PLANNING AND BUDGETING IN THE PROVINCES OF FEDERAL NEPAL

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The Asia Foundation

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Study Team:
Dr. Khim Lal Devkota, Amrit Shrestha, Abhas Ghimire

Editor:
Madhu Raman Acharya

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The SMFFN project seeks to assist spheres of governments in implementing federal fiscal governance system by providing platforms to key stakeholders for shared understanding of processes in intergovernmental relations and coordination. The Programme is implemented by The Asia Foundation in partnership with the Forum of Federations (FoF), the Nepal Administrative Staff College (NASC) with funding from UKAID.

Government of Nepal

National Planning Commission

Singha Durbar, Kathmandu, Nepal

Prof. Puspa Raj Kadel, Ph.D
Vice-Chairman

Government of Nepal National Planning Commission Singh Durbar, Kathmandu

Ref

FOREWORD

Nepal's Constitution envisions an equitable and peaceful society, good governance, development and prosperity by ending all forms of discrimination and ensuring social justice based on inclusive and participatory proportional representation. The National Planning Commission is committed to facilitate the Government of Nepal, provincial and local governments toward fulfilling our national aspiration of "Prosperous Nepal, Happy Nepali". This national ambition can only be achieved through cooperation, coordination and collaboration among all spheres of government. The Constitution authorizes spheres of government to exercise their exclusive and concurrent powers by making laws, policies, plans, and annual budgets within their respective jurisdictions.

Though it has been nearly four years since the formation of provincial governments, provinces are still in the early stages of fulfilling their full mandates. They have largely completed their institutional setup, staffing and legislation. Key tenets of fiscal federalism have been institutionalized, as fiscal transfers, revenue sharing, and public financial management are being practiced by all three spheres of government. Provinces have started formulating their own plans and budgets, provincial planning commissions, and resource committees have been formed in almost all provinces. What precisely this looks like within each province at this still early stage of Nepal's federalism remains largely opaque in the public eye.

In this context, it is my pleasure to offer my moral support to The Asia Foundation's comparative study of provincial planning, budgeting and public financial management systems of all seven provinces. As the key policy instrument of all levels of government, this study of the provincial planning and budgeting will be useful to all stakeholders involved and interested in the implementation of fiscal federalism in Nepal, including the National Planning Commission, Ministry of Finance, National Natural Resource and Fiscal Commission, provincial planning commissions, and the federal and provincial governments. I would like to congratulate the Foundation for taking this initiative forward and completing this study despite the constraints imposed by the pandemic. I hope that this study will inspire other researches in the realm of fiscal federalism and public financial management in all spheres of government. This is not merely a snapshot of the present moment, but a piece of Nepal's history being made by those working at all levels of government to realize the ambitions set forth in the nation's Constitution. The road ahead is long and promising.

Prof. Dr. Puspa Raj Kadel
Vice Chairperson
National Planning Commission

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The most pronounced change within Nepal's 2015 Constitution was the establishment of provincial governments. The first four years since formation of the seven provincial governments laid the foundation of basic minimum policies, legislations, and institutional framework for their operation and service delivery to the constituencies. Despite these early building blocks, general uncertainty and debate persists on the efficacy of this level of the three-tiered federal governing system.

Limited information and data about provincial governments make for an opaque picture of their performance. These discussions of provincial government utility typically occur in private spheres largely given the roots of public demand for federalism across the country as part of the negotiated Comprehensive Peace Agreement that concluded Nepal's decade-long armed conflict. Nepal's still very young Constitution and visioned governing systems are to be made ever better through dynamic dialogue, which is hindered by the provincial information and data gap. No more critical information is needed in public dialogue than that related to the management of public finances.

The Asia Foundation took this as a departure point to contribute to the collective understanding of provincial management of their finances disaggregated by province. This study captures a picture of provincial planning and budgeting processes. The intention is to not judge, but to understand a more complete set of variables, acknowledging achievements and challenges of provincial governments. The management of public finances focuses on the people who are navigating systems and processes within the first term implementation of Nepal's federalism.

Included herein is a review of legal and institutional arrangements, the systems, and practices in fiscal federalism and public financial management in the provinces. While the report analyzes the practice of fiscal federalism including expenditure and revenue assignment, fiscal transfers, and revenue-sharing applicable to the provinces, it also provides a brief overview

of the provincial planning and budgeting systems and practices as well as a comparative study of the budgets and plans of the provinces along with a review of public financial management.

I hope that this preliminary exercise will provide some factual basis to the ongoing discussion on the performance of the provincial governments while also inspiring further research in similar areas of public financial management.

The study started in February 2020, when Covid-19 was only beginning to impact Nepal and South Asia. Like so much, the study methodology and approach, which was envisioned to be largely rooted in field research and in-person interviews, necessarily adapted in light of the pandemic and associated lockdowns and regulations. This resulted in the study being almost completely desk based. In this difficult situation, information needed for the study was collected from email, telephone and virtual discussions with relevant agencies of the federal and province governments.

I express my gratitude to Dr. Khim Lal Devkota, Amrit Shrestha and Abhas Ghimire, who prepared a detailed study report by gathering vast amount of information despite the constraints imposed by the pandemic, analyzing the information in detail, and consulting with relevant stakeholders. Likewise, I thank Mr. Madhu Raman Acharya for preparing and editing this summary report on the basis of the detailed study report. I acknowledge Jean-Louis Van Belle for developing the preliminary framework for this study, as well as Bishnu Adhikari, Parshuram Upadhyay and Amol Acharya for conceptualizing the study and managing it throughout.

Finally, I express my sincere appreciation to representatives of the Government of Nepal, province governments, local governments, donor agencies, and other subject experts for their valuable suggestions and validation of the findings of the study. In particular, I am grateful to Dr. Puspa Raj Kadel, Vice Chairperson of the National Planning Commission, for taking time to read this report and providing his encouragement through the Foreword.

Meghan Nalbo
Country Representative

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ACRONYMS AND ABBREVIATIONS

CGAS	:	Computerised Government Accounting System
CBS	:	Central Bureau of Statistics
CoA	:	Chart of Accounts
COSO	:	Committee of Sponsoring Organisations of the Treadway Commission
FCGO	:	Financial Comptroller General Office
FMIS	:	Financial Management Information System
FPFR	:	Finance Procedure and Fiscal Responsibility
GDP	:	Gross Domestic Product
GoN	:	Government of Nepal
IFMIS	:	Integrated Financial Management Information System
IGFA	:	Intergovernmental Fiscal Arrangement
IGRC	:	Intergovernmental Relations and Coordination
LGOA	:	Local Government Operations Act
LMBIS	:	Line Ministry Budget Information System
LSGA	:	Local Self-Governance Act
MoEAP	:	Ministry of Economic Affairs and Planning
MoF	:	Ministry of Finance
MOPID	:	Ministry of Physical Infrastructure Development
MTEF	:	Medium Term Expenditures Framework
NNRFC	:	National Natural Resources and Fiscal Commission
NPC	:	National Planning Commission
NPR	:	Nepali Rupee
NPSAS	:	Nepal Public Sector Accounting Standards
O&M	:	Organisation and Management
OAG	:	Office of the Auditor General
OPMCM	:	Office of the Prime Minister and Council of Ministers
OCMCM	:	Office of the Chief Minister and Council of Ministers

OSR	:	Own Source Revenue
PDAC	:	Provincial Development Action Committee
PFPA	:	Provincial Finance Procedure Act
PFM	:	Public Financial Management
P-LMBIS	:	Provincial Line Ministry Budget Information System
PTSA	:	Provincial Treasury Single Account
PPA	:	Public Procurement Act
PPC	:	Provincial Planning Commission
PPMO	:	Public Procurement Monitoring Office
PTCO	:	Provincial Treasury Controller Office
RMIS		Revenue Management Information System
SAI	:	Supreme Audit Institution
SDG	:	Sustainable Development Goals
SuTRA	:	Sub-National Treasury Regulatory Application
TSA	:	Treasury Single Account
VAT	:	Value Added Tax

1 INTRODUCTION

1.1. Background

Nepal adopted a federal system of governance after promulgating its new Constitution in 2015. The Constitution prescribes a three-tier governance system with federal, provincial, and local levels. Each level consists of an elected executive and a legislative branch. The Constitution defines the exclusive and concurrent list of powers of each level of government, each level is authorised to exercise their powers by making laws, policies, plans, and annual budgets within their respective jurisdictions. All three levels can, in matters within their jurisdiction, formulate laws on their financial powers, levy taxes, collect revenue, formulate their annual budget, devise plans and policies, and implement them.

In accordance with the Constitution, seven provinces were created and provincial governments were formed in January-February 2018 after elections to Provincial Assemblies were held in November-December 2017. Many federal laws were swiftly adopted to allow these federal units to exercise their powers in accordance with the Constitution. As expected, there were challenges in implementing the federal system including the transfer of the erstwhile unitary institutions and employees to sub-federal (provincial and local) levels.

Since they were created, provincial governments have established their planning institutions and have introduced their periodic plans. They are implementing their policies and programmes and have completed three budget cycles. This report summarises the system and process of provincial planning and budgeting, and presents a comparative analysis of the plans and budgets introduced by the provinces. It also gives a brief introduction to the legal, institutional, and practical matters related to fiscal federalism in the provinces. This report is based on a study conducted by a team of experts between March and July 2020.

1.2. Objectives and Methodology

The main objectives of this report is to present a comparative analysis between provincial plans, programmes, and budgets; and to review the legal, institutional, and practical issues behind fiscal federalism in Nepal's provinces. Specific objectives include:

- Review legal and institutional arrangements related to planning and budgeting systems, and fiscal federalism in the provinces

- Study the trends and issues of fiscal federalism, including expenditure and revenue assignments, fiscal transfers, and revenue-sharing applicable to the provinces

- Analyse the planning and budgeting processes of the provinces and conduct a comparative analysis of the provincial plans and budgets adopted and implemented so far

The duration of this study coincided with the national lockdown period between March and July 2020 due to the COVID-19 pandemic. Many government offices remained closed during this period compelling the study to be desk-based. It was possible to obtain information from provinces through telephone and email exchanges and virtual meetings with elected representatives, high-level officials, and staff members of provincial and federal government ministries and agencies.

Published and unpublished documents and reports at the federal and provincial levels, including the provincial budget speeches, policy and programme documents, federal and provincial periodic plans, mid-term expenditure frameworks, provincial government progress reports, and publications of the fiscal commission, financial comptroller, audit institutions, and other provincial government agencies, were reviewed during the process.

1.3. Comparative Features of the Provinces

There is considerable diversity between the seven provinces, including in their geographical size and population (Table 1). Karnali is the largest province in terms of land area but is the smallest in terms of population. Bagmati is the most populous province. Province 2 is the smallest in terms of geographical area, but is also the most densely populated province.

Table 1: Geographic and Demographic Features of the Provinces

Provinces	Number of Districts	Number of Local Levels	Population (million)	Population (%)	Area (km^2)	Area (%)	Density (per sq. km.)
Province 1	14	137	4.5	17.1	25,905	17.6	175
Province 2	8	136	5.4	20.4	9,661	6.5	559
Bagmati	13	119	5.5	20.9	20,300	13.8	272
Gandaki	11	85	2.4	9.1	21,504	14.6	112
Lumbini	12	109	4.5	17.0	22,288	15.1	202
Karnali	10	79	1.6	5.9	27,984	19.0	56
Sudurpaschim	9	88	2.6	9.6	19,874	13.5	131
Nepal	**77**	**753**	**26.5**	**100**	**147,516**[1]	**100**	**180**

Source: CBS (2020)

Socioeconomic indicators of production, economic growth rate, human development, and the indices of poverty reveal disparities between the provinces. Bagmati accounts for more than a third (35.8%) of the national GDP, while Karnali contributes the least (4.2%). Sudurpaschim and Gandaki are also on the lower end in terms of contributing to national GDP.

1 Area as of new map of Nepal issued by the Survey Department in June 2020.

Table 2: Socioeconomic Indicators of the Provinces

Particulars	Nepal	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim
GDP (NPR billion)	**3,767**	596	519	1,350	335	534	161	272
Contribution to GDP (%)	**100**	15.8	13.8	35.8	8.9	14.2	4.3	7.2
Economic Growth Rate, 2019/20 (%)	**2.28**	3.41	2.28	1.23	2.68	2.00	3.58	4.08
Human Development Index (HDI)	**0.587**	0.580	0.510	0.661	0.618	0.563	0.538	0.547
Multi-Dimensional Poverty Level (%)	**28.6**	19.7	47.9	12.2	14.2	29.9	51.2	33.6
Life Expectancy at Birth (Years)	**69.7**	70.7	68.9	72.0	73.3	68.8	67.0	66.3
Literacy Rate (15 years and above) (%)	**58**	64	40	69	67	58	52	54

Source: Compiled from NPC (2020); MoF (2020b); UNDP (2020)

According to the Nepal Human Development Report 2020, only Bagmati and Gandaki Provinces are above the national average of the Human Development Index (HDI). Karnali has the lowest HDI (Table 2). Sudurpaschim, Province 2, and Lumbini feature at the lower end of the HDI. More than half of Karnali residents and close to half of Province 2 residents are living in multi-dimensional poverty. Bagmati and Gandaki are better off than the rest of the provinces in terms of the Multi-Dimensional Poverty Index (MDPI). People in Province 1, Bagmati, and Gandaki can expect to live longer than the national life expectancy at birth, while the other provinces have a life expectancy below the national average. Province 2 has the lowest literacy, while Karnali, Lumbini, and Sudurpaschim also have literacy rates below the national average.

In 2018/19, the overall provincial economic growth rate was over 6 per cent. However, due to the coronavirus pandemic that caused lockdowns and the suspension of economic activities, provinces have been negatively affected. Differences in socioeconomic indicators can have a long-term impact on provincial development. The differences seen in the "initial endowments" are to be taken into account when developing strategies to reduce the horizontal imbalance and to promote equitable development among the provinces. This is one of the objectives of the federal system of governance in Nepal.

2 LEGAL AND INSTITUTIONAL ARRANGEMENT

This chapter reviews the legal and institutional aspects of fiscal federalism in Nepal. It also lists the key accomplishments of fiscal federalism and the planning and budgeting system used in the provinces, and also lists the main challenges to it along with policy recommendations on its legal and institutional aspects.

2.1. Constitutional and Legal Arrangement

a) Constitutional Foundations of Fiscal Federalism

Nepal's Constitution provides for different aspects of fiscal federalism. Article 56 defines the structure of the Nepali state as consisting of the federal, provincial, and local levels. Article 57 divides state power between the three levels, which are further enumerated in the constitutional Schedules. Schedule-5 enumerates the 35 exclusive powers of the federation. Schedule-6 lists the 21 exclusive powers of the provinces and Schedule-8 lists the 22 exclusive powers of the local units. Each level is mandated to exercise its exclusive powers in accordance with the Constitution and respective laws. Schedule-7 of the Constitution enumerates 25 concurrent powers shared between the federation and the provinces. The federal and the provincial government can exercise these powers in accordance with the Constitution and federal and provincial laws. Similarly, Schedule-9 includes 15 concurrent powers shared between the federal, provincial, and local levels, which can be exercised in accordance with the Constitution, and federal, provincial, and local laws.

Article 57 (6) requires that any law made by a Provincial or Local Assembly by exercising their concurrent powers has to be consistent with federal law, and laws made at the local level are to be consistent with provincial laws. Article 59 (1) of the Constitution states that all three levels can formulate laws, prepare an annual budget, take decisions, formulate plans and policies, and implement them in matters related to their financial powers within their respective jurisdiction. According to Article 59 (2) of the Constitution, for financial matters under the concurrent list, federal policies, standards, and laws can be made to be applicable to the provinces as well.

The Constitution provides functional responsibilities and revenue powers to the sub-federal levels and provides for fiscal transfers, including grants and revenue-sharing. Provinces can, in matters within their jurisdiction, levy taxes and collect revenue in accordance with Article 60 (1) of the Constitution. Article 60 (2) states that the Government of Nepal (GoN) shall make the necessary arrangements to equitably distribute the revenue it generates between the federal, provincial, and local levels. According to Article 60 (3), the amount of fiscal transfer that a province or local unit receives is recommended by the National Natural Resources and Fiscal Commission (NNRFC).

Article 60 (4) of the Constitution states that the GoN shall distribute fiscal equalisation grants to provincial and local units on the basis of their expenditure needs and capacity to generate revenue. Article 60 (5) mandates provinces distribute fiscal equalisation grants and revenue collected from its sources to local units based on the latter's expenditure needs and revenue capacity. In Article 60 (6), the Constitution mentions that the GoN will make arrangements for conditional, complementary, and special grants for provinces and local units from the Federal Consolidated Fund in accordance with federal law. Article 60 (7) stipulates that the distribution of revenue between the federal, provincial, and local levels shall be transparent. Article 60 (8) requires that federal laws regarding revenue distribution should take into account national policy and national needs; reduction of regional imbalance; ending poverty, inequality, and exclusion; and the autonomy, fiscal powers, service delivery, revenue generation, potential use of revenues, and the execution of emergency needs of the provinces and local units.

Article 116 of the Constitution envisages the establishment of a Federal Consolidated Fund. All funds received by the Government of Nepal, including those from revenues, loans, and other incomes will be credited to the Federal Consolidated Fund. Similarly, Article 204 envisages the establishment of a Province Consolidated Fund in which the provinces are required to deposit all revenues received, all loans raised, and all amounts received in the repayment of any loans from the federal government. Likewise, each local unit is also required to set up their own Local Consolidated Funds in accordance with Article 229 of the Constitution.

Articles 231-237 of the Constitution has provisions related to intergovernmental relations between the federal, provincial, and local governments. Article 232 of the Constitution mentions that the relation between the federal, provincial and local governments shall be based on the principles of cooperation, co-existence, and coordination, which is among the defining features of Nepal's federal system.

Article 59 (1) of the Constitution empowers the three levels of government to formulate and implement plans, policies, and programmes, and make their own annual budgets within their respective jurisdictions. Article 59 (3) requires sub-federal governments to adhere to federal laws regarding their budgetary processes. Article 59 (7) states that federal laws will guide the provincial system in relation to budgets, public financial management, and fiscal discipline. The Constitution empowers the Office of the Auditor General (OAG) to audit expenditure details of all federal, provincial, and local entities.

Article 285 (3) of the Constitution allows for provincial and local levels to create and operate their own services for their employees in accordance with the law. Under the transitional provisions in the Constitution provided in Article 302 (2), the GoN is mandated to adjust civil servants from the erstwhile government service to federal, provincial, and local governments in accordance with the law.

b) Federal Laws with Regard to Fiscal Federalism

The federal parliament has enacted important laws in order to implement the constitutional provisions for fiscal federalism. These include laws related to intergovernmental fiscal transfers, the role and responsibility of the fiscal commission, the operations of local governments, financial procedures, fiscal responsibility, etc.

The Intergovernmental Fiscal Arrangement Act, 2074 (IGFA Act, 2017) was enacted to implement intergovernmental fiscal transfers among the three levels of government. The IGFA Act defines the process related to the transfer of grants, revenue-sharing, borrowing, budget management, public expenditure, and financial discipline for all three levels of government.

The National Natural Resources and Fiscal Commission Act, 2074 (NNRFC Act 2017) defines the institutional arrangement, and roles and responsibilities of the NNRFC along with the principles of fiscal federalism in accordance with constitutional provisions.

The Finance Procedure and Fiscal Responsibility Act, 2076 (FPFR Act, 2019) was enacted to make the financial management system accountable, transparent, and result-oriented. It provides standards and guidelines for the management and operation of the Federal Consolidated Fund and other government funds. It contains provisions related to budget formulation, disbursement, expenditure, accounting and reporting of financial transactions, internal controls, and audits. The FPFR Act requires the Financial Comptroller General's Office (FCGO) to consolidate financial statements across all levels and submit the same to the OAG. Provinces are required to keep their accounting and financial statements as approved by the GoN in accordance with the FPFR Act.

The Local Government Operations Act 2074 (LGOA, 2017) incorporates the unbundled constitutional functions of local governments and provides a mechanism for their operations. It also defines the financial procedures of local governments, including the establishment of their consolidated funds, maintenance of their accounts in prescribed formats, the process of preparing their budgets, and the mechanism for spending and public procurement. It also requires the local levels to introduce internal control systems including internal audits and the submission of their accounts for final audits.

The Federal, Provincial and Local Level (Coordination and Interrelations) Act, 2077, popularly known as the Intergovernmental Relations and Coordination (IGRC) Law, 2020, enacted by the federal parliament in accordance with Article 235 of the Constitution contains provisions on intergovernmental relations and coordination. This law provides criteria and standards for intergovernmental relations and coordination, including that for introducing laws and policies at the provincial and local levels. It envisages that federal laws should not encroach upon the exclusive powers of the provincial and local levels, and that provinces should not encroach upon the exclusive powers of local levels when making their respective laws. This law has empowered the provinces to make laws with regard to their concurrent powers. It is expected to foster cooperation and coordination in matters of common interests and resolve disputes between and among the federal units.

c) Provincial Laws on Fiscal Federalism

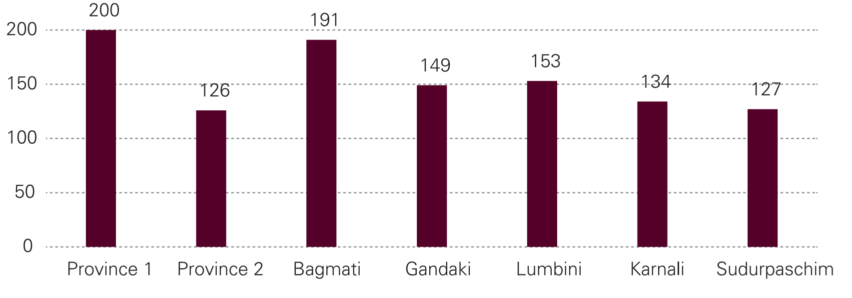
All the provinces have enacted their Province Financial Procedures Act which provide the legal basis for public spending, financial reporting, and accountability. They have also introduced their Provincial Intergovernmental Fiscal Transfer Act and Revenue Sharing Act. As of December 2020, provinces have altogether enacted 333 laws laws (Shah et al., 2021, Feb 4), including in the areas of security, governance, economic development, social development, and infrastructure development. Bagmati and Lumbini have introduced the highest number (59) of laws each, followed by Province 1 (49), Gandaki (46). Province 2 and Sudurpaschim each have enacted 42 laws. Karnali has enacted the least number (36) of laws.

2.2. Organisation of the Provinces

When provincial governments came into existence in January-February 2018, they assumed office without any previous experience and institutions in place. An interim Organisation and Management (O&M) survey conducted in March 2018 by the GoN recommended establishing various institutions at the federal, provincial, and local levels. Based on its recommendations, 676 different agencies and offices were approved for the provinces. The report of the O&M survey provided the basis for administrative restructuring, legal arrangements, organisational structure and positions, employee adjustment, capacity-building, and intergovernmental relations.

More offices were transferred to the provinces after this and by July 2019, there were 1,080 provincial offices, of which Province 1 had the highest (200) and Province 2 had the lowest number of offices (Figure 1). As of July 2020, the total number of provincial government offices increased to 1,475. This number included ministries, directorates, divisional and district offices, and projects at the province level including the offices transferred from the federal government.

Figure 1: The Number of Institutions at the Province Level



Source: OAG (2020)

2.3. Institutional Framework for Fiscal Federalism

As the custodian of fiscal federalism, the National Natural Resources and Fiscal Commission (NNRFC) is an independent entity constituted by the Constitution for designing the intergovernmental fiscal transfer mechanism. The NNRFC plays a key role in estimating fiscal resources particularly for fiscal transfers and determining the basis for distribution. The NNRFC is entrusted with the responsibility of ensuring fiscal equity through the fair distribution of resources to the three levels. It plays a crucial role in designing a balanced and transparent intergovernmental fiscal transfer mechanism that is expected to reduce vertical and horizontal fiscal imbalances and resolve potential disputes that may arise between the levels of government, especially in areas of fiscal transfers and natural resource mobilisation. The NNRFC is also mandated to recommend the criteria and principles for the mobilisation of natural resources to federal units. It also determines the ceiling of internal loans raised by analysing each province's economic factors.

The Ministry of Finance (MoF) of the federal government is entrusted with several responsibilities with regard to fiscal federalism. Among other things, the MoF is responsible for executing fiscal transfers through the federal budget as per the recommendations of the NNRFC. The MoF is the key institution responsible for preparing and implementing the federal budget.

At the provincial level, the Ministry of Economic Affairs and Planning (MoEAP) is the main institution with regards to planning and budgeting. The responsibility of the MoEAP includes economic analysis, formulation and implementation of economic policies, revenue-sharing, and fiscal management at the provincial level. It coordinates with sectoral ministries in formulating and implementing periodic and annual sectoral development plans for the provinces. The MoEAPs are also responsible for executing fiscal transfers from provincial to local units through the provincial budgets. They are also responsible for liaising with the MoF.

2.4. Public Financial Management Institutions

The FCGO is the principal institution regarding public financial management (PFM). It is the main government agency in charge of treasury management and operations. Headed by the Financial Comptroller General, the FCGO oversees budget implementation, treasury and cash management, prepares the consolidated accounts of the three levels of governments, and determines financial reporting and accounting procedures, etc. in accordance with the law.

Provincial Treasury Controller Offices (PTCOs) are key institutions that handle PFM in the provinces. They are responsible for managing and overseeing the financial management of the provinces including the operation of the Province Consolidated Fund, facilitating the implementation of the provincial budgets, maintaining accounts for income and expenditure, and preparing the province's annual financial statements. The PTCOs operate the Provincial Treasury Single Account (PTSA) that helps manage and integrate the expenditures of provincial governments in a manner consistent with the accounting and financial reporting system of the GoN. They also help to implement the province's public procurement system.

2.5. Planning and Budgeting Institutions

The National Planning Commission (NPC) is responsible for formulating national periodic and strategic plans and development policies for the overall development of the country. The NPC is supposed to develop evidence-based sectoral polices and help implement them. The NPC is also mandated to coordinate, support, and facilitate the formulation and implementation of development policies and plans for the federal, provincial, and local governments. It assesses resource needs, identifies sources of funding, and allocates budgets for socio-economic development. The NPC is also responsible for developing and managing national statistical systems and institutions. It serves as a central agency for monitoring and evaluating development policy, plans, and programmes, and is the custodian of development indicators.

Provincial Planning Commissions (PPCs) are responsible for formulating provincial plans and development policies, and facilitating their implementation. They identify the resources required for economic activities in their respective provinces and guide the overall development of the provinces. In other words, PPCs perform a similar function in the provinces as that of the NPC for the federal government. They are also responsible for monitoring and evaluating the programmes and activities, and reporting to provincial governments. PPCs are chaired by the Chief Minister of their province and have provisions for the vice-chairpersons and members to be appointed by their respective provincial governments. All the provinces have formed their own planning institutions, some as PPCs (Province 1, Lumbini, Karnali) and others (Province 2, Bagmati, Gandaki, Sudurpaschim) as Province Policy and Planning Commissions (PPPCs).

2.6. Audit and Oversight Institutions

In accordance with the Constitution, the final audit of the federal, provincial, and local government's accounts is conducted by the OAG, the supreme audit institution of Nepal.

The parliamentary committees of provincial assemblies, mainly the Finance Committee and the Public Accounts Committee, have oversight functions related to fiscal federalism, and planning and budgeting in the provinces. Sectoral parliamentary committees, including those on social development, natural resources, and infrastructure development, also have oversight functions related to the planning and budgeting of sectoral issues in the provinces.

The Financial Procedure Act of each province requires the formation of a Resource Committee, led by the Minister for Economic Affairs and

Planning, that is expected to analyse indicators of provincial economic development. The committee helps project the resource needs and expenditure estimates for the upcoming fiscal year and carries out a mid-term review of the implementation of the budget during the fiscal year. Resource Committees have been formed under the chairmanship of the Minister of Economic Affairs and Planning in Province 1 and Bagmati, under the Secretary of Economic Affairs and Planning in Karnali and Sudurpaschim, and under the chairmanship of the vice-chairman of the their respective PPCs in other provinces.

Most provinces have formed their Province Development Councils (PDC) with their chief ministers as the chair and representatives of local governments and the private sector as members. The PDCs deliberate over approach papers and plans and make recommendations before they are adopted by provincial governments.

Most provinces have formed the Province Development Action Committee (PDAC), under the chairmanship of their respective chief ministers. The PDAC is responsible for conducting periodic reviews and finding solutions to problems in developing policies, plans, and programmes in their province. It is the highest body for monitoring and evaluating provincial policies, plans, and programmes, and for devising solutions to their problems.

2.7. Institutions for Intergovernmental Relations

Article 234 of the Constitution establishes the Inter-Provincial Council chaired by the prime minister, with the federal ministers of finance and home affairs and the chief ministers of the provinces as its members. It is mandated to resolve political disputes between the federation and the provinces or between the provinces to maintain and strengthen intergovernmental relations.

The IGFA Act provides for an Intergovernmental Fiscal Council (IFC) chaired by the federal minister of finance. It is a forum for consultations on intergovernmental fiscal arrangements and related matters between the three levels of government. Members of the IFC include the minister of economic affairs and planning of each province, along with two local level representatives from each province including one woman member, and three expert members nominated by the federal government.

The Local Government Operations Act, 2074 (LGOA, 2017) envisages a Province Coordination Council (PCC) in each province to coordinate between the province and local levels in matters of policy coherence, partnerships in planning, use of concurrent powers, and the use and sharing of natural resources and royalties. The IGRC Law carries over the provision for the PCC in each province. PCCs are supposed to establish relations and coordinate on development projects to be carried out by provincial and local governments in areas covering their concurrent powers, or those related to more than one unit. In each province, the PCC is headed by the chief minister, and consists of provincial ministers for economic affairs and planning, internal affairs, and the principal secretary as its members. The PCC also consists of at least one member from each district of the province who is nominated by the chief minister from among the chairpersons and vice chairpersons of local governments and District Coordination Committee (DCCs) of which at least a third have to be women.

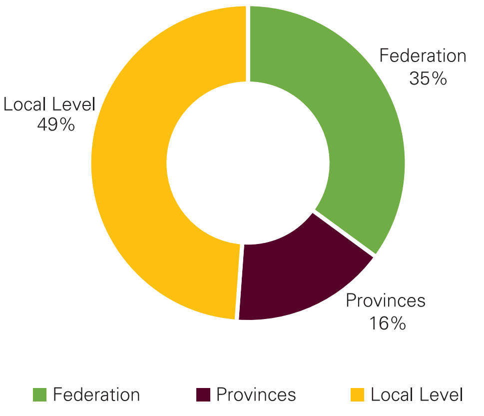
The IGRC Law includes a provision for a National Coordination Council (NCC) chaired by the prime minister and consisting of the federal ministers of finance, home affairs, law and general administration, as well as the chief ministers of the provinces and seven persons representative of all provinces nominated by the prime minister from among the chairpersons or vice-chairpersons of local governments, including at least three women. The NCC is supposed to strengthen intergovernmental relations to formulate and implement laws, plans, policies, and strategies in matters related to the concurrent powers across all three levels of government. The IGRC Law also provides for Sectoral Committees headed by their respective federal ministers with relevant sectoral ministers of the provincial governments, along with one chair or vice-chair from the local levels as its members. The Sectoral Committee is to maintain coordination between the three levels of government while formulating sectoral laws, plans, and policies, and to engage in consultations with provincial and local governments to maintain the quality and continuity of plans and programmes.

2.8. Employee Adjustment

Article 285 (3) of the Constitution states provinces and local governments can create and operate their own services for their employees in accordance with the law. Under the transitional provisions of the Constitution, Article 302 (2) mandates the GoN to adjust civil servants from the erstwhile government services to the federal, provincial, and local levels in accordance with the law. Under this provision, the adoption of the Civil Servant Adjustment Act, 2075 (2018) paved the way for the adjustment of the erstwhile civil servants to federal, provincial, and local levels.

In accordance with the interim O&M survey conducted by the federal government, it was estimated that the federal government would need 48,606 civil servants (35%), while the provincial governments would need 22,297 (16%), and local levels would need 67,719 (49%) of the total estimated 138,622 employees (Figure 2). This would require substantively more civil servants than the then existing number, which was 99,571 before the adjustment. Out of the employees provisioned for the provincial administration, 28 per cent were supposed to be of the officer level, and 39 per cent of the assistant level. The remaining one-third of the estimated staff of the provinces were "classless" employees consisting of vehicle drivers, office help, forest guards, etc.

Figure 2: Share of the Estimated Civil Service Positions across the Levels of Government



Source: MoF (2019b)

By March 2019, a total 99,571 civil servants were adjusted, of which 39,960 (40.12%) were retained at the federal level, 13,821 (13.87%) adjusted to provinces, and the remaining 43,807 (43.98%) sent to local levels. Among the provinces, Lumbini, Bagmati, and Province 1 received the higher share of the adjusted employees, whereas Karnali received the least (Table 3).

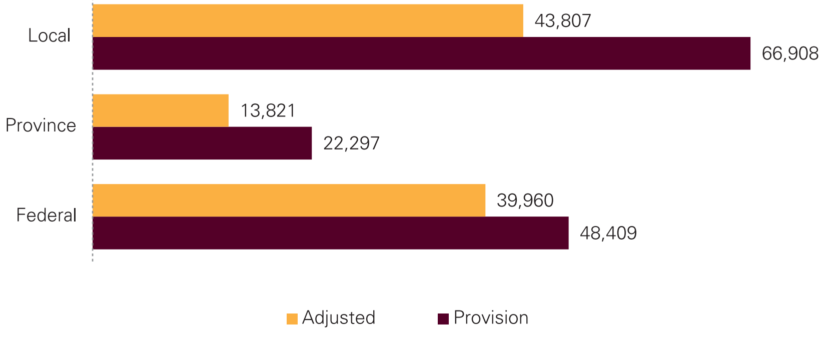
Table 3: Adjustment of Staff Compared to Provisions and Vacancies

Province	Provisioned	Adjusted	Vacant	% Fulfilled	% Vacant
Province 1	3,373	2,415	958	71.6	28.4
Province 2	3,158	1,812	1,346	57.4	42.6
Bagmati	3,906	2,525	1,381	64.6	35.4
Gandaki	2,699	1,748	951	64.8	35.2
Lumbini	4,037	2,532	1,505	62.7	37.3
Karnali	2,332	1,334	998	57.2	42.8
Sudurpaschim	2,792	1,455	1,337	52.1	47.9
Total	**22,297**	**13,821**	**8,476**	**62.0**	**38.0**

Source: MoFAGA (2018); OAG (2020)

With the employee adjustment to different levels of government com-pleted, albeit with some delay, it compelled provinces to operate without essential staff for most of their first two years. Even after the adjustment, provinces were short of 8,476 staff positions, which constituted 38 per cent of provisioned positions. On a provincial breakdown, Sudurpaschim (47.9%), Province 2 (42.6%) and Karnali (42.8%) had the higher share of vacant positions compared to other provinces (Table 3).

Figure 3: Provision and Adjustment of Civil Servants



Source: MoF (2019b)

To fulfil vacant positions, provinces will have to recruit their own employees on top of the adjusted civil servants. Despite the formation of their Provincial Public Service Commissions (PPSCs), provinces were not able to recruit their own employees due to the delay in enacting the Federal Civil Service Act. Provincial civil service laws cannot be adopted before federal civil service laws are adopted, as they are to draw their norms, principles, and standards from them. Pending the adoption of the Federal Civil Service Act and the formulation of the provincial civil service laws in most provinces, the PPSCs of a few provinces have begun to provisionally recruit the staff as requested by their respective provincial governments.

In accordance with the Employee Adjustment Act, 2018, provinces are expected to conduct their own O&M surveys to define their institutional and human resource needs. A few provinces have already initiated the surveys.

The human resources situation in the provinces with regard to the implementation of fiscal federalism and public financial management, including for accounting and economic planning, is not encouraging. Provinces are short of employees in these disciplines and are facing vacancies or a quick rotation of staff in these categories. Discussions with provincial stakeholders revealed that provincial governments are understaffed in the revenue service, economic planning and statistics service. In the accounting group, there is a shortage of staff in senior positions.

2.9. Legal and Institutional Accomplishments

The legal bedrock for fiscal federalism has been established. Fiscal federalism is enshrined in the Constitution, which lists the fiscal powers and responsibilities of the federal, provincial, and local governments. All three levels have begun to exercise the functions assigned and revenue powers granted to them by the Constitution. The Constitution contains provisions regarding expenditure assignment, revenue powers, fiscal transfers, revenue-sharing, and the sharing of proceeds from natural resources in a balanced and transparent manner.

Necessary laws for the implementation of the constitutional arrangement for fiscal federalism have been formulated. Basic policies, laws, and operating procedures have been enacted in the early stages of fiscal federalization. The IGFA Act and the NNRFC Act provide the necessary legal basis for the execution of fiscal federalism. Provinces have enacted laws necessary to strengthen their provincial responsibilities with regard to fiscal federalism, and planning and budgeting.

The fiscal commission is operational. The Constitution mandates the NNRFC to make recommendations for fiscal transfers and to develop formulas and principles concerning this. As the guardian of fiscal federalism, the fiscal commission has been devising formulae for fiscal transfers and revenue-sharing among all levels of the government and making recommendations in accordance with the Constitution.

Institutional mechanisms for sorting out issues of intergovernmental fiscal management have been stipulated. The NNRFC provides the mechanism to resolve issues related to the intergovernmental fiscal transfers. In accordance with the IGFA Act, the Intergovernmental Fiscal Council was established to solve issues related to intergovernmental fiscal management between the three levels of government, including in expenditure and revenue assignments.

2.10. Institutional and Legal Challenges

Delays in federal legislation on a few key issues related to their concurrent powers have affected the process of provincial legislation. Although a few provincial governments have proactively drafted laws, they have not gone into implementation because of a lack of federal legislation providing a framework for them. For example, Province 2 has adopted its Provincial Civil Service Act even though the federal civil service law has not been adopted by the federal parliament. Other provinces have not been able to introduce their civil service laws in absence of the Federal Civil Service Act, a bill to which was tabled in the federal parliament two years ago, but is yet to be adopted.

The structures of provincial ministries are imbalanced and there is insufficient coordination between provincial agencies. This issue was highlighted in the fifty-seventh annual report of the Auditor General published in July 2020. There is some duplication of work occurring between the PPCs and the MoEAPs, as the relation between the two bodies is yet to be properly defined. A few provinces have set up sectoral line offices at the district or cluster level such as the Agriculture Knowledge Centres, Livestock Service Centres, and District Education Development and Coordination Units, which should have been transferred to the local levels, which have the competence on these subjects in accordance with the Constitution.

Employee adjustment has not fulfilled the human resource gap in the provinces. Even after the adjustment of civil servants from the erstwhile unitary government, more than a third of the positions in the provinces remain vacant. Except for provisional recruitment by a few provinces, the Provincial Public Service Commissions have not been able to recruit employees for the provinces in the absence of federal and provincial civil service laws. Further, there is no stability in senior positions as the chief secretary and secretaries of provincial ministries who come from the federal government are transferred frequently. Often, newly promoted officers are sent to the provinces as secretaries.

Insufficient institutional development support provided by the federal government to provincial governments. Provincial governments complain that they do not receive cooperation for institutional strengthening, staff appointment and retention, capacity-building, formulation of laws, devolution of authority, and allocation of resources.

The federal government has retained several offices and projects that come under the jurisdiction of provincial and local governments, creating an overlap in expenditure assignments. There is concern among provinces that the federal government has overstepped its jurisdictions in retaining offices that are supposed to be transferred to provincial and local levels. Projects and offices having more resource and functional powers are retained at the federal level and the ones considered less important or with fewer resources are transferred to the provincial and local levels. For example, the federal government has retained offices such as the Department of Local Infrastructure (DoLI), the National Rural Transportation Improvement Programme, Suspension Bridge Division, Small Irrigation Project, etc. which are under the mandate of provincial or local levels.

The NNRFC is yet to be fully institutionalised. The formation of the NNRFC was delayed for two years after the start of the federal system of governance. Though the Constitution envisages the NNRFC consisting of up to five members, only a chairperson was appointed in the beginning. The NNRFC lacks an integrated database and mechanism to substantiate its decisions and recommendations on the system of grants. The GoN is often bypassing the recommendations of the NNRFC and the latter's constitutional powers have been weakened through legal documents (Bhattarai, 2020).

The provinces lack human resources for the implementation of fiscal federalism and public financial management. There is a staff shortage especially in revenue and economic planning and statistical services. Provinces are short on positions in these disciplines and are facing vacancies or a quick rotation of staff in these categories. In the Accounting Group, there is a shortage of staff in senior positions.

2.11. Policy Recommendations

Assure the functional autonomy of provinces to execute their responsibilities under fiscal federalism: It is important for institutions related to intergovernmental fiscal relations to be proactive and persuade each level of government to respect the jurisdiction of the others. Contradictory federal laws limiting functional autonomy and constitutional mandates should be reviewed and made coherent.

Institutionalise the NNRFC: If fiscal federalism is to be firmly implemented, the NNRFC should be allowed to play an active role in fulfilling its constitutional mandate. It requires support to build its capacity, conduct studies, and do research to develop informed and evidence-based policy making, and to harmonise federal legislation to strengthen its constitutionally mandated functional autonomy and roles. Its recommendations on fiscal transfers, revenue-sharing, borrowing, and use and sharing of resources should be implemented earnestly.

Expedite federal laws on the concurrent powers of the federal and provincial governments: Since federal laws are expected to set the principle, norms, and criteria for provincial roles within the concurrent jurisdictions of the federal and provincial governments, federal laws are necessary for allowing provinces to proceed with their own laws and to execute their concurrent responsibilities in their respective sectors. Pending legislation on several sectoral federal laws should be expedited to allow provinces to proceed with their own legislation.

Improve the quality of provincial legislation through better standards and frameworks from the federal level: The implementation of provincial laws on finance procedure, public procurement, tax and non-tax regulations, etc. need to be strengthened through operational regulations. The parliamentary committees of Provincial Assemblies need institutional support to develop their capacity to deliberate on the provincial law-making process.

Devolve more institutions to the provinces: The Constitution grants powers and responsibilities to sub-federal governments including more than half the functional powers of government. The federal government needs to be proactive in devolving more authority and resources to the lower levels. For example, the Department of Local Infrastructure (DoLI), National Rural Transportation Improvement Programme, Suspension Bridge Division, Small Irrigation Project, etc. should be devolved to the provincial level in accordance with their functions. A time-bound plan for the transfer of federal institutions and responsibilities to the provinces would help in implementing the constitutional spirit and provisions.

Complete the provincial O&M Surveys to determine the organisational structure and human resources needed: The design of institutional arrangements in the provinces was rushed during the restructuring of the state. Provinces were assigned a uniform structure without taking into account their differences and diverging needs. Provinces should complete their own O&M Surveys to identify their needs and capacities regarding their institutions and employees. They should only create new positions after the O&M Surveys and they should develop job descriptions and terms of references for each post created. Recruitment to the provincial civil service should be based on a merit system and inclusive principles as per the provisions envisioned in laws related to the Provincial Public Service Commission. The practice of appointing employees on service contracts should be discouraged, except for service-related jobs, and those that require specific technical skills.

Operationalise institutions related to intergovernmental relations and coordination: The institutions and mechanisms for intergovernmental relations and coordination need to be activated and strengthened by establishing the necessary operating procedures, guidelines, and institutional development support. The meetings between the institutions designed for intergovernmental relations and coordination should be regularised and their recommendations should be implemented.

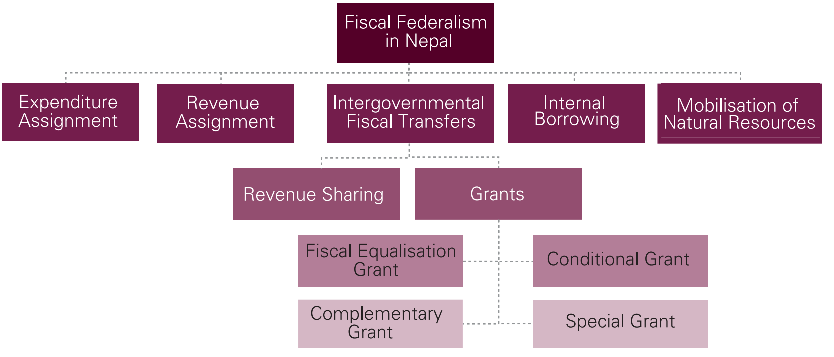
3 PRACTICES IN FISCAL FEDERALISM IN THE PROVINCES OF NEPAL

This chapter reviews the mechanism and practice of implementing fiscal federalism in Nepal, including revenue and expenditure assignment, intergovernmental fiscal transfers, and revenue-sharing, and trends in expenditure, revenue, and fiscal transfers made available to the provinces so far. It also lists the key accomplishments of fiscal federalism, and the main challenges and policy recommendations for it in relation to the provinces of Nepal.

3.1. Pillars of Fiscal Federalism

As stated in the previous chapter, the Constitution of Nepal has adopted the basic tenets of fiscal federalism through the distribution of the state power among federal units and institutional mechanisms for the transfer of resources to sub-federal units. The main pillars of fiscal federalism in Nepal include the expenditure assignment, revenue assignment, fiscal transfers (grants and revenue-sharing), borrowing, and mobilisation of natural resources (Figure 4).

Figure 4: Fiscal Federalism in Nepal: A Schematic Overview



Source: Derived from NNRFC (2019)

3.1.1. Expenditure Assignment

Schedules 5 to 9 of the Constitution list the exclusive and concurrent powers and functional responsibilities of the federal, provincial, and local governments. The respective level of government has the power to make expenditures in matters under its exclusive jurisdiction. Provinces are assigned with exclusive functions including the administration of provincial police, banking and financial institutions, operation of radio, FM, and television, provincial statistics, trade and industry, provincial highways, vehicle management, and transportation. Provinces also share concurrent powers with federal and local levels which includes cooperatives, education, health, agriculture, hydropower, drinking water, irrigation, forest, environment, mines and minerals, social security, vital registration, etc. (Table 4).

Table 4: Exclusive and Concurrent Powers of the Three Levels of Government

Level	Exclusive Powers	Concurrent Powers	
		Federation and Provinces	Federation, Provinces and Local Level
Federation	Defence and Military, Central Police, Armed Police Force, Central Planning, Central Bank, Foreign Affairs, Telecommunications, Federal Civil Service, International Trade, Civil Aviation, etc. (Schedule 5)	Civil and Criminal Procedure, Evidence and Oaths, Supply and Distribution of Essential Goods and Services, Legal Matters, Planning, Family Planning and Population Management, Casino, Lottery, etc. (Schedule 7)	Cooperatives, Education, Health, Agriculture, Utility Services, Disaster Management, Archaeology, etc. (Schedule 9)
Provinces	Provincial Police Administration, Operations of Banking and Financial Institutions, Operation of Radio, FM, Television, Provincial Statistics, Provincial Highways, Agriculture and Livestock Development, Factories, Industrialization, Trade, Business, Transportation, etc. (Schedule 6)		
Local Level	Town Police, Cooperative Institutions, Operation of FM, Management of Local Services, Basic and Secondary Education, Basic Health and Sanitation, Local, Rural and Agro-roads, Local Record Management, etc. (Schedule 8)		

Source: Adopted from the Constitution of Nepal

The exclusive and concurrent powers create the basis for the expenditure assignment of provinces. The IGFA Act mandates each level of government to prepare an estimated statement of public expenditure on the subjects under its domain each fiscal year, including a statement of recurrent and capital expenditure as well as fiscal arrangements which are executed through the annual budget.

3.1.2. Revenue Assignment

Provinces are assigned with revenue powers which include tax and non-tax sources and royalties from natural resources. The revenue powers assigned to provinces include agricultural income tax, house and land registration fees, motor vehicle tax, entertainment tax, vehicle tax, tourism fees, service fees, fines, penalties, and other taxes that may be levied in accordance with provincial laws in matters under their jurisdiction (Table 5). Only agricultural income tax is under the exclusive domain of the provinces. Other revenue sources assigned to the provinces can also be levied by federal or local governments. In order to resolve this dilemma, a Single Tax Administration (STA) system has been introduced. In accordance with the IGFA Act, provinces collect motor vehicle tax for themselves as well as for the local levels and local levels collect building and land registration fees, advertisement tax, and entertainment tax levied by themselves as well as by the province.

Table 5: Revenue Powers of the Federal, Provincial, and Local Levels

Source of Revenue	Federal Level	Provinces	Local Level
Tax Revenue			
Customs	√		
Excise Duty	√		
Value Added Tax (VAT)	√		
Individual Income Tax	√		
Corporate Income Tax	√		
Remuneration Tax	√		
Agriculture Income Tax		√	
Entertainment Tax		√	√

Source of Revenue	Federal Level	Provinces	Local Level
Motor Vehicle Tax		√	√
Advertising Tax		√	√
Building and Land Registration Fee		√	√
Wealth/Property Tax			√
Land Tax			√
House Rent Tax			√
Business Tax			√
Non-Tax Revenue			
Passport and Visa Fees	√		
Lottery, Casino Charges	√		
Service Fees	√	√	√
Tourism Fees	√	√	√
Penalties	√	√	√
Other			
Other tax and non-tax revenue levied according to federal, provincial, and local laws	√	√	√

Source: Adapted from the Constitution of Nepal, 2015 and the IGFA Act

The situation for own-source revenue (OSR) in the provinces is not very promising.[2] In 2017/18, provinces collected a nominal amount of OSR of a little over one million rupees, according to the OAG audit report for that year. The provinces had just been created that fiscal year and their financial activities were not fully functional. Institutions and laws were also just beginning to evolve, constraining revenue generation and collection in the provinces.

The OSR of the provinces has steadily risen since over the last three years. In 2018/19, provinces collected NPR 19.54 billion as their OSR. In 2019/20, provinces had revised estimates for the collection of NPR

2 Due to the lack of a breakdown, the own-source revenue is computed on the basis what is left of the total budget after subtracting grants, revenue-sharing, internal loans, and the cash balance.

29.18 billion as their OSR. That year, all provinces showed a favourable growth rate averaging 18.4% in their OSR collection from that of the previous fiscal year, despite the impact of the coronavirus pandemic in the latter half of the fiscal year. For 2020/21, the provinces had projected collections of NPR 38.22 billion as OSR, but is expected to drop due to the economic impact of the coronavirus pandemic (Box 1).

Box 1: The Economic Impact of COVID-19 on Provinces

The impact of COVID-19 was unfolding when this study was completed in July 2020. Downward trends were reported on many economic indicators including economic growth, expenditure, and revenue collection. Budget and programme implementation were also affected.

Economic Growth: The estimated rate of economic growth in 2019/20 for the country was revised from a projected 7.0 per cent to 2.3 per cent as the pandemic hit businesses, economic activities, imports, revenue collection, government expenditure, and programme implementation. This downward revision was expected to adversely affect the economic growth rate of the provinces as well. All provincial plans have projected an average economic growth of above 9.0 per cent for the period of their first plan. This growth projection is likely to be adversely affected by the pandemic, at least in the short run, though a recovery is possible in the longer run if the provinces execute their resilience objectives as mentioned in their budgets.

Realignment of programme and budget objectives: Provinces have listed the handling of the coronavirus crisis and its economic impact as one of the main objectives in their budgets and programmes for 2020/21. This realignment in budget objectives may affect the implementation of their plans and other socioeconomic objectives in the short run, but may eventually bring the provinces back on track with their economic objectives.

Shortfall in expenditure: Provinces were already facing difficulty in realizing their annual expenditure targets. COVID-19 further weakened their spending capability, as budget implementation and programme execution cycles were adversely affected. Most provinces also took the opportunity to rationalise their expenditure, cutting unproductive expenditures and activities.

Fiscal transfers: There was no data available to support any change in projected fiscal transfers actually made available to provinces during the period. But, the decline in the overall budget of the federal government had some impact in fiscal transfers, resulting in a reduction in the growth rate of fiscal transfers projected for 2020/21. A decrease in fiscal transfers will adversely impact the fiscal space of provincial and local governments. Rationalising the expenditures is crucial to managing this shrinking fiscal space.

Revenue collection: Revenue collection declined across the board in the last quarter of 2019/20 due to the effect of the lockdown imposed during the pandemic. According to the FCGO, monthly revenue collection started to decline from the month of April 2020, while the MoF estimates a 25 per cent reduction in the projected revenue collection in the budget speech of FY 2020/21.

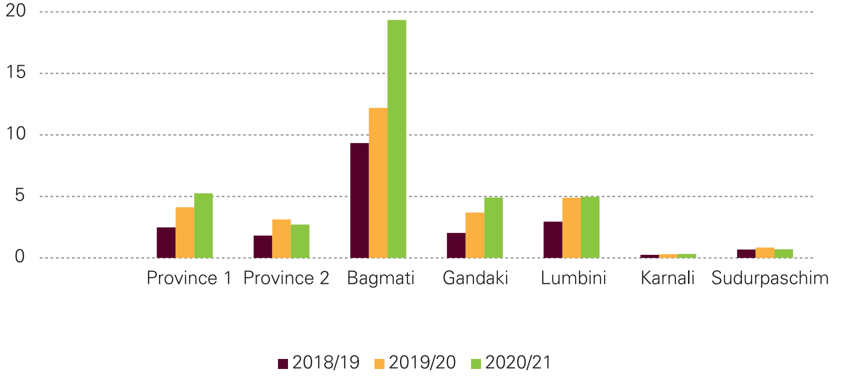
Revenue-sharing: Because of the shortfall in revenue for the federal government, the amount received by the provinces from revenue-sharing was impacted in the form of reduced ceilings of revenue-sharing provided to the provinces and local units in 2020/21. Actual revenue-sharing month by month also started to decline. If this situation persists, the celling of NPR 61 billion for revenue-sharing determined for 2020/21 may have to be lowered, which will have a further negative impact on provincial programmes.

Budget implementation and programme execution: Provinces were able to retain their budgeting cycles despite the pandemic.

But, the overall environment for budget and programme implementation was pushed behind and provinces missed many targeted physical and financial activities.

Among the provinces, Bagmati continues to collect the highest share of OSR, while Karnali has the lowest (Figure 5). Sudurpaschim also has a low share of OSR among the provinces.

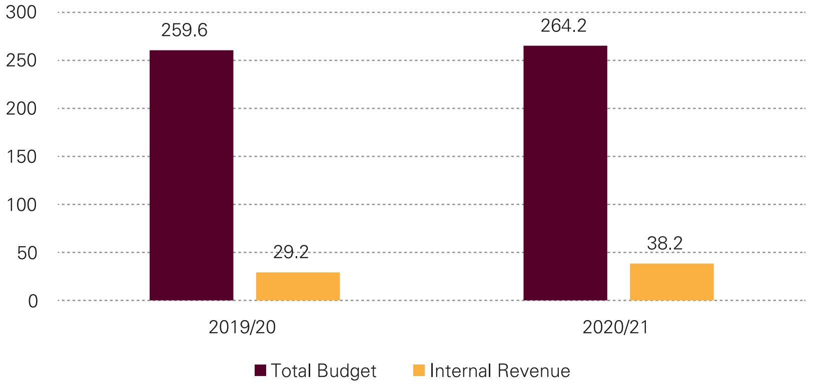
Figure 5: Own-Source Revenue of the Provinces (NPR Billion)



Source: Data from Annex-1

Overall, the share of OSR in provincial budgets was 11.24 per cent for 2019/20, which rose incrementally to 14.47 per cent in 2020/21.

Figure 6: Share of Own-Source Revenue in the Budgets of the Provinces (NPR Billion)

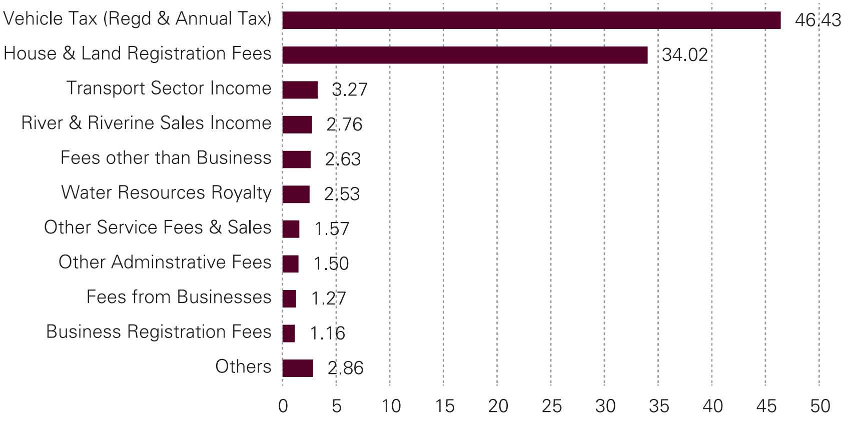


Source: Data from Annex-1

The code wise composition of revenue for the provinces (Figure 7) reveals that vehicle tax comprises the largest share (46.43%) followed by house and land registration fee (34.02%). Other sources had a nominal contribution to provincial revenue, showing that taxation is concentrated in non-productive sectors. Provinces need to explore additional sources for revenue, especially from more productive sectors.

Province 1 has a notable share of revenue (9.93%) from other service fees. The share of other administrative fees was highest (7.44%) in Gandaki, while that of fees from businesses was higher (8.79%) in Province 2. This demonstrates that each of the provinces have revenue potentials from different sources.

Figure 7: Sources of Provincial Revenue, 2018/19 (%)



Source: Data from Annex-2

3.1.3. Fiscal Transfer

Under the federal system, the provincial and local governments started to receive fiscal transfers from the federal government since 2017/18. Since then, sub-federal units have received nearly a third of the federal budget and over one-tenth (11%) of the country's GDP as fiscal transfers each year, this can be considered a good practice in federalism (Devkota, 2020). In 2019/20, the sub-federal units received NPR 463.4 billion in fiscal transfers, which increased to NPR 485.1 billion in 2020/21 (Table 6). Provinces as a whole received fiscal transfers equal to 11.4 per cent of the federal budget in 2019/20. This ratio dropped marginally to 10.9 per cent in 2020/21.

Table 6: Fiscal Transfers to Sub-Federal Levels (NPR Billion)

Fiscal transfer	Province		Local		Total	
	2019/20	2020/21	2019/20	2020/21	2019/20	2020/21
Fiscal Equalisation Grant	55.3	55.2	90.0	90.5	145.3	145.7
Conditional Grant	44.6	36.4	124.0	161.0	168.6	197.4
Special Grant	5.0	3.1	5.0	6.8	10.0	10.0
Complementary Grant	5.0	5.2	5.0	4.8	10.0	10.0
Revenue-sharing	65.0	61.1	65.0	61.1	130.0	122.1
Total	**174.9**	**160.9**	**289.0**	**324.2**	**463.8**	**485.1**
Ratio of transfer with respect to federal budget (%)	11.4	10.9	18.9	22.0	30.3	32.9

Source: Devkota (2020)

a. Grants

Articles 60 (3) to 60 (6) of the Constitution establishes four types of grants: Fiscal Equalisation Grants, Conditional Grants, Complementary Grants, and Special Grants. These grants are provided by the federal government to provincial and local levels and by provincial governments to local levels.

(i) Fiscal Equalisation Grants

The IGFA Act and the NNRFC Act elaborate on the provisions for fiscal equalisation grants which comes in the form of direct formula-based unconditional grants to provinces and local levels. The IGFA Act stipulates that fiscal equalisation grants will be made available to provinces and local levels upon the recommendations of the NNRFC on the basis of their "need for expenditure" and "revenue capacity". Each year, the NNRFC recommends the criteria and weightage for the allocation of fiscal equalisation grants (Table 7).

Table 7: Fiscal Equalisation Grants Allocation Formula

Criteria	Weightage (%)		
	Province (For 2018/19 and 2019/20)	Local (For 2018/19 and 2019/20)	Province and Local (For 2020/21)
Human Development Index	-	10	10
Social and Economic Disparity	15	5	5
State of infrastructure development	10	15	10
Revenue Capacity	-	-	5
Expenditure Needs	-	70	70
Cost of Service Delivery Index	60	-	-
Multidimensional Poverty Index	15	-	-
Total	**100**	**100**	**100**

Source: NNRFC (2019); NNRFC (2020a)

After the provincial governments were formed in the last quarter of 2017/18, the federal government transferred nominal fiscal equalisation grants to each province, totalling NPR 7.14 billion for all seven. In 2018/19 and 2019/20, the provinces received NPR 50.3 billion and NPR 55.3 billion in fiscal equalisation grants respectively. In 2020/21, the provinces were provided with fiscal equalisation grant of NPR 55.2 billion. In the last three fiscal years, provinces received over a third of the total fiscal equalisation grants transferred to sub-federal governments (Table 8).

Table 8: Fiscal Equalisation Grants to Sub-Federal Levels (NPR Billion)

	2017/18	2018/19	2019/20	2020/21
Province 1	1.02	6.6	8.2	8.0
Province 2	1.02	7.0	7.1	7.0
Bagmati	1.02	6.0	7.6	7.7
Gandaki	1.02	6.8	7.1	7.1
Lumbini	1.02	6.9	7.5	7.6
Karnali	1.02	9.1	9.9	9.6
Sudurpaschim	1.02	7.9	8.0	8.1

	2017/18	2018/19	2019/20	2020/21
Total of provinces	7.14	50.3	55.3	55.2
Total of all local levels	148.6	85.2	90.0	90.1
Total province and local levels	155.7	135.5	145.3	145.3
Share of fiscal equalisation grant received by the provinces (%)	4.6	37.1	38.1	38.0

Source: NNRFC (2019); NNRFC (2020a)

(ii) Conditional Grants

Conditional grants can be provided by the federal government to provinces and local levels as well as by provinces to local levels to implement projects on the basis of criteria prescribed by the NNRFC. The IGFA Act states that conditional grants may specify terms and conditions in relation to the implementation of projects or activities that are to be carried out by the receiving government. Receiving governments are expected to abide by the conditions tied to these grants.

Provinces started to receive conditional grants in 2018/19. In that fiscal year, provinces received NPR 63.1 billion in conditional grants. In 2019/20, the conditional grants made available to them was reduced to NPR 44.55 billion. This further came down to NPR 36.4 billion in 2020/21. While conditional grants made available to the provinces is decreasing, the amounts given to local levels has been increasing (Table 9).[3]

3 The conditional grants to the local levels appear higher because it consists of the remuneration of school teachers up to the secondary level.

Table 9: Conditional, Special and Complementary Grants (NPR Billion)

Type of grant	Provinces				Local Level			
	2017/18	2018/19	2019/20	2020/21	2017/18	2018/19	2019/20	2020/21
Conditional grant	-	63.1	44.6	36.4	76.4	109.8	123.9	161.1
Special grant	-	2.8	5.0	3.1	-	5.0	5.0	6.8
Complementary grant	-	4.0	5.0	5.2	-	5.0	5.0	4.8

Source: Compiled from MoF (2018); MoF (2019a); MoF (2020a); NNRFC (2019)

(iii) Complementary Grants

The IGFA Act provides for complementary grants or matching grants that the federal government may provide to provinces or local levels and that provinces can provide to local levels to implement projects for infrastructure development. Complementary grants are provided on the basis of a ratio to the total cost of a project, and is based on criteria including project feasibility, expected inputs and outputs as well as the project implementation capability of the respective governments. In principle, complementary or matching grants are provided to meet the demands of initiatives by sub-federal governments. So far, the provinces and local levels have only received complementary grants nominally, about NPR 5 billion each year.

(iv) Special Grants

According to the IGFA Act, the federal government may provide special grants to the provincial and local levels and provincial governments to local levels for any specific project that enhances the delivery of basic services and helps achieve balanced development or uplift marginalised communities. In principle, special grants are provided to support the supply side initiative of the federal government.

Provincial and local levels have been receiving small amounts of special grants since 2018/19 (Table 9). That year, provinces were provided NPR 2.8 billion as special grants. In 2019/20, they received NPR 5.0 billion as special grants, which was reduced to NPR 3.1 billion in 2020/21.

b. Revenue-Sharing

Article 60 of the Constitution states that the GoN will make necessary arrangements to equitably distribute the revenue it generates from all its sources between the federal, provincial, and local levels as per the recommendations of the NNRFC and that revenue-sharing will be done in a "balanced and transparent" manner. It spells out the criteria and principles for revenue-sharing which includes national policies, the financial powers and the autonomy of the sub-federal units, services to be rendered by the sub-federal units, a reduction of regional imbalances and inequality, and the revenue potential of the sub-federal units.

The IGFA Act provides for the creation of a Federal Divisible Fund where VAT and excise duty is collected from domestic production to be shared with all three levels of government. Out of the total amount deposited into this fund, 70 per cent is to be distributed to the federal level, 15 per cent to the provinces, and 15 per cent to local levels. (Table 10).

Table 10: Provision of Revenue-Sharing (%)

Sources of Revenue	Federal Government	Provinces	Local Governments
Value Added Tax	70	15	15
Excise Duty	70	15	15

Source: The IGFA Act

Each year, the NNRFC recommends criteria for revenue-sharing with provincial and local levels based on population, geographical area, human development, expenditure needs, revenue collection efforts, infrastructure development, and socioeconomic disparity (Table 11).

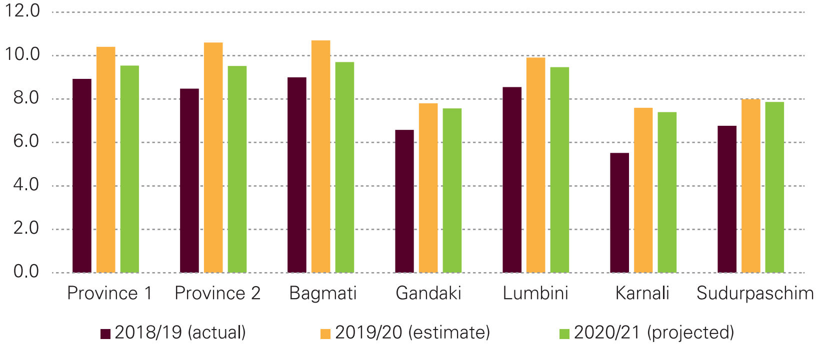
Table 11: Revenue-Sharing Criteria to the Province and Local Levels

Criteria	Weightage (%)	
	(2019/20)	2020/21)
Population	70	60
Geographical Area	15	15
Human Development Index	5	5
Expenditure Needs	-	5
Efforts for Revenue Collection	-	3
Infrastructure Development	10	10
Special Criteria	-	2
Total	**100**	**100**

Source: NNRFC (2019), NNRFC (2020e)

As per Section 6 of the IGFA Act, divisible amounts related to VAT and excise in a given month are to be transferred to the respective levels within the next month. The distribution of royalty from natural resources is done on an annual basis.

Figure 8: Revenue-Sharing to Sub-Federal Levels (NPR Billion)



Source: Data from Annex-3

Provinces started to receive funds from revenue-sharing in 2018/19. In that fiscal year, the provincial and local governments received a total of NPR 53.8 billion under revenue-sharing (Figure 8). In 2019/20, the total amount of revenue-sharing increased to NPR 65.0 billion each. In 2020/21, this amount is projected to decrease to NPR 61.1 billion due to the economic impact of the COVID-19 crisis.

3.1.4. Mobilisation of Natural Resources

The Constitution provides a mechanism for the equitable distribution of benefits derived from natural resources, including the royalties and services, between the three levels of government. The three levels can invest in projects for the mobilisation of natural resources on the basis of cost and benefit sharing in accordance with the law. The ratio of cost and benefit on the investment is fixed at the recommendation of the NNRFC in accordance with the law. The NNRFC is expected to coordinate among the three levels of government and resolve any dispute related to the mobilisation and sharing of the costs and benefits of natural resources. The NNRFC is also supposed to recommend measures to minimise the environmental impact of these projects.

The IGFA Act provides for the sharing of royalties from natural resources, including from water, electricity, forests, mining, mountaineering, and other natural resources, to federal, provincial, and the local governments as per the recommendation of the NNRFC. The IGFA Act stipulates that the federal government will get 50 per cent of the royalty from natural resources, while the provincial governments will receive 25 per cent, and local levels will receive 25 per cent.

The NNRFC recommends the criteria for determining the distribution of royalties from natural resources, including from mines, electricity, mountaineering, etc. based on geographical situation, affected area, and population (Table 12).

Table 12: Criteria and Weightage of Indicators for Determining the Share of Royalties

S.N.	Indicators	Mountaineering	Electricity	Mines
1.	Geographical situation	40	50	50
2.	Local Level with Base camp	10	-	-
3.	Affected area	25	25	30
4.	Affected population	25	25	20
	Total	**100**	**100**	**100**

Source: NNRFC (2019)

Separately, the NNRFC has also recommended criteria for the sharing of royalties from forests and conservation areas (Table 13).

Table 13: Criteria for the Sharing of Royalties form Forests and Conservation Areas

S.N.	Indicators	Forests	Conservation Area
1.	Situation of forest/ conservation area	20	10
2.	Area of forest or conservation area	40	40
3.	Affected area	20	-
4.	Affected population	10	35
5.	Participation in sustainable development	10	15
	Total	**100**	**100**

Source: NNRFC (2019)

3.1.5. Borrowing

In its Article 251 (1) F, the Constitution states that the NNRFC can recommend fixing the limit of internal borrowing for the federal, provincial, and local levels taking into account the overall economic indicators of the country. The IGFA Act allows all governmental units to borrow internal loans within the limits recommended by the NNRFC with the approval of the GoN. For 2020/21, the NNRFC recommended that the federal government limit its internal loans to 5.5 per cent of GDP, and that sub-federal governments remain within 12 per cent of the sum of the amount received as revenue-sharing and own source revenue when raising internal loans (NNRFC, 2020b). The NNRFC also recommended that provinces may utilise internal loans so raised in activities that help capital formation and provide long-term benefits, and in which the return on investment can generate resources for loan repayment. Provinces have been recommended not to raise internal borrowing for administrative and recurrent expenditure and on non-productive sectors.

As per the IGFA Act, the power to obtain foreign grants or loans rests with the federal government, which may use those funds to implement plans and programmes at the provincial and local levels. The sub-federal governments cannot receive any foreign grants and loans without the approval of the federal government. The IGFA Act states that provincial and local levels can obtain federal loans for which they need to sign an agreement with the federal government. In order to access federal loans, provinces must submit a request to the MoF detailing the use of the loan, mode of payment, and time-frame. If the federal government deems the request reasonable, the MoF enters into an agreement with the concerned province for loan disbursement and repayment. If provinces fail to repay the loans to the federal government, the federal government can recover such loans from the grants to be provided to the concerned province as stipulated in the IGFA Act. Provinces can also issue bonds to raise capital from internal markets.

Table 14: Internal Borrowing of the Provinces (NPR Billion)

	2019/20		2020/21	
	Total Budget	Internal Loan	Total Budget	Internal Loan
Province 1	42.2	0.0	40.9	5.0
Province 2	38.7	1.3	33.6	1.0
Bagmati	47.6	0.0	51.4	0.0
Gandaki	32.1	2.0	34.8	2.0
Lumbini	36.4	0.0	36.4	0.0
Karnali	34.4	0.8	33.7	0.0

	2019/20		2020/21	
	Total Budget	Internal Loan	Total Budget	Internal Loan
Sudurpaschim	28.2	0.0	33.4	0.0
Total	**259.6**	**4.0**	**264.2**	**8.0**
Provincial Average (%)	**100.0**	**1.6**	**100.0**	**3.0**

Source: Compiled from provincial budget speeches and red books for FY 2019/20, 2020/21

So far, provinces have only utilised a nominal amount of borrowing as a source for their budgets. The share of borrowing as a source of financing in the provinces remains low, 1.55 per cent in 2019/20 and 3.03 per cent in 2020/21 (Table 14).

Although provinces can raise internal loans, a legal framework for it is yet to be established. Provinces are drafting laws and procedures regarding internal loans and devising tools to service debts. Once the mechanism gets institutionalised, then it will be possible for provinces to raise more from internal borrowing.

3.1.6. Fiscal Transfers from the Province to Local Governments

In accordance with the IGFA Act and provincial laws, provinces can provide fiscal equalisation grants, conditional grants, complementary grants, and special grants to local levels. The IGFA Act stipulates that provinces shall distribute fiscal equalisation grants to local levels from what they have received from federal grants as well as from their own sources. They are expected to do so taking into account the expenditure needs and revenue capacity of local levels. Provinces are expected to provide such transfers upon the recommendation of the NNRFC in accordance with provincial laws. Local levels can use fiscal equalisation grants received from the provincial government and the federal government in any project or programme as they deem necessary. For 2020/21, the NNRFC has recommended a weightage based on the criteria of human development (10%), socioeconomic disparity (5%), status of infrastructure (10%), revenue capacity (5%), and need for expenditure (70%) of local levels in determining the fiscal equalisation grants given by provinces to local levels (NNRFC, 2020a).

The IGFA Act states that provinces may provide conditional grants to local levels according to the basis prescribed by the NNRFC in accordance with the provincial laws. The NNRFC has recommended that conditional grants from the province to local levels should be clear, measurable, and implementable, and that local levels must utilise the grants only for the purpose for which they have been provided (NNRFC, 2020c). Provinces and local levels are expected to include conditional grants in their respective budgets and programmes.

In accordance with the IGFA Act, provinces may provide complementary grants to local levels in accordance with provincial laws on the basis of the ratio to total cost of any project. Provinces may provide special grants to local levels in accordance with provincial laws and the procedures and other provisions prescribed by the GoN.

Table 15: Fiscal Transfers from Provinces to Local Governments, 2020/21 (NPR Billion)

Types of Grant	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudur-paschim	Total
Fiscal Equalisation Grant	1.0	1.0	1.3	1.1	0.6	0.8	0.6	6.3
Conditional Grant	0.8	1.1	3.1	0.3	2.0	0.8	0.1	8.1
Special Grant	0.0	0.8	0.3	0.2	1.0	0.4	0.5	3.2
Complementary Grant	1.4	0.3	2.6	0.6	1.5	1.1	1.0	8.5
Total Grant	**3.2**	**3.3**	**7.2**	**2.2**	**5.1**	**3.0**	**2.2**	**26.2**
Provincial Budget	40.9	33.6	51.4	34.3	36.4	33.7	33.9	264.2
% of fiscal equalisation grant to the provincial budget	2.4	3.0	2.4	3.1	1.7	2.4	1.9	2.4
% of all transfers in province budget	7.7	9.7	14.1	6.3	14.1	8.9	6.6	9.9

Source: Compiled from provincial budget speeches for FY 2020/21

Provinces started providing fiscal transfers to local levels from 2018/19. In 2020/21, provinces provisioned fiscal transfers including fiscal equalisation grants, conditional, grants, complementary grants, and special grants, averaging nearly 10 per cent of their budgets to local levels (Table 15). They have provided 2.4 per cent of their budgets to local levels as fiscal equalisation grants. Among the provinces, Bagmati and Lumbini provided the highest share of their budgets (14.1% each) to local levels as fiscal transfers. Sudurpaschim shared the lowest share of its budget (6.6%) with local levels as fiscal transfers.

3.2. Key Accomplishments

Expenditure assignment is provided by the Constitution. The functional responsibilities assigned to provinces under the Constitution has been further elaborated by federal laws and the unbundling of functions approved by the federal government. These functions have been incorporated in the business allocation rules of the provinces.

Provincial revenue powers are codified in the Constitution. Apart from the revenue powers assigned to them in the constitutional annexes, provinces have the power to determine their tax base and rates within subjects under their jurisdiction.

A system of fiscal transfers is in place. Fiscal transfers are recognised as the constitutional rights of the sub-federal units. The provincial and local levels have started to receive fiscal equalisation, conditional, matching, and special grants from the federal government. The NNRFC has been recommending the criteria and bases for determining the fiscal transfer system. Provinces have also started providing fiscal transfers as fiscal equalisation, conditional, complementary, and special grants to local levels in accordance with the law.

The principle of equity is applied in fiscal transfers. Karnali, which lags behind in indicators of socioeconomic development, receives the largest share of fiscal equalisation grants. Sudurpaschim, also on the lower side of socioeconomic indicators, has also received a higher share of fiscal equalisation grants than other provinces.

Provincial revenue has been increasing. In recent years, provinces have expanded their tax horizon by exercising their functions in areas such as radio and FM operation, business registration, drinking water charges, etc. This reflects the intent of the provinces to widen their scope of revenue.

A mechanism for revenue-sharing and the sharing of royalties from natural resources has been established. Provincial and local levels have each been receiving 15 per cent of the revenue collected from VAT and excise duty, and 25 per cent of the royalty collected from the use of natural resources including from water, forest, electricity, mining, and mountaineering. The NNRFC has been recommending the criteria for revenue-sharing and the sharing of royalties received from natural resources.

Limits for internal debt have been introduced. The NNRFC has been recommending provincial and local levels to limit internal debt to a certain percentage of the amount they have received as revenue-transfers and own-source revenue. For 2020/21, the NNRFC has recommended provinces to not let their internal debt exceed 12 per cent of their total own-source revenue and the amount received from the federal government as revenue-sharing (NNRFC, 2020b).

3.3. Main Challenges

There are overlaps in expenditure assignment. There is considerable duplication in functional responsibilities among the three levels of government in the Constitution itself, including in the exclusive and concurrent powers of the three levels (Acharya et al., 2020). The report of the Auditor General highlights the overlap in functional jurisdictions among the levels of government. Although the responsibilities listed in the schedules of the Constitution have been elaborated through an unbundling exercise approved by the federal government and in federal and provincial laws, there remain overlaps in the assignment of functional powers of the three levels, including in education, health, roads, irrigation, agriculture, etc.

The revenue powers of the provinces are inadequate compared to the assignment of functional responsibilities. The Constitution itself has not granted much revenue powers to the provinces, making them dependent on federal grants and transfers, which currently account for more than two-thirds of their total expenditure. Provinces do not have much revenue powers, except those that they have to share with local levels. They are heavily reliant on limited sources such as motor vehicle tax and building and land registration fees. The share of their own source revenue is very low. Provinces have not explored other sources of revenue including those from entertainment and advertisement taxes, income from the sale of services and goods, tourism fees, agricultural income, etc.

There is an absence of clarity in the revenue powers of provincial and local levels on natural resources including in the royalties, fees, service charges, etc. collected from them. The collection of taxes from natural resource such as stone, gravel, slate, sand, limestone, and riverine materials fall under the concurrent powers of the provincial and local levels. In the absence of clear delineation of taxing powers on these resources, provinces have not been able to utilise their jurisdiction in revenue from these sources. Other areas of provincial revenue such as FM radio operation fees, advertisement tax, television operation, etc. have to be brought into the scene as well.

Several local governments have been unable to provide the revenue they have collected for the provincial government on time. A few provinces have experienced this situation and have issued notices to local levels to deposit the provincial revenue they have collected from natural resources, including from the riverine resources, and have threatened to withhold other grants to local levels, if they failed to do so.

There is a problem in the definition of agricultural income tax, the only revenue power of provinces that is not shared with local levels. The Income Tax Act, 2001 has exempted basic income tax in agricultural production except agrobusinesses. Although almost all provinces have made provisions to levy taxes on agricultural income and fixed the rate of its collection, it remains to be implemented, as they are in conflict with the federal act in this regard. Agricultural sales tax, the sole revenue jurisdiction of provinces, is not to be seen in their financial statements.

The revenue collection system of provinces remains weak. Provinces do not have functional institutions such as a tax collecting unit of their own. Their system for collection, management, and mobilisation of revenue is yet to evolve effectively. As a result, information on the daily status of provincial revenue collection and mobilisation is hard to obtain on a monthly and quarterly basis.

There is a practice of inappropriate accounting of fiscal transfers. In the federal and provincial budgets, fiscal transfers are categorised as recurrent expenditure. Due to this, the amount of current expenditures appears larger than what is believed to be the share of the government's expenditure in unproductive sectors.

Provinces get a nominal share of complementary (matching) and special grants. Provinces have been complaining that they have not been given a fair share in fiscal transfers, mainly in the form of complementary and special grants, which have remained minimal so far. In principle, complementary grants should be demand-based and special grants can be supply-driven, something ignored in designing the transfers.

The system of fiscal transfers has not addressed the issue of equity among provinces with a larger population and lower indicators of socioeconomic development. Constitutionally, fiscal equalisation grants are required to be distributed on the basis of expenditure needs and revenue capacity. The formulae-based system for equitable fiscal equalisation grants is yet to address demographic characteristics including the population size of the provinces. Despite having a large population, low revenue, and weak social and humanitarian infrastructure, Province 2 has not received a commensurate share of the fiscal equalisation grants, which is something assembly members of the province have been asking.

There are no loan-related laws. The IGFA Act provides that provincial and local levels can take loans from the GoN within a prescribed limit. Based on this provision, a few provinces have included borrowing from the federal government in their budgets. Provinces have not been able to mobilise internal loans due to a lack of loan-related federal laws.

3.4. Policy Recommendations

Clarify overlaps in functional assignment: Overlaps in the existing assignment of functions among the three levels of government that create duplication in expenditure assignment need to be corrected through federal laws.

Revisit the revenue powers of the Provinces: As finance should follow functions in a federal system, the revenue powers of the provinces need to be revisited, including in the drafting of laws related to their concurrent powers.

Introduce a system of separate accounting for fiscal transfers in the federal and provincial budgets instead of the practice of showing them under recurrent expenditure: Fiscal transfers should be accounted separately as such instead of clubbing it together with recurrent expenditure. This will help reflect the real expenditure levels.

Amend laws related to the utilisation of revenue from local natural resources: Amendments in the LGOA and the IGFA Act should be made to clarify rights over the use of local natural resources including stone, gravel, sand, and riverine materials between provincial and local levels. The NNRFC has recommended the legislation of an integrated law and amendment of existing laws in this regard.

Introduce laws related to internal loans: Laws for mobilising internal loans should be enacted so that sub-federal governments can exercise their constitutional rights to increase their fiscal space through internal borrowing.

Widen the revenue horizons of provinces: While the Constitution provides limited revenue powers, provinces need to expand their sources of revenue to reduce dependency upon fiscal transfers. Provinces need to improve revenue administration and expand their revenue horizon from underutilised sources like advertisement tax, entertainment tax, tourism fee, etc. Provinces should be allowed to exercise their constitutional powers on revenue in coordination with local levels.

Rationalise grants: The federal government should adhere to the fundamental principle of grant distribution which dictates that unconditional grants (fiscal equalisation) should be increased overtime, while conditional grants should gradually decrease. There is also a need to use special grants strategically to foster the equitable development of provinces and areas with lower socioeconomic status. Karnali and Sudurpaschim should be supported through more special grants to offset their weak indicators on socioeconomic development.

Provinces should refrain from the practice of withholding or threatening to withhold grants to local levels: Though this is not a systemic issue, it was reported in a few provinces that they have threatened to withhold grants to local levels that have not transferred the revenue they have collected on behalf of the province. This is not a good practice for fiscal independence and for the implementation of the constitutional principle of cooperation, coordination, and coexistence among the three levels of government, and should be discouraged.

4 PROVINCIAL PLANNING AND BUDGETING

This chapter contains an overview of the planning and budgeting process and practices in provinces, including periodic plans, medium-term expenditure frameworks, budgeting systems, and project implementation mechanisms. This is followed by a comparative analysis of provincial plans and their budgets over the past three fiscal years. It also summarises key accomplishments, the main challenges, and policy recommendations in provincial planning and budgeting systems.

4.1. Planning and Budgeting Overview

Development planning in Nepal began in 1956 when the National Planning Commission was established and the first five-year plan was introduced. Nepal has since implemented nine five-year plans and five three-year plans. The fifteenth National Development Plan is under implementation.

Under the federal system, all three levels of governments – federal, provincial, and local – have the authority to make and implement their own periodic plans. Article 59 (1) of the Constitution states, "The Federation, Province and Local levels shall make laws, make annual budget, decisions, formulate and implement policies and plans on any matters related to financial powers within their respective jurisdictions." The IGFA Act stipulates that the federal, provincial, and local levels shall prepare an estimated statement of public expenditures on subjects under their domain each fiscal year, including those for recurrent and capital expenditures and fiscal arrangements. While preparing the statement of public expenditure, the IGFA Act also requires that each level prepare a Mid-term Expenditure Framework (MTEF) projecting expenditure for the next three years. Provinces have been adhering to the IGFA in formulating their plans and budgets. The IGFA Act asks the federal, provincial, and local governments to develop revenue proposals from tax and non-tax revenue sources for the next fiscal year and submit a proposal for expenditures and revenues in their annual budgets.

All the provinces have established their provincial planning institutions. Province 1, Lumbini, and Karnali have established their planning institutions as the Province Planning Commission (PPC), while Province 2, Bagmati, Gandaki, and Sudurpaschim have established it as the Province Policy and Planning Commission (PPPC).

The planning and budgeting process provides an opportunity for various levels of the government to identify their goals and strategies as well as to estimate resources and the benefits of planned activities. So far, all the provinces, except Sudurpaschim, have introduced their five-year development plans. Sudurpaschim is currently in the process of drafting an approach paper. Provinces have introduced and implemented three budgets and are in the process of implementing their fourth budgets.

4.1.1. Planning Process

The provinces are observing planning steps and processes before adopting their provincial development plans. Typically, they publish an overview of the provincial economic situation, including the socioeconomic indicators, state of physical infrastructure, sectoral statistics, potentials, challenges, and opportunities for the development of their respective province. Then, they collect suggestions from different sectors including political representatives, the private sector, and other stakeholders. They then prepare an approach paper for their provincial plan which is shared with the NPC for consultation. After necessary reviews, the approach papers are approved by the provincial Council of Ministers. Based on this, sectoral ministries develop their detailed plans and sectoral policies. Then, the Provincial Planning Commission (PPCs) develops a final draft of the provincial plan including the objectives, strategies, sectoral policies, plan outlay, and implementation strategies. This draft is floated for discussion with all stakeholders. The PPCs then submit the draft to the Province

Development Council. After necessary review and refinement, the plan is sent to the provincial Council of Ministers for final approval. Almost all the provinces have adhered to this process while developing their provincial development plans.

4.1.2. Medium-Term Expenditure Framework (MTEF)

To strengthen linkages and coherence between longer-term plans and annual budgets, the concept of the MTEF has been introduced in Nepal since the Thirteenth Plan. As a three-year rolling plan, the MTEF helps maintain integration between periodic plans and annual budgets.

The IGFA Act requires that all three levels of government to prepare an MTEF every year including a projection for a three-year plan along with their annual budget. The MTEF is supposed to contain objectives, justification, and outcomes of the three-year plan including the projection of expenditure and their projected sources. It enables provinces to create a rollover budget based on the progress of actual expenditures. It includes projections of revenues and expenditures for the next three fiscal years. The MTEF helps maintain fiscal discipline by allocating expenditures in priority areas and adds accountability and stability to the planning process.

The FPFR Act stipulates that the NPC should develop the framework of the MTEF and the respective ministries should develop their sectoral MTEFs. The institutional setup for the preparation of a provincial MTEF comprises of a Steering Committee led by the minister for economic affairs and planning, a resource committee, and MTEF working committees.

All provinces have started developing MTEFs aligned with their periodic plans. The provincial MTEFs are employing logic based on their plans and fiscal strategy to project expenditure growth. The MTEFs provide the basis for the prioritisation of programmes.

The available MTEF of five provinces for the last three fiscal years shows that it is based on an incremental approach (Table 16). All provinces that have prepared the MTEF have used 2018/19 as the base year, except Bagmati which used 2017/18 as the base year. There is a wide projection gap, indicating that provincial MTEF projections are not aligned with actual performance. This demands for more realistic expenditure analysis. There is a lot of room for improvement in the provincial MTEF system.

Table 16: MTEF Projection of the Provinces (NPR Billion)

Province	Base Year 2018/19	2019/20	2020/21	2021/22	% change 1st Year	% change 2nd Year	% change 3rd Year
Province 1	35.9	43.0	50.4	59.7	19.6	17.2	18.6
Province 2	38.5	33.1	39.5	47.0	-14.1	19.3	19.0
Bagmati	27.8	30.5	34.7	41.6	9.6	13.8	20.0
Gandaki	24.0	32.1	38.5	46.2	33.8	20.0	20.0
Lumbini	23.1	36.4	41.1	43.9	57.7	12.7	7.0

Source: Compiled from the MTEF of respective provinces

4.2. The Budgeting Process

Provinces have the authority to formulate and implement their own budgets and programmes. Each province's minister for economic affairs and planning is required to present the provincial budget to their respective provincial assembly. Among other things, the budget should include revenue estimates, expenditures to be borne by the Provincial Consolidated Fund, and expenditures to be made in the upcoming fiscal year.

With some minor variations, the process and elements of the provincial budgets are similar across all seven provinces. Provinces are observing the planning and budgeting process stipulated in federal and provincial laws, including important milestones therein. Most provinces are also adhering to provincial budgeting calendars (Annex-4), though a few provinces are often found to be missing key deadlines. The budget-related process of the provinces takes place in a cyclical fashion similar to the budget cycle of the federal government. This involves a number of steps and processes including:

a) Projection of Revenue and Expenditure

According to the IGFA Act, provincial governments are required to submit financial statistics, including projections of revenue and expenditure for the upcoming fiscal year to the MoF by the end of Poush (mid-January). The MoF then makes the projected details of revenue distribution and fiscal equalisation grants available to the provinces by the end of Falgun (mid-March).

b) MTEF, Resource Estimation

The Finance Procedure Acts of the provinces requires the MTEF to be prepared before formulating the budget for the upcoming fiscal year. In contrary to the IGFA Act, provinces are required to forecast revenues and expenditure for the upcoming fiscal year by the end of Magh (Feb 15).

c) Budget Ceilings and Guidelines

The MoEAP provides guidelines and frameworks to prepare the MTEF and budget for provincial ministries. These constitute the basis for preparing the budget, prioritisation, expenditure, and the MTEFs. The budgeting guidelines together with the budget ceilings are sent to the respective ministries and agencies by the second week of Falgun (mid-March). The MoEAP must enter ministry-wise budget ceilings in the provincial line ministry budget information system (P-LMBIS) before sending them to the concerned ministries and agencies. The ministries should then enter their programmes into the P-LMBIS for themselves as well as for offices under them and stay within the budget ceilings and guidelines before sending it back to the MoEAP by Baisakh 5 (third week of April).

d) Pre-Budget Discussion

When proposing the budget, the respective ministries and agencies should submit physical and financial progress on the previous fiscal year and that of the first six months of the current fiscal year. The budget submitted by the ministries and agencies are discussed at the MoEAP and PPC. A few weeks prior to submitting the budget, the MoEAP is supposed to present the principles, objectives, priorities, and key policies of the budget to the Provincial Assembly for pre-budget discussion.

e) Budget Presentation

The IGFA Act prescribes the federal government to present its budget to the parliament on Jestha 15 (end of May) every year. Similarly, provincial governments are required to present their budgets to the respective provincial assemblies by Ashad 1 (Mid-June). The Finance Procedure Acts of the provinces stipulate that in addition to expenditures incurred on the Provincial Consolidated Fund and those authorised by the Province Appropriation Act, budget statements must also include details of the previous fiscal year's actual revenue and expenditure, the MTEF projection, and statement on grants, public debt and investments.

f) Budget Release

Provincial government agencies can spend the amounts mentioned in the annex of the Appropriation Act on the basis of their annual programmes after the Appropriation Act is adopted. The Finance Procedure Acts of all the provinces stipulate that the authorised agency has to provide authorisation of the amount approved by the Appropriation Act, within seven days. The budget is authorised in the P-LMBIS itself for spending from the respective line agencies.

g) Accounting of Transactions

Every spending agency is responsible for maintaining its own account. In accordance with the FPFR Act, provinces are supposed to keep their accounts in the prescribed formats with the approval of the FCGO. The PTCOs are required to maintain the Provincial Consolidated Funds, the integrated account of foreign grants received through the GoN, and amounts received from loan assistance, investments, and other transactions. The amount allocated to the concerned office is to be paid through the Treasury Single Account (TSA) system according to the procedure prescribed by the PTCOs. It is the responsibility of the PTCOs to prepare integrated financial statements for all the transactions of provincial governments and submit it to the MoEAP, the FCGO, and the OAG.

h) Financial Reporting

The IGFA Act requires all three levels of government to conduct annual reviews of their budget implementation and make the report public by the end of Kartik (November 15). The MoEAP must publish a semi-annual and annual evaluation report on the implementation of all aspects of the budget within two months after the end of the fiscal year.

i) Internal Auditing

The FPFR Act stipulates that provincial and local level offices are required to conduct an internal audit of their accounts on the basis of regularity, economy, efficiency, and effectiveness of the transactions. It mentions that it is the responsibility of provincial and local levels to implement the internal audit recommendations. Sub-federal governments are expected to constitute internal audit committees to ensure that internal audits are conducted regularly.

PTCOs are supposed to perform internal audits of all provincial level offices in accordance with the Provincial Finance Procedure Acts. They should submit reports of internal audits to the OAG for a final audit. Provincial governments are also required to make such reports public. Each provincial government office is supposed to introduce its own internal control system in accordance with the Provincial Finance Procedure Act.

j) Final Auditing

The Constitution mandates the Auditor General to conduct external audits of all levels of governments. Every provincial office or agency is required to submit all accounting and financial statements covering income, expenditure, and other transactions for the final audit to the OAG.

4.3. Linkage between Federal and Provincial Plans

Nepal's long-term vision, mission, and strategies for socioeconomic development are embedded in its national development plan. The fifteenth national development plan has adopted the development motto of "Prosperous Nepal; Happy Nepali". Milestones of the national plan's long-term vision for Nepal are to graduate from the group of least developed countries by 2022, become a middle-income country by 2030, and a high-income country by 2043 (2100 B.S.). All the periodic, sectoral, and spatial plans of all three levels of government are guided by this vision. In addition to this, the national development plan is based on the perspective of sectoral plans and the implementation of the Sustainable Development Goals (SDGs).

In their provincial development plans, provincial governments have embraced socio-economic development as their primary objective in alignment with the fifteenth national development plan. Provincial plans have tried to align their priorities, strategies, and targets with the national periodic plan while taking into account their own needs and potentials. Strategies for increasing production, employment, and sustainable development in the provinces go hand in hand with federal planning strategies.

Provincial plans show considerable linkages with the longer-term vision of the GoN. The long-term goals of Province 1, Bagmati, and Karnali are in line with federal long-term frameworks, but those of the other provinces do not have as much in common. The objectives of all the provincial plans are aligned with the national development plan, except for Province 2 which has not stated its objectives in its plan. Aligning with the national development plan, all seven provinces have increased expectations of private sector investment. Estimates of investments from the cooperative sector in the provinces range from 3.4 per cent to 5.8 per cent. Province 1, Gandaki, and Lumbini have also factored in potential investments from the community sector in their plans, something lacking in the plans of other provinces and that of the federal government. The comparison of the federal and provincial periodic plans including linkages and coherence is presented in Annex-5.

Table 17: Economic Targets and Sectoral Contribution in Provincial Plans

Particulars	Nepal	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali
Average Rate of Economic Growth (%)*	9.6	9.7	9	10.6	11.4	9.5	14.9
Projected Investment (NPR Trillion)	9.23	1.44	1.15	3.77	1.01	1.21	0.52
Sectoral Contribution to Total Investment							
Public	39	38.7	38	32.3	35.6	33	53.7
Private	55.6	53.8	58	61.9	58.1	62.1	42.6
Cooperative	5.4	5.5	4	5.8	4.4	3.4	3.7
Community	-	2	-	-	1.9	1.5	-

Source: Compiled from NPC (2020) and provincial periodic plans

Bagmati, Gandaki, and Karnali have clearly mentioned the drivers of transformation, including infrastructure and tourism, in their respective provincial plans. Other provinces have not identified such drivers. The target rates of economic growth of the provinces range from 9 to 15 per cent, which are fairly ambitious as is that of the national development plan with a target of 9.6 per cent.

Provinces have adopted 2018/19 as the base year and 2023/24 as the final year, in coherence with the duration of the fifteenth national development plan. The sector classification and main pillars of provincial plans replicate those adopted by the NPC for the national development plan.

4.4. Analysis of Provincial Budgets

Provincial governments have executed three full budgets and are currently implementing their fourth budget. This analysis of provincial budgets is focused on the budget's objectives and priorities, sources of the budget, resource outlay, expenditures, and programmes.

4.4.1. Budget Objectives and Priorities

The provincial budgets of 2019/20 had three to seven objectives, including rapid economic growth, improvement in the living standards of citizens, employment promotion, poverty alleviation, and the implementation of the fundamental rights of citizens. They had between four to eight priorities including infrastructure development; expansion of social security; investment in the agriculture, tourism, industry, and energy sectors; protection of marginalised and vulnerable communities; and human resource development.

In 2020/21, the objectives of all provincial budgets are focused on the handling of the coronavirus pandemic and improving health services and protection from infectious diseases. They prioritise immediate relief to people affected by the pandemic, expansion of health care services, development of health-related infrastructure and health-related human resources, and the development of social sectors.

The objectives and priorities of provincial budgets mostly align with federal priorities, which include rapid economic development, eradication of extreme poverty, uplifting backward areas and communities, expansion of social security, improvements in the living standard of citizens, upholding the fundamental rights of citizens, social justice, and building the foundations for a prosperous socialism-oriented economy. A comparison between the objectives and priorities of the federal and provincial budgets is provided in Annex-6.

4.4.2. Resource Outlay

In 2017/18, the federal government transferred NPR 1.02 billion as a fiscal equalisation grant to each province, resulting in a total provincial budget of NPR 7.14 billion. The provinces adopted their first budget with this grant as their sole resource. In 2018/19, provinces adopted their first full budget totalling to NPR 206.4 billion. In 2019/20, the size of the total provincial budget increased to NPR 258.6 billion.

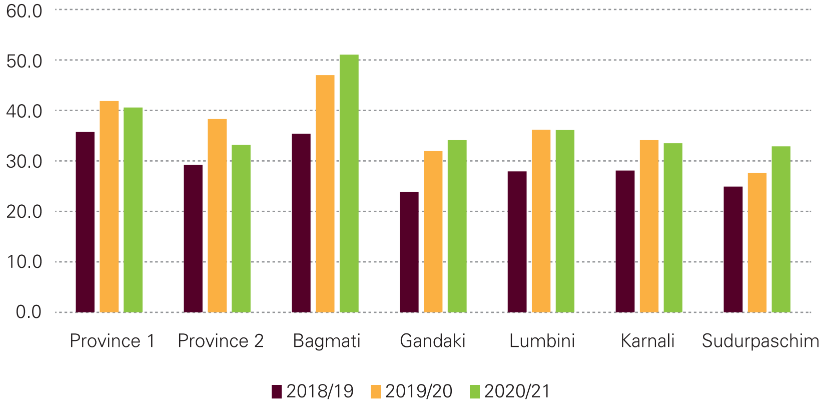
Table 18: Provincial Budgets (NPR Billion)

Province	Budget (NPR Billion)				% Change	
	2017/18	2018/19	2019/20	2020/21	2019/20	2020/21
Province 1	1.02	35.9	42.1	40.9	17.2	-2.9
Province 2	1.02	29.4	38.5	33.6	31.1	-12.9
Bagmati	1.02	35.6	47.3	51.4	32.8	8.7
Gandaki	1.02	24.0	32.1	34.3	33.8	6.8
Lumbini	1.02	28.1	36.4	36.4	29.7	-0.2
Karnali	1.02	28.3	34.4	33.7	21.5	-1.8
Sudurpaschim	1.02	25.1	27.8	33.9	10.7	22.0
Total	**7.14**	**206.4**	**258.6**	**264.2**	**25.3**	**2.2**

Source: Compiled from provincial budget speeches for FY 2018/19, 2019/20, 2020/21

In 2020/21, the total provincial budget marginally increased to NPR 264.2 billion as compared the previous fiscal year. Bagmati has the largest budget (NPR 51.4 billion), while Sudurpaschim has the smallest (NPR 33.9 billion). The impact of the coronavirus pandemic is visible in terms of the provincial budget size, the rate of growth dropped from 25.3 per cent in 2019/20 to 2.2 per cent in 2020/21 (Table 18). Only three provinces – Bagmati, Gandaki, and Sudurpaschim – saw an increase in the size of their budget. The other provinces saw a negative growth rate on their budgets compared to the previous fiscal year. Except for a few provinces, there was steady growth in budget sizes over the last three fiscal years (Figure 9).

Figure 9: Provincial Budgets (NPR Billion)



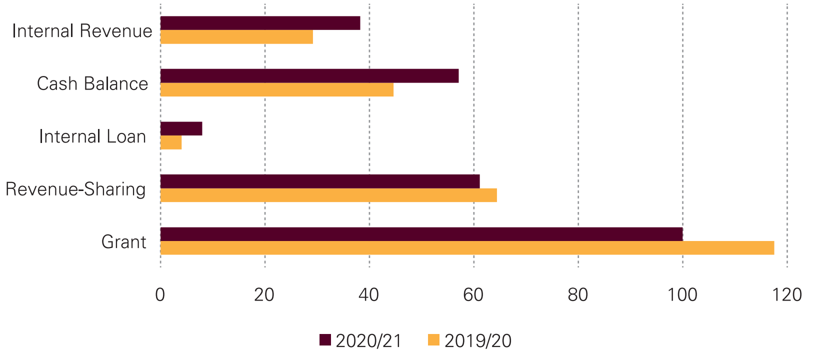
Source: Data from Table 18

4.4.3. Source Analysis

Provinces are in the early stages of managing their own resources and are largely reliant on federal grants and revenue-sharing. In 2019/20, grants comprised nearly half (45.2%) the sources of provincial budgets, while revenue sharing comprised nearly a quarter (24.8%). In 2020/21, the share of grants decreased to 37.8 per cent and the share of revenue-sharing also decreased marginally to 23.1 per cent. The share of own-source revenue in provincial budgets increased marginally from 11.2 per cent in 20219/20 to a projected 14.4 per cent in 2020/21 (Annex-7).

The share of internal revenue, cash balance, and internal loans in provincial budgets showed some increase, while that of grant and revenue-sharing showed some decline between 2019/20 and 2020/21 (Figure 10).

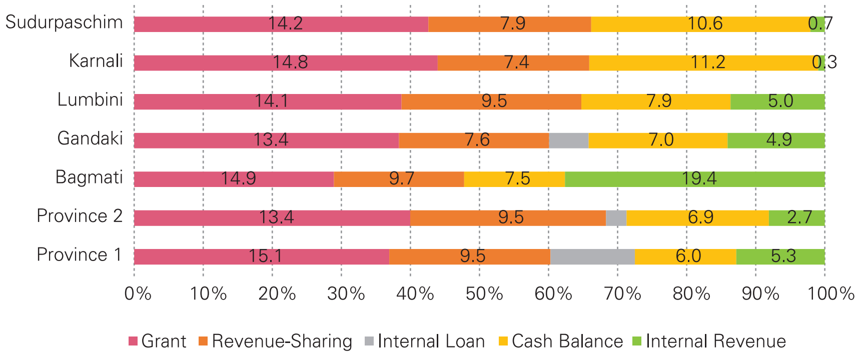
Figure 10: Sources of the Total Provincial Budgets (NPR Billion)



Source: Data from Annex-7

Province wise comparisons shows that a higher share of grants and revenue-sharing are of the budget source in Karnali, Sudurpaschim, Province 2, and Lumbini. The share of own-source revenue is higher in Bagmati, Province 1, Lumbini, and Gandaki. The cash balance contributed a higher share to the source of budgets in Sudurpaschim and Karnali (Figure 11). Expected revenue mobilisation is in a weak position with four provinces having revenues contribute to less than 10 per cent of the total budget. While Bagmati boasts a 26 per cent share, the situation is rather grim in Karnali (0.8%) and Sudurpaschim (2.98%). The share of internal loans in provincial budgets is negligible as only a few provinces have utilised this avenue as a source for their budgets.

Figure 11: Sources of the Provincial Budgets, 2020/21 (NPR Billion)



Source: Data from Annex-7

No province has shown foreign grant or loan as a source in their budget, even though they are executing several foreign-aided projects with the approval of the GoN. This owes to the practice of showing external grants and loan sources in the federal budget, because of the constitutional provisions for accounting for foreign aid.

4.4.4. Expenditure Analysis

In the first provincial budgets (2017/18) recurrent expenditures accounted for 58.8 per cent and capital expenditures counted for 41.2 per cent of the total outlay of NPR 7.14 billion. That year, the provinces could only spend a little over a third (35.3%) of their budget.

In 2018/19, the total provincial budget was NPR 206.4 billion, of which 41.3 per cent was projected as recurrent and 58.6 per cent was allocated as capital expenditure. That year, provinces incurred expenditures amounting to 55.4 per cent of the total outlay. Bagmati had the highest share of capital expenditure (68.1%), while Sudurpaschim had the lowest (51.1%). The average capital expenditure for all provinces was 57.2 per cent in that fiscal year.

In 2019/20, the total expenditure outlay amounted to NPR 258.6 billion, of which 46.5 per cent was recurrent and 53.5 per cent was capital expenditure. That fiscal year, provinces incurred 61 per cent of their total expenditure. Gandaki had the highest share of capital expenditure (64.8%) while Karnali had the lowest (48.9%).

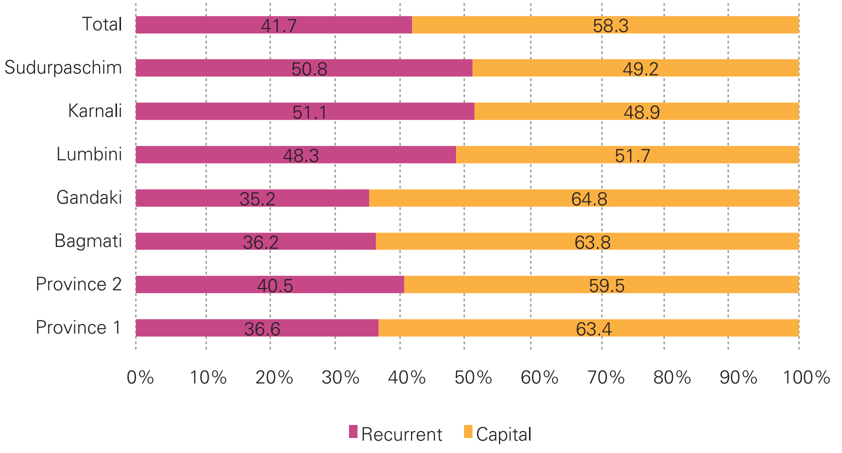
For 2020/21, of the total expenditure outlay of NPR 264.2 billion, 47 per cent is recurrent and 53 per cent is capital expenditure. Because of the coronavirus pandemic, the actual expenditure may come further down in 2020/21 as projected expenditures could not be executed due to the national lockdown.

The share of capital expenditure in the provinces remains significantly higher (52.9 %) than the share of capital expenditure in the federal budget, which stood at 24 per cent in 2020/21. On that count, provincial budgets are more balanced than the federal budget in terms of layout between capital and recurrent expenditures. Despite a fair balance between recurrent and capital expenditures, the decreasing size of capital budgets has posed concerns as the provincial budget size is increasing without a commensurate increase in actual expenditure, which has less of a significance towards the economic growth of provinces.

Though the size of capital as well as recurrent expenditure in provincial budgets is increasing, the gap between recurrent and capital expenditure is decreasing with a rise in recurrent expenditure.

A province-wise comparison of the 2019/20 provincial budgets shows that the share of capital expenditure based on revised estimates is on the higher side in Gandaki, Bagmati, Province 2, and Province 1, while it is about the same as recurrent expenditure in the others (Figure 12).

Figure 12: Share of the Recurrent and Capital Expenses in the Provincial Budgets, 2019/20 (%)



Source: Data from Annex-8

According to the consolidated financial statement of the FCGO, 61 per cent of the total capital expenditure was incurred in the last quarter of the fiscal year, and more than half of that in the last month of the fiscal year alone. This tendency of spending in the second half, even more so in the last quarter, is prevalent in provinces as well.[4] To mitigate such short-comings, provinces need to introduce monthly financial reporting that provides interactive information such as in the chief minister dashboard with details of physical and financial progress.

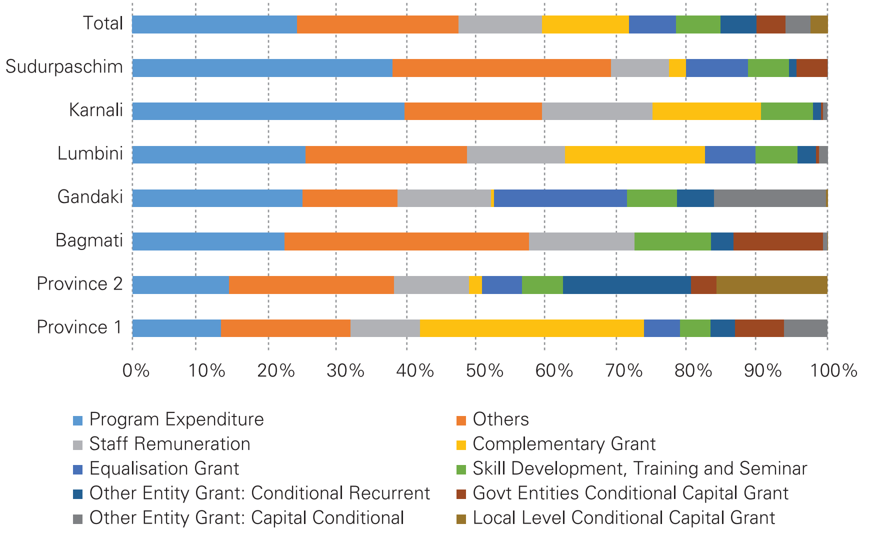
The code wise analysis of recurrent and capital expenditure shows that roads account for the largest share of capital expenditure and programme expenses account for the largest share of recurrent expenditure. In 2018/19, programme expenditures, which comprised training and soft skills, was at the top with 23.7 per cent of total recurrent expenditure. Staff remuneration was also among the main contributors to recurrent

4 The quarterly expenditure of the Provinces could not be analysed due to the lack of information as most provincial offices were closed due to lockdown and they didn't have mechanism for data sharing.

expenditure at 12 per cent. Karnali and Sudurpaschim incurred the highest share of programme expenses as a part of their recurrent expenditure among all the provinces.

An item wise breakdown of recurrent expenditures of the provinces for 2020/21 shows a higher share of programme expenditure, staff remuneration, skill development, etc. (Figure 12). There is a large allocation under the unspecified "others" expense heading. The inclusion of grants including those for local levels has inflated the recurrent expenditures of the Provinces. In fact, some of these grants may be capital grants and others may be used by local levels as programme expenditure.

Figure 13: Item wise Recurrent Expenditure of the Provinces, Projected for 2020/21 (%)



Source: Data from Annex-9

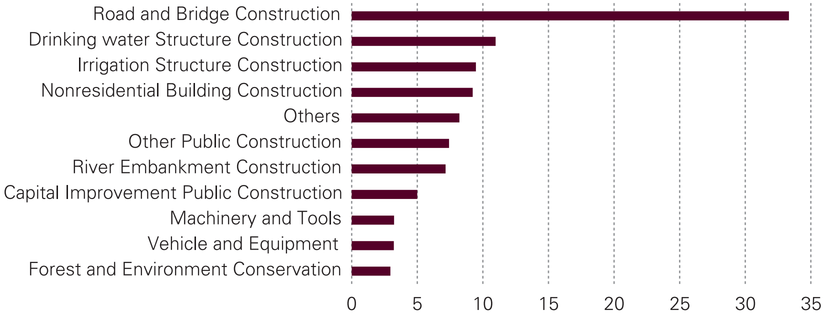
Provincial recurrent expenditure is seen to be inflated due to the accounting of fiscal grants under this heading. Fiscal transfers or grants are not actual expenditures and might eventually be left unspent by local governments.

Capital expenditure in the provinces is highly concentrated to a few items. Road construction accounts for more than one third of the total capital expenditure, followed by drinking water, irrigation, and non-residential building construction.

In 2018/19, provinces were spending a third of their capital expenditure on road and bridge constructions, followed by drinking water, irrigation, office buildings, and river embankments (Figure 13). There is substantive share of expenses listed as "others" in capital expenditure. Expenditure in office vehicles, which is a contested topic in provincial budgets, covered about 3.2 per cent of capital expenditure.[5] Karnali and Province 1 had a higher expenditure on vehicles. Province 2 has no expenditure under this item, possibly because of incorrect reporting.

In 2019/20, provinces faced resource constraints due to the impact of the COVID-19 pandemic. They promised to reduce spending on allowances, downsize operational expenditures, and some of them have even halted the opening of new offices.

Figure 14: Sector Wise Allocation of Capital Expenditures in All Provinces, 2018/19 (%)

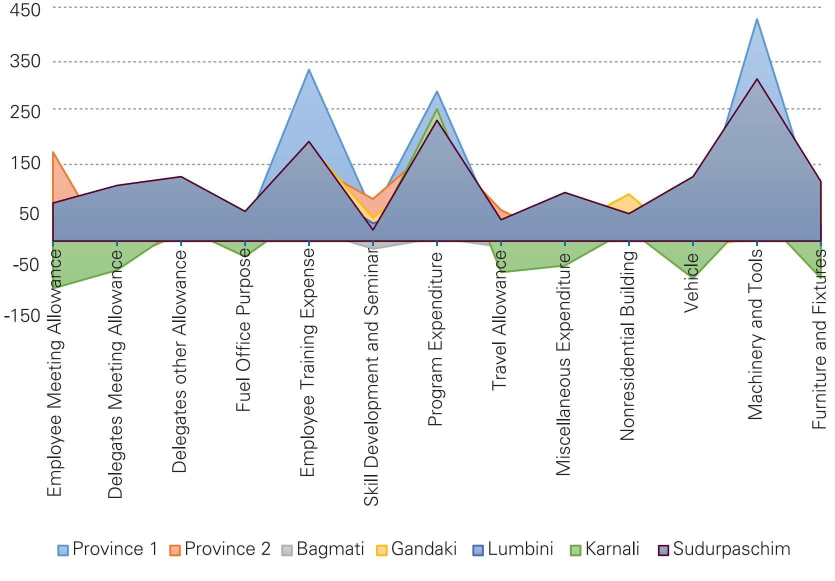


Source: Data from Annex-10

5 Even though vehicle expenditure is kept under capital expenditure, its associated operating costs increase recurrent expenditure.

An analysis of the changes in allocation in various budget heads showed that that in 2020/21, recurrent expenditure in budget headings such as programme expenditure, employee training expenses, delegate allowances, and meeting allowances has increased compared to that in 2019/20. On the capital expenditure side, the change in budget size in a few headings such as machinery and tools had increased more than threefold. As promised, Karnali has put some efforts into downsize its recurrent expenditure. It has cut meeting allowances, fuel expenses, and travel allowances (Figure 14). Province 2 had decreased allocations to meeting allowances and Bagmati had done so on travel expenses. In its budget speech, Province 1 committed not to open new institutions, but building and furniture costs are escalating, which defies the statement. Most of the provinces have reduced costs on vehicle expenditure, which is a welcome development.

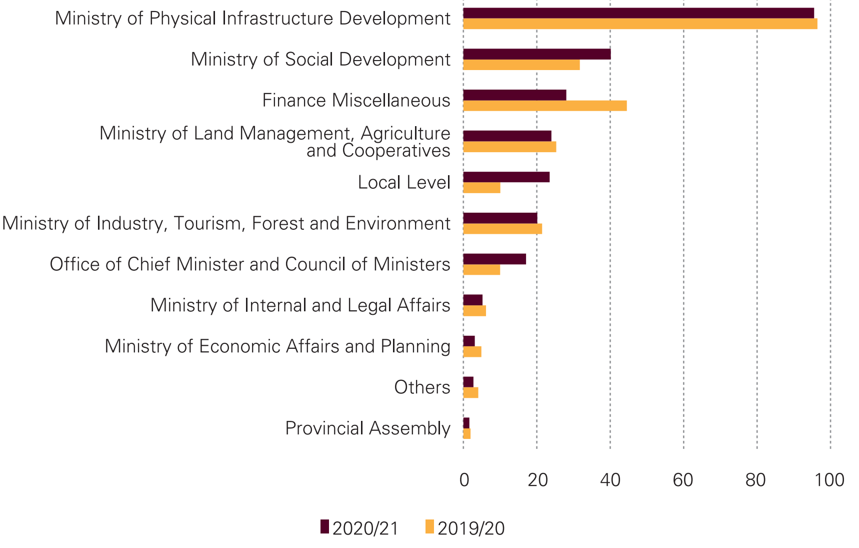
Figure 15: Change in Budget of 2020/21 Compared to the Estimate of 2019/20 (%)



Source: Data from Annex-11

The ministry wise allocation of provincial budgets shows that almost all provinces allocated the biggest share of their budget to their respective provincial Ministry of Physical Infrastructure Development (MoPID) (Figure 15). In 2019/20, more than a third (37.5%) of the total budgets of all provinces was allocated to that ministry followed by the Ministry of Economic Affairs and Planning (MoEAP) (17.3%), the Ministry of Social Development (12.4%), and Ministry of Land Management, Agriculture and Cooperatives (9.9%). In 2020/21, the same trend continues in which almost all provinces have allocated the biggest share of their budgets to their MoPIDs (36.6%) followed by allocation to the Ministry of Social Development (15.4%).

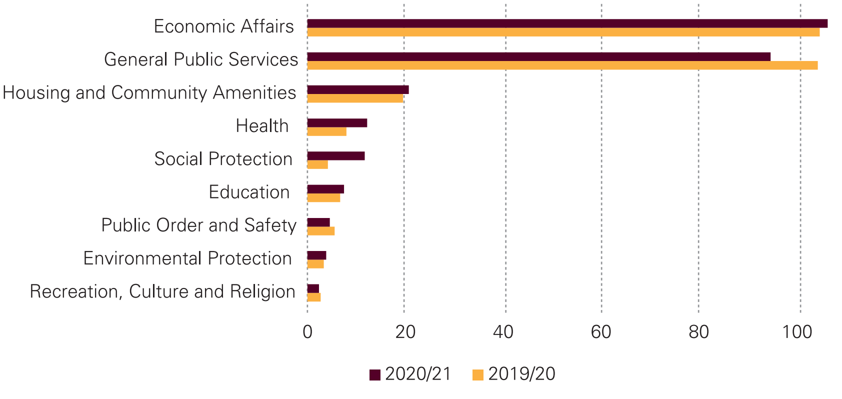
Figure 16: Ministry Wise Budget Allocation of the Provinces (NPR Billion)



Source: Data from Annex-12

Almost all provinces have large unspecified allocations under the "Finance Miscellaneous" heading. In 2019/20, a substantive portion of the budget (17.3%) of the provinces was allocated under this heading. Though the allocation on that heading has dropped, it still remains high at 10.7 per cent in 2020/21 (Annex-12). In Province 2, the share of the budget allocated under "Finance Miscellaneous" heading is 29.5%. Such allocation of a bulk of resources under the miscellaneous heading is not considered good budgeting practice as this shows budget planning inefficiency and should be discouraged.

Figure 17: Function Wise Allocation in the Provinces (NPR Billion)



Source: Data from Annex-13

In terms of functional classification,[6] the provinces are focusing on economic affairs and general public service which covers more than 80 per cent of overall expenditure (Figure 17). In 2019/20, a bigger share of the provincial budgets was allocated for economic affairs (40.4 %) and General Public Services (40.3%). Housing and community amenities comprised 7.5 per cent of the budget, while the health and education sectors comprised 3.08 per cent and 2.6 per cent respectively. Sectors such as health, education, and the social sector cover less than 10 per cent of the overall provincial budget. In 2020/21, the composition of sectors observed a slight change to address the demand of the coronavirus pandemic when the focus of the country was on the health and safety of citizens. Allocation to social protection also increased marginally. The

6 The sectors are based on the Classification of Functions of Government (COFOG) adopted by the UN system.

allocation to General Public Services decreased from 40.2 per cent in 2019/20 to 35.9 per cent in 2020/21 (Annex-13).

4.4.5. Budget Deficit

The IGFA Act empowers the federal, provincial, and local governments to submit deficit budgets to their respective assemblies detailing the sources for meeting the deficit, provided that they are not used to bear their administrative costs.

In 2017/18, all seven provinces introduced balanced budgets. In 2018/19, Gandaki and Karnali had a nominal budget deficit of NPR 1.4 million and NPR 1.0 million respectively. By the third budget for 2019/20, all seven provinces had big deficits, amounting to a total deficit of 18.5 per cent (Table 19). The provincial budget deficit has dropped in 2020/21 to 2.8 per cent. Province 1 has the highest budget deficit (12.2%), while Sudurpaschim has the lowest (0.9%). Bagmati, Lumbini, and Karnali had no budget deficits this fiscal year.

Table 19: Deficit Budget of Provinces (NPR Billion)

	Total Budget (NPR Billion)		Deficit (NPR Billion)		Deficit (%)	
	2019/20	2020/21	2019/20	2020/21	2019/20	2020/21
Province 1	42.1	40.9	6.5	5.0	15.5	12.2
Province 2	38.5	33.6	8.8	1.0	22.9	3.0
Bagmati	47.3	51.4	6.5	0.0	13.6	0.0
Gandaki	32.1	34.3	6.8	1.0	21.2	2.9
Lumbini	36.4	36.4	5.0	0.0	13.7	0.0
Karnali	34.4	33.7	9.7	0.0	28.2	0.0
Sudurpaschim	27.8	33.9	4.5	0.3	16.0	0.9
Total	**258.6**	**264.2**	**47.7**	**7.3**	**18.5**	**2.8**

Source: Compiled from provincial budget speeches and red books for FY 2019/20, 2020/21

4.4.6. Arrear Liabilities

Expenditure arrears in one fiscal year are required to be reallocated for payments in the upcoming fiscal year. This results in locking of funds for the previous year's expenditure rather than funding the new fiscal year's budget. This is one of the drawbacks of the principle of annuality,[7] which is a generic issue in the government budgeting and expenditure system. Provincial programmes reflect this practice. For example, in the annual budget for Bagmati in 2019/20, an activity of the MoPID was allocation "for payment of 2018/19 road". There are a number of carried over programmes kept under the *Kramagat Karyakram* (continuous programmes) in the province.

The payment of arrears from previous years has become politically contentious in a few provinces. For example, in Province 2 in 2018/19, there was a total of NPR 870 million payable to 842 projects for work completed by user committees. Users protested against the provincial government due to non-payment. This issue was also raised in the Provincial Assembly, forcing the meeting of the assembly to be kept on hold for over a month. A high-level parliamentary investigation suggested a legal prohibition on payments during the current fiscal year for work completed in the previous fiscal year.

There is no commitment accounting mechanism in the provinces to account for commitments raised when contracts are entered into for the delivery of goods and services. Provinces have difficulties in settling their liabilities on expenditures incurred because of an absence of such a mechanism. There are no records of contingent liabilities that provincial governments are expected to pay in the future. This needs to be accounted for to improve the financial management of the provinces.

4.4.7. Cross-Cutting Budgeting Issues

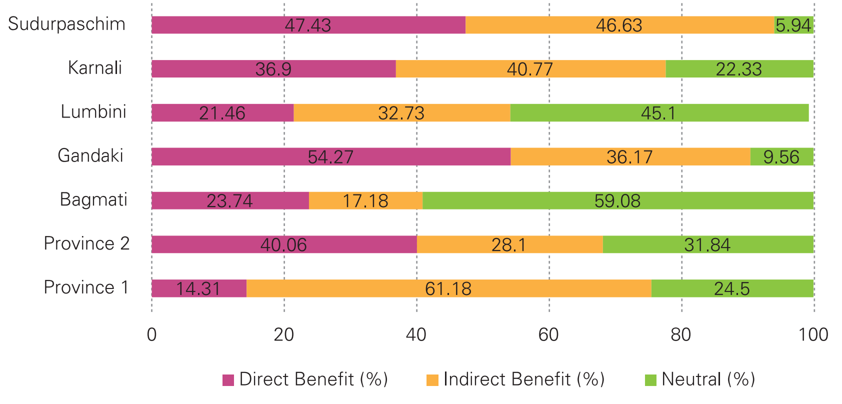
Provinces have started cross-cutting budgeting practices including gender-responsive and climate change budgeting. With the use of the P-LMBIS, these cross-cutting budgets are reflected in provincial budget documents.

7 According to the "principle of annuality", the government offices are required to spend the allocated budget within the fiscal year for which it is authorised or they will lose it.

a. Gender-Responsive Budgeting

Gender-responsive budgeting is one of the cross-cutting budgeting practices that provinces are adhering to. The gender responsive guidelines for provinces that set criteria for classifying the budget into direct and indirect gender benefits and gender-neutral categories were introduced in 2019. Provincial budgets have been gender-responsive since 2019/20.

Figure 18: Gender-Responsive Budgeting in the Provinces, 2020/21 (%)



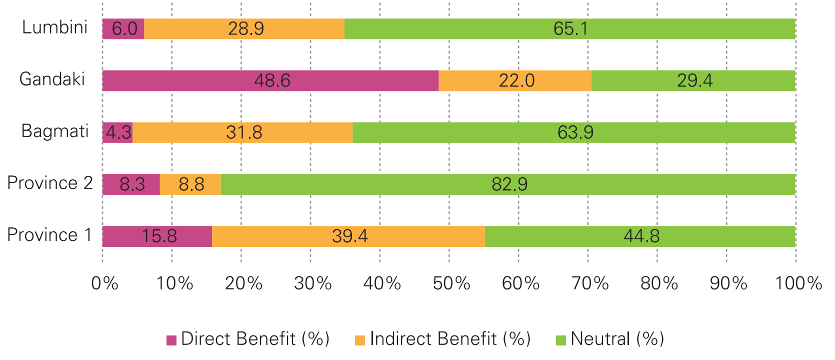
Source: Data from Annex-14

In 2020/21, nearly a third (32.7%) of provincial budgets are directly gender-responsive, slightly lower than that of the federal budget (38.1%). Gandaki, Sudurpaschim, and Province 2 have a higher share of direct gender-responsive budgets. Indirect gender benefits are higher in the budgets of Province 1, Sudurpaschim, and Gandaki, whereas the share of gender-neutral budget is higher in Bagmati, Lumbini, and Province 1 (Figure 18). Provinces are expected to take more concrete actions to determine the impact of programmes for a gender-balanced budget.

b. Climate Change Budgeting

Provinces have started climate budgeting although the accounting systems used may vary, as shown in the diversity of the shares in direct and indirect benefits to climate change. Except for a few provinces, notably Gandaki, provincial budgets are climate-neutral (Figure 19). In 2020/21, Gandaki has shown the highest direct benefits (48.5%) to climate change from its budget, while Bagmati has the least direct climate benefit (4.3%). Provinces need to improve their practices in climate budgeting, including through the application of uniform accounting systems.

Figure 19: Climate Change Budget of the Provinces, 2020/21 (%)



Source: Budget Speeches of the Provinces for 2020/21

c. Localization of the Sustainable Development Goals (SDGs)

Most provinces have mentioned that they will attach a priority to the implementation of the SDGs in line with national commitments and indicators. Most provinces localised the SDGs after their periodic plans were adopted. Bagmati has published its status and roadmap for internalising the SDGs (Bagmati PPPC, 2020). Karnali's PPC has published baseline statistics and information regarding the SDGs in the province (Karnali PPC, 2019). Gandaki's plan acknowledges the attainment of the SDGs as one of the elements guiding the strategic alignment of its provincial plans. It claims to have "internalised" the SDGs in their plan, but has not included a breakdown of targets and indicators for the SDGs in the planning document.

4.4.8. Project/Programme Implementation and Management

Provinces have started to adopt a number of tools and guidelines for the execution of their projects and programmes. These include tools like a project bank, the classification of projects, provincial pride projects, and large and innovative projects.

a. Project Banks

The FPFR Act envisages a national project bank at the NPC. Sectoral ministries are expected to submit their projects in the project bank according to the guidelines and criteria approved by the NPC.

At the provincial level, a few provinces have initiated their own project banks expecting to prioritise and streamline their development projects and to ensure pre-project preparation prior to their approval and implementation. The MoEAP of Bagmati has a dedicated unit for the project bank and has created a project bank portal. Province 1, Gandaki, Lumbini, and Karnali are in the process of creating their own project banks.

Box 2: NPC Guidelines for Project Classification

The NPC guidelines for project classification envisions that the federal government shall undertake large projects with substantial impact on the economy, while the provinces shall undertake development activities, and local governments focus on service delivery. It has defined project classification guidelines in 23 sectors. Among other things, the NPC guidelines suggests that:

- Large programmes that cover more than one province and that require huge funding including from development partners will be handled by the federal government;
- Agencies, boards, and funds that are not suitable at the federal level will be closed down;

- Multiyear contracts operated and liabilities generated by the federal government in projects under the functional jurisdiction of provincial and local governments shall be delegated to the respective local government after their capacity is developed;
- Programmes that are similar in nature are to be merged and transferred to the respective level of government;
- To avoid duplication, programmes need to be proposed in coordination with all three levels;
- National pride and strategic projects are to be carried out by the federal government;
- Work-in-progress programmes of the respective jurisdictions are to be delegated to the provincial and local levels with source assurances.

Source: NPC (2018)

b. Project Classification and Distribution Guidelines

The FPFR Act mandates the NPC to introduce a classification for projects implemented by the federal, provincial, and local governments. Provinces are expected to observe these guidelines, developed by the NPC for project classification, when preparing their budgets. The project classification guidelines propose certain types of projects to be carried out at the federal, provincial, or local levels in 23 sectors of which 21 are applicable to the provinces.

c. Provincial Pride Projects

Most provinces have identified provincial pride projects, similar to the national pride projects identified by the NPC. Ideally, these projects are supposed to be implemented with the province's own resources and based on the unique potentials and opportunities present in the province. However, only a few such projects have transformative potentials, the others are imitations of national pride projects directed to attract attention. Commitment towards their implementation remains weak, as demonstrated by low expenditure rates in the provinces.

d. Execution of Large Projects

Provinces have started to execute large projects of their own.[8] Based on the 2019/20 Annual Development Programme Book published by each province, it is possible to gauge the interest of provincial governments in executing big projects. These projects include those introduced under the delegated and conditional programmes of the federal government. Most provinces have initiated several such large programmes/projects including those in the physical infrastructure, social development, agriculture, industry, tourism, and environment sectors. For example, Bagmati has initiated the Kulekhani-Bhimphedi Tunnel project under its large projects.

In 2019/20, there were 185 programmes and projects of NPR 100 million or more in all provinces (Annex-16). Bagmati had the highest number (50) of such projects, followed by Karnali (46). Sudurpaschim had the lowest number of such projects (15). Nearly half (49.9%) of such projects were under the provincial MoPIDs, this was followed by the Ministry of Land Management, Agriculture and Cooperatives (5%), and the MoEAPs (10.3%).

Table 20: Sector-wise Allocation of Programmes/Projects above NPR 100 Million (2019/20)

Sectors	Province 1	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total
Total (NPR 100 million)	**42.6**	**86.3**	**35.2**	**41.3**	**95.5**	**25.6**	**326.5**
Share of Sectors (%)							
Road & Bridge	22.25	38.74	23.09	41.57	34.07	31.18	33.30
Agriculture	26.78	18.32	21.20	37.96	6.23	17.21	18.60
Drinking water	4.34	2.94	14.38	0.00	11.59	16.90	7.61

8 For this analysis, programmes and projects of Rs. 100 million or more are considered to be large projects.

Sectors	Province 1	Bagmati	Gandaki	Lumbini	Karnali	Sudurpas-chim	Total
Security	15.83	9.58	7.11	0.00	0.00	0.00	5.36
Land Settlement & Residence	10.80	6.72	3.50	5.08	2.67	0.00	4.99
Irrigation	2.72	5.23	0.00	0.00	10.31	0.00	4.75
Tourism	0.00	1.16	12.12	0.00	3.81	0.00	2.73
Education	0.00	3.82	0.00	3.27	0.00	16.55	2.72
Health	0.00	1.16	0.00	2.54	0.00	4.69	1.00
Other	17.28	12.33	18.60	9.58	31.32	13.46	18.95
Total %	100	100	100	100	100	100	100

Source: Compiled from the annual development programme books of provinces for FY 2019/20

In 2019/20, one third of the total allocation for big projects of more than NPR 100 million were in the road and bridge sector (33.3%), followed by agriculture (18.6%), drinking water (7.6%), and the security sectors (5.4%). The total budget allocated to such projects in all provinces amounts to NPR 32.65 billion. Provincial investment in large projects in the education and health sector are very low at 2.7 per cent and one per cent respectively. Other sectors, including energy, parks, stadiums, buildings, underground irrigation, etc. grouped as "other" received 18.95 per cent. However, the number of such programmes and projects do not necessarily show the direction of public expenditure in the provinces.

Major programmes of above NPR 100 million include programmes such as the funds allocated to provincial assembly members to launch programmes in their constituencies, road upgradation, building construction, and miscellaneous programmes. Province 1 has launched a public private partnership programme for agro-entrepreneurship. Bagmati has one for the cold storage of fruits and vegetables. Gandaki has a large project for the capacity enhancement and reconstruction of homestays. Lumbini and Karnali have road projects under this category. Sudurpaschim has the Chief Minister's Integrated Agro and Horticulture Programme. This indicates that such large provincial programmes are focused on infrastructure development and the agriculture sector. But these programmes are not linked to their respective provincial plans and policies and are mostly distributive rather than intended for transformative change. These programmes may seem to be catchy on the surface, but their actual implementation is questionable, the financial and physical progress on these projects has not been very encouraging. Provinces are yet to develop medium-sized projects and programmes that cannot be delivered by local levels or in which the federal government does not have overriding interests.

e. Innovative Provincial Programmes

Provincial governments have initiated many programmes that are original and unique to their province's potential to bring about socioeconomic transformation. Such innovative programmes are targeted in infrastructure, agriculture, education, basic health service, women empowerment, and environmental protection.

Province 1, Province 2, Lumbini, and Bagmati have programmes providing identification cards to the farmers. Lumbini, Karnali, Sudurpaschim, Province 1, and Province 2 have initiated the Chief Minister Employment Programme. Province 2 has initiated the innovative *Beti Padhau Beti Bachau* (Educate Daughters Save Daughters) programme that has earned praise. Bagmati has started a similar programme in higher education for women under the *Chori Buhari Uccha Sikchya* (Daughter Daughter-in-law Higher Education) programme and also has a One School One Nurse programme. All provinces except Karnali have initiated the Integrated City Development Programme. In other provinces, there are innovative programmes in energy, drinking water, and tourism. A list of some of these programmes brought forward by provincial governments through their annual budget is included in Annex-17.

Though many such programmes have been adopted, only a few have transformative potential in the provinces. The innovative endeavours of provincial governments are yet to bring tangible results and benefits to people. For the overall development of the province, provincial governments must identify such programmes.

f. Small Projects in the Provinces

Provinces continue to make provisions for petty programmes with small budgets. They have been carrying out many small programmes below NPR 10 million, most of which are focused on distribution. For example, Province 1 had 675 small projects of less than NPR 10 million on its budget for 2019/20. This trend has been somewhat corrected in 2020/21. Bagmati has even smaller programmes. In 2020/21, Bagmati province alone had 858 programmes below NPR one million, including many in infrastructure development. In some instances, such small programmes have been introduced to create multiyear projects by inserting indicative token amounts into the budget, with an intent that the same will be carried over in the next fiscal year. Such programmes are scattered and it is unlikely that such projects will be implemented. Such tendencies distort the participatory budget preparation process and should be discouraged. By agreed principle, provinces should not undertake projects and programmes below the ten million threshold, these should be delegated to local governments.

4.5. Public Financial Management in the Provinces

As discussed in Chapter Two, many legal, institutional, and software reform measures have been introduced with a view to strengthening public financial management (PFM) in Nepal, including at the sub-federal levels. Reforms in provincial PFM include: adhering to budget calendars, cycles, and medium-term expenditure frameworks; encouraging transparency, accountability, and timely financial reporting; strengthening internal controls; and complying with audit recommendations.

4.5.1. Treasury Management and Cash Planning

All seven provinces have established their consolidated treasury accounts as mandated by the Constitution. They receive federal grants and revenue transfers in these accounts. In the federal setup, the provincial and local governments are not required to return unspent portions of their fiscal equalisation grant, this remains in their respective consolidated funds. They can utilise this cash balance as a source of budget for the next fiscal year.

Treasury operation in the provinces is streamlined through the use of the Provincial Treasury Single Account (PTSA) system which is linked to the Treasury Single Account (TSA) of the federal government. The Government Financial Transaction Directives, 2075 (2018) issued by the FCGO directs the handling of these fund accounts maintained at the central bank. Challenges exist in integrating operational accounts with non-operational accounts. Provinces have adopted a cash basis of accounting for the treasury.

Table 21: Treasury Position of the Provincial Governments (NPR 10 Million)

	2017/18	2018/19
Province 1	36.88	854.28
Province 2	40.86	935.27
Bagmati	75.11	1,312.08
Gandaki	72.51	843.35
Lumbini	82.98	1,123.57
Karnali	78.62	1,243.50
Sudurpaschim	76.07	871.37
Total	**463.04**	**7,183.43**

Source: FCGO (2018); FCGO(2019)

As of 2018/19, Bagmati had the highest treasury balance followed by Karnali and Lumbini (Table 21). Low amounts of treasury position show that provinces have to raise more own-source revenue within the fiscal year to meet expenditure needs. On average, provinces have NPR 10 billion in treasury reserves. The accumulation of cash balances in the treasury are also due to the low expenditure capacity of the provinces. The cash balance is likely to dwindle once they are back on track with spending.

4.5.2. Internal Controls

In accordance with the federal FPFR Act, all government offices at the federal, provincial, and local level are required to develop internal control systems in an approved format. The Internal Control Guidelines, 2075 (2020) introduced by the FCGO serves as an important tool for internal control and public financial management. Among other things, the FCGO guidelines identify the elements of internal control including the framework for internal control, risk evaluation, control activities, and IT systems for controlling and monitoring the internal control systems. The FCGO guidelines make the office chiefs and managers of all public entities responsible for introducing the internal control guidelines. They provide a framework for internal control in project management, procurement, contract management, and financial administration.

The Province Finance Procedure Acts (PFPAs) require all accounting officials in all provincial government offices to introduce internal control systems to ensure activities carried out by their offices are prudent, effective, and efficient. The PFPAs stipulate the creation of an internal control committee headed by the chief of each office. The committee is expected to strengthen the internal control system by making sure activities are efficiently and economically performed, and are result-oriented while minimizing financial risk, improving financial reporting, settling irregularities presented by the audit, and complying with the COSO framework.[9] The formats for such internal controls are provided by the respective PTCOs.

The PFPAs also mandate the PTCOs or the designated offices carry out an internal audit of the provincial government offices every four months focusing on the regularity, economy, efficiency, and effectiveness of their

9 The COSO framework is adopted by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) consisting of the accounting and internal audit associations in the United States of America.

economic activities. All provinces submit their accounts to the OAG for external auditing. The OAG takes into account internal audit reports and actions taken on them by the respective government offices.

4.5.3. Audit Irregularities

As of July 2020, the OAG has conducted two external audits of the provinces. The fifty-seventh OAG Report has shown audited amounts and irregularities for the provinces for 2017/18 and 2018/19. The OAG report shows that it has audited 998 provincial offices and entities, covering a total audited amount of NPR 19, 587.8 million. In 2018/19, it has shown irregularities constituting 4.3% of the audited amount (Table 22).

Table 22: Total Audited Amounts and Irregularities

	Audited Amount (NPR Million)		Irregularities		% of Irregularities	
	2017/18	2018/19	2017/18	2018/19	2017/18	2018/19
Province 1	65.7	3466.5	2.2	167.4	3.4	4.8
Province 2	69.4	2573.1	16.5	182.5	23.7	7.1
Bagmati	27.5	3947.5	0.1	98.7	0.4	2.5
Gandaki	29.6	2389.3	0.1	164.5	0.2	6.9
Lumbini	20.4	3028.4	0.1	94.7	0.3	3.1
Karnali	23.8	1900.5	0.0	51.7	0.1	2.7
Sudurpaschim	26.2	2282.5	0.6	88.3	2.3	3.9
Total	**262.6**	**19587.8**	**19.5**	**847.8**	**7.4**	**4.3**

Source: OAG (2019); OAG (2020)

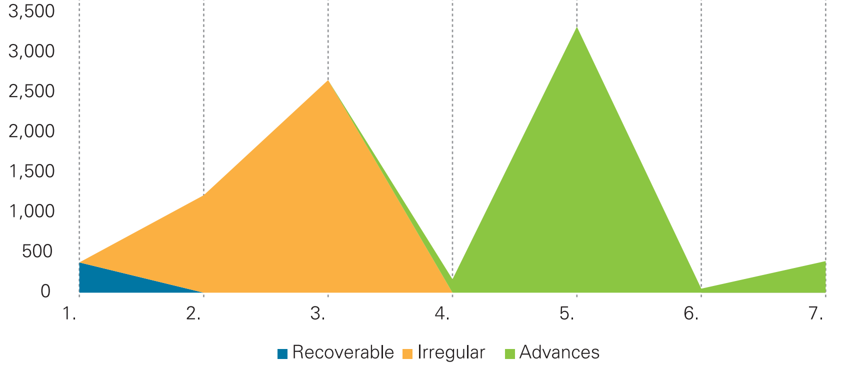
The OAG report shows *beruju* (irregularities) which includes recoverable, regularisable, and advance payments. The amount of the budget and irregularities was small in 2017/18 as it only covered the three months after the provinces were formed. In 2018/19, the level of irregularities was higher in Province 2 (7.0%) than in the other provinces. The provincial average of irregularities against the audited amount dropped from 7.4 per cent in 2017/18 to 4.3 per cent in 2018/19.

Table 23: Audit Irregularities in the Provinces in 2018/19 (NPR Million)

S.N.	Particulars	Recoverable	Irregular	Advances	Total	%
1.	Recoverable amount	380.2			380.2	4.6
2.	Irregular (non-compliance)		1,217.8		1,217.8	14.9
3.	Unsubstantiated (documents not submitted etc.)		2,659.7		2,659.7	32.4
4.	Staff Advance			169.9	169.9	2.1
5.	Mobilisation advance			3,325.1	3,325.1	40.6
6.	LC advance			49.9	49.9	0.6
7.	Other advances			395.8	395.8	4.8
	Total	**380.2**	**3,877.5**	**3,940.7**	**8,198.4**	**100.0**

Source: OAG (2020)

Figure 20: Irregularities in the External Audit of Provinces, 2018/2019 (NPR Million)



Source: Data from Table 23

The breakdown of the reported irregularities (Figure 20) in the provinces shows a higher share of advances, of which mobilisation advances paid for contracts occupy the biggest size of irregularities (40.6%). The shares of unsubstantiated amounts (32.4%) and non-compliance (14.9%) also remain high.

The OAG audit report highlighted some of the weaknesses in provincial budgeting and accounting practices, including non-compliance in preparing the consolidated financial statements on time, the practice of refunding unspent conditional grants, a high frequency of programme virement, the practice of keeping big amounts of unappropriated funds in the provincial budget, and that of direct procurement in the provinces. Among other things, the OAG report states that provincial programmes were not formulated as per the SDGs, periodic plans, and the MTEFs.

4.5.4. The PFM Framework in the Provinces

In order to assess the effectives of public financial management (PFM) systems, a public expenditure and financial accountability (PEFA) framework was introduced in Nepal in 2001. Among other things, the PEFA framework employs indicators including that of expenditures, revenue collection, arrears, transparency in intergovernmental fiscal transfers, public access to fiscal information, participation in the budget process, multiyear perspectives in fiscal planning, predictability of funds, management of cash balance, public procurement system, financial accounting and reporting, regularity of accounts, timeliness of budgeting reports and financial statements, effectiveness of internal controls, internal audit, and external audit and oversights, and legislative control. This framework was applied in the assessment of the PFM system in Nepal during the second PEFA assessment carried out in 2015 by the Nepali government (MoF, 2015).

Among other things, the PEFA II prioritises several actions related to the improvement of PFM systems in the provinces. This included the preparation and introduction of financial responsibility laws, upgradation, and integration of various software and IT systems used in PFM (BMIS, LM-

BIS, FMIS, RMIS, and TSA), strengthening MTEFs, improvements in commitment recording and controls, cash planning, implementation of the NPSAS, review of the PFM system at sub-federal levels, introduction of output-based budget systems, electronically executing expenditure systems, improvement in public procurement management, improvements in the internal audit system, financial reporting and accounting, and development of accounting manuals and guidelines. These indicators guide the effectiveness of the PFM system in the provinces. The next phase of PFM reforms was initiated under the PEFA 2016 framework and will be executed by 2025/26.

The PEFA framework is applied at the level of the District Treasury Offices (DTCOs) as recommended by the second PEFA assessment report (2015), and can be aggregated at the province levels and covers local levels as well.

4.6. IT Systems in Planning, Budgeting, and PFM

IT systems developed by the federal government were introduced for revenue-sharing, transfers, and expenditure accounting in the provinces. The IT systems operated at the province level include accounting and reporting through the Revenue Management Information System (RMIS), Computerised Government Accounting System (CGAS), Treasury Single Account (TSA), etc. The CGAS, TSA, and the Financial Management Information System (FMIS) are integrated for accounting and reporting systems, including for generating information on transactions and financial reports. The FMIS is a central level consolidation system which is supported by the district wise expenditure control system.

An IT-enabled PFM system has enhanced accounting and reporting practices in the provinces. All three levels of government require an integrated system for enhanced functional capability and transparency. A study has been initiated to implement the Integrated Financial Management Information System (IFMIS) in all seven provinces.

Provinces have used software such as SuTRA and the Provincial Line Ministry Budget Information System (P-LMBIS), based on the Line Ministry Budget Information System (LMBIS) of the federal government, for budget planning. The P-LMBIS is operational with an updated Chart of Accounts (CoA) and all the provincial governments have used this system to prepare their budgets since 2019/20. It provides for a top-down approach of budget planning and ceiling allocation, and bottom-up approach for activity submission. The P-LMBIS supports major functions required for budget allocation and execution. Budget authorisation is also provided through this system. Once the budget is endorsed, programmes are entered into the P-LMBIS system for authorisation, including for expenditure.

4.7. Key Accomplishments

Provinces have formed their planning institutions and started formulating their own periodic plans. Province 1, Lumbini, and Karnali have created Province Planning Commissions, while the others have created their planning institutions as the Province Policy and Planning Commissions (PPPCs). Province 1, Province 2, Bagmati, Gandaki, and Lumbini have formulated their periodic plans. Karnali has released an approach paper for its development plan. Sudurpaschim is yet to adopt a provincial plan, but it is being prepared.

Provinces have adopted budgetary guidelines, priorities, and calendars, and are generally adhering to them. Most provinces have started prioritising their projects and programmes.

Provincial governments have adopted fiscal tools like the MTEF to manage budgeting and planning. Resource committees have been formed in all seven provinces to estimate provincial resources and determine the limits/ceilings of expenditures. The practice of sending advance budget ceilings has also been initiated.

Coherence is seen between federal and provincial plans and budgets, at least in principle and in objectives. All the provinces have formulated and implemented budgets and programmes in line with the federal system. The provinces have aligned their periodic plans and approach papers with the objectives and strategies of the national development plan.

Provinces are implementing software-based systems for their budgeting. The provincial budgeting process is streamlined through the use of an IT system, including the P-LMBIS. It assists in formulating and implementing provincial budgets. Attempts have been made to link the P-LMBIS with the federal LMBIS. Provinces have established IT systems such as the PTSA for accounting and expenditure management. These systems and tools have enabled the compilation of financial data and promoted accountability and transparency in PFM.

Provinces have started to execute large projects of their own, mainly for physical infrastructure development. Provinces are designating province pride projects and have started to develop innovative projects for delivering public services and infrastructure development.

A few provinces have started to set up their project banks. In some provinces, sectoral ministries have started submitting projects and using the guidelines for project banks in their budget formulation process.

Provinces have established a functional public financial management (PFM) system. The PFM system and architecture specified in the Constitution and relevant laws to it have been introduced. Provinces have the necessary PFM institutions and laws in place. Their Provincial Finance Procedure Acts guide their public financial management systems. Financial laws, regulations and procedures, internal control systems, fund operation guidelines, and accounting systems and standards that lie at the heart of the PFM system are in place. It includes the process and system for the budget cycle, expenditure, and reporting.

Various PFM tools have been applied. PFM tools, such as the unified Chart of Accounts and Provincial Treasury Single Account (PTSA), which are linked with the federal TSA, accounting formats and standards, and internal control guidelines are in place in the provinces. These tools allow for the integration of expenditures in a manner consistent with the accounting and financial reporting system of the GoN. The unified accounting codes allow for the integration of data across the three levels of government and enable consolidation and the financial reporting of the provinces. Provincial governments have been able to produce financial statements based on the Nepal Public Sector Accounting Standard (NPSAS) applied at the federal level. Consolidated funds at provincial and local governments, and divisible funds for revenue-sharing have come into operation. Accounting formats have also been developed to migrate from a cash basis to an accrual basis of accounting.

There is a framework for internal control. The internal control framework developed by the FCGO is applicable to all three levels of government. Provincial government agencies are required to develop and implement their own internal control frameworks to adhere to the COSO framework and the International Standards of Supreme Audit Institutions (ISSAI). Internal audits are being conducted by the PTCOs.

The final auditing for the past fiscal years has been completed. The OAG has published its audit report for the provinces for 2017/18 and 2018/19, which are publicly available.

4.8. Challenges in Provincial Planning and Budgeting

Provincial plans lack transformational policies and programmes and look like the replication of national plans, appearing to be plans for planning's sake. Most provincial plans are without a concrete vision for rapid transformation that will boost economic growth and employment opportunities. The plans' targets are somewhat unrealistic and difficult to achieve, and they have weak accountability mechanisms for implementation.

Participatory planning is weak. In the unitary system, the planning process began at the settlement level and ended at the NPC. Local bodies used to start the plan formulating process with discussions in settlements, wards, village/municipal councils, service areas, and district councils. The process concluded upon submission of the details to the sectoral ministries and the NPC. The lack of such a step-wise bottom-up planning process that involves all stakeholders from the settlement level to the very top is being felt in the provinces.

There is a lack of guidelines for project selection and prioritisation. Budgeted programmes are implemented without sufficient preparation and have not been able to yield high returns. Inter-agency coordination is not as effective, leading to difficulties in programme implementation and in achieving results.

Federal parliamentarians distribute resources to their constituency-based programmes on their own without consulting provincial governments. Through the Local Infrastructure Development Partnership Programme, federal parliamentarians distribute resources without consulting provincial governments. Provinces, with limited internal resources, mimicked this practice in the form of constituency infrastructure development programmes. This ignores public participation in planning. The practice of allocating budgets in the name of constituency development is still prevalent despite widespread criticism.

Provinces are lagging behind in publishing their annual development programmes. Details of plans and programmes related to all the sectoral ministries must be submitted to the Province Assembly for discussion after the approval of the budget. All province governments have not submitted their annual development programmes, some have approved the budget speech itself as the annual development programme.

Provinces execute too many petty programmes, mostly for securing multiyear commitments. Small programmes are proposed without clear guidelines for multiyear budgeting and without introducing the practice of source assurance and commitment accounting. This may create an imbalance in resource allocation in future budgets.

Provinces tend to spend the most in the last quarter. These expenditure patterns are malpractices in public spending across the three levels of government.

Provinces keep chunks of unspecified "miscellaneous" expenses without detailing activities. Provincial ministries have unspecified programmes with large amounts allocated to them.

There is no practice for commitment accounting. Commitments made or contracts entered into by provincial governments are not recorded. As a result, they cannot account the total commitment, and the possible liability generated due to such commitments.

There are no clear guidelines for project selection, prioritisation and multiyear budgeting. Projects banks are yet to be institutionalised.

Links between the localisation of the SDGs and provincial plans are weak. Though the provincial plans of most provinces mention the attainment of the SDGs among their priorities, provincial plan documents do not demonstrate a linkage as the plan documents were adopted before the localisation of the SDGs. Provincial plans do not provide a breakdown of provincial targets and indicators for achieving the SDGs. Some sectoral targets and indicators related to the SDGs are included in the respective sectoral plans and indicators of the provinces, but most provinces are without a breakdown of provincial targets and indicators related to the SDGs.

Provinces face difficulties in prioritizing cross-cutting issues. Gender-responsive and climate change budgeting practices are rather formal and do not reflect being high priorities for provincial governments. The practice of gender-responsive and climate change budgeting is ritualistic and varies in provinces owing to different accounting practices.

There is inconsistency in the use of Chart of Accounts. During the line-item wise analysis of codes, it showed that there is inconsistency in the use of the revised CoA released by the FCGO. The financial reports of the provincial governments show that the economic codes are varying and are not uniformly applied. Some of them are using CoA 2074, without amendment, while others are using the second amendment. "Other revenue" seems to have unduly reported at higher levels. The same scenario is expected during the consolidation of the financial statements.

There is some noncompliance of accounting standards. The compliance of accounting standards such as on third-party payment and consolidation procedures are not being fully adhered to.

There exist multiple non-operational accounts in provincial governments. These non-freeze accounts bypass the budget process, making it difficult track them in the provincial consolidated accounts.

Public disclosure system is weak. Information is not available on the website of the PTCO and respective spending units. The general-purpose financial statement was also not publicly available. Provinces are not publishing financial information in a timely manner. The timeliness of financial reporting is crucial for making economic decisions. The OAG audit reports have highlighted that provincial governments have been lagging behind in compiling their financial information. Often, their financial reports are not publicly available.

There is a lack of integration between software systems in the provincial PFM system. The integration between LMBIS and P-LBMIS as well as that between the TSAs and the LMBIS has been a problem. This was identified in the mid-year budget review document of Province 1 for 2019/20. Many offices are using standalone spreadsheets to record transactions due to the instability of these systems. The lack of integration increases the risk of exceeding expenditure and the chances of making unnecessary virements for programmes.

4.9. Policy Recommendations

Seek to balance provincial budget allocation: Provinces are focused on physical infrastructure and there is low allocation for social sectors. They need to strike a balance in their budget allocation across different sectors.

Develop guidelines for the prioritisation of projects: Provinces need to develop guidelines for the prioritisation of projects with detailed criteria, resource estimates, and realistic rates of return.

Develop guidelines for multiyear programmes and projects: Provinces need to initiate commitment accounting to ensure future liability for contracts executed as this will assist in managing their resources and in cash planning and forecasting.

Discourage unallocated miscellaneous budgets: Provinces should discontinue the practice of allocating budgets under "finance miscellaneous" headings without elaborating the programmes.

Publish provincial economic surveys: Provinces need to start publishing Provincial Economic Surveys prior to introducing their annual budgets. The process can be streamlined by coordinating with other provincial counterpart agencies, the NPC, and the CBS.

Make the planning process participatory and bottom-up: The planning process adopted by provincial governments should be made participative and demand-driven. Bottom-up planning approaches needs to be embraced in order to foster a sense of participation and ownership among citizens.

Institutionalise the system of project banks: Provinces may need to acquire technical and managerial capacity to implement their own project banks. Similar to the federal government, provincial governments need to institutionalise the project bank by developing guidelines to make development planning more agile and efficient.

Discourage petty programmes: Provinces are executing several small programmes and projects that could be executed by local governments. Provincial governments need to focus on strategic and transformative programmes and projects, delegating small programmes to local governments. Budget related guidelines should establish a minimum threshold (e.g., NPR 10 million) below which provinces may not devise any programmes or projects.

Discourage the constituency-based projects of parliamentarians: Constituency-based programmes ignore public participation and encourage "pork barrel" projects. Provincial government have initiated similar programmes. This practice needs to be discontinued at all levels.

Set criteria for designating provincial pride projects: Provinces should establish certain criteria for designating provincial pride projects. This can include projects that can be executed with their own sources and which are unique to the respective province and has transformative potentials for them.

Implement guidelines for gender-sensitive budgeting: Provinces have initiated gender-based budgeting, but the proportion of provincial budgets directly benefitting gender inclusion is below the federal proportion. Federal guidelines need to be implemented so as to make gender-responsive budgeting more than a token gesture.

Improve public disclosure and transparency: An integrated IT system for the consolidation and public disclosure of daily financial information from all agencies in all levels of government needs to be developed. For better public disclosure and transparency on revenues and transfers, an interactive dashboard could be added to the relevant provincial websites to display live financial data. Sufficient investment in hardware, software, and the capacity development of employees is needed in order to maximise the benefits of e-governance.

Integrate and make PFM software compatible: There is a need to integrate the LMBIS and P-LMBIS. The integration of PTSA and P-LMBIS should also be seen as a priority.

Strengthen internal controls: The internal control system of provinces needs to be strengthened on the basis of the COSO and the FCGO frameworks.

Implement external audit recommendations: Provinces should strive to reduce audit irregularities making the concerned offices accountable for the same. They should implement external audit recommendations including the introduction of performance or output budgeting, control of unproductive expenditure, prioritisation of projects, effective monitoring, and internal controls.

CONCLUSION

Nepal's nascent experience of a federal system of governance has gathered good momentum with regard to the exercise of the constitutional rights of federal units, their legal and institutional development, transfer of employees and resources, and in their planning, programming, and budgeting exercises. Because it is in the early stages of implementation, the exercise of federalism is fraught with many challenges and constraints. The federal government has yet to prioritise the formulation of laws, devolution of authority, allocation of resources, em-ployee appointment and retention, and capacity building.

Provincial governments spent the first two years formulating laws, managing staff, creating the necessary institutional and physical structures for their offices, and building technical capacity. They have now started to focus on socioeconomic development and the execution of programmes and activities that can bring benefits to the people. Despite many hurdles, provincial governments are on track in terms of planning, budgeting, and programme implementation. Though the impact of the coronavirus pan-demic has created setbacks and slowdowns in socioeconomic develop-ment activities, provincial governments have started moving in the right direction on these counts and are expected to rebound to continue their targeted objective, goals, and activities, including those stated in their re-spective plans, programmes, and budgets.

Despite having started from scratch and having faced numerous chal-lenges, the country has achieved a lot in terms of fiscal federalism. The provinces have also accomplished key milestones in implementing fiscal federalism, including the institutionalisation of fiscal transfers and reve-nue-sharing.

The practices in fiscal federalism should be institutionalised by revisiting the revenue powers of the provinces and widening their revenue bases including those from the natural resources. The criteria and database of the NNRFC should be strengthened and its recommendations on fiscal transfers should be implemented in earnest. Fiscal transfers should be rationalised by increasing fiscal equalisation grants and reducing conditional grants and providing special grants to foster equitable development of provinces with lower socioeconomic development indicators. Laws related to internal loans should be introduced. The practice of public disclosure and transparency should be strengthened. The institutions and programmes under the functional jurisdiction of the province need to be transferred to the respective levels. The provinces should be allowed to set up their own organisation structure and hiring their own employees in accordance with law. Sectoral laws should be adopted; and institutions and stipulated provisions for intergovernmental fiscal relations should be activated.

The provincial governments should undertake reform initiatives to streamline their planning and budgeting practices by developing guidelines for multiyear programmes; prioritising projects, institutionalising their project bank; discouraging unspecified miscellaneous allocations; minimising unproductive recurrent expenditure; discouraging constituency-based petty programmes and focusing on transformative and innovative projects; making planning bottom-up and participatory; improving monitoring and evaluation; and reducing reported audit irregularities. They should make their budgets more gender and climate responsive.

Provincial governments must be supported with institutional strengthening, capacity-building, timely legislation of pending federal laws, and better intergovernmental relations, while the federal government needs to devolve more responsibilities and resources to enable them to execute their constitutionally-mandated responsibilities and powers.

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ANNEXES

Annex-1: Revenue of the Provinces (NPR Billion)

Province	Revenue Amount (NPR Billion)		
	2018/19 (actual)	2019/20 (revised)	2020/21 (projected)
Province 1	2.48	4.12	5.25
Province 2	1.82	3.13	2.72
Bagmati	9.34	12.2	19.35
Gandaki	2.03	3.69	4.91
Lumbini	2.95	4.90	4.97
Karnali	0.24	0.30	0.32
Sudurpaschim	0.68	0.84	0.70
Total	**19.54**	**29.18**	**38.22**

Source: Compiled from provincial budget speeches for FY 2020/21

Annex-2: Sources of Provincial Revenue in 2018/19 (NPR 10 Million and %)

S.N.	Description	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total
Total revenue (NPR 10 Million)		**248**	**182**	**934**	**203**	**295**	**24**	**68**	**1,953**
1	Vehicle Tax (%)	47.24	40.13	41.76	62.96	51.41	35.22	57.58	46.43
2	House & Land Registration fees (%)	34.15	15.60	42.08	21.53	27.68	45.49	32.88	34.02
3	Transport sector income (%)	3.24	6.11	3.21	-	4.69	3.93	-	3.27
4	River and riverine income (%)	-	0.21	5.62	-	-	-	1.43	2.76
5	Fees other than business (%)	-	27.16	-	-	-	7.90	-	2.63
6	Water resources royalty (%)	-	-	4.27	-	3.23	0.01	-	2.53
7	Other service fees (%)	9.93	0.05	0.01	0.07	0.36	0.61	6.80	1.57
8	Other administrative fees (%)	1.36	1.57	0.22	7.44	1.55	5.70	-	1.50

S.N.	Description	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total
Total revenue (NPR 10 Million)		**248**	**182**	**934**	**203**	**295**	**24**	**68**	**1,953**
9	Fees by business (%)	3.56	8.79	-	-	-	-	-	1.27
10	Business registration fees (%)	-	-	-	4.24	4.75	-	-	1.16
11	Others (%)	0.53	0.38	2.82	3.76	6.34	1.14	1.30	2.86
	Total	100	100	100	100	100	100	100	100

Source: Compiled from provincial budget speeches (Annex-2) for FY 2020/21

Annex-3: Revenue-Sharing to Sub-Federal Levels (NPR Billion)

	2018/19	2019/20	2020/21
Province 1	8.9	10.4	9.5
Province 2	8.5	10.6	9.5
Bagmati	9.0	10.7	9.7
Gandaki	6.6	7.8	7.6
Lumbini	8.6	9.9	9.5
Karnali	5.5	7.6	7.4
Sudurpaschim	6.8	8.0	7.9
Total Provinces	**53.8**	**65.0**	**61.1**
Local Levels	**53.8**	**65.0**	**61.1**

Source: Compiled from MoF (2018); MoF (2019a); MoF (2020a); NNRFC (2019)

Annex-4: Provincial Budget Calendar

S. N.	Areas	Timeframe
1.	Projection of Revenue and expenditure to federal government	Poush End (Mid Jan)
2.	Expenditure and sources projection	Magh End
3.	Budget guidelines and budget ceiling and the MTEF frameworks (also based on periodic plans)	Falgun 2nd week (February 1st week)

S. N.	Areas	Timeframe
4.	Receiving budget ceiling and guidelines for equalisation grants and revenue distribution from federal government	Falgun End (Mid-March)
5.	Sending budget ceiling by ministries to its office and directorates	Baisakh 5 (Mid-April)
6.	Approval from provincial development council	Jestha 3 (Mid May)
7.	Conduct district level meetings for budget discussion by the district coordination committee	Baisakh 15 (April last)
8.	Budget planning seminars and selection of programmes based on priority and sending it to respective ministry	Baisakh 20 (First week of May)
9.	Detailed project plan, survey, projection, and prioritisation by subject ministry and entry into project banks	Jestha 15 (May End)
10.	Detailed discussion of the projects and programmes with the subject ministry, MoEAP, and PPC to give final shape	Jestha 22 (First Week of May)
11.	Approval of annual programmes by provincial council of ministers	Jestha 28 (Second Week of May)
12.	Presentation of the budget at the provincial assembly	Ashad 1 (Mid-June)
13.	Budget approval and publication through provincial publication	Ashad End (Mid July)

Source: Derived from the IGFA Act and the budgeting guidelines of the provinces

Annex-5: Comparison of the Federal and Provincial Periodic Plans (2018/19-2080/81)

Particulars	GoN	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali
Long-term Vision	Prosperous Nepal, Happy Nepali	Hygienic, Happy and Progressive Province	High Human Development and dignified Prosperous Madhesh Society	Well-cultured and Happy citizens; Socialism oriented prosperous Province	Prosperous Province: Happy Citizens	Prosperous Province, Happy Province Citizens	Prosperous Karnali, Happy Karnali Residents
Long-term Goal	Four on the basis of prosperity and five bases of happiness	Four on the basis each of cleanliness, happiness, prosperity	Improvement in living standards through high economic growth	Four on the basis each of culture, happiness, prosperity	High productivity and disciplined life	Improvement in living standards through high economic growth	Five areas of prosperity and seven areas of happiness
Long-term Strategy	Eight including employment oriented economic growth	Seven including increased production in agriculture as well as non-agriculture sectors	Twelve including increased crop production	Nine including increase of production	18 including research and development	Six including expansion of physical infrastructure	Six including attainment of SDGs
Drivers of Transformation	Nine including quality tourism	NA	NA	Six including quality tourism	Seven including tourism	NA	10 including quality infrastructure
Long-term Objectives	Three including basis for prosperity	Five including employment generation	NA	Five including development of human capital	Three including development of self-reliant economy	Four including increase of production	Infrastructure Development and socio-economic development

Source: Compiled from NPC (2020) and provincial plans

Annex-6: Linkage between the Federal and Provincial Budgets

Basis	GoN	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim
2020/21								
Number of budget objectives	4	5	9	3	6	4	6	6
Main Budget Objective	Making public life safe by protecting citizens from different disasters including contagious diseases	Making the lives of the citizens safe and reliable by protecting citizens from all kinds of diseases including the coronavirus epidemic	Improving the living standard of citizens through improved health services	Protecting lives from all kinds of epidemics, outbreaks and disasters	Managing effectively the prevention, control and treatment of the coronavirus epidemic	Expanding of infrastructure, manpower and capacity in the health sector and increasing public access to health services	Making the lives of the citizens safe and comfortable by protecting the people from the Covid19 epidemic	Saving lives of citizens of the province managing the risk of all kinds of diseases and disasters
Number of priorities	6	9	none	6	8	7	7	6
Main priority	Expansion of health services and health infrastructure and development of medical manpower to make quality health services universally accessible and keep citizens safe from health risks including the coronavirus epidemic	Expansion of reliable health services and development of health infrastructure to increase access to health care and protect all citizens from all kinds of diseases including coronavirus	Policies were discussed without mentioning priorities	Expansion of health services and building a reliable public health system to protect the people of the province from all kinds of health risks including Covid-19	Improvement of health institutions and development of capable manpower	Improvement of the health sector, expansion of health service coverage, development of education and social sectors	Management of quarantine and isolation facilities to protect the people from the Covid-19, increasing availability of essential medicines, health materials and equipment, expansion of testing and provision of treatment	Immediate relief to the poor and people most affected by the epidemic

Basis	GoN	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim
2019/20								
Number of objectives	3	3	5	3	7	3	5	4
Main Budget Objectives	Improvement in the living standards of citizens	Employment and poverty alleviation	Improvement in the living standards of citizens	Implementation of fundamental rights of citizens	Formulation of laws & strengthening organisational structure	Rapid economic growth	Rapid economic development through infrastructure development	Broad and sustainable economic growth
Number of priorities	5	5	8	6	7	4	6	8
Main Priorities	Expansion of social security and welfare state	Investment in agriculture, tourism, industry & energy sectors	Protection of poor, marginalised and vulnerable communities	Infrastructure development	Infrastructure development	Development of tourism, agriculture, industry, infrastructure & human resource development	Roads, infrastructure, and transportation	Targeted programmes for poverty alleviation

Source: Compiled from federal and provincial budget speeches for FY 2019/20, 2020/21

Annex-7: Sources of Provincial Budgets (NPR Billion)

	Total Budget	Budget source				
		Grant	Revenue sharing	Internal loan	Cash balance	Own-source revenue
2019/20						
Province 1	42.2	21.2	10.3	0.0	6.6	4.1
Province 2	38.7	16.2	10.4	1.3	7.7	3.1
Bagmati	47.6	18.1	10.6	0.0	6.8	12.2
Gandaki	32.1	14.0	7.7	2.0	4.8	3.7
Lumbini	36.4	16.6	9.9	0.0	5.0	4.9
Karnali	34.4	16.9	7.4	0.8	8.9	0.3
Sudurpaschim	28.2	14.5	8.0	0.0	4.8	0.8
Total	**259.6**	**117.4**	**64.4**	**4.0**	**44.6**	**29.2**
Provincial Average (%)	**100.0**	**45.2**	**24.8**	**1.6**	**17.2**	**11.2**
2020/21						
Province 1	40.9	15.1	9.5	5.0	6.0	5.3
Province 2	33.6	13.4	9.5	1.0	6.9	2.7
Bagmati	51.4	14.9	9.7	0.0	7.5	19.4
Gandaki	34.8	13.4	7.6	2.0	7.0	4.9
Lumbini	36.4	14.1	9.5	0.0	7.9	5.0
Karnali	33.7	14.8	7.4	0.0	11.2	0.3
Sudurpaschim	33.4	14.2	7.9	0.0	10.6	0.7
Total	**264.2**	**99.9**	**61.1**	**8.0**	**57.0**	**38.2**
Provincial Average (%)	**100.0**	**37.8**	**23.1**	**3.0**	**21.6**	**14.5**

Source: Compiled from provincial budget speeches and red books for FY 2019/20, 2020/21

Annex-8: Recurrent and Capital Expenditure of the Provinces (NPR Billion)

	2018/19 (actual)			2019/20 (revised estimate)			2020/21 (projected)		
	Total	Recurrent	Capital	Total	Recurrent	Capital	Total	Recurrent	Capital
Province 1	21.2	9.8	11.4	30.3	11.1	19.2	40.9	18.9	21.9
Province 2	14.8	6.9	7.8	25.9	10.5	15.4	33.4	15.4	18.0
Bagmati	13.7	4.4	9.3	29.8	10.8	19.0	51.4	26.3	25.1
Gandaki	13.9	5.2	8.7	20.4	7.2	13.2	34.8	14.3	20.0
Lumbini	17.0	6.9	10.2	26.8	12.9	13.9	36.4	17.7	18.6
Karnali	10.0	4.8	5.2	15.9	8.1	7.8	33.7	14.7	19.1
Sudurpaschim	14.2	6.9	7.2	16.7	8.5	8.2	33.4	16.3	17.1
Total	**104.8**	**44.9**	**59.9**	**166.0**	**69.2**	**96.8**	**264.0**	**123.7**	**139.8**
%	**100.0**	**42.8**	**57.2**	**100.0**	**41.7**	**58.3**	**100.0**	**46.9**	**52.9**

Source: Compiled from provincial budget speeches for FY 2019/20, 2020/21

Annex-9: Item Wise Recurrent Expenditure Items of the Provinces in 2020/21 (%)

Particulars	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total
Programme expenditure	12.79	13.93	21.90	24.45	24.96	39.15	37.45	23.70
Staff remuneration	10.01	10.73	15.20	13.45	14.11	15.87	8.35	12.02
Conditional grant	32.22	1.91	0	0	14.48	0	0.44	9.58
Equalisation Grant	5.13	5.77	0	19.19	7.29	0	8.95	6.73
Skill development, training and seminar	4.45	5.85	10.94	7.14	6.01	7.52	5.92	6.41
Other entity grant: conditional recurrent	3.51	18.39	3.26	5.35	2.70	1.11	1.09	5.24
Government entities, Conditional capital grant	7.04	3.71	12.86	0	0.38	0.30	4.40	4.13
Other Entity grant Capital Conditional	6.27	0	0.67	16.05	1.28	0.66	0.05	3.57
Complementary Grant	0	0	0	0.36	5.61	15.58	1.94	2.87
Local Level Conditional Capital grant	0	15.97	0.01	0.28	0	0	0	2.50
Others	18.58	23.74	35.16	13.73	23.18	19.81	31.41	23.25
Total %	100	100	100	100	100	100	100	100

Source: Compiled from provincial budget speeches (Annex-5) for FY 2020/21

Note: Bagmati, Gandaki and Karnali had not provided conditional grants to local levels in 2018/2019. Bagmati and Karnali had also not provisioned complementary grants.

Annex-10: Sector-Wise Breakdown of Capital Expenditure, 2018/19 (NPR 10 Million)

Particulars	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total
Total capital expenditure	**1141**	**784**	**931**	**872**	**1017**	**523**	**723**	**5990**
Sector-wise Allocation (%)								
Road and Bridge construction	34.68	37.22	30.46	28.55	26.73	35.81	43.48	33.28
Drinking water structure construction	13.60	1.36	9.32	23.42	10.79	5.75	8.28	10.96
Irrigation structure construction	9.36	2.54	10.72	10.78	9.35	9.99	13.63	9.46
Non-residential building construction	9.29	14.82	6.05	4.99	9.03	18.48	5.83	9.22
Other public construction	13.30	8.83	10.09	4.13	6.00	3.08	2.12	7.40
River embankment construction	4.56	6.05	8.23	6.27	8.37	8.09	9.75	7.15
Capital improvement public construction	3.88	13.30	5.62	8.57	-	2.63	1.21	4.98
Machinery and tools	2.29	4.48	2.03	1.47	4.08	3.99	5.17	3.22
Vehicle and equipment	4.60	-	2.60	1.81	3.51	6.74	3.98	3.21
Forest and environment conservation	0.91	3.91	8.37	-	4.26	2.37	0.18	2.94
Others	3.55	7.49	6.51	10.03	17.88	3.07	6.36	8.20
Total %	100	100	100	100	100	100	100	100

Source: Compiled from provincial budget speeches (Annex-5) for FY 2020/21

Annex-11: Change in the Provincial Budgets from 2019/20 to 2020/21 (%)

Particulars	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim
Recurrent Expenditure							
Employee meeting allowance	0.25	174.77	57.15	56.88	1.38	(92.62)	74.76
Delegates Meeting allowance	18.29	(39.95)	73.63	17.22	(6.13)	(57.05)	109.62
Delegates other allowance	34.39	14.47	29.46	6.43	4.01	28.21	126.70
Fuel office purpose	24.45	38.41	36.30	9.01	25.64	(30.06)	58.39
Employee training expense	336.72	152.58	23.29	189.64	114.07	59.35	195.60
Skill development and seminar	54.55	82.58	(14.95)	46.07	34.94	10.35	21.90
Programme expenditure	294.01	192.44	6.18	142.71	75.82	259.95	237.13
Travel allowance	7.91	60.92	(10.95)	0.36	39.04	(61.01)	42.12
Miscellaneous Expenditure	38.46	1.35	36.22	25.65	17.17	(47.78)	95.65
Capital Expenditure							
Non-residential building	27.71	41.30	7.58	92.33	25.65	23.34	53.88
Vehicle	11.07	(45.63)	(18.37)	(13.83)	(10.36)	(73.08)	126.84
Machinery and tools	436.13	216.93	101.19	6.77	78.59	60.03	318.70
Furniture and fixtures	35.56	5.14	31.24	110.41	32.02	(72.56)	117.34

Source: Compiled from provincial budget speeches (Annex-5) for FY 2019/20, 2020/21

Note: Figures in parenthesis indicate negative growth

Annex-12: Ministry Wise Budget of the Provinces, 2019/20 (NPR 10 Million)

Particulars	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total	% Total
2019/20									
Provincial Assembly	33	44	42	14	33	16	15	197	0.76
Office of Chief Minister and Council of Ministers	28	90	62	132	61	528	111	1,012	3.90
Ministry of Economic Affairs and Planning	91	136	31	163	15	12	47	495	1.91
Ministry of Industry, Tourism, Forest and Environment	383	280	498	203	288	286	230	2,168	8.35
Ministry of Land Management, Agriculture and Cooperatives	404	350	492	242	446	343	280	2,557	9.85
Ministry of Internal and Legal Affairs	148	92	149	59	80	70	28	626	2.41
Ministry of Physical Infrastructure Development	1,985	804	1,781	1,595	1,584	1,070	939	9,758	37.59
Ministry of Social Development	416	398	679	339	439	470	470	3,211	12.37
Finance Miscellaneous	601	1,442	859	351	327	335	589	4,504	17.35
Local Level	100	186	125	105	362	80	62	1,020	3.93
Others	31	50	42	10	6	225	45	409	1.58
Total	**4,220**	**3,872**	**4,760**	**3,213**	**3,641**	**3,435**	**2,816**	**25,957**	**100**
2020/21									
Provincial Assembly	24	44	32	12	26	10	19	167	0.63
Office of Chief Minister and Council of Ministers	76	463	87	249	57	618	179	1,729	6.54
Ministry of Economic Affairs and Planning	60	28	16	19	13	15	164	314	1.19

Particulars	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total	% Total
Ministry of Industry, Tourism, Forest and Environment	356	325	385	184	280	228	278	2,037	7.71
Ministry of Land Management, Agriculture and Cooperatives	400	327	377	316	401	270	333	2,425	9.18
Ministry of Internal and Legal Affairs	127	95	88	59	71	42	47	529	2.00
Ministry of Physical Infrastructure Development	1,793	902	1,781	1,447	1,502	1,131	1,111	9,666	36.59
Ministry of Social Development	553	634	659	468	561	525	663	4,062	15.37
Finance Miscellaneous	440	329	981	451	184	152	301	2,838	10.74
Local Level	242	172	724	213	514	300	214	2,378	9.00
Others	19	38	13	66	26	84	30	276	1.05
Total	**4,090**	**3,356**	**5,143**	**3,484**	**3,635**	**3,374**	**3,338**	**26,421**	**100**

Source: Compiled from provincial budget speeches for FY 2019/20, 2020/21

Annex-13: Provincial Budgets by Sectoral Classification (NPR 10 Million)

Sectors	Province 1	Province 2	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total	%
2019/20									
General Public Services	1060	2647	1940	724	1911	1421	737	10439	40.27
Public Order and Safety	148	96	151	2	58	72	29	555	2.14
Economic Affairs	1706	834	1849	1846	1088	1584	1572	10480	40.43
Environmental Protection	133	0	95	59	43	3	0	334	1.29
Housing and Community Amenities	956	29	407	218	210	18	117	1954	7.54
Health	108	62	97	105	77	228	120	797	3.08
Recreation, Culture and Religion	3	0	163	2	99	3	0	270	1.04
Education	91	12	59	103	57	106	242	671	2.59
Social Protection	14	193	0	154	59	0	0	420	1.62
Total	**4220**	**3873**	**4762**	**3213**	**3601**	**3435**	**2816**	**25921**	**100**
2020/21									
General Public Services	1047	1734	2120	909	1658	1144	859	9471	35.85
Public Order and Safety	127	100	87	2	55	43	47	461	1.75
Economic Affairs	1302	1065	2317	1743	1196	1260	1759	10643	40.28
Environmental Protection	162	0	104	59	62	0	0	387	1.46
Housing and Community Amenities	979	81	335	223	301	0	157	2075	7.85
Health	246	180	127	126	127	188	229	1223	4.63
Recreation, Culture and Religion	139	0	1	4	89	3	0	235	0.89
Education	60	37	53	189	91	32	286	750	2.84
Social Protection	28	158	0	229	55	704	1	1175	4.45
Total	**4090**	**3356**	**5143**	**3484**	**3635**	**3374**	**3338**	**26421**	**100**

Source: Compiled from provincial budget speeches and red books for FY 2019/20, 2020/21

Annex-14: Gender-Responsive Budget of the Provinces (%)

Province	Direct Benefit (%)	Indirect Benefit (%)	Neutral (%)
2020/21			
Province 1	14.31	61.18	24.5
Province 2	40.06	28.1	31.84
Bagmati	23.74	17.18	59.08
Gandaki	54.27	36.17	9.56
Lumbini	21.46	32.73	45.1
Karnali	36.9	40.77	22.33
Sudurpaschim	47.43	46.63	5.94
2019/20			
Province 1	NA	NA	NA
Province 2	29.74	22.37	47.89
Bagmati	13.61	28.25	58.14
Gandaki	66.03	28.54	5.43
Lumbini	14.28	35.31	50.41
Karnali	30.1	27.47	42.43
Sudurpaschim	51.24	44.23	4.53

Source: Compiled from provincial budget speeches for FY 2019/20, 2020/21

Annex-15: Sector Wise Types of Programmes and Projects Executed by the Provinces

S. N.	Sector	Type of projects to be conducted at the provincial levels
1.	Governance, Good governance	Provincial governance, inter-local level coordination, delivery of goods and services, result-based management of the provincial and local level projects
2.	Finance	Provincial plans and public finance, foreign aid coordination with approval from the federal level, fiscal transfers to local levels
3.	Industry, Commerce and Supplies	Small and cottage industry promotion and regulation, entrepreneurship promotion, internal markets and related skills, industrial villages, trade information and export promotion, supply of essential goods and services to the local levels
4.	Energy, Water Resources and Irrigation	Electricity generation projects of up to 20 megawatts, indulging solar, hydropower; small transmission lines (11-33 KV), rural electrification, and Medium-sized irrigation projects, including projects expanding to more than one local levels, new-technology based river and watershed management, ground water projects, medium-sized river control and management, landslides (over 20,000 sq. m. area).
5.	Law and order and parliamentary affairs	Provincial laws, mediation, reconciliation, legal education
6.	Agriculture, livestock and birds	Production-centred farms, productivity generating programmes, commercialisation and marketisation of agriculture, seeds regulation, and supply
7.	Land management, cooperative and poverty alleviation	Targeted programme for freed *kamaiya, haliya,* etc., *guthi* management, cooperatives operating in two or more local levels, capacity development of cooperatives
8.	Drinking water	Basic water production, processing, and supply, medium-sized drinking water projects, solid water management and processing covering more than on local unit

S. N.	Sector	Type of projects to be conducted at the provincial levels
9.	Internal affairs	Law and order, provincial police, human trafficking, drugs, provincial highway security, NGO registration, recording and regulation, disaster management
10.	Physical infrastructure, transport	Provincial highways and their bridges, local and agro-road from the past, link-road to the province capitals, roads linking two or more local units; suspension bridges, transport regulation, including transport company regulation
11.	Women, children and senior citizens	Women's development programmes, awareness programmes, provincial old age homes and orphanages
12.	Forest and Environment	Community and lease forestry in more than one Local Levels, herb development, processing and marketisation, watershed management, province museums on forest, wildlife and biodiversity, provincial zoos, air pollution control, climate change mitigation and adaptation-related programmes, afforestation, wood-industry, forest fire control, eco-tourism, forest and wildlife crime, agro-forestry, urban afforestation
13.	Education, science and technology	School teacher training, SEE examination, disability-friendly schools, vocation and technical education, polytechnics, science museums, community libraries, delegated tasks from the Teacher Service Commission, model schools, provincial education statistics
14.	Youth and sports	Youth scientist's promotion, youth policy and programme, national development volunteers, scouts, provincial sports infrastructure, provincial sports competitions
15.	Labour, employment and social security	Skill development, domestic employment promotion

S. N.	Sector	Type of projects to be conducted at the provincial levels
16.	Urban development	Urban development, urban infrastructure development, provincial housing and buildings, provincial capital development, inter-city projects, targeted housing, settlement development, conference centre development
17.	Culture, tourism and civil aviation	Provincial tourism infrastructure, preservation of languages, scripts, heritages and fine arts, provincial museums, culture and tourism promotion
18.	Federal affairs and general administration	Local governance community development and local infrastructure development, provincial and local affairs training centres, provincial and civil service, and local level employee services
19.	Communication and information technology	FM radio, cable TV regulation, wireless and broadband infrastructure at the provinces, ICT parks and villages
20.	Health and population	Former provincial and zonal hospital and Ayurveda hospitals, vaccination, medicine and medical equipment, coordination of health services at the local level, provincial population management and statistics management
21.	Planning and statistics	Provincial plan, MTEFs, internalisation of the SDGs, public private partnerships at the provincial level, provincial statistics management

Source: Compiled from NPC (2018)

Annex-16: Number of Programmes/Projects of NPR 100 million or more

Ministry	Province1	Bagmati	Gandaki	Lumbini	Karnali	Sudurpaschim	Total	%
Ministry of Physical Infrastructure Development	8	24	8	16	20	7	83	44.86
Ministry of Social Development	-	7	1	3	1	5	17	9.19
Ministry of Land Management, Agriculture and Cooperatives	4	11	4	10	6	1	36	19.46
Ministry of Industry, Tourism, Forest and Environment	-	3	2	-	7	1	13	7.03
Ministry of Internal Affairs and Law	3	2	2	-	1	-	8	4.32
Ministry of Economic Affairs and Planning	11	2	-	-	6	-	19	10.27
Province legislature/ parliament	-	-	-	-	-	-	0	-
OCMCM	-	1	2	-	5	1	9	4.86
Others	-	-	-	-	-	-	0	-
Grand Total	**26**	**50**	**19**	**29**	**46**	**15**	**185**	**100.0**

Source: Compiled from annual development programme books of all provinces for FY 2019/20

Note: Province 2 had not published its annual development programme book, hence is missing in this analysis.

Annex-17: Innovative Programmes of the Provinces for 2020/21

S.N.	Sector	Province	Name of Programme
1.	Agriculture	Province 1, 2, Lumbini, Bagmati	Farmers Identification Card
		Province 1, 2, Gandaki, Sudurpaschim	Chief Minister's Agriculture Programme
2.	Health	Province 1, Bagmati, Gandaki, Lumbini, Karnali, Sudurpaschim	Integrated health services
		Bagmati	One Medium School One Nurse Programme
3.	Employment and Poverty reduction	Province 1, 2, Lumbini, Karnali, Sudurpaschim	Chief Minister Employment Programme
		Lumbini	Skill Mapping and Self-Employment Programme
4.	Education	Province 1, Province 2, Bagmati, Karnali, Sudurpaschim	Vocational education and online education
		Province 2	"Beti Padhau Beti Bachau" Programme
		Bagmati	"Chori Buhari Uchha Sikchya" Programme
5.	Physical infrastructure	Province 1, Province 2, Bagmati, Gandaki, Lumbini, Sudurpaschim	Integrated City Development Programme
		Karnali province	Provincial Ring Road
6.	Energy	Province 1, Gandaki, Karnali, Sudurpaschim	Rural Area Energy Outreach Programme
7.	Drinking water	Province 2, Lumbini, Karnali, Sudurpaschim	Safe Drinking Water Programme
		Province 1, Bagmati, Gandaki	Ek Ghar Ek Dhara Programme
8.	Tourism	Province 1, Bagmati, Gandaki, Lumbini, Karnali	Provincial Tourism Masterplan
		Province 2	Internal Tourism Promotion Programme
9.	Women, children and Senior citizen	Province 1, Bagmati, Gandaki,	Zero Tolerance on Gender-Based Violence
		Lumbini, Karnali, Sudurpaschim	Senior Citizen Integration Centres

Source: Compiled from province policy and programmes and budget speeches for FY 2020/21