



Intergovernmental fiscal transfers

What this presentation is about

- Current problems in Nepal's intergovernmental fiscal transfers
- Presentation of advantages and disadvantages of criteria commonly used in intergovernmental fiscal transfers in Nepal
- Some illustration on local government revenue composition in European countries

Intergovernmental fiscal transfers

- Intergovernmental fiscal transfers are necessary, if
 - the principle of self-funding of layers of government is violated (meaning that each level of government should have sufficient revenues assigned to fund for the functions assigned to that level)
 - = vertical fiscal imbalance is given
- Typically, intergovernmental fiscal transfers are necessary in state structures in which local jurisdictions are heterogeneous (economical situation, accessibility, service provision)

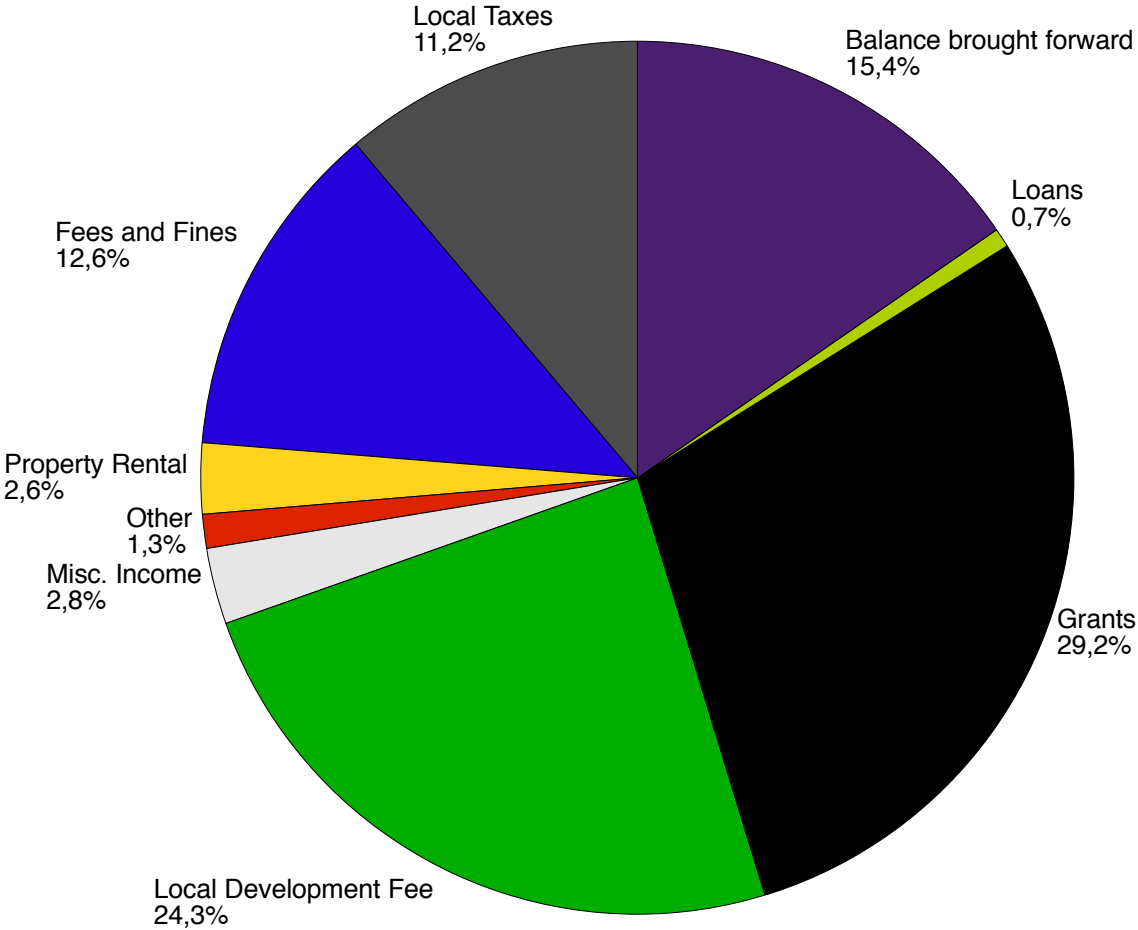
Some illustrations of Nepal's heterogeneous state structure

- There are 75 DDCs, 58 municipalities, and 3,912 VDCs
- The largest VDC is three times bigger in terms of population than the smallest municipality.
- The three DDCs in Kathmandu Valley (Kathmandu, Bhaktapur and Lalitpur) account for about 80% of the total tax income of Nepal
- The biggest municipality (Kathmandu) is about 66 times larger in terms of population than the smallest (Dhulikel).

The situation of local government finance for municipalities

Current situation

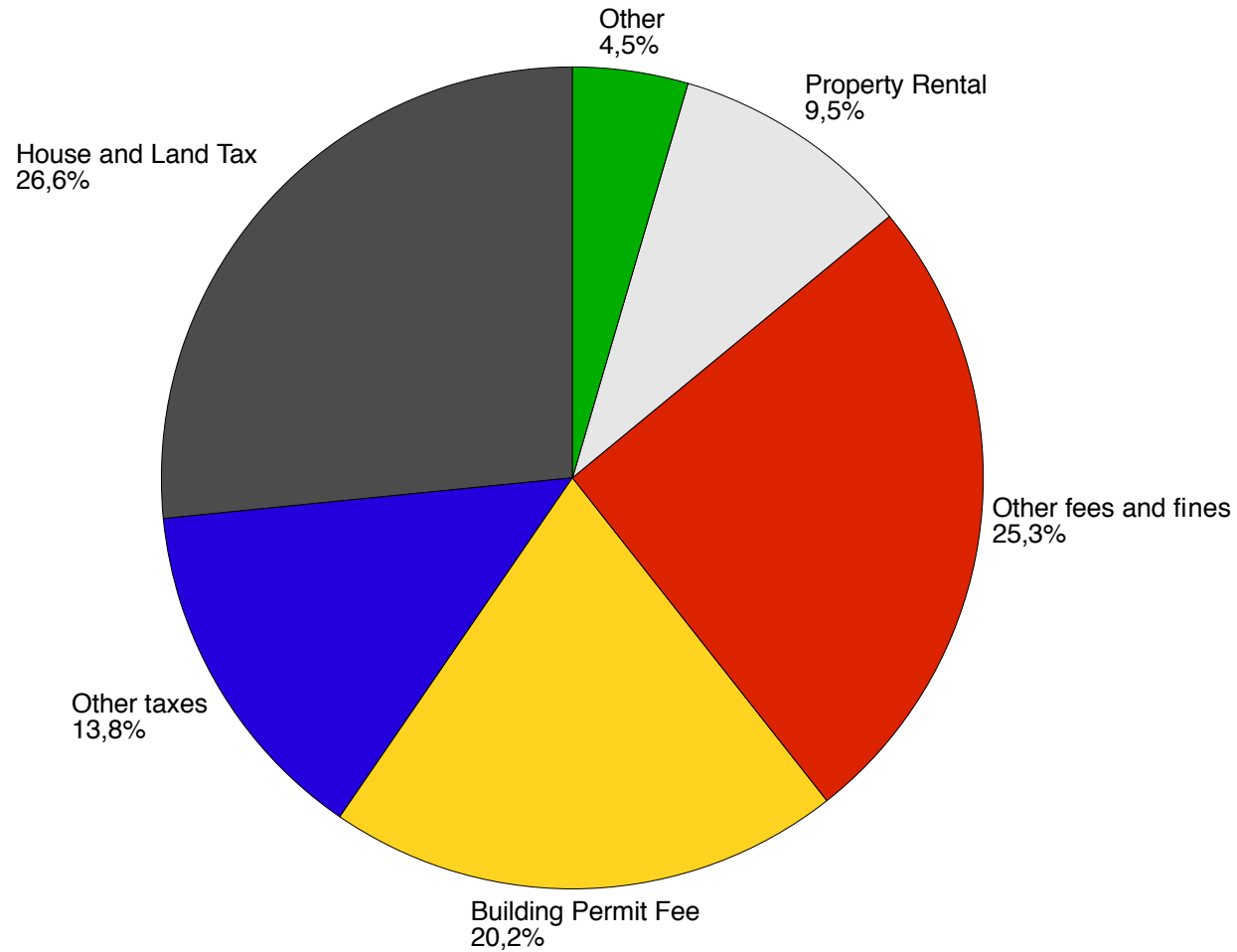
income composition of municipalities



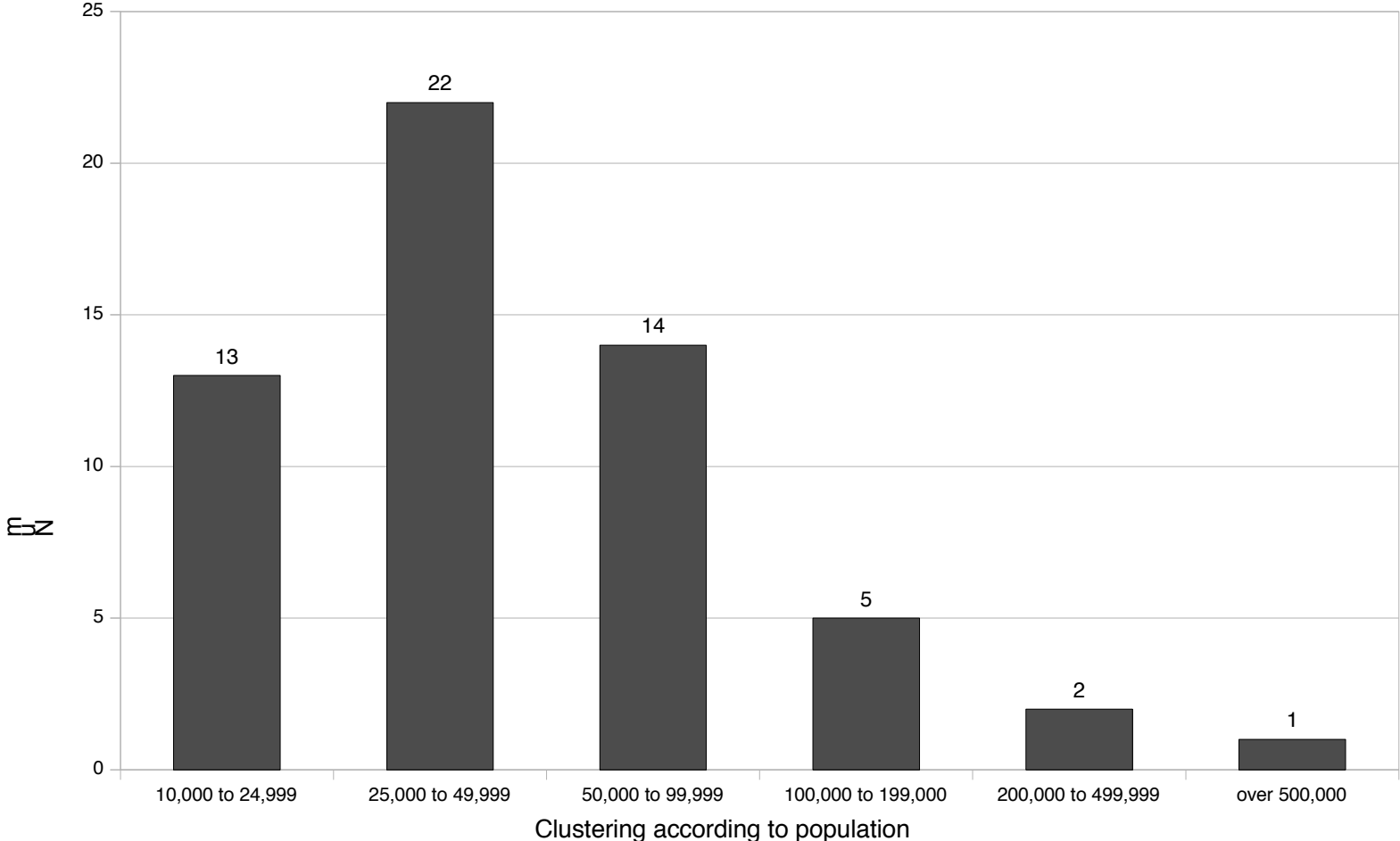
Current situation

- Significant Local Development Fee (now municipal grant) increase, regarded by municipalities as „own source revenue“ due to historical octroi, formally however an input to gross fund for intergovernmental fiscal transfers
- Consequently, share of own source revenue declining
- Availability of topping-up grants under MC/PM scheme funded through LGCDP (international donor assistance)

Own source revenue of municipalities



Clustering of municipalities according to population



High fiscal imbalance

- extremely uneven allocation of former LDF increases horizontal fiscal imbalance
- comparatively low share of own source revenue in a number of municipalities

Criteria used in FY 2010/2011 for municipalities

- population 50% (unweighted)
 - area 10% (geographical setting)
 - poverty 25% (based on HDI)
 - taxing power 15% (input from gtz/udle)
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- severe problems with current elements and definitions:
 - unweighted population
 - no data for poverty, and high correlation with population
 - area: little statistical evidence

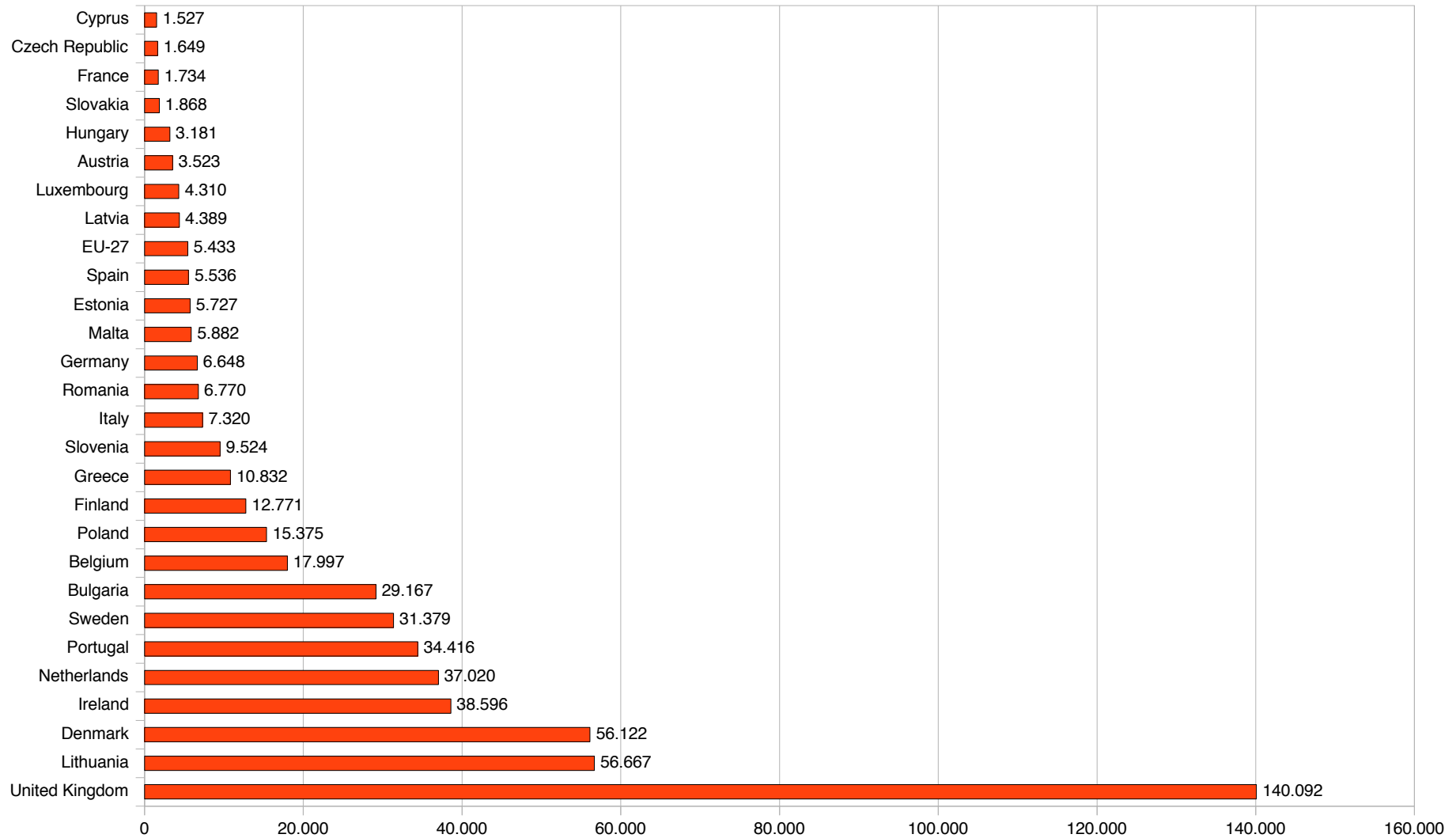
VDC – even bigger problems

- proposed 7.83 bln fund for the 3,912 VDCs in Nepal
- minimum amount of 1.5 mln and maximum amount of 3.0 mln defeats purpose of formula-based grant allocation
- over 1,500 VDC would be overfunded (as there are VDC with only 196 inhabitants), and over 500 would be underfunded (as the largest VDC counts more than 44,000 inhabitants)
- further, elements of the grant formula do not comply with statistical considerations

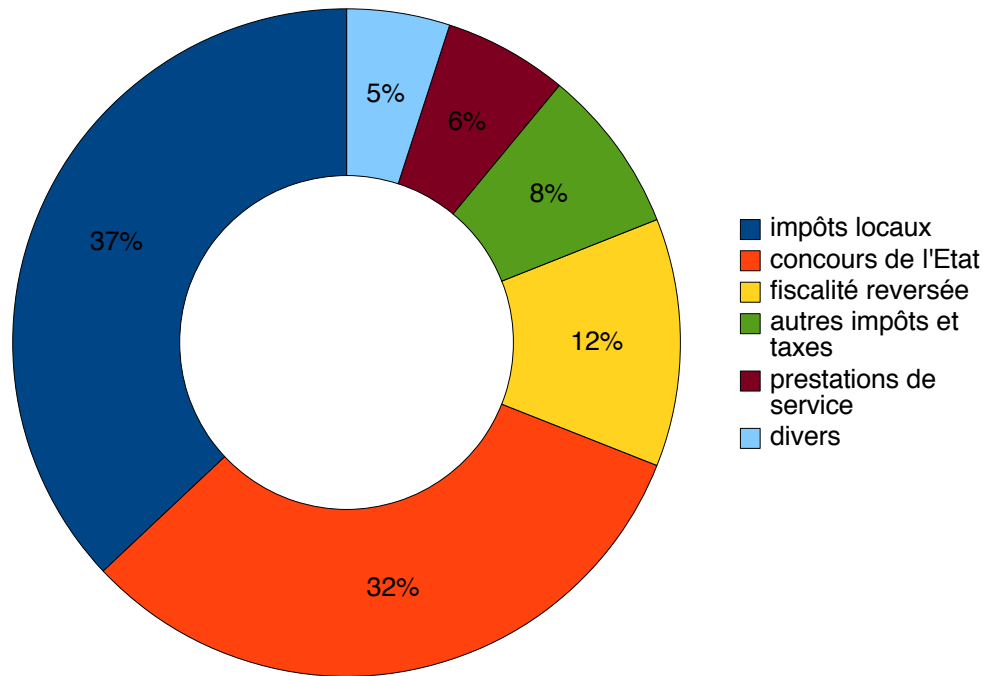
Why the design of intergovernmental fiscal transfer is a difficult task

- variety of local governments in population numbers
- variety of local governments in functions allocated
- variety of local governments in terms of economic and social power
- ...

Variety across Europe: just a glance

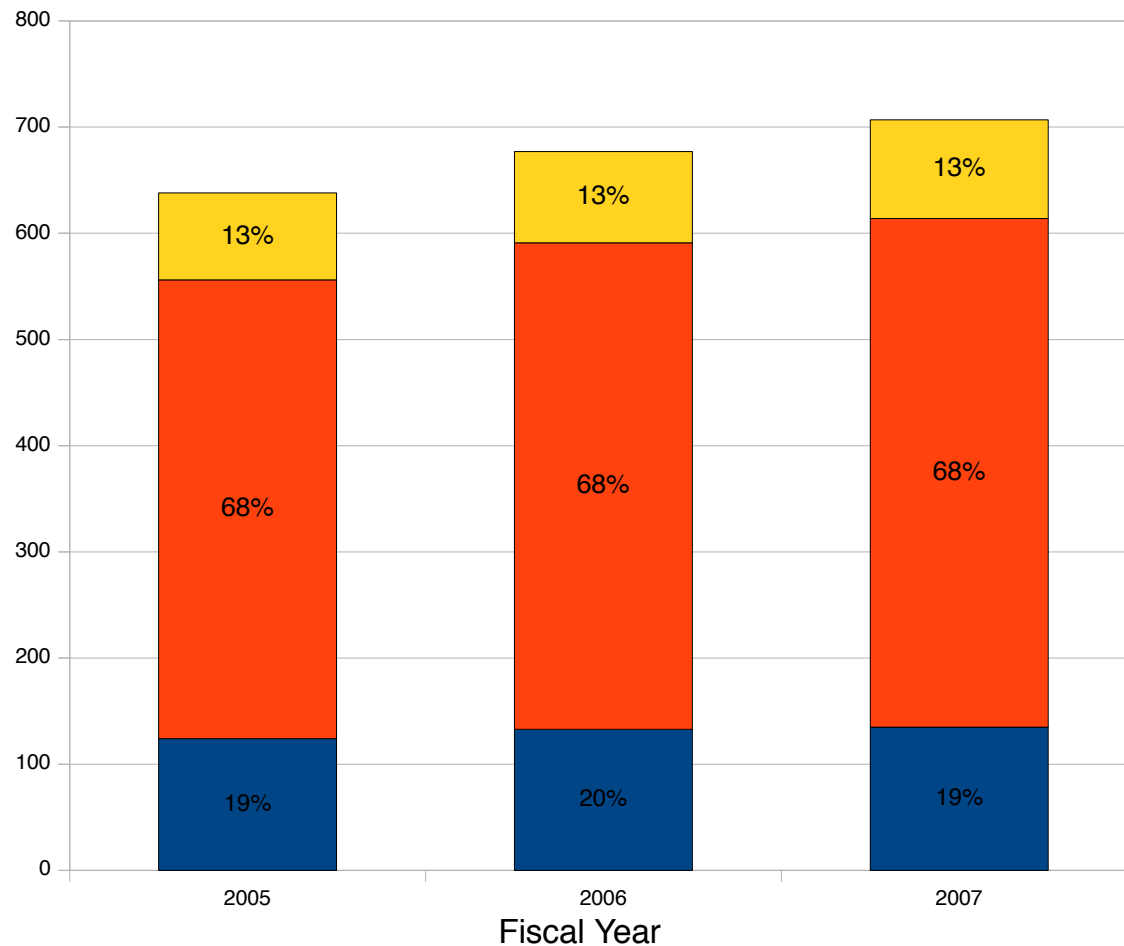


Income composition of French local government



- Taxes are most important (37%)
- followed by intergovernmental fiscal transfers (32%)

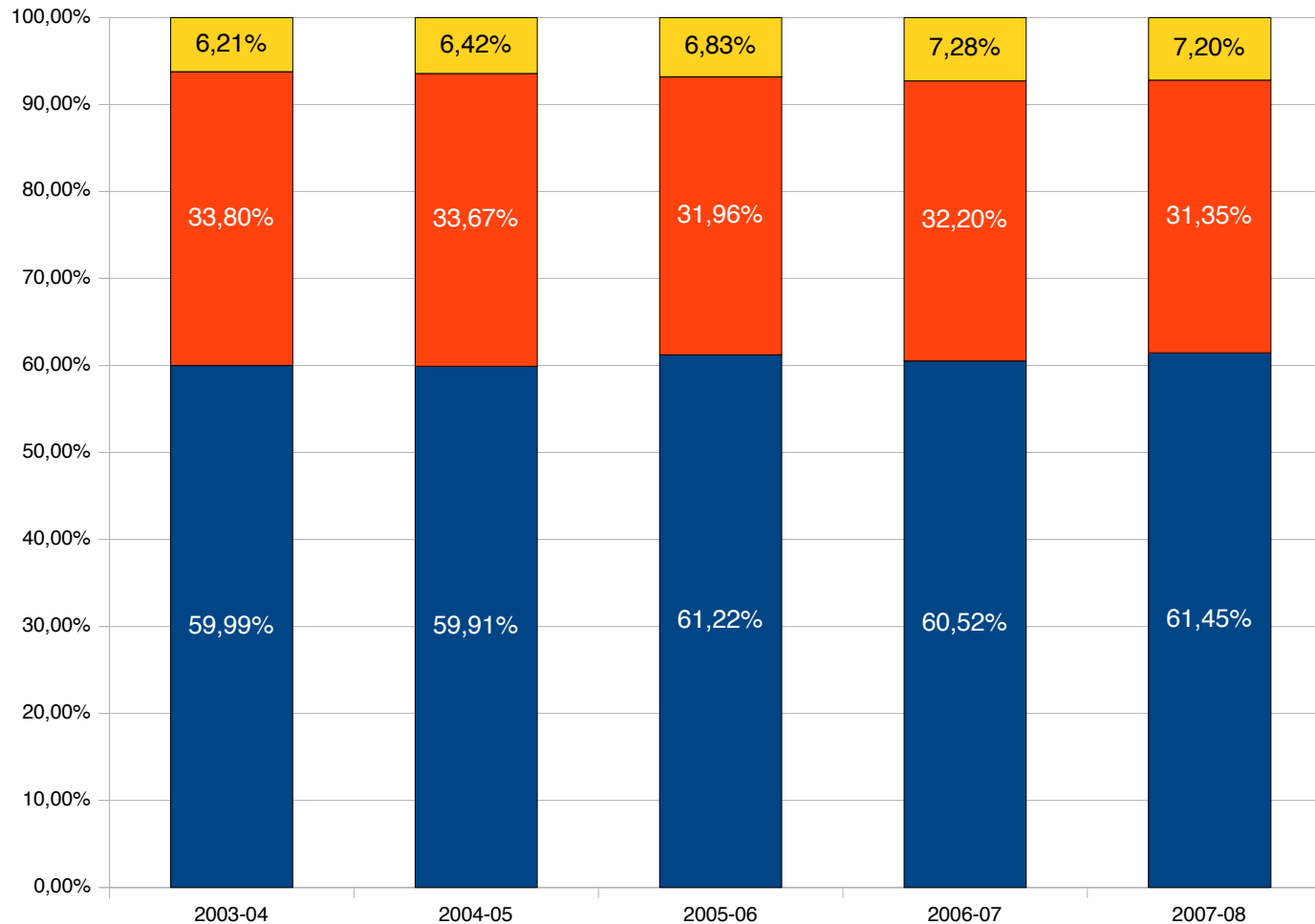
Income composition of Swedish local government



- 68% from local taxes
- only 13% from central government

■ General government grants and equalisation
■ Tax revenue
■ Income of activities

Income composition of English local authorities



- high dependency from central government

Other Income
Own Source Revenue
Grants

Summary: What is needed

- A clear and common understanding of local governments' role and function in a federal Nepal
- A clear-cut, formula-based grant system with unconditional and conditional grants
- An advisory and supervisory role of the Local Body Fiscal Commission and the General Auditor on local government budget practice