

***Policy Paper
on
Decentralization***

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His Majesty's Government of Nepal

List of Acronyms and Abbreviations

ADDC/N	Association of District Development Committee
DDC	District Development Committee
DIMC	Decentralization Implementation Monitoring Committee
DIP	Decentralization Implementation Plan
DIMWC	Decentralization Implementation Monitoring Working Committee
HDI	Human Development Index
HMG/N	His Majesty's Government of Nepal
LB	Local Bodies (DDC, VDC, Municipality)
LBFP	Local Body Fiscal Commission
LSGA	Local Self-Governance Act
LSGR	Local Self-Governance Regulation
MLD	Ministry of Local Development
MoF	Ministry of Finance
MuAN	Municipal Association of Nepal
JDF	Joint Coordination Forum
PERC	Public Expenditure Review Commission
PRSP	Public Expenditure Review Commission
PRSP	Poverty Reduction Strategy Paper
VDC	Village Development Committee
VDP	Village Development Program

Decentralization in Nepal

Efforts, Experiences and Strategies

Introduction

Among the various definitions and practices of decentralization, Nepal has experimented with different modes of decentralization, ranging from delegation to deconcentration and, ultimately, to devolution. The Constitution of the Kingdom of Nepal-1990 has envisioned decentralization as a fundamental element of democracy. The overall policy framework recognizes subsidiary governance as the guiding principle of decentralization. The overarching goal of decentralized governance is to promote good governance, strengthen pluralistic democracy and reduce poverty. Thus, decentralization in Nepal is based on the country's governance system, administrative structure, socio-cultural factors and past experiences.

The concept of decentralization and participatory development has a long history in Nepal. A significant process of decentralization was initiated with the enactment of the Decentralization Act in 1982 and the adoption of relevant regulations in 1984. These legal frameworks forwarded the process of de-concentration of functional responsibilities to the district level of governance.

After the restoration of democracy, three separate Acts — The District Development Committee (DDC) Act, the Village Development Committee (VDC) Act, and the Municipality Act — were enacted in 1992 and LBs¹ were formed in accordance with the new Acts.

Present Context

Based on the recommendation of a High Level Decentralization Coordination Committee formed under the Chairpersonship of the Prime Minister in 1996, the Local Self-Governance Act (LSGA) was enacted in 1999. The Act laid the foundation for a local self-governance system in the country. It has statutorily recognized the role of local self-governance and devolution to make LBs more responsive and accountable to their populace.

The Constitution of the Kingdom of Nepal (1991) has recognized decentralization as a means to ensure optimum involvement of the people in governance under the spirit of democracy. To implement the guiding principle of the Constitution, His Majesty's Government of Nepal promulgated in 1999- the Local Self Governance Act (LSGA) and formulated a series of accompanying regulations. These legal

¹ The term 'LBs' is used to signify the local elected governments or LBs that include VDC, DDC and Municipality.

frameworks have increased the authority and responsibilities of the local bodies and increased the devolution of administrative, judicial and fiscal powers to the local elected bodies. The spirit of LSGA calls for comprehensive transferring of central decision making power and implementing authority on local level development activities to the local bodies. In a sense what Nepal has achieved on decentralization during the past decade is a matter for pride. Despite political instability the landmark LSGA was approved and there has been intimate collaboration between HMG/N, donors and civil society in supporting a common framework. Local bodies are a reality in Nepal today and each day even more so.

Assessment of Country Efforts and Achievements

After the enactment of the LSGA, the following major steps have been taken towards strengthening local governance.

Local-Self Governance Regulations

The government approved the Local Self-Governance Regulation and Financial Administration Regulations in 2000. These legal frameworks have made effective almost all the provisions of the Act. The Ministry of Local Development (MLD) designed and organized orientation programs for all DDC and Municipal officials, line agency chiefs and other partner agencies on nation-wide basis. Some of the districts organized similar orientation programs for VDC officials and front-line development workers at their own initiative.

Peer Review of Decentralization Process

Under the provision made in the LSGA, a high-level Decentralization Implementation Monitoring Committee (DIMC) is in place. Based on the recommendations of a Peer Review, a joint effort of HMG/N and donors, to determine the status of decentralization in Nepal, the following actions have been taken.

- The MLD has established a common platform called Joint Coordination Forum for Decentralization (JCFF) involving government agencies, civil society, the private sector and donor representatives.
- The Decentralization Implementation Plan (DIP), prepared in a collaborative manner, has been approved by the DIMC, and has recently issued instructions to all ministries and government agencies to start implementation.

- The LBs Finance Commission has completed its study and its recommendations are being implemented gradually. Most of the recommendations have been included in the recently approved DIP.

Activation of the DIMC and the DIMWC

In response to the issues and constraints raised by various studies, the first meeting of the DIMC identified 23 conflicting Acts and decided to amend them in accordance with the LSGA. The second meeting of DIMC (held in March 2001) recommended a 13-point policy review agenda to the government that includes instructions on: (i) development of a longer-term DIP; (ii) review of LBs' structure and number; (iii) classification of tasks between the government and LBs; (iv) amendment to sectoral Acts that conflict with the LSGA; and (v) promotion of HMG/N-donor coordination.

Similarly, the DIMWC, the working committee of the DIMC, has been active in enabling the DIMC. A responsible high-level official has been appointed by each concerned ministry to work as the focal person to facilitate the decentralization process.

Public Expenditure Review Commission (PERC)

The government under the recommendation of the Public Expenditure Review Commission has initiated merging some line agencies (Drinking Water, Irrigation, Housing and Urban Planning) and establishing a District Technical Office (DTO) in each district under the coordination of the Local Development Officer, which can be taken as an important step in transpering central level responsibility to local level.

Joint Coordination Forum for Decentralization and Thematic Groups

Based on the recommendations of the joint peer review and the decisions of the DIMC, the HMG/N formed a Joint Coordination Forum (JCF) for local governance in July 2001, involving various ministries, LB associations, donors, civil society and the private sector, to begin reviewing the situation for policy improvement. The JCF has identified five thematic areas — sectoral devolution, organization and structure of LBs, fiscal decentralization, institutional development and capacity building, monitoring and policy feedback. Based on the thematic areas identified, Thematic Groups have been organized for further work on preparing the DIP in those areas.

Government's Commitment to Devolution

The HMG/N is seriously looking into the following aspects as its priority issues (MoF/PRA Progress Report, 2000):

- Defining the tasks and service jurisdiction of LBs and central agencies to avoid: (a) uncoordinated flow of resources, (b) program duplication, and (c) overlapping. Central agencies are gradually being confined to the functions of monitoring and directing, strengthening the hands of LBs, providing financial support and coordinating at the center and local level.
- Improving the monitoring mechanism and institutional capacity to ensure the efficient use of resources made available to LBs.

The HMG/N's program and budget (2001/2002) has proposed devolution of basic and primary education, primary health, agriculture (including livestock), and postal services to LBs.

The associations of LBs² are playing a pragmatic role through the collective voicing of their interests. This is contributing to the internalization of the decentralization process. The Association of District Development Committees (ADDC/N) is becoming active in recent years. The ADDC/N's involvement in the joint review of decentralization and sharing of information through its network are some of the examples of its significant contribution.

The government has drafted two bills to amend 10 sectoral Acts that conflict with the LSGA and to amend some provisions of the LSGA. Both the Acts have been submitted to the parliament after the approval of the cabinet.

The LSGA lays down the vision for decentralization, the end goal of where Nepal wants to go. The difficulties lie in implementation. As in all other democracies this needs to be an on-going process, sometimes faster, sometimes slower, where first things are done first, politics are important and one must seize opportunities for change. In Nepal a large gap still remains between legal provisions and actual devolution. Political decentralization has taken place. But administrative and fiscal decentralization are largely inadequate, there are issues of accountability of local bodies to the people, and the capacity of locally elected authorities to assume their new roles is very limited.

The third meeting of high level DIMC under the chairpersonship of Prime Minister Sher Bahadur Deuba approved on January 8, 2002 a comprehensive time-bound DIP. It includes more than 60 activities to be implemented by different ministries

² These associations are: Association of District Development Committees, Municipal Association of Nepal and VDC Association, Nepal

and the National Planning Commission (NPC) within the next five years. It includes the following basic components:

1. Functions and responsibilities;
2. Budget and its flow;
3. Staffing arrangement;
4. Staff Accountability towards LBs;
5. Capacity building; and
6. Effective monitoring.

The DIMC has also made decisions for immediate arrangements for the implementation of the DIP on short-term (within one year), medium-term (two-year) and long-term (five-year) basis. The DIMC instructed all concerned agencies to make necessary arrangements for sectoral devolution immediately. The DIP included the recommendations of LBFC and HMG/N-Donor joint review of 'Decentralization in Nepal, 2001'. The DIP was prepared in a collaborative manner involving government agencies, donors, professionals and representatives of the LB associations.

Decentralization is difficult everywhere. It involves a change in the mindset of how government operates. The role of central government remains important, even more important, in a decentralized system. But its role is largely different, more of regulating, monitoring, financing and facilitating the operation of local bodies, and ensuring delivery of public services that are national in nature. But the central bureaucracy often feels threatened by decentralization. They see it as a loss of power, they resist change. Nepal is no different in this respect.

Current Issues of Decentralization and Local Governance

1. Nepal adopted and operationalized an administrative decentralization model for more than three decades before the 1990s. An institutional setup was created to support the model on a vertical-control basis with strong top-down management practices. A centralized planning and budgeting system still exists in the form of line agencies, which follows the blueprint approach and set targets and budget from the center. Furthermore, development activities are vertically integrated but horizontally uncoordinated.

The LSGA devolved some activities to the local level in order to streamline local development activities. The LSGA has fundamentally transferred comprehensive central decision-making power and resources to the local level through the process of devolution. In this context, the overall administrative system, current practices, staffing arrangements and accountability features have to be shifted from their central orientation to the

local level. Therefore, there has been resistance, particularly from technical line ministries, to opening of sectoral units under the DDC umbrella. However, the DIP has included sectoral devolution as a mandatory provision, which would facilitate policy adoption and program initiatives in the long run.

2. Weak capacity of the LBs and lower-level governance units have constrained their ability to sustain their autonomy provided by the law, which is already evident in the case of some of the LBs. Capacity issues include their present weak resource absorption capacity. The responsibility of capacity building assigned to the government and the line ministries by the LSGA has not been operationalized effectively.

An effective local governance system requires backstopping support of a strong, effective and efficient center. There are three key functions that have to be performed by the center: firstly, strategic direction for planning and resource allocation, second, technical and financial support, and third, provision of necessary regulatory framework. Reorientation and capacity building of the central-level bureaucracy from a controlled to a decentralized environment, nonetheless, is a prerequisite for the effective functioning of the LBs. A weak center cannot monitor and guide enabled local bodies.

3. The LSGA devolved some of the sectoral functions to different levels of governance. However, the tasks and functions of the LBs have not been defined clearly and delineation is yet to be made mandatory for linking it properly with the finance system. Moreover, management capacity and accountability have not been linked effectively.
4. It is strongly felt that the number of LBs in Nepal, especially the VDCs, is too large from the perspective of planning, administration, coordination, cost efficiency and service delivery. The number of locally elected representatives is too large and does not correspond with the LBs' resource capacity. In fact, more than 90 percent of the VDCs, 40 percent of the municipalities and 25 percent of the DDCs are fully dependent on government grants for providing honorarium to elected officials and to cover their basic administrative expenses. This situation has not been of much help to raising the level of investment in development activities for poverty reduction. Similarly, the number of executive committee members and council members requires streamlining.
5. The structure of the LBs has posed difficulties in operationalizing the local governance system efficiently. The existing collective decision-making process does not ensure proper accountability.

Two-way information flow and feedback between the LBs and the citizenry is one of the mechanisms of transparency ensuring accountability. The current practice does not ensure the transparency and accountability envisioned by the LSGA.

6. The block grant has not yet been either requirement- or criterion-based and transparent enough. Equity has remained the crucial issue of grant distribution each year. Furthermore, revenue sharing without equalization schemes does not ensure equity. In view of the implications of revenue sharing and block grants on public service provisions, the present system needs revisiting. Also, an equitable system of resource allocation to the LBs has to be reworked to avoid further widening of regional disparities and inequality in terms of resource distribution.
7. In view of the limited revenue base of the LBs, there is a greater need to share more of the responsibility of development with the private sector, the communities, and self-supporting NGOs. The LSGA has provided space for development actors other than public-sector institutions for local development. But there is no clear methodology for involving non-state development partners in development planning and programming processes other than through the implementation of projects. The private sector is principally recognized as an active development partner, but its roles are not clearly articulated at the operational level. Thus, non-state development partners have not yet been properly linked with the LBs' planning and programming system.
8. The monitoring aspect of decentralization and local governance is still weak.

Areas of Reform and Strategies

In Nepal there are no other options but to decentralized to empower people to resolve their own problems. The geography and remoteness of Nepal pose special challenges for service delivery, often solutions need to be found locally. There are striking disparities between rural and urban areas and between different regions of the country. And the current fiscal situation is straining central government. The HMGN views decentralization as a means to improve the quality and distribution of public expenditures towards improved service delivery and addressing inequalities. Through decentralization HMGN expects to:

- improve accountability of local bodies to the people;
- improve resource allocation;
- improve service delivery;
- address regional disparities;

- increase development efforts for local resource mobilization.

Recognizing this, HMG in the Ninth Plan articulates the link between self-governance and more effective rural development. The Tenth Plan has “poverty reduction” as the overarching goal to be achieved through greater participation of the local bodies, NGOs, CBOs and local institutions in providing service delivery. To this end, HMG is committed to decentralization as the means to ensure delivery services to the people by the people themselves.

The Priority Ahead

The government's high commitment towards decentralization is clearly spelled out. However, initiatives from the sectoral ministry is imperative to develop a devolution package consisting of functions and responsibilities; budget and a clear fund flow mechanism; staffing arrangements and their accountability towards LB's. They will be included in the sectoral strategies of the 10th Plan, and be monitored and reviewed at a later stage making sectoral ministry responsible and accountable to decentralized commitment for that sector.

The Prime Minister, Chair of the DIMC has directed the line ministries to complete the first step of devolution process within this fiscal year. These sectors include education, health, agricultural extension (including the livestock services), postal and infrastructure development works. Rests of the functions to be devolved have been included in the DIP. The monitoring committee for the implementation of the budget and program for 2001-2002 shows government's concern in the advancement of the decentralization and this need to be backed up by decentralization section/division from with in the sectoral ministry.

As discussed above the issue is not where to go on decentralization. The LSGA spells this out clearly and there is little discord on this. The issue is how to get there, what to do first, how to sequence and prioritize reforms. We believe that the immediate priority should be building the capacity of local bodies to enable them to manage the newly inherited powers. But we do not believe that capacity building of local bodies should precede the decentralization of powers. International experience suggests that driving a capacity program prior to decentralizing powers often leads to a top-down, supply side delivery of capacity support. Instead, international lessons point to potential synergy between decentralization (devolution of powers) and capacity building efforts in the public sector. Simply put, local bodies that are given powers and are held accountable for their newly earned responsibilities have a greater incentive to define and seek out the type of capacity support needed to deliver on their obligations. Capacity building programs have the potential of becoming more demand driven in the context of decentralization. In sum, decentralization, i.e. transfer of fiscal and administrative

powers, can help accelerate the capacity building process. But, the potential synergy between decentralization and capacity building is not automatic. Effective capacity building requires at the minimum:

- ◆ a clear fiscal decentralization framework
- ◆ a clear accountability for the devolved responsibilities
- ◆ markets and institutions able to respond to the emerging demand for capacity support
- ◆ a minimum level of capacity within local bodies to manage a program of capacity building

Central government is committed to put these conditions in place and will play an important but critical role to support the growth of capacity at the local level. HMGN strategy for decentralization in Nepal is based on a three part system linking central government with local bodies. One leg is a fiscal support, the second leg is a capacity support, and the third leg is the monitoring and evaluation system.

Fiscal Support

HMGN strategy for fiscal support will comprise the following initiatives:

- Put in place the Fiscal Commission to propose and advise Cabinet on fiscal decentralization policy. The work of the Fiscal Commission will focus initially on the following three areas:
- Clarify expenditure assignments between the three levels of government – central, DDCs, and municipalities/VDCs.
- Set-up a framework for fiscal transfers from central government comprising *current grants* to equalize fiscal capacity and address regional disparities and bridge vertical fiscal imbalances; *capital grants* provided as an incentive to catalyze specific type of expenditures; and a grant to hire a basic number of people as staff members and to set up the minimum administrative capacity. The rules of decentralization will include fiscal controls and a system for hard-budget constraints imposed by central government. Local bodies should realize that abuse of own-financial resources will not lead to a bail-out from upper-tier governments
- Clarify revenue assignments and propose effective systems for local revenue administration. While many local taxes and fees can be successfully collected by local bodies as part of an autonomy and capacity building package, others of more technical complexity are better managed by

specialized agencies or higher level governments on behalf and for local bodies upper-tier governments should be specified.

Capacity Support

Having provided the fiscal resources for managing local responsibilities, the second leg of support is a capacity vehicle. The vehicle should have two windows – a demand window and a supply window.

- The demand window is a simply a rapid response grant. As local authorities begin implementation of their responsibilities, different local bodies will face different types of capacity constraints. Some may require assistance in planning; others in community management; others in managing public private partnerships or specific training and so forth. These constraints cannot be predicted, are dynamic in nature, and are best understood by the local authorities themselves. The demand window would provide grant resources for local authorities to define and contract-in the capacity. Some may hire private sector assistance, others will contract in NGOs, and some may commission training institutions to design courses, and so forth.
- The supply window of the capacity vehicle is more complex and is based on the reality that many local bodies do not even have basics to manage their devolved responsibilities. Basic financial management, personnel management, planning structures, and other administrative elements is often missing or partially missing. And central government requires the implementation of certain basic systems to successfully implement a program of decentralization – statutory requirements to be fulfilled by local authorities in the areas of budgetary, financial, and regulatory matters. An institutional set up dedicated to helping the implementation of the statutory requirements and supporting the cluster of the weakest local authorities (or strengthening of the existing institutions) will be needed to form the supply window of the capacity vehicle.

The mobile nature of the teams enables the capacity vehicle to create a network among the local authorities for a shared learning approach where local authorities learn from each others experience and provide a mutual support in the reform process. Learning can be accelerated between local bodies where stronger local bodies can be mobilized to support others.

In addition, NPC capacity is in place to estimate the means and provide districts with the guidelines to match the goals of periodic plans and annual plans and its linkages with the national plans and priorities. However, those areas still need capacity strengthening measures including that of the capacity of the Ministry of Local Development and the sectoral ministries. Similarly, budget and guidelines

are being sent to the district but the linkages with the goals, estimations and allocations fall short in quality support as envisaged in the Act. This requires setting-up of units within NPC and MLD to oversee the process streamlined. This also seeks for the network linkages among key sectoral ministries and MLD with the NPC.

Similarly the establishment of District Technical Office shows steps in strengthening of the local technical capacity to deliver the quality services to the local people. This is a step towards development of professionalism, sustainability and quality assurance in the service of the local bodies. The outsourcing and involvement of the non-governmental organization and civil societies in this endeavor needs concerted effort.

The vision of the Local Service has been introduced and endorsed in the DIMC as envisaged in LSGA. The concept has been framed and an approach paper is being developed for wider discussion. This will lead the district to own LSGA and manage the affairs of the local levels effectively.

Governance through social mobilization is being institutionalized through LDF. The intervention to poverty alleviation is made through the LB's, who are close and has direct access to the poor community or the people. This effort will be further strengthened to meet the objective of local level service delivery.

Monitoring and Evaluation

Decentralization of powers and sharing of responsibilities between different tiers of government is a complex process. There are a variety of risks involved and a dynamic form of learning and if need be "correction in mid-stream" is needed. Central government is better placed to do the monitoring and evaluating the process. The design of an M&E system is as complex as a capacity vehicle. Minimum conditions to be addressed are: What indicators to monitor? Who monitors and where do the results get reported? What are the thresholds that will trigger a policy response, what should these responses be and who should undertake them? These issues have to be address as soon as possible.

Conclusion

The commitment of the government through the peer group review, formation of the joint coordination forum on decentralization, works of the thematic group and the DIP itself inclusive of the devolution of the functions and the recommendations of the fiscal commission are some reflections of the government commitments. In addition, decentralization plan and national framework on capacity enhancement

for poverty alleviation are two major documents along with various reform steps at the moment. Similarly, the Tenth Five Year Plan (draft approach paper) has adopted decentralization as crosscutting theme. It has included several strategies to facilitate the devolution process in line of the commitment made in the LSGA and detailed in the DIP. All these efforts reveals that reviewing and revisiting of the role and functions of MOF, NPC, MLD and the line ministries in linking the goals of LSGA and implementation of overall programs in achieving the objectives and principles of decentralization will be strengthen.

HMGN proposes to pursue decentralization through a three legged approach involving fiscal devolution, capacity building and monitoring and evaluation, of which the main principles were outlined above. Some work has already been done in this regard but this strategy needs to be detailed and operationalized, with assignment of responsibilities and accountabilities in its implementation. The first step will be the elaboration of an Action Plan specifying monitorable activities and financial resources needed and go for actions that has been already decided.