Assessing Fiscal Autonomy of Local Government in Nepal: A Study of Chitwan District

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Abstract

This study observes the fiscal autonomy of local governments in Chitwan District, within the framework of fiscal federalism in Nepal. The study employs a descriptive-analytical research design and relies entirely on secondary data. Fiscal autonomy is assessed using a ratio-based methodology FAR, FSR, and TTDR to evaluate internal revenue strength, expenditure-financing capacity, and dependency on intergovernmental transfers. The findings reveal persistently low fiscal autonomy in Chitwan District, as a 0.151 FAR indicates that local governments generate only 15.1 percent of total revenue from internal sources. Likewise, the 0.145 FSR shows that own-source revenues finance merely 14.5 percent of total expenditure, reflecting a limited capacity to fund services and development activities independently. In contrast, a 0.711 TDR suggests that 71.1 percent of local government revenue in Chitwan sows high degree of vertical fiscal dependence. The study concluded that increasing fiscal dependency and nominal fiscal autonomy will disturb Nepal's evolving fiscal architecture, which will raise the question about the sustainability of the entire federal system of the country.

Keywords: *Fiscal Federalism**, Fiscal Autonomy, Revenue Autonomy, Expenditure Dependency, Local Government Efficiency, Nepal.*

Introduction

Among these different modalities, cooperative federalism has been adopted by the Nepalese constitution. Cooperative Federalism, also known as marble cake federalism, is a government structure that emphasizes working together by different levels of government to resolve issues and lay out better policies. In cooperative federalism, there is coordination and cooperation among different tiers of government. Local government is the frontline implementing agency, so it is considered the backbone of the country. The concept of efficiency in local governments has gained increasing importance among scholars, the public sector, and stakeholders. This concept suggests that subcentral governments, such as local governments, can achieve greater fiscal efficiency in the allocation of public resources (Tiebout, 1956; Musgrave, 1983).

This study is concentrated in the Chitwan district, which covers approximately 2,238.39 square kilometers of land, representing 1.52 percent of the country's total land area, and had a population of 719859 persons, which represents 2.46 percent of the total population (Statistics, 2023). Administratively, the district is divided into seven local levels, comprising one metropolitan city, five municipalities, and one rural municipality, with considerable variation in size and population distribution and economic activities. Bharatpur Metropolitan City, the district's economic hub and principal urban center, covers an area of 432.95 sq. km., which consist largest population of 369,268. Ratnanagar Municipality encompasses an area of 68.68 Sq. km, and supports a relatively high population of 89905, reflecting its urbanizing character. Kalika Municipality spans 149.08 km² with a population of 52,164, while Khairahani Municipality, characterized by relatively dense settlement, covers 85.58 km² and accommodates 67,385 inhabitants. Rapti Municipality occupies 212.31 km² with a population of 66,617. On the other hand, Ichchhakamana Rural Municipality, situated in the northern hill region, extends over 166.73 km² but supports a comparatively smaller population of 27,643, indicative of low population density attributable to rugged topography and limited accessibility. Madi Municipality, surrounded by Chitwan National Park occupy the area of 218.24 km², has a population of 38,295 people (Statistics, 2023).

Purpose of the Study

Economically, Chitwan exhibits a diversified sectoral structure encompassing commercial agriculture, livestock production, poultry farming, aquaculture, trade and commerce, tourism, manufacturing industries, and educational and health services. This economic diversity is underpinned by fertile alluvial plains, expanding urban centers, and strategic transportation corridors that facilitate regional connectivity and market access. The pronounced spatial and demographic heterogeneity among local administrative units, coupled with mixed land use patterns and diverse economic functions, positions the Chitwan district as a significant case study for examining population distribution dynamics, land use transitions, and local economic development trajectories. Despite the different strengths, the local government of Chitwan can't perform well in the case of fiscal autonomy. To date, there is little empirical literature on the fiscal autonomy of local governments in Nepal. In this context, the selection ofthe district constitutes a strategic choice, as the district comprises three out of the four categories of local government, including metropolitan city, municipality, and rural municipality. It offers institutional diversity within a single study area. Moreover, Chitwan is widely recognized as the 78th district of Nepal because of the high level of in-migration from across the country, resulting in a heterogeneous population structure. So, the district reflects administrative demographic and economic characteristics like those observed at the national level. In this context, the findings of this study are expected to partially represent the national scenario and

contribute meaningful insights to the fiscal autonomy of local governments in Nepal.

Research Gap

In Nepal, prospective fiscal decentralization and intergovernmental transfers have been widely discussed; most existing studies remain conceptual, which focused at the national and provincial levels. Very limited empirical research has quantitatively measured local governments' fiscal autonomy using systematic indicators of own-source revenue capacity, expenditure self-reliance, and transfer dependency. Furthermore, prior studies rarely provide a comparative analysis across local governments and district aggregates to reveal the extent of vertical fiscal imbalance. So, there is insufficient empirical evidence to determine whether local governments in Chitwan are fiscally autonomous or fundamentally reliant on intergovernmental transfers.

Research Statement

Despite constitutional provisions for fiscal decentralization, it is not clear whether local governments in Nepal have real fiscal autonomy or remain heavily dependent on intergovernmental transfers due to limited internal revenue capacity.

Ethical Consideration

The study uses secondary data and involves no personal or confidential information. Data are properly cited, accurately reported, and analyzed objectively using consistent methods. The research maintains transparency, academic integrity, neutrality, and responsible use of public information.

Objectives of the Study

The primary objective of this study is to measure the fiscal autonomy of local governments in Chitwan. In line with the identified issues, the specific objectives of this study are as follows:

1. To find out the fiscal autonomy ratio and its implications for local governments in the Chitwan district.

2. To identify the Self-Reliance Ratio for the local government in the study area.

3. To explore the Transfer Dependency Ratio of the local government in Chitwan and its effect.

Review of Literature

Richard Musgrave coined the phrase "fiscal federalism" in 1959, and Wallace E. Oates popularized it in the 1970s with his book of the same name, which became the theory of fiscal federalism (Jha, 2015). Rao and Singh (2005) argued that fiscal federalism is based on factors determining the optimal degree of fiscal decentralization, principles

underlining the assignment of functions and sources of finance of governments of different vertical levels, and the design of suitable inter-governmental transfer schemes to fulfill the objectives of 'equity' and 'efficiency'. The value of fiscal federalism may differ from that of unitary systems because fiscal federalism may be associated with higher governance efficiency (Adhikari & Shrestha, 2019). Fiscal federalism is considered the best institutional setting for delivering public services. Furthermore, most studies on fiscal federalism discuss decentralization rather than federalism (Rao, 2016).

Theoretical Review

The validity of the empirical study on the fiscal federalism economic efficiency relationship has been undermined because of the lack of an adequate theoretical framework. However, some scholars (Oates, 2005) were of the view that the traditional theory for the argument of fiscal federalism is that it may provide greater economic efficiency in the allocation of resources of the public sector, and provision of local public goods, and this allocative efficiency will lead to economic development (Tiebout, 1956).

According to Oates (2005), taxation at the local level has been found to boost efficiency and welfare gains as a beneficial effect of bringing the government closer to the people because the local government serves the interests of its residents. Taxes placed on local citizens have an immovable basis and are simple to administer locally, making them suitable for local government (Musgrave, 1983). Property taxes are the most common tax imposed on local governments worldwide, including Nepal.

This comprehensive theoretical review explores Principal Agency Theory, Fiscal Federalism, Benefits-Pay-Principal Theory, the Cost-of-Service Theory of Taxation, the Efficiency Service Theory, the Intergovernmental Fiscal Framework, the Revenue Enhanced Model, the Benefit Model of Local Finance, the Modified Quantitative Service Delivery Model (MQSDM), and the Theory of Fiscal Federalism. This article examines the foundations, principles, and applications of these theories in the context of local government finance (Akapelwa & Mwange, 2023).

The theoretical lens of the Modified Quantitative Service Delivery Model (MQSDM) developed by Khalil & Adelabu (2012)departments and agencies (MDAs is the guiding principle of this study. The Modified Quantitative Service Delivery Model (MQSDM) is a framework developed to assess the efficiency and effectiveness of service delivery in local governance (Khalil & Adelabu, 2012). This study provides a comprehensive understanding of the relationship between financing and service delivery and how this relationship can be improved (Akapelwa & Mwange, 2023).

Empirical Review

These political reforms aim to enhance fiscal autonomy, improve fiscal frameworks,

and measure their impact using various fiscal indicators. This study examines the motivations driving these reforms, examines the evolution of fiscal autonomy, and assesses its effects on local government autonomy.

The local government is expected to develop Mimika's potential through creative efforts from its apparatus to increase local revenues. The funds transferred from the central government are intended to be spent on the consumption of goods and services to support economic activities in the region (Marlissa & Blesia, 2018).

The constitution of Nepal assigns tax rights to the three tiers of the government in Article 57; Schedules 5–9. As per the assignment, customs duty, VAT, excise duty, corporate income tax (CIT), and personal income tax (PIT) are exclusive rights of the central government. The entertainment tax, advertisement tax, vehicle tax, and house and land registration fee are concurrent rights of provincial and local governments. Property/land tax, business tax, house rental tax (except rental income of entities), and local natural resource taxes are assigned exclusively to the local government. Agriculture income tax is solely assigned to the provincial government (IIDS, 2020).

In the context of taxation, the provincial government sets the motor vehicle tax rate and collects the levy. The provincial government retains 60% of the tax revenue, and the remaining 40% is distributed to the provincial municipalities. The provincial government uses metrics such as population, road length, and forested areas to calculate the portion of car tax that local governments pay. These indicators are given weights of 45%, 50%, and 5%, respectively. The provincial governments set the rates for home and land registration fees and entertainment taxes, while local governments collect the money. The local government sets the advertising tax rate and handles the tax administration. The local government retains 60% of the total tax revenue it receives from the registration of homes and properties, the entertainment tax, and the advertising tax, while splitting the remaining 40% with the provincial government. Local governments manage taxes on real estate, rental, business, and natural resources. Only provincial governments are responsible for administering agricultural income taxes. Natural resource royalties, tourism fees, service fees, and fines are shared rights among federal, provincial, and local governments (IIDS, 2020).

By analyzing the relationship between source revenues and the total local budget, as well as the evolution of local budgets, we can gain a deeper understanding of efficiency in the Nepalese local government. Only the transformation of power is not sufficient. It is necessary to enhance the allocative and technical efficiency of local government to sustain the federal system. (Sienkiewicz, 2021) analyzed case studies from various countries to understand the outcomes and challenges of efficiency in relation to fiscal autonomy.

In Nepal, the provision of three tiers of power-sharing mechanisms was based on

coexistence, cooperation, and coordination. However, the federal government appears hesitant to support sub-national governments because of the centralized mindset of bureaucrats and politicians. The constitution has focused on intergovernmental relations, but such relationships fail because of imbalances in vertical and horizontal relationships, fiscal dependency, and bureaucracy's Chandra-seeking attitude (Acharya, 2021).

Rai (2024) marking the first such event after two decades following the restructuring of Nepal following the new Constitution. Subsequently, a second local-level election occurred in 2022, facilitating the selection of municipal representatives. Over six years, citizens have had the opportunity to benefit from the services provided by the local government (LG focuses on the intellectual community within the province as its sample population. As opinions were collected, the research revealed that local governance in the Madhesh Province falls below the   Local governments should enhance and reinforce local governance to support the institutionalization of federalism and democracy.

Didiktus *et all. (*2024) found that the financial capacity of the regional government of Sikka Regency is very low, with an independence ratio of 11.66% and a regional financial dependency ratio of 78.21%, with an instructive relationship pattern. This provides an understanding that Sikka Regency's regional income comes from transfer funds provided by the central government, which is greater than PAD.

Conceptual Framework

The conceptual framework illustrates the determinants of fiscal autonomy for local governments. It focuses on three major indicators: the Fiscal Autonomy Ratio (FAR), the Fiscal Self-Reliance Ratio (FSR), and the Transfer Dependency Ratio (TDR**).** Own-source revenue (internal Revenue), derived from local taxes, fees, and service charges, serves as the basis for both FAR and FSR. FAR measures the proportion of total current revenue generated from internal sources, thereby indicating the extent of revenue independence. FSR evaluates the extent to which internal revenues cover total expenditures, reflecting the degree of budgetary self-reliance. Finally,inter-governmental transfers, such as grants and subsidies with revenue sharing received from higher levels of government, form the basis of TDR. TDR shows the dependency of local governments on external transfers by the higher level of government. Accordingly, the framework posits that FAR and FSR exert a positive influence on fiscal autonomy, while TDR has a negative influence, as higher transfer dependency undermines local financial independence.

Fiscal Autonomy
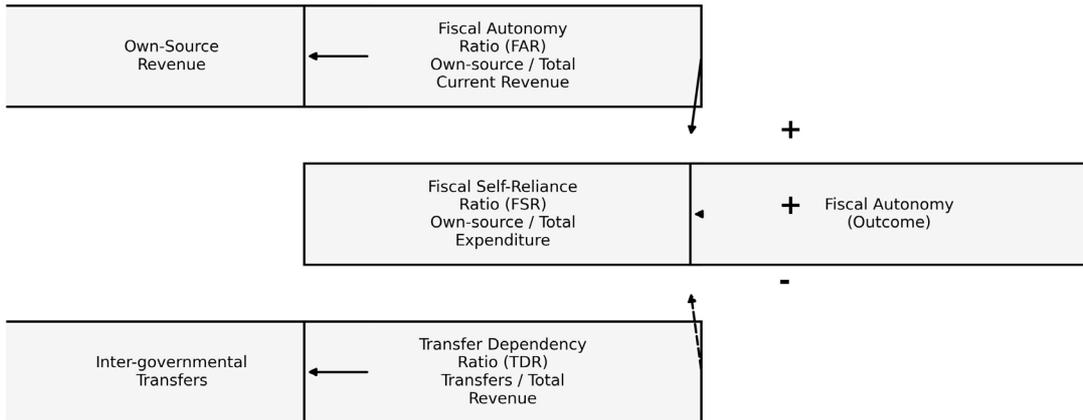
Source: Created by the author

Methodology

This study adopts a descriptive and analytical research design to examine the degree of fiscal autonomy of local governments in Chitwan District, Nepal. The analysis relies exclusively on secondary data, collected from the 62nd Annual Report of the Office of the Auditor General Nepal (OAG, 2025). The study covers all seven local governments of Chitwan District, covering metropolitan, municipal, and rural municipal units; therefore, no sampling technique is applied. The use of audited secondary data enhances the reliability, validity, and comparability of fiscal indicators across local governments. Given the objectives of the study, ratio analysis is employed as the major analytical tool, as it is widely used in fiscal federalism and public finance literature to assess revenue independence, expenditure financing capacity, and dependence on intergovernmental fiscal transfers (Farvacque-Vitkovic & Kopany, 2019). The ratios are computed using consistent accounting figures reported by the OAG, ensuring uniform measurement across local governments. Fiscal autonomy in this study is measured using three key fiscal ratios:

First is the Fiscal Autonomy Ratio (FAR), the Fiscal Self-Reliance Ratio (FSR), and the Transfer Dependency Ratio (TDR). The Revenue Autonomy Ratio reflects the extent to which a local government depends on its own-source (internal) revenue rather than external funding and is calculated as:

$$FAR = \frac{Internal\ \mathrm{Re}venue\ of\ Local\ Government}{Total\ \mathrm{Re}venue\ of\ Local\ Government}$$

A higher FAR indicates greater revenue-raising authority and autonomy, while a lower value suggests stronger dependence on external sources.

Next is the Fiscal Self-Reliance Ratio (FSR), which measures the extent to which a local government can finance its total expenditure using internally generated revenue. This ratio captures expenditure-side fiscal strength rather than revenue composition. A higher FSR implies that a local government can sustain its operations with limited reliance on grants or shared revenues, while a lower FSR reflects fiscal vulnerability and dependence on higher levels of government. FSR computed as:

$$FSR = \frac{Internal\ Revenue\ of\ Local\ Government}{Total\ Expenditure\ of\ Local\ Government}$$

The interpretation follows the same threshold structure: low fiscal self-reliance (0.00–0.30), medium fiscal self-reliance (0.31–0.60), and high fiscal self-reliance (0.61–1.00).

The final is the Transfer Dependency Ratio (TDR) that captures the degree to which local government expenditure is financed through intergovernmental fiscal transfers and revenue sharing. This ratio reflects vertical fiscal dependence within Nepal's federal structure. A higher TDR indicates stronger dependence on external fiscal support, while a lower value implies greater fiscal independence. This ratio is calculated as:

$$TDR = \frac{Transfer\ Federal\ Gov + Transfer\ Provincial\ Gov + Revenue\ Sharing}{Total\ Expenditure\ of\ Local\ Government}$$

For analytical consistency, TDR values are interpreted as high dependency (0.61–1.00), medium dependency (0.31–0.60), and low dependency (0.00–0.30). Unlike RAR and FSR, higher values of TDR signify weaker fiscal autonomy.

Result

The section presents and discusses the findings of fiscal autonomy across local governments, Chitwan District, and Bagmati Province using the Fiscal Autonomy Ratio (FAR), Fiscal Self-Reliance Ratio (FSR), and Transfer Dependency Ratio (TDR). Tables and bar diagrams have been used to illustrate inter-local variation and vertical differences across administrative levels. The results are discussed considering the fiscal federalism theory and the existing empirical review.

Bagmati Province, one of Nepal's seven provinces, is composed of one hundred and nineteen local governments consisting of 3 metropolitan cities, 1 sub-metropolitan city, 41 municipalities, and 74 rural municipalities. Using ratio-based methodology—Fiscal Autonomy Ratio (FAR) = internal revenue / total revenue, Fiscal Self-Reliance Ratio (FSR) = internal (own source) revenue / total expenditure, and Transfer Dependency Ratio (TDR) = (federal transfers + provincial transfers + revenue sharing) / total expenditure. Bagmati Province records 0.14 FAR, 0.141 FSR, and 0.653 TDR.

Figure 1: Bagmati Province
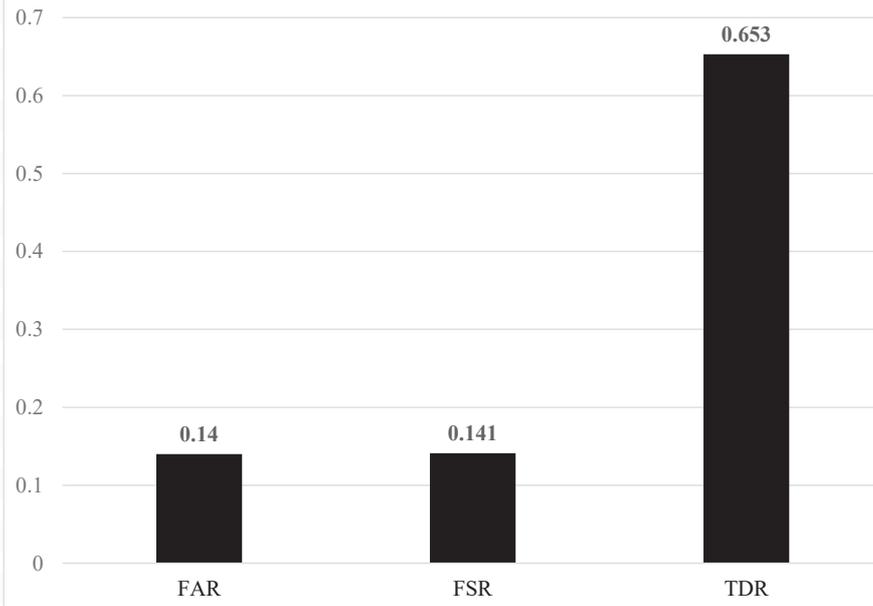
Chitwan district is one of the developed districts of the country because of its economic, geographical, and social conditions. Out of 7 local governments, only one is a rural municipality,5 are municipalities, and one metropolitan city. Despite this, Chitwan exhibits low fiscal autonomy and low fiscal self-reliance while showing high dependence on intergovernmental transfers. Chitwan District aggregates to 0.151 FARm, 0.145 FSR, and 0.711 DTR. It can be presented as follows.

Figure 2:Chitwan District
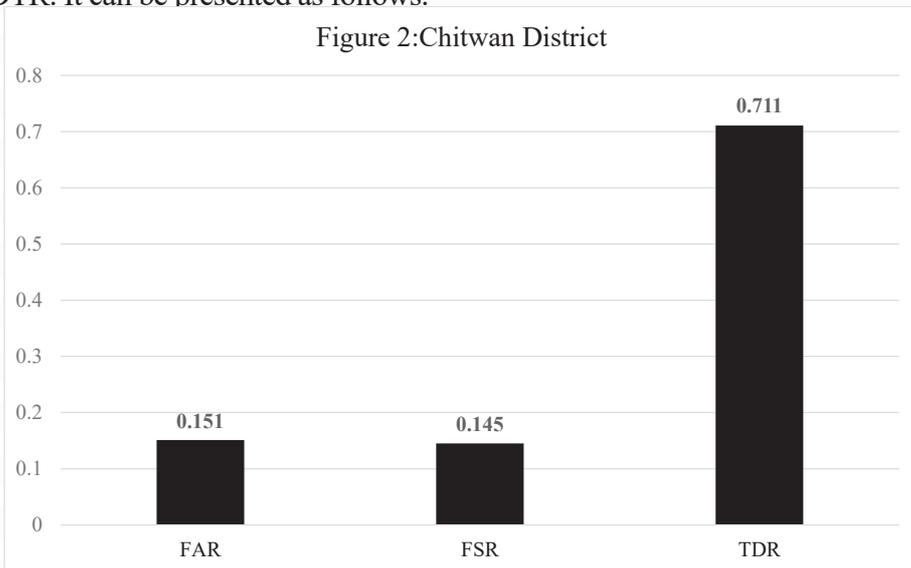
Despite the strong economic and geographical foundation, the FAR and FSR of this district remain in   FAR measures the share of a local government's total revenue that is raised from its internal sources and is interpreted with thresholds low (0.00–0.30), which implies low fiscal autonomy. It is the ratio between internal revenue and total revenue. The value lies between 0 and 1, where a higher value represents better performance and vice versa. FAR for seven local governments in Chitwan stands as Bharatpur Metropolitan City 0.242; Ratnanagar Municipality 0.100; Khairahani Municipality 0.091; Kalika Municipality 0.068; Madi Municipality 0.062; Ichhyakamana Rural Municipality 0.048, and Madi Municipality 0.032, respectively. It is illustrated in the following figure.

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Figure 3: Fiscal Autonomy Ratio (FAR)
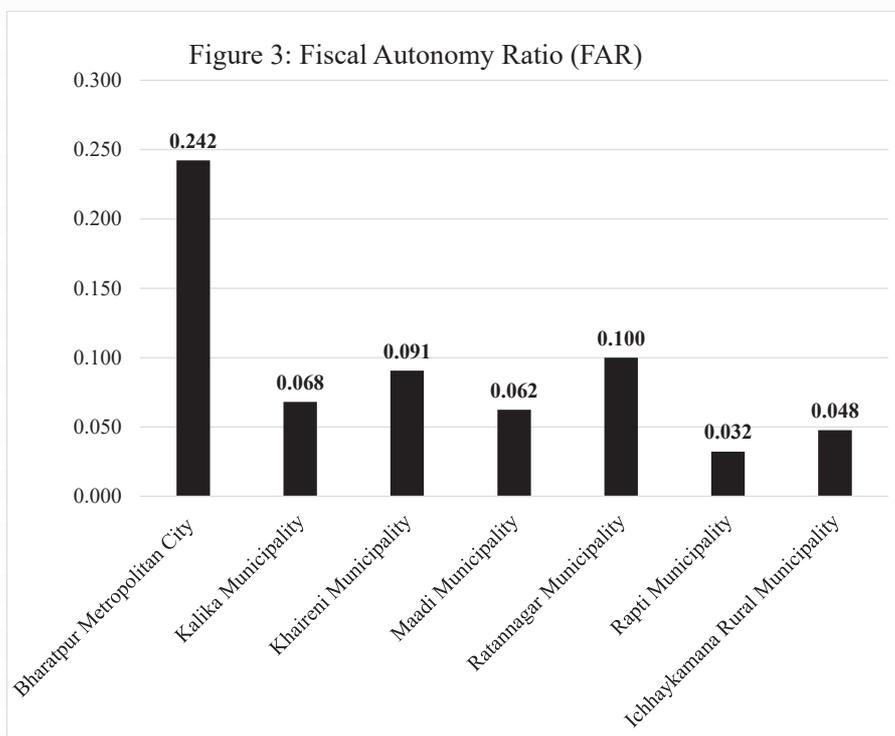
The Fiscal Self-Reliance Ratio (FSR) is another indicator for the fiscal autonomy measurement of local government. It is the ratio between internal revenue and total expenditure. Like FAR, the value of FSR lies between 0 and 1, where a higher value represents better performance and vice versa. As mentioned in the methodology, FSR is categorized as low, medium, and high scale. FSR for seven local governments in Chitwan stand as Bharatpur Metropolitan City 0.237; Ratnanagar Municipality 0.089; Khairahani Municipality 0.084; Kalika Municipality 0.067; Madi Municipality 0.061; Ichhyakamana Rural Municipality 0.046, and Rapti Municipality 0.031, respectively.

Figure 4: Fiscal Self-Reliance Ratio (FSR)
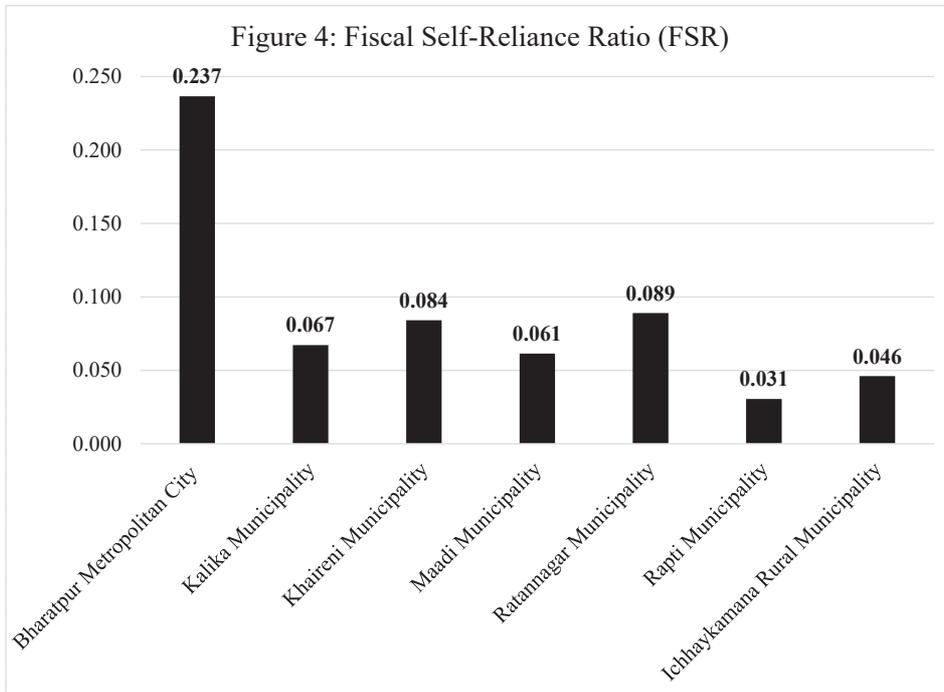
Finally, the study used the Transfer Dependency Ratio (TDR) as one of the major fiscal performance indicators. It is the ratio between fiscal transfer (Transfer from the federal government+ transfer from provincial+ revenue sharing) and total revenue. The value lies between 0 and 1, where a higher value represents low performance of local government and vice versa. As mentioned in the methodology, the higher the TDR value applies, the higher the dependency of the local government's revenue on fiscal transfers and vice versa. In Chitwan, the TDR ratios of Bharatpur Metropolitan City are 0.748, Kalika Municipality 0.661, Khaireni Municipality 0.586, Madi Municipality 0.926, Ratnanagar Municipality 0.643, Rapti Municipality 0.545, and Ichhyakamana Rural Municipality 0.769.

Table 5 : Transfer Dependency Ratio (TDR)
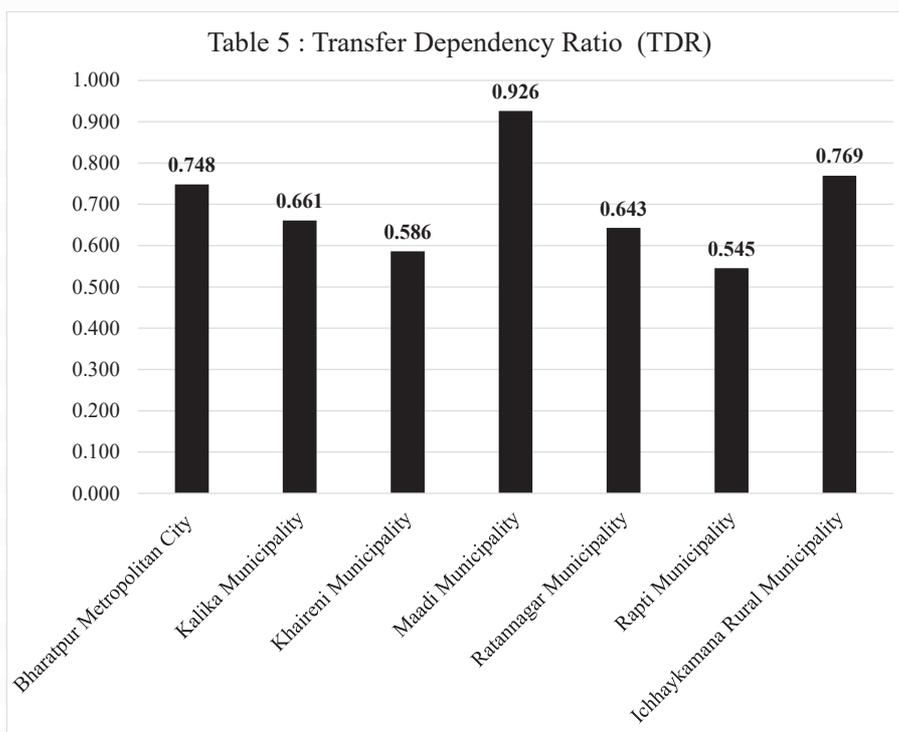
Discussion

 As we know, Bagmati province is a comparatively strong province in the country, but values indicate low fiscal autonomy and low fiscal self-reliance at the provincial level, while showing high dependence on intergovernmental transfers. FAR and FSR both fall in the "low" band (0.00–0.30), meaning internal revenue contributes only 14% on total revenue. Similarly, self-dependency on the expenditure of the local government stands as 14.1%, which is a small share of receipts and is insufficient to finance expenditures. The constitution of the country provided enough fiscal rights to local government, but their revenue highly (65.3%) depends on the upper level of government, falling in the "high" band (0.61–1.00), signifying substantial vertical dependency that weakens local discretion and makes inefficient local government.

the "low" category, which is slightly above that of the Bagmati province. The data shows that internal revenue only contributes 15.1% of total revenue, where self-dependency is only 14.5%. The result indicates that the revenue dependency of all local governments inside the district stood as 71.1% on federal and provincial transfers to meet expenditures. The practical implication is constrained fiscal autonomy and limited capacity for locally financed service delivery and investment; this elevates the risk that any transfer reductions or delays will disturb public services, which ultimately reduce efficiency and effectiveness of the local government in the study area.

As mentioned in the methodology, FAR is categorized as low, medium, and high scale. All the local governments in Chitwan fall in the low category, with Bharatpur the highest at 0.242 and Rapti the lowest at 0.032, showing that even the metropolitan center relies heavily on external funding while smaller and rural municipalities have extremely limited internal revenue bases. The implication is reducing local autonomy and constrained fiscal choices. Comparatively, Bharatpur performs higher FAR suggests better—but still insufficient—capacity to raise own resources, whereas Rapti, Madi, Kalika, Ichhyakamana, Khaireni, and Ratnanagar need urgent improvement in revenue mobilization measures. FSR is the ability of a local government to finance its expenditures from its own resources and uses the same low/medium/high thresholds as all Chitwan units record low FSRs, with Bharatpur again the highest (0.237) and Rapti lowest (0.031), meaning internal revenues cover only 23.7% for Bharatpur metropolitan city and 3.1% for Rapti Municipality. This implies heavy reliance on grants for regular development expenditure of the local government. Particularly acute for Madi and Rapti, while Bharatpur has comparatively more fiscal space, albeit still inadequate. To improve FSR, actions should prioritize increasing own revenues and prioritizing capital expenditure efficiency. Introducing performance-based budgeting and channeling conditional grants toward investments that enhance revenue capacity so that internal revenue grows to meet a larger share of expenditures.

Limitations of the Study

The study relies solely on secondary data from the Nepalese government's financial reports, which may contain reporting inconsistencies beyond the researcher's control. The research is only quantitative ratios (FAR, FSR, TDR) analysis, it does not include qualitative factors like. The analysis is limited to financial indicators, which do not assess service delivery outcomes. As the study focuses on fiscal autonomy in the early years of federal implementation so the findings may have limited generalizability.

Conclusion and Recommendation

Municipal FAR and FSR values of the study area predominantly lie in the low band (0.00–0.30), and TDRs are uniformly high (0.545–0.926), with district and provincial aggregates reflecting a similar pattern. Comparing municipalities reveals that there are meaningful divergences: Bharatpur Metropolitan City, although still within the "low" category, records the highest FAR/FSR (0.242 and 0.237) inside the district. Low FAR and FSR combined with high TDR imply that local governments in Chitwan have limited their own sources of revenue capacity and cannot finance their recurrent and development expenditures without substantial transfers from higher government levels. Where substantially lower relative transfer pressure than the weakest units, while Maadi, Rapti, Ichhayakamana, and Kalika show extreme transfer dependence and minimal internal revenue capacity. The holistic ratio analysis, including FAR, FSR, and TDR, suggests that current fiscal autonomy and local revenue bases are insufficient to ensure autonomous, sustainable local finance. In these circumstances, local governments remain economically vulnerable to transfer policy

changes and service delivery at the local level. This pattern indicates structural constraints in local tax bases and administrative capacity. It creates uneven service delivery potential within the district and exposes municipalities to fiscal vulnerability. As we know, the local government is the frontline implementing agency for public service delivery, so it is considered the backbone of the country. An increasingly fiscal dependency and nominal fiscal autonomy will disturb Nepal's evolving fiscal architecture, which could undermine vertical fiscal balance. If local fiscal autonomy becomes weaker, it will raise the question about the sustainability of the entire federal system itself.

To strengthen sustainable local finance in the Nepalese context, priority should be given to expanding and modernizing local tax bases. Review and broaden the coverage of the municipal tax system, including integrated property tax, local service fees, business and tourism, and other levies. Property valuation systems should be updated and digitized to capture untapped revenue. Improve revenue administration capacity by providing staff training and digitizing IT systems, following the canons of economy, certainty, and equity on tax system to strengthen revenue administration. It helps to increase the FAR and FSR of the study area for fiscal autonomy. Enhance predictable, formula-based, and unconditional fiscal transfers that strengthen local revenue mobilization for quality service delivery. Recalling conditional grants for priority projects and including needs-based supplements for low-capacity municipalities to reduce intra-municipal disparity. Improving local fiscal management through medium-term budgeting and performance monitoring. Finally, the Nepalese local government needs to reduce TDR, raise FAR and FSR over time, and make Nepal's federal decentralization more fiscally resilient and equitable. For further research, undertake diagnostic studies of local tax potential, analyze transfer composition, and complement quantitative ratios with qualitative fieldwork to enhance policy interventions.

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