Fiscal transfer help to promote coexistence and cooperation among governments.

Resources are allocated among all government through fiscal transfer and optimum mobilization of resources. So, Fiscal federalism is not end but instrument of citizen’s progress and prosperity. But the interrelationship between governments and resources mobilization capacity effects to governance. It is necessary to improve intergovernmental fiscal transfer system.

The rights of the three tiers of government are included in the schedule of the constitution (GoN, 2015). Functional and revenue rights, provision of fiscal transfers, and borrowing of the provinces and local levels are enshrined in the constitution. In terms of functional responsibilities, Nepal’s constitution is devolved. Functional responsibilities are pyramidal from the bottom to the top (more expenditure responsibilities at the provincial and local levels, and lower at the federal).

The constitution of Nepal has also given many responsibilities to the sub-federal units(provincial and local governments), but the revenue-raising rights to fulfil these responsibilities are nominal.

The constitution provides more revenue-raising rights to the federal government. Intergovernmental fiscal transfers can be mobilised to reduce the fiscal gap between functional responsibilities and revenue-raising rights. According to this arrangement, provincial and local governments receive four grants, namely fiscal equalisation grant, conditional grant, special grant, and matching grant. After the country entered into federalism, all these four grants have been received by provincial and local governments.

The provinces and local levels are expecting more fiscal equalisation grants from the federal government. However, they are getting more funds under conditional headings. There are lots of problems with this grant. The schemes and programmes of this grant are small. In the current fiscal year 2020-21, the provinces received conditional grant funds amounting to Rs36.35 billion. The total number of conditional programmes is 13,256. The local levels received Rs161 billion in conditional grants for 84,000 programmes and projects (MoF, 2021), suggesting the federal government still enjoys sending petty programmes and projects to the sub-federal levels.

Fiscal transfers are the main source of revenue for sub-federal units in most countries. In federal countries, revenue-raising rights are relatively more decentralised to sub-federal units,so fiscal transfers account for a smaller share of sub-federal budgets. A 2019 report of the World Observatory on Sub national Government Finance and Investment reveals that the share of transfers is 43 percent in federal countries and 53 percent in unitary countries. But in Nepal, around 80 percent of the income of sub-federal units comes through fiscal transfers including revenue sharing (Devkota, 2020).

In Nepal, the grant allocation to the provinces for the current fiscal year 2020-21 has been politically questioned in Parliament. There may be dissatisfaction with the budget and programmes; but since the grant is allocated with standard norms and procedures, it is not good to raise questions over grant allocation.

If the fiscal need is not taken into consideration, problems will arise. Problems would not have arisen if fiscal need tools had been taken seriously. Finally, the role of the NNRFS is paramount in the distribution of grants. However, there have been attempts to weaken the commission. It is completely wrong and unfortunate for the fiscal federalism. It is also necessary to have a legal mechanism of implementing all kinds of grants including fiscal equalisation as per the recommendation of the commission.

There are some debates and issues of Intergovernmental fiscal transfer. It is urgently needed to manage the revenue and grant distribution between three types of government. So, after implementation intergovernmental fiscal federalism in Nepal, following debates are seen in intergovernmental fiscal transfer area:

- Equal and justifiable distribution of revenue and grant is needed. Local governments are empowered to collect revenue on local resources under the subject in their jurisdiction.
- Empower to National Natural Resources Commission as constitution institution and made easy to distribute central resources.

- Increasing good governance at local and provinces level.
- Tax rate is not equal and high for poor people. Some local governments have double tax system. Local governments have not own law about intergovernmental fiscal transfer arrangement.
- The own-source revenue rights of the subnational governments, especially for the provinces, are highly limited. Most of the revenue rights assigned to provincial governments overlap with those of local governments, such as the vehicle tax, land registration fees, entertainment tax, advertisement tax, etc.
- Due to the lack of revenue-raising authority, provinces are forced to depend on federal fiscal transfers and revenue sharing, which currently account for more than two-thirds of their total revenues.
- The condition of revenue collection by the constitution, the revenue rights of local governments include the property tax, house rent tax, business tax, advertisement tax, service fees, etc. Despite possessing authority for most of the subnational revenue handles, local governments have not paid much attention to revenue mobilization.
- The share of own-source revenue in their total revenue pool is minimal.
- Compared to the taxing powers now controlled by local governments, their revenue efforts have been far from reaching their potential.
- Provinces have far fewer revenue-collecting rights; they have not maximized the activation of the rights they do hold.
- The largest components of the province's own-source revenues are the vehicle tax and house and registration fees. Provinces can also collect revenues from entertainment and advertisement taxes, fines, tourism fee, and income from sale of services and goods, etc. Even with these rights, provincial own-source revenues remain small.

Although sub-national governments receive the lion's share of their revenues from federal fiscal transfers, the related policies and management of these transfers are still plagued with problems. However, the programs and projects of this grant are very small, with dozens of programs and projects

Not only should the federal government increase the size of these fiscal transfers to resolve this issue, but it should also work to reduce the haphazard nature of conditional grant allocation.

Disappointing performances despite the challenges, a primary institutional framework necessary for fiscal federalism has been formed and the necessary laws governing the functioning of subnational governments have been enacted.

2. Objectives

The major objective of this article is to synthesize empirical issues of intergovernmental fiscal transfer contemporary system in Nepal.

3. Methods Used and Result Analyzed

Intergovernmental transfers are grants from one level of government to another or between governments at the same level. They are important instruments for securing,controlling, and influencing the delivery of public services and transfers in a multilayered government structure. Intergovernmental grant schemes function is a core question for policymakers in many countries and for economists and political scientists trying to understand the fiscal side of the public sector. Intergovernmental grants transfer huge sums between governments and thus have substantial distributional and re-distributional consequences both in terms of service level, tax rates, and equity. Traditional approaches to the study of intergovernmental grants focus on efficiency gains that could be reaped from designing optimal intergovernmental grants schemes.

This 'first generation of fiscal federalism (FGFF)' literature assumes that intergovernmental grants are instruments used by a benevolent social planner to achieve allocative efficiency, macroeconomic stability, and equity.

The 'second generation of fiscal federalism (SGFF)' literature rejects the assumption of a benevolent planner and argues that intergovernmental grants are subject to decisions made by politicians and bureaucrats that have and pursue their own interests. Consequently, thisliterature focuses on how political and fiscal institutions shape such interests and create incentives for policymakers' behaviour.

Many questions relating to the role of politics for intergovernmental grants, however, remain unanswered. Within the framework of the second generation of fiscal federalism, this dissertation contributes to our understanding of intergovernmental grants by investigating when and how political factors affect intergovernmental grant schemes. The contribution of the proposed article is twofold.

First, it suggests a framework for analyzing when political factors affect intergovernmental grants focusing on three stages: 1) the introduction, 2) the allocation, and 3) effects of grants. The would build on a comprehensive understanding of how politics may affect intergovernmental grants and argues that all three stages must be considered in order to understand the political side of intergovernmental grant schemes.

Second, the would contribute to three specific literatures on how political factors affect intergovernmental grants: intergovernmental lobbying, strategic allocation of grants, and effects of grants (the flypaper effect).

The article would find that intergovernmental lobbying is an important political factor for understanding intergovernmental grants, since local governments use substantial resources to lobby the central government for grants. The article would sheds light on which strategies local governments use and explores potential explanations for a given strategy choice. Strategic grant allocation is investigated with a focus on how it unfolds in multiparty systems. Relatively little is known about this aspect of strategic grant allocation, since the existing literature has been mostly focusing on two-party systems.

The article would discuss on theoretical grounds how strategic grant allocation in multiparty systems and two-party systems may differ. Empirically, the article finds no evidence of strategic allocation, suggesting that political factors are less important for the distribution of grants. Regarding the effects of grants, the article would find that local governments respond asymmetrically to changes in grants and in citizens' income. The response, however, depends on ideology, which suggests that political factors are important to consider when studying effects of grants. The article would point to important ways political factors affect intergovernmental grant schemes. While the article does not cover all instances of political influence it highlights that considering political factors are important for understanding the fiscal side of the public sector. Finally, since the empirical studies of the article will be conducted in Nepal, the article would provide new insights about the Nepal intergovernmental grant scheme which are useful for policy makers at all governmental levels in this country.

This analyzes the intergovernmental fiscal transfer in Nepal. This article is based on secondary sources of analysis and comparison which were taken from the various sources like National Natural Financial Resource Commission, national and international journals,and scientific publications including book and reports.

There is no single modality of IGFT for all countries, different modality in different countries. In other sector, international treaty and law are being formulated by UN and other institution but not in intergovernmental fiscal transfer. In national level, inter sector policies and laws are not suitable and strong to promote IGFT system.

Various theoretical literatures (Abiad et al., 2020; Freinkman&Yossifov, 1999; Kopits and Mihaljek, 1993; Lual, 2019; Mendes, 2005; Miyazaki, 2020; Noiset and Rider, 2010; OECD/KIPF, 2016; Prasad, 2015; Reddy and Reddy, 2018; Regmi, 2016; Rodden et al., 2003; Sepulveda and Martinez-Vazquez, 2011; Shah, 1994; Singh, 2004Smoke and Kim, 2003; Subedi, 2014; Veiga and Veiga, 2010; among others) are on international context about intergovernmental fiscal transfer. Some studies are viewed in this paper to know the best modality of intergovernmental fiscal transfer empirically.

This study is related with the fiscal transfer policies of former Soviet Union. This report included that perhaps the most dramatic economic change in the disintegration of the Soviet Union involves the vertical and horizontal fiscal relations among various levels of government. In fact, there is hardly another area (money, trade) in which centrifugal forces have acted so rapidly and so powerfully since the late 1980s. Further modifications are under way; in practically all the new independent states there is an ongoing search for stable and durable intergovernmental fiscal arrangements.

The work of Ma (1997)provides an overview of the IGFT mechanisms in nine major industrial and developing countries (Cases of the United States, Canada, the United Kingdom, Australia, Germany, Japan, Korea, India, and Indonesia), with special reference to the design of equalization transfers. Most of these countries have relatively developed formula-based transfer systems and represent the major varieties of transfer systems adopted in the world which that is guidance for Nepal.

To shed light on decentralization in Russia, Freinkman and Yossifov(1999) examine intergovernmental fiscal relations within regions. To analyze trends, they review channels of fiscal allocation within regions-tax sharing and local transfer schemes. To evaluate the potential impact of various fiscal decentralization patterns on regional economic performance (including growth and the budget deficit), they study data on the structure of 89 Russian consolidated regional budgets for 1992-96.

They find that local governments' relative share of Russia's consolidated budget, although substantive (roughly a quarter of the total budget), did not expand after 1994. The federal government's relative role in financing public goods and services declined as the relative role of local governments increased substantially. Local governments collected more revenues in 1996 (6.4 percent of GDP) and spent more than regional governments. They also substantially increased social financing (including health, education, and social protection). However, Russia made no progress toward a more transparent system for tax assignments.

The average level of expenditure decentralization is similar for ethnically Russian regions and national republics and okrugs but revenue arrangements differ greatly. True decentralization has taken place in oblasts and krais, where local authorities are provided with a bigger share of subnational tax revenues. A redistribution model applies in republics and autonomous okrugs, where greater local outlays have been financed through larger transfers from regional governments.

Regions near each other tend to have similar budget arrangements - the result of intensive interactions between neighbors and probably supported by the activities of regional associations. The size of a region's territory does not influence decentralization outcomes.

Fiscal decentralization seems positively related to the share of education spending in regional budgets. And regions with more decentralized finances tend to experience less economic decline. But budget control is weaker in more decentralized regions. Instability and lack of transparency in intergovernmental fiscal relations provide sub-national governments little incentive for responsible fiscal policy. Further decentralization without greater transparency could bring greater debt and deficits.

The functional and revenue responsibilities should be clarified

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at all levels of government. It is crucial to ensure non-overlapping responsibilities between the center and local authorities, in order to avoid duplication and waste of public resources as well as to warrant better service quality (Ter-Minasian, 1997; Ahmad et. Al; 2006).

One of the best books edited by Paul Smoke and Yun-Hwan Kim (Smoke and Kim, 2002) is entitled- Intergovernmental Fiscal Transfers in Asia: Current Practice and Challenges for the Future. In this book, various authors have explained and analyzed the practice and challenges of intergovernmental fiscal transfer system of Asian countries. They have also described the theory and practice of intergovernmental transfer of developing countries of Asia. Authors have suggested for improving Fiscal performance of each level of government. the different topic about intergovernmental fiscal transfer. They have examined pertinent theories, international experiences, and evolution of fiscal equalization arrangements between thecentral governments and provincial or state governments, as well as the underlying rationale, problems, and issues in those countries.

The new focus on the greater fiscal role by local governments has been supported byinternational development agencies, for example, UNDP, World Bank, ADB, and European Union. ADB has stepped up its assistance for regional development projects in relation to increasing economic and political decentralization in its member countries. At present, fiscal strengths of sub-national governments are assuming even greater importance in the operations of ADB as it places the emphasis of its operations on poverty reduction and the participation of local stakeholders, including local communities and low-level governments, in its projects and programs. This operational shift has been strengthened by a significant increase in loans and technical assistance to address poverty, education, health, regional development, and environment. All of these require sound backup of fiscal resources, covering capital and recurrent expenditures, from sub-national governments as well as their enhanced institutional capacity.

Singh (2004) examines several aspects of India's system of Intergovernmental Fiscal Relations (IGFR). It first reviews the origins and context within which the IGFR system was established and examines how it has evolved. It describes the nature of the system, including assignment of powers and functions, intergovernmental fiscal transfers, and the principles that guide their design. It examines several other dimensions of the IGFR system, such as its interface with policy imperatives, evolution of norms, and recent institutional developments. It concludes with an assessment of lessons learned so far and key challenges that lie ahead.

Tsui (2005) the underlying factors shaping fiscal disparities at the county level in China. Using a data set containing budgetary figures for all county-level jurisdictions from 1994 to 2000, he derives trends of county-level fiscal disparities. In addition, he develops a coherent framework to assess the impact of the local tax system and the intergovernmental transfer system on fiscal disparities after the introduction of a tax-sharing system.

Dabla-Norris (2005) reviews the changing nature of intergovernmental fiscal relations between the provinces and the central government in China over the past two decades and provides an assessment of the success of previous reforms in meeting their objectives. Key existing weaknesses in the current system that undermine these objectives are identified

Alternative instruments, procedures, rules, and incentives that could result in better outcomes are outlined by drawing upon relevant cross-country experiences.

Broadway and Shah (2007) discuss about intergovernmental fiscal transfer of three types of government: central, intermediate, and local government. They have explained of different topics; public service accountability, fiscal management, public service delivery, public expenditure, local governance in developing countries, intergovernmental fiscal transfer,study practice of India, Belgium, Germany, and South Asia. This study emphasized the design of good federal fiscal arrangements.

This study is in 18 series which are related to intergovernmental fiscal transfer of three types of government- central, intermediate, and local government. Authors has explained of different topics; public service accountability, fiscal management, Public service delivery, Public expenditure, Local governance in developing countries. Intergovernmental fiscal transfer, study practice of India, Belgium, Germany, and South Asia. This book brings together trainings modules on intergovernmental fiscal transfer. Different s wearer collected as learning program by Canadian International Development Agency. This is World Bank institute learning events. Various authors had collected theoretical and behavioural information and explained the practice. This study emphasized the design of good federal fiscal arrangements.

As a rule, there is a role for both general-purpose and special-purpose matching grants (for example, for infrastructure). From the points of view of both the grantor and recipient governments, it is generally advisable that the total pool of resources to be distributed in general-purpose transfers be set in a stable but flexible way (for example, as a percentage of central taxes, adjustable every few years). Some lessons can be drawn from this analysis.

The transfers should be objectively and transparently determined, usually based on a recognized formula that is not the subject of ongoing political negotiations. These arrangements should be established by the central government, an expert commission, or an intergovernmental committee the menu of procedures available for adopting and modifying intergovernmental fiscal transfers involves tradeoffs. While some theorists argue for nonnegotiable rules, in practice, rules are almost always negotiable. Every country resolvesthe tension between flexibility (for economic or political reasons) and certainty (for planning public policy agendas) differently, and the equilibrium between these two

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goals has shifted over time. The traditional view of intergovernmental finance, prevailing in the 1970s, suggested that virtually everything to do with intergovernmental fiscal transfers should be decided unilaterally by the federal government. And prevails in developing countries the emerging model is one in which "jurisdictional boundaries and the assignment of functions and finances have to be taken as determined at some earlier (constitutional) stage and notopen to further discussion in normal circumstances"

Sorens (2008) argues that most empirical work on fiscal federalism, understood as a system in which sub-central governments enjoy widespread taxation and expenditure autonomy, is fundamentally flawed because the operationalization and measurement of fiscal federalism in the empirical literature conflict with the conception of the system in the theoretical literature. A broader view of fiscal federalism as a system of "economic self-rule" matches up better with the concept employed in the theoretical literature, but its measurement requires sacrificing the beguiling precision of the currently used, ratio-scale variables. Cross-national empirical tests using a proposed measure for 43 countries find that more fiscally federal countries have smaller government consumption and government share of GDP.

Lual (2018) dealt with intergovernmental fiscal transfer in comparative analysis of three federal countries (e.g., Germany, Nigeria, and Ethiopia)., Author highlights the procedure for establishing and modifying intergovernmental transfers as well as the design of intergovernmental transfers and reviewing the legal framework and experience of these three federal countries on intergovernmental fiscal transfers. Using qualitative method, study describes about intergovernmental effective fiscal transfer that creates the balances between central- sub national government in revenue expenditure power and responsibility.

The theory of fiscal decentralization, inter alia, involves the assignment of responsibilities and functions between the federal government and the sub-national governments. Mikayilov (2007) introduce the tax-sharing practice into the intergovernmental fiscal transfers system in Azerbaijan, described that tax sharing would complete the revenue sources of local governments for their improved fiscal position, and explained of conceptual framework of fiscal decentralization regarding tax-sharing transfers were analyzed. Author studied of the whole fiscal decentralization and local taxation practices in Azerbaijan. Deductive-empirical approach is used to analyze financial document regarding fiscal capacities of local government and interview with local government officials. The research used qualitative research, for example, content analysis, critical analysis

Although there are laws regulating financial activities of local self-government bodies, the local financial-economic position appears weak. Municipalities do not have enough resources; it is impossible to solve local different issues. Local tax payments and fees continually make up a small part of the overall revenues of municipal budgets and do not cover the expenses of the municipalities in full. The local budget system is characterized by a number of negative aspects. No full allocation of land and property taxes to local government. Municipalities have big potential for more local revenues—from land and property taxes. No concrete registration system and incorrect calculation of properties.

Purfield (2016) explains the transformation of South Africa's provincial and local government spheres to implementing more than half of general government spending today, up from just under a third two decades ago. At the advent of democracy in 1994, the government needed to develop a framework that would promote equity, extend services to all, and reduce poverty by redistributing national revenues. The 1996 South African Constitution assigned revenue and expenditure responsibility and related functions to newly established sub-national governments, establishing three separate but interdependent spheres of government, each with specific powers, functions, and responsibilities, along with provisions for revenue assignments. The intergovernmental fiscal framework has evolved over the years and has proven resilient to major changes, such as the restructuring of local governments. Although much more needs doing to enhance fiscal management at different levels in order to improve service delivery and strengthen accountability, the system providesa unifying fiscal framework across the government.

In the context of Denmark, Marie Kjærgaar(2016) described that how the relationship between national and local governments affects local fiscal performance and points to ways in which party politics can moderate this relationship, presented two theories, for example, FGFF and SGFF framework and its affect in intergovernmental grants and explained about intergovernmental grant and its effect in public service deliver. This study finds evidence that local governments in Denmark respond asymmetrically to changes in grants. This highlights that increasing unconditional grants to local governments may in the long run lead to an expansion of the local public sector. Moreover, ideology is found to moderate the response togrants by individual local politicians. This indicates that predicting the effect of installing a new grant or altering existing ones is not always straightforward, since it depends on power constellation at local government level.

The local government system and decentralization through IGFTs are inextricably linked to each other and as such the degree of achieving the objectives of local government largely depends upon the nature of the structure of the central-local relationship.

Local authorities may fail to fully internalize the cost of local spending when they can finance their marginal expenditure with central transfers that are funded by taxpayers in other jurisdictions; therefore, this behavior can lead to overspending, relaxation of tax collection, low revenue, and weakening of fiscal balance (Sow and Razafimahefa, 2017).

According to Mukherjee (2020), a comprehensive multistage Value Added Tax (VAT) system, namely Goods and Services Tax (GST), is introduced in India since July 1, 2017. GST encompasses various taxes from Union and State indirect tax bases, and it is a dual VAT system with concurrent taxation power to Union and State governments. It was envisaged that removal of cascading of taxes and enshrining destination-based consumption tax system under GST will encourage investment and improve ease-of-doing business in India. Thoughit is not right time to comment on success or failure of Indian GST system unless the tax system stabilises, so far revenue mobilisation from GST is not encouraging. The shortfall in GST collection has been acknowledged in the 'Medium Term Fiscal Policy cum Fiscal Policy Strategy Statement' of the Union Budget 2019–2020. The genesis of revenue shortfall may be design and structural in nature and/or compliance and tax administration related. However, the uncertainty surrounding GST revenue collection is an issue which needs an in-depth assessment for fiscal management of Union and State governments. The impact of revenue uncertainty will not be restricted to Union finances alone; it will spill over to state finances through inter-governmental fiscal transfers. Therefore, depending on seriousness of the uncertainties associated with GST revenue collection, devising an inter-governmental fiscal transfer framework may be a challenging task for the Fifteenth Finance Commission. Given the information available in the public domain, this attempts to explore possible causes of revenue shortfall and assess possible impacts of revenue shortfall on Union and State finances.

Yalmiz and Zahirn (2020) shed light on whether Indonesia has embarked on a new development model. Comparing to Japan, Taiwan, South Korea, Singapore, Hong Kong and, more recently, China and Vietnam, their narrative is meant to underscore the importance of what have been missing in policymaking in this country, namely: order, focus, coherence, rationality and continuity. They are absolutely crucial for effective conduct of policies in anypolitical system, be it a democracy or not.

The work of Al-Samarral and Lewis (2021) consists of seven countries (Sudan, Uganda, Indonesia, Columbia, Brazil, Bulgeria, and China) case studies that explore how fiscal transfers affect education sector financing and ultimately sector outcome. This study has provided guidance and direction for the country case studies. This study is also benefited to make policies for many countries about Intergovernmental fiscal transfer.

Alok (2021) sees that constitutionally, there is a wide disparity between assignment of revenue powers and expenditure responsibilities to the local governments and therefore, IGFT has to be designed for local governments with an objective to enhance their fiscal capacity. He defines and presents measures of fiscal attributes, viz. fiscal needs, fiscal capacity, fiscal effort, and disability factor which have been considered for an optimal design of IGFT. Examination of state finance commissions' reports, in India, he reveals that the States have undertaken such criterion reflecting these attributes to transfer resources to local governments from states.

Reviews of Existing IGFT Practices in Nepal

Constitution, laws, and policies are the foundations of federal governance. Without constitutional, legal, and policy mandate no federalism exist. Federalism-friendly laws and policies are the preconditions for fiscal federalism as well as effective fiscal transfer. It is further considered instrumental in strengthening fiscal federalism. There are many legal and policy frameworks Intergovernmental fiscal transfer in Nepal. The major policy frameworks can be explained as follows.

Nepal formally became a federal country with the promulgation of its new Constitution in September 2015 (GoN, 2015). With the implementation of federalism, the overall structure of Nepal's governance system changed significantly. The state power in the previous unitary system was divided into three tiers of government: federal, provincial, and local. Nepal has seven provinces and 753 local governments.

Nepal's new federal constitution provides equal state power to each level of federal unit (that is, federal, provincial, and local governments). These governments' functional responsibilities are enshrined in the schedules of the constitution, with expenditure responsibilities devolved to the sub-federal units while revenue-raising rights remain highly centralized. To bridge the gap between revenue rights and expenditure needs, the constitution mandates fiscal transfers; sub-federal units receive four grant types (fiscal equalization, conditional, special, and matching).

Table 1: Types of Fiscal Transfer Grants

SN	Type	Concept
1	Fiscal equalization grants	Federal transfer to province and local government, province transfer to local government on basis of expenditure and revenue capacity.
2	Matching grants	Federal transfer to province and local government for implement infrastructure development.
3	Conditional grants	One level of governments transfer grants to other government with condition to implement any project and program.
4	Special grants	One level of governments transfer grants to other government with condition to implement special project and program.

IMF (2019) analyzes Nepal's newly established fiscal federalism framework and highlights gaps in the current structure and the potential economic impact and discuss policy recommendations. IMF further suggests that managing effective fiscal federalism in Nepal require strong efforts to strengthen public financial management and enhance the implementation capacity at all levels of government to mitigate risks to fiscal sustainability and achieve allocate efficiency gains.

After the federal restructuring, three levels of governments were created in Nepal. Whereas the provincial set-up is entirely new, local governments were formed by restructuring the former local units. The Constitution separates the exclusive and concurrent jurisdictions for the three levels, while residual rights rest with the federal government. But, in many instances, lists for exclusive and concurrent jurisdictions are unclear or in conflict with each other. Therefore, it is not easy for laws to be enacted at local and provincial levels – especially when it pertains to areas of concurrent jurisdiction. Although the Constitution establishes the supremacy of federal laws, the federal government has failed to issue important structural laws after long time. Therefore, the provincial and local governments continue to carry out more functions in areas transferred to them by the federal government and less within their areas of jurisdiction.

According to the essence of 60 (2) (3) (4) (5) of the Constitution of Nepal (GoN, 2015), the federal government has provided financial equalization grants to the state government and local level and to the local level subordinate to the state government on the recommendation of National Natural Resources and Finance Commission. Arrangements have been made for distribution. Similarly, in 60 (6), the Government of Nepal has made provision for the distribution of conditional grants, supplementary grants, or special grants for other purposes provided by the Federal Reserve Fund.

- The National Natural Resources and Finance Commission have been set up as a constitutional body for determining the structure and recommendation of financial transfers. (Part 26)
- Intergovernmental Finance Management Act, 2074 (2017):
  Provision has been made for detailed interpretation and facilitation of implementation of the provisions mentioned in the constitution.
- National Natural Resources and Finance Commission Act, 2074 (2017)
- Procedure on Supplementary Grants, 2075 (2018)
- Procedure for Special Grants, 2075 (2018)
- National Natural Resources and Finance Commission (NNRFC)
- Intergovernmental Finance Council
  To have membership of state and local level representatives under the coordination of the Minister of Finance.
- Provincial Coordinating Committee

Under the convenorship of the Chief Minister and with the membership of the local level chief, deputy chief or chairperson, vice-chairperson

As mentioned above, an intergovernmental financial transfer is a system of transferring financial instruments between the governments of the country subject to the law. It has played an important role in the effective implementation of fiscal federalism. Various provisions have been made in the constitution for its operation in Nepal. Institutional and legal arrangements have been made to facilitate the implementation of the constitutional provision.

4. Conclusions

Intergovernmental fiscal arrangement means that the management of resource at all levels of government for development work. It is a pillar of fiscal federalism. Fiscal arrangements are constitutionally recognized in Nepal. The constitution itself envisions four types of fiscal arrangements, namely fiscal equalization, conditional, matching, and special grants. Apart from this, there is also a provision of additional fiscal arrangements to the Province and Local level through law in the form of revenue sharing. The constitution stipulates that fiscal equalization grants should be distributed based on the 'expenditure needs' and 'revenue capacity' of sub-federal governments.

The constitution has made it mandatory for the provinces to provide fiscal transfers to their local governments as well. The constitution also provides for a National Natural Resources and Fiscal Commission as a constitutional body to work in the field of fiscal transfers. For the implementation of the constitutional provision of intergovernmental fiscal arrangement, intergovernmental fiscal arrangement act is made by federal government.

The province and local level have received constitutionally granted fiscal transfers. The provinces have also made fiscal transfers to the local level. The constitution also stipulates that the amounts of fiscal transfers received by the province and local levels will be as recommended by the commission.

The intergovernmental fiscal transfer is arranged by federal law within a short time of entering federalism should be taken positively. Nepal's fiscal transfers are in line with the 'finance follows the functions' principle. Further, transfer allocation is somewhat transparent.

After the promulgation of the constitution in 2015, the state structure of Nepal underwent transformative changes to comply with the new federal system of governance. The state power of the former unitary system was divided across three tiers of governments. Accordingly, the provincial and local governments have had new functions in this federal set-up, with the provincial level of government being entirely new. The constitution lists exclusive and concurrent fiscal rights for the three levels of government. These rights were elaborated through law to resolve possible disputes between the federal units. The Intergovernmental Fiscal Arrangement Act 2017, and the Local Government Operation Act 2017 have been promulgated. These laws have laid the foundation for the implementation of federalism in Nepal. The subnational governments (local and province levels) have begun implementing the law to carry out their constitutional responsibilities. Nepal's federalism is based on the principle of cooperation and coexistence. The federal government has enacted laws related to fiscal rights. Due to this law, all level of governments has been able tofunction smoothly

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