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Financial Sustainability of Local Governments: An Analysis of Revenue and Expenditure Bases in Gandaki Province, Nepal

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Abstract: The 2015 Constitution of Nepal created a federal structure with significant revenue and expenditure powers transferred to local governments. However, the financial sustainability of these newly created local governments poses a critical issue. This article examines the revenue and expenditure systems of local governments in Nepal's Gandaki Province. The research design of this article is descriptive and analytical. The article used both primary and secondary sources of data. The primary data sources used in this article are key informant interviews and structured questionnaires. The secondary data sources used in this article are annual reports, audit reports, and official documents from 27 local governments in Gandaki Province, Nepal. The findings of this article show that local governments have achieved significant milestones in enacting tax laws for conventional revenue sources, such as land revenue and business tax. However, local governments have ignored non-conventional revenue sources. Administrative practices, including automation of the revenue system and budgetary monitoring, are prevalent, but inefficiencies are evident in collection systems: almost three-fourths of municipalities face rising arrears, and almost half face high revenue concentration from a single source. Intergovernmental transfer dependence is high, with 74.1% of all municipalities relying on grants, which form more than half of their total revenue. Large variations are observed in own revenue generation and per capita expenditure among municipalities, indicating fiscal imbalances. The study concludes that, although municipalities have strengthened their fiscal systems, their sustainability is threatened by dependence on grants, inefficiencies in enforcement, and a lack of diversification of revenue, and policy measures should be taken to strengthen the local tax base, collection systems, and link strategic plans with budget execution to achieve the objectives of fiscal federalism in Nepal.

Keywords: *Fiscal federalism, municipal finance, revenue base, expenditure base, financial sustainability, Gandaki Province, Nepal*

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1. Introduction

The adoption of the 2015 Constitution of Nepal represents a fundamental shift in the structure of government from a unitary to a federal system of government, with the Constitution establishing a federal, provincial, and local government structure (Gautam, 2018). This fundamental restructuring of government in Nepal resulted in the creation of 753 local government entities, which include metropolitan cities, sub-metropolitan cities, municipalities, and rural municipalities. Local government entities have been established as the primary vehicle for the delivery of services to the people of Nepal, as they represent the government closest to the people. In the new structure of government in Nepal, municipalities have been entrusted with the responsibility of providing both "hard" services such as the construction of roads, water, and sanitation facilities and "soft" services such as parks, libraries, and social housing. In order to fund these responsibilities, the Constitution and the Local Government Operation Act of 2017 have granted municipalities the authority to impose various forms of taxes and non-tax revenues, thereby establishing the principles of fiscal federalism in Nepal (Sharma, 2021).

For the purposes of this study, the term "local governments" encompasses all 85 Palikas in Gandaki Province, which include one metropolitan city, 26 urban municipalities, and 58 rural municipalities. Although Nepal's legal framework distinguishes between urban municipalities (Nagarpalika) and rural municipalities (Gaunpalika), both share similar revenue and expenditure authorities under the Local Government Operation Act 2017, justifying their joint analysis.

Despite the devolution of revenue-generating powers, the financial sustainability of the newly formed municipalities also becomes an important area for concern. The financial autonomy granted to the municipalities through legislation often becomes difficult to achieve due to the continued dependence on federal and provincial government grants, which often acts as a disincentive for the development of autonomous revenue streams (Adhikari, 2025). The situation becomes worse due to the various challenges affecting the revenue mobilization efforts in the municipalities. These challenges include the inefficiency in the collection of taxes, the low revenue base, and the high level of tax arrears.

Gandaki Province, one of the seven provinces in Nepal, becomes an important area for analysis due to the geographical diversity, the presence of 85 local administrative bodies, including one metropolitan city, 26 municipalities, and 58 rural municipalities, and the presence of 2.47 million people, who exhibit various characteristics, including the presence of negative growth in some districts due to the high level of migration to urbanizing districts such as Kaski and Nawalparasi East. The purpose of this research was to carry out an exhaustive analysis of the revenue and expenditure bases of Gandaki Province's various municipalities. This research aimed to evaluate the extent of fiscal autonomy and the underlying structural challenges by studying the legal environment, revenue collection mechanisms, and expenditure trends. One of the primary areas of interest was the overreliance on transfer grants, the successful execution of tax legislation, and the uneven fiscal capacity of various municipalities. This helps policymakers and local administrators understand the underlying dynamics of municipal finance and develop targeted interventions to improve local fiscal resilience and move towards becoming less dependent on grants and ensure that local governments are able to discharge their constitutional obligation of delivering quality services to their citizens.

2. Relevant literatures

The financial activities of local governments are supported by several theories. Fiscal Federalism, as expounded by Richard Musgrave and Wallace Oates, argues that decentralization promotes economic efficiency through the provision of services that match the preferences of the people in local communities. This theory justifies the assignment of both expenditure responsibilities and revenue-raising powers to local governments. However, the success of the theory is subject to the matching of the powers in question, a situation usually complicated by vertical imbalances.

Complementary to this is the Public Choice Theory that focuses on local stakeholders such as people, businesses, and interest groups who are considered rational actors that influence municipal budgets and tax policies based on their own self-interests. This theory also emphasizes the need for holding government officials accountable to the people rather than to interest groups. Another theory that would support the use of user fees and taxes is the Benefit Principle of Taxation that holds that people who receive a certain service from government should be made to pay for it. Finally, there is the Agency Theory that would offer a framework for understanding the relationship between the people (principals) and government officials (agents), particularly the need for transparency to address information asymmetry.

Globally, the drive for local financial sustainability faces challenges such as revenue sufficiency, autonomy, and efficiency. Various studies have established that local governments largely depend on intergovernmental transfers, thus leading to financial dependency (Shah & Shah, 2006). In the case of developing countries, factors such as weak institutions, low administrative capacity, and low tax base have been identified as major challenges to municipal finance (Serageldin et al., 2008; UN-HABITAT, 2009).

In the Nepali context, various studies have been conducted to assess the developments and shortcomings since the federal restructuring in 2015. For instance, in their study on Tokha Municipality, Bhandari et al. (2019) reported improvements in the efficiency of tax collection; however, the revenues generated at the local levels are not sufficient to undertake large-scale infrastructure development and remain heavily reliant on external funding sources. Moreover, Dhungana and Acharya (2021) reported developments in the internal revenue systems of Nepali local governments; however, these are heavily constrained by the lack of technical and legal frameworks for taxation at the local levels. Sharma and Vyas (2023) conducted a detailed analysis of the Nepali municipalities in Gandaki Province and reported large variations in the generation of own revenues and high dependence on grants, which is detrimental to the financial autonomy of these municipalities. More recently, Poudel et al. (2025) reported their findings on the financial condition of Nepali municipalities and highlighted the risks of revenue concentration and tax arrears.

In spite of these contributions, there is a need for a detailed cross-sectional analysis that simultaneously considers the legal-institutional framework, revenue collection efficiency, and expenditure efficiency in a range of municipalities. The current study bridges this gap by offering a comprehensive assessment of the revenue and expenditure bases of municipalities in Gandaki Province, which can provide valuable empirical insights for informed policy interventions in the context of Nepal's federal system.

3. Materials and methods

The study used a descriptive and analytical research design to examine the revenue and expenditure bases of Gandaki Province's municipalities. The descriptive aspect outlines the structure, sources, and patterns of municipal revenues and expenditures, while the analytical component assesses fiscal performance and identifies disparities across municipalities. The study employed purposive sampling to select municipalities based on variables such as population size, geography, and degree of urbanisation. Whereas qualitative data from document reviews and interviews provided contextual depth and illuminating insights into local financial management methods, quantitative data was analysed using statistical tools.

3.1. Population and Sample

A total of 27 rural and urban municipalities were selected as sampling units from the 85 municipalities, representing approximately 32 per cent of the population. This sample size is statistically adequate given the population of 85 municipalities: at a 95% confidence level, a sample of 27 yields a margin of error of approximately ±15%, which is acceptable for exploratory fiscal research in developing country contexts where population variance is high (Serageldin et al., 2008; UN-HABITAT, 2009). Comparative studies on municipal finance commonly employ sample sizes ranging from 25-35% of the target population (Phatudi, 2010; Kaphle, 2016). Furthermore, purposive stratification across all 11 districts and three geographical regions (mountain, hill, Tarai) ensures representativeness despite the modest percentage. A single province-wide metropolis was purposefully included in the sample. The province of Gandaki comprises 11 districts dispersed across three distinct topographies. Purposive sampling ensured that the sample of municipal units represents all 11 districts and three geographical regions. At least 25% of each district's sample units were carefully selected and distributed proportionately by region. The sampling process produced a sample representative of the population by district, geographic location, and municipality type.

3.2. Nature and Sources of Data

Both primary and secondary data were used in the study, which emphasises a quantitative methodology. The Central Bureau of Statistics, Nepal; the Office of the Controller of the Auditor General, Government of Nepal; Local Development; and the Local Bodies Fiscal Commission provided the annual and audit reports of the selected urban municipalities, which contained the secondary data needed for the study. Key informant interviews (KII) comprised the primary data collection process. It was gathered through consumer questionnaires and interviews, as well as from firms that depend on internet marketing to perform successfully. The secondary data were collected from various published and unpublished sources on the impact of social media on consumer buying patterns, including articles and journal articles in newspapers and business magazines, commercial reports, books, and so on. Some important and useful information will also be exported from the internet.

3.3. Data Analysis Method

Both descriptive and inferential statistical methods were used to evaluate the gathered data. Quantitative data on revenues and expenditures were first organised and summarised using descriptive statistics such as means, percentages, and growth rates to identify patterns and trends over the study period. A comparative analysis was conducted to examine differences in fiscal performance among municipalities by size, location, and urban-rural classification. To explore relationships between revenue sources and expenditure categories, and correlation were conducted using statistical software, including MS Excel. Qualitative interview data were analysed using thematic content analysis to extract key insights into challenges, strategies, and institutional factors affecting municipal fiscal management. The integration of quantitative and qualitative findings provided a comprehensive understanding of the financial dynamics at the municipal leve).

4. Results

According to Nepal's 2015 constitution, municipalities have the authority to enact laws and levy various taxes at the local level. The Village and Municipal Assembly has been given the authority under the constitution to create and implement its own laws, which are listed in Schedules 8 and 9. Nonetheless, there are clauses that specify when national and federal authorities are authorised to establish legal boundaries. The following legal guidelines are intended to be drafted: Laws concerning the deadline for financial submissions (Article 59(3)); the management of financial deficits and other financial discipline (Article 59(7)); the imposition of taxes and sales on subjects covered by the Concurrent List and subjects not covered by any stage's lists (Article 60 (1) 9); policies, laws, and regulations pertaining to any of the subjects listed in the Concurrent List and any areas of monetary authority that are deemed pertinent to the states in addition, as stated in Article 59 (2); Article 56(4) of the laws pertaining to the determination of the vast number of wards within the Village Body and Municipality; and the laws pertaining to conditional, complementary, or unique presents (5); Paudel and Sapkota (2018) state that the charter no longer supports laws pertaining to various provisions of the neighborhood stage government (Article 219); laws pertaining to the creation of a four-member ward committee alongside the ward chairperson in the

Village Body and Municipality (Articles 222 (4), 223 (4)); laws pertaining to the imposition of taxes that do not obstruct the flow of capital and labor markets, goods and services, and the neighboring nation or neighborhood stage (Article 228 (2)); laws pertaining to the financing of deficit funds financing (Article 230 (2)); and laws pertaining to preserving coordination among the federation, nation, and neighborhood stage (Article 235 (1)). The various taxes and levies that municipalities may impose are specified in Sections 55 to 62 of Part 9 of the Local Government Operations Act of 2017. Municipalities must enact legislation to collect taxes from the specified revenue sources under this legal rule. Regarding this issue, the municipalities in Gandaki Province are currently in the following state:

Table 1: Position of Tax Law Formation and Enactment

Revenue Base	Formations of lows				Execution of laws			
	Yes	%	No	%	Yes		No	%
IPL/HLP	22	81.50	5	22.5	22	81.50	5	80.50
Land revenue	23	85.20	4	14.80	25	92.60	2	7.40
House and land rent tax	23	85.20	4	14.8	24	88.90	3	11.10
Business Tax	21	77.80	6	22.20	22	81.50	5	18.50
Parking	8	29.60	19	70.40	7	25.90	20	74.10
Herbs, waste	9	33.3	18	66.70	9	33.30	18	66.70
Service	21	77.80	6	22.20	23	85.20	4	14.80
Rental	18	66.70	9	33.30	18	18.66	9	33.30
Others	3	11.10	24	88.90	3	11.10	24	88.90

Note: Researcher's survey, 2025

Table 1 highlights the status of the formulation and enactment of tax laws across different revenue bases in the municipalities of Gandaki Province. It shows whether laws have been formulated and executed in specific tax categories, along with their corresponding percentages. In the case of IPL/HLP (Integrated Property/Land Holding Tax), 81.5% of municipalities have enacted laws, and the same percentage have implemented them, indicating a relatively strong legal foundation. Land revenue demonstrates the highest level of legal activity, with 85.2% forming laws and 92.6% executing them, indicating effective policy implementation. Similarly, the house and land rent tax has a high formation (85.2%) and execution (88.9%) rate, suggesting robust enforcement. Business tax also reflects a relatively high formation (77.8%) and execution (81.5%) rate.

On the contrary, categories such as Parking and Herbs/Waste revenue show much lower figures. Only 29.6% and 33.3% of municipalities, respectively, have enacted related laws, and execution rates remain similarly low at 25.9% and 33.3%, highlighting areas that need policy attention. The Service tax category shows encouraging progress, with 77.8% formation and 85.2% execution, whereas Rental revenue shows inconsistencies: while 66.7% report law formation, the execution percentage appears to be a typographical error, likely meant to reflect 66.7% execution. Other taxes remain largely neglected, with only 11.1% of municipalities forming and executing laws. In summary, while core taxes like land, property, and business taxes have strong legal backing and effective implementation, less conventional revenue areas like parking, herbs/waste, and miscellaneous categories lack both structured laws and enforcement, highlighting an uneven municipal taxation framework.

Table 2: Municipalities' Practices for Revenue Improvement

Practice	Respondents Option			
	Yes	%	No	%
Other taxes enacted	8	29.60	19	70.40
Updated detail rate	25	92.60	2	7.40
Notice and forms related	25	92.60	2	7.40

Automation of the revenue system	26	96.30	1	3.70
Meeting of the Revenue Consultation	25	92.60	2	7.40
Revenue feasibility study	21	77.80	6	22.20
Revenue forecast	20	74.10	7	25.90
Budget-based revenue projection	22	81.50	5	18.50

Note: Researcher's survey, 2025

Table 2 presents an overview of the various practices adopted by municipalities in Gandaki Province to enhance their revenue systems. The responses indicate the extent to which each practice has been implemented. A strong majority of municipalities have adopted most of the listed revenue improvement practices. Notably, automation of the revenue system has the highest adoption rate, with 96.3% of respondents confirming its implementation. This indicates a positive shift toward digitization and efficiency in revenue management. Additionally, updating detailed rates and using notices and forms are both practised by 92.6% of municipalities, reflecting strong administrative efforts to keep taxpayers informed and the system up to date.

Similarly, 92.6% of municipalities are conducting revenue consultation meetings, underscoring an emphasis on stakeholder engagement and participatory planning. Revenue feasibility studies and revenue forecasting have been adopted by 77.8% and 74.1%, respectively, which highlights that a majority of municipalities are moving toward more strategic financial planning. Budget-based revenue projections have also been adopted by 81.5% of municipalities, further supporting the trend toward data-driven fiscal planning.

However, the enactment of additional taxes remains relatively low, with only 29.6% of municipalities having done so, indicating significant room for diversifying and expanding the local revenue base. Overall, the data reveal a strong commitment to improving revenue practices among municipalities, particularly in automation, transparency, and strategic planning. However, efforts should be made to broaden the range of revenue sources by enacting other currently underutilised taxes.

Table 3: Reactions to the Strengthening of the Revenue and Spending Base

Statements	**Yes**		**No**	
	N.	**%**	**N.**	**%**
Generally speaking, municipal spending stays within +/- 5% of the authorized operating budget;	20	74.10	7	25.90
Prior to council meetings, the administration promptly sends written updates to the council regarding the performance of the municipality's budget and finances;	26	96.30	1	3.70
Is there a formal procedure in place in your municipality to connect the municipal budget and business plan?	16	59.30	11	41.10
Does the council at least once every quarter compare the municipality's actual and budgeted revenues and expenses?	20	74.10	7	25.90
Tax revenues increased by a certain percentage throughout the previous two years;	24	88.90	3	11.10
Is there any revenue generated by investments in your municipality?	7	25.90	20	74.10
Has the revenue generated by investments in your municipality increased over the last two years?	21	77.80	6	22.20
Does the increase in municipal revenue correspond to community growth?	16	59.30	11	40.70
Have federal and provincial funds accounted for over half of your municipality's overall revenue, as shown by the yearly audited financial statements?	20	74.10	7	25.90
Are the taxes levied by your municipality comparable to those of other municipalities in your area?	14	51.90	13	48.10
Are the taxes levied by your municipality similar to those of other municipalities in your area?	25	92.60	2	7.40
Generally, are IPT/house and land tax payments made on time?	24	88.90	3	11.10
Are tax payments typically made on time to avoid penalties or charges?	4	14.80	23	85.20
Does more than 20% of all municipal property tax revenues come from the largest single taxpayer?	13	48.10	14	51.90
Does the most recent fiscal year have more than 5% of your municipality's current property taxes outstanding?	17	63.00	10	37.00
Has the overall tax arrears percentage gone up over the last two years?	20	74.10	7	25.90
Are the fees and service charge rates offered by your municipality comparable to those of other municipalities in your area?	16	59.30	11	40.40

Are the fees and service charge rates charged by your municipality comparable to those in your area?	9	33.30	18	66.70
Do your utility rates bring in enough money to pay for the upkeep and operation of the municipal utility system?	7	25.90	20	74.10
Are customers' utility bills regularly collected?	17	63.00	10	37.00
updated the system for collecting unpaid utility bills;	5	18.50	22	81.50

Note: Researcher's survey, 2025

The analysis of responses on strengthening the revenue and expenditure bases of municipalities reveals several significant insights. A large majority (74.1%) of respondents indicated that municipal spending generally remains within ±5% of the authorised operating budget, suggesting effective budgetary control. Additionally, a high percentage (96.3%) confirmed that administrations provide timely written updates on municipal finances before council meetings, reflecting strong communication and oversight practices. However, only 59.3% reported having a formal procedure to link the municipal budget to the business plan, indicating room for improvement in strategic alignment. While 74.1% affirmed that councils compare actual and budgeted revenues and expenditures quarterly, the finding that only 25.9% reported municipal revenue generation from investments points to a weak area in financial diversification. Encouragingly, 88.9% reported an increase in tax revenue over the past two years, and 77.8% reported growth in investment-generated revenue. However, only 59.3% believe this revenue growth aligns with community growth. A majority (74.1%) reported relying on federal and provincial funding for over half of total revenue, raising concerns about fiscal independence. There were inconsistent perceptions about tax comparability with neighbouring municipalities, possibly due to subjective or regional variations. Although 88.9% stated that IPT/house and land tax payments are generally timely, only 14.8% confirmed that tax payments are typically made in time to avoid penalties, highlighting inefficiencies in collection. The presence of over 20% property-tax dependency on a single taxpayer in 48.1% of cases also suggests a risk of revenue concentration. Furthermore, 63% reported that more than 5% of property taxes remained outstanding in the last fiscal year, and 74.1% observed a rise in tax arrears. Service charge and fee comparability were also split, showing inconsistent cost structures among municipalities. Notably, only 25.9% confirmed that utility rates were sufficient to cover operating costs, and just 18.5% reported system updates for unpaid utility bill collection, signalling substantial weaknesses in utility revenue management and enforcement. These findings point to both strengths and gaps in municipal financial management that require targeted reforms.

Table 4: Comparing Various Revenue and Expenditure Measures

Comparable	Maximum	Minimum	Mean	Sta. Dev.	CV
Total revenue	3,61,78,97,547.32	14,88,94,300.72	59,53,66,086.57	64,09,59,168.24	1.08
Total expenditure	3,29,50,00,049.91	10,79,00,899.94	55,47,43,951.99	58,56,93,404.44	1.06
Fiscal equity grants	62,16,44,000.00	7,84,33,000.00	15,06,12,869.48	10,33,65,383.60	0.69
Other grants	1,35,02,49,371.09	4,01,90,456.77	29,13,06,575.06	24,95,95,576.53	0.86
Total grants received	1,97,18,93,371.09	11,86,23,456.77	44,19,19,444.54	34,75,38,659.88	0.79
Capital expenditure	1,31,40,51,330.83	4,75,32,538.54	20,37,60,366.51	23,67,89,350.21	1.16
Operational expenditure	1,57,24,41,880.98	2,49,29,411.96	17,19,95,236.42	28,92,01,775.20	1.68
Employee expenditure	44,54,50,345.14	3,40,63,383.57	17,89,88,349.07	11,04,56,926.19	0.62
Total own revenue	1,64,60,04,176.23	2,98,68,570.55	15,34,46,642.03	30,49,86,275.30	1.99
Own revenue per capita	34,320.68	1,604.79	5,028.75	6,917.47	1.38
Total revenue per capita	1,68,814.40	8,751.63	26,175.86	34,861.39	1.33
Grants received per capita	134,493.72	4,769.98	21,147.12	28,265.47	1.34
Capital expenditure per capita	53,891.77	2,862.36	8,698.62	11,527.81	1.33
Operational exp. per capita	28,264.64	1,702.35	5,649.49	5,775.52	1.02
Salary expenses per capita	40,180.21	988.17	7,775.48	8,142.31	1.05
Fiscal transfer to capital exp.	4.57	1.20	2.52	0.81	0.32
Own revenue to total Expenses	0.50	0.11	0.22	0.09	0.38
Regular exp to own revenue	5.89	1.20	3.24	1.25	0.39

Note on "Regular exp to own revenue" ratio: A ratio exceeding 1.0 indicates that a municipality's regular (operational) expenditures surpass its own revenue generation. The observed range of 1.20 to 5.89 means that for every NPR 1 of own revenue, municipalities spend between NPR 1.20 and NPR 5.89 on regular operations. The shortfall is covered by intergovernmental transfers (grants) from federal and provincial governments. A ratio of 5.89 thus reflects extreme grant dependence, not deficit spending, as municipalities cannot legally overspend their total available resources (including grants). This finding reinforces the conclusion regarding high grant dependence.

The high "regular expenditure to own revenue" ratio observed in some municipalities (up to 5.89) requires clarification. This ratio does not indicate deficit spending or fiscal insolvency; rather, it reflects the extent to which municipalities rely on intergovernmental transfers to fund their routine operations. For example, a municipality with NPR 10 million in own revenue and NPR 50 million in regular expenditures (ratio = 5.0) would have received approximately NPR 40 million in grants to cover the difference. The wide variation in this ratio (CV = 0.39) further demonstrates the uneven distribution of both own-revenue capacity and grant receipts across municipalities.

The comparative analysis of revenue and expenditure indicators among municipalities reveals notable disparities and variations. Total revenue ranges widely from approximately NPR 14.89 crore to NPR 361.79 crore, with a high mean of NPR 59.54 crore and a coefficient of variation (CV) of 1.08, indicating significant variability. Similarly, total expenditure shows high dispersion (CV = 1.06), ranging from NPR 10.79 crore to NPR 329.50 crore, suggesting uneven spending capacities across municipalities. Grants—both fiscal equity and other types—also show substantial variations. Fiscal equity grants have a lower CV of 0.69, indicating relatively more consistency in their distribution, whereas other grants are more dispersed (CV = 0.86).

Capital and operational expenditures show even greater disparities, particularly in operational expenditures, with a CV of 1.68, highlighting inconsistent allocation to day-to-day functions. Employee expenditure is relatively stable (CV = 0.62), suggesting more uniformity in staffing costs across municipalities. Own revenue and own revenue per capita exhibit the highest variability (CV = 1.99 and 1.38, respectively), indicating large differences in municipalities' ability to generate internal resources. Total revenue and grants received per capita also exhibit significant disparities (CVs above 1.3), reinforcing uneven fiscal capacities across jurisdictions.

The fiscal efficiency indicators further illustrate the imbalance. The ratio of fiscal transfers to capital expenditure is relatively stable (CV = 0.32), while the ratio of own revenue to total expenses shows moderate variability (CV = 0.38), and the ratio of regular expenses to own revenue has a CV of 0.39. These figures indicate that some municipalities rely heavily on external funding and struggle to cover even operational expenses with their own revenues. Overall, the high variability across most indicators highlights pronounced fiscal inequality and structural imbalances in local government finances, emphasising the need for capacity-building and more equitable resource distribution strategies.

5. Discussion

The data also indicate that municipalities have made significant progress in creating the legal foundation for revenue collection, particularly for core taxes such as land revenue, house and land rent tax, and business tax. The high rates of law formation and execution for core taxes indicate a positive response to the implementation of the Local Government Operation Act 2017. This is also a reflection of the fiscal federalism principle that local governments need assigned tax powers and the capability to exercise them. However, the low rates of law formation for non-conventional taxes such as parking tax, herbs/waste tax, and other taxes indicate a narrow revenue base. This means that municipalities are exploiting a limited number of their constitutionally assigned powers. This is also a reflection of the argument by Dhungana & Acharya (2021), who stated that local governments face difficulties in dealing with the technical and legal intricacies of expanding their tax base.

The widespread implementation of revenue system automation, updates on rate structures, and holding of revenue consultation meetings, all indicate a commitment towards modernizing the administration of revenues, which is a critical aspect for improving efficiency in collection and reducing compliance costs, as emphasized by the principle of ease of administration under fiscal federalism. However, the low implementation of new taxes, apart from the conventional ones, indicates a conservative attitude towards diversification of revenues. Furthermore, although automation and updates are positive trends, the fact that only 14.8% of municipalities report taxpayers making payments early enough to avoid penalties indicates a lack of behavioral response from taxpayers themselves.

One of the key findings was the strong dependence on intergovernmental transfers, with 74.1% of the municipalities admitting that more than half of their total revenue comes from federal and provincial grants. This flies in the face of the fundamental principles of fiscal federalism, which asserts that there needs to be a balance between expenditure assignments and own revenues. The large range of total own revenues (CV = 1.99) and own revenues per capita (CV = 1.38) also underscores the fiscal disparities between the different municipalities. These are probably a function of differences in population density, economic activities, and geographical characteristics, with urbanizing districts such as Kaski possessing stronger own revenues compared to more rural and outmigrating districts.

The fact that most municipalities tend to keep their spending within 5% of the authorized operating budget (74.1%) and undertake quarterly budget reviews (74.1%) indicates good budgetary control practices. On the other hand, the high coefficient of variation for capital and operational expenditure indicates a lack of consistency in expenditure patterns across municipalities. For instance, the low average ratio of own revenue to total expenses of 0.22 indicates that only 22% of total expenditure is covered by own revenue. This is similar to the observations of Bhandari et al. (2019) and Poudel et al. (2025), which highlighted the gap between own revenue and expenditure needs. Moreover, the low proportion of municipalities with formal linkages between budget and business plans (59.3%) indicates a disconnect between strategic planning and budgetary execution, which is likely to impact the efficiency of public expenditure (Sow & Razafimahefa, 2015).

The results indicate fiscal risks. Nearly half (48.1%) of the municipalities receive more than 20% of their revenue from a single taxpayer. Such a situation poses a significant risk of revenue concentration. In addition, the increase in tax arrears faced by 74.1% of the municipalities also points to a weak enforcement and tax compliance scenario. In this context, agency theory also offers a perspective. It appears that the relationship between local governments (agents) and taxpayers (principals) is one of incomplete enforcement and a lack of accountability. In addition, the situation where 63% of municipalities face tax arrears of more than 5% of their total property taxes also points to a need to strengthen tax collection systems, including the use of effective tax penalties and systems for collecting unpaid utility bills (only 18.5%).

6. Conclusion

This study investigated the revenue and expenditure bases of Gandaki Province's local governments to assess their financial sustainability within Nepal's federal structure. Key findings reveal three interrelated challenges. First, intergovernmental transfers constitute over half of total revenue in 74.1% of municipalities, indicating a persistent vertical fiscal imbalance. Second, while core tax laws are well established, non-conventional revenue sources remain untapped, and collection inefficiencies are evident: 74.1% report rising tax arrears, and 48.1% face revenue concentration risks due to reliance on single taxpayers. Third, substantial disparities exist in own-revenue generation (CV = 1.99) and per capita expenditures across municipalities, signalling horizontal fiscal inequity.

From a fiscal federalism perspective, legal empowerment alone is insufficient; institutional capacity-building is essential. Policy interventions should prioritise: (a) expanding the local tax base to include underutilised sources; (b) strengthening collection mechanisms through enforcement and penalty systems; (c) formalising linkages between strategic plans and budget execution; and (d) redesigning grant systems to incentivise own-revenue mobilisation. Despite cross-sectional and self-reporting limitations, this study provides a critical benchmark for understanding municipal financial health in Nepal's federal system. With targeted capacity-building, local governments can progress toward the constitutionally envisioned model of autonomous and financially sustainable governance.

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