

Journal of Political Science

(A Peer-Reviewed, Open Access Journal; JPPS Star Ranked and Indexed in NepJOL)

ISSN 2362-1273 (Print); ISSN 2773-8132 (Online)

Volume 25, February 2025

<http://ejournals.pncampus.edu.np/ejournals/jps/>

Published by

Department of Political Science, Prithvi Narayan Campus, TU, Pokhara, Nepal

Email: polsc@pncampus.edu.np; URL: www.pncampus.edu.np

Exploring the Financial Health of Municipalities in Nepal

Devilal Sharma, PhD ¹, Resam Lal Poudel ¹, Umesh Singh Yadav, PhD ²,
Surya Bahadur G C, PhD ², Indra Prasad Tiwari, PhD ³, Ajay Thapa, PhD ³

¹Faculty of Management, Prithvi Narayan Campus, Tribhuvan University, Nepal

²School of Business, Faculty of Management, Pokhara University, Nepal

³School of Social Science and Development Studies, Pokhara University

Corresponding Author: Devilal Sharma Email: dlshaema@gmail.com

Copyright 2025© The Author(s). With permission of the concerned author(s), the publisher shall publish the articles for the first edition. The journal is licensed under a [Creative Commons Attribution-ShareAlike 4.0 International License](https://creativecommons.org/licenses/by-sa/4.0/).



DOI: <https://doi.org/10.3126/jps.v25i1.75771>

Submitted 10 Nov. 2024; Reviewed 24 Nov. 2024; Accepted 30 Dec. 2024; Published 15 Feb. 2025

Abstract

This study examines financial distress faced by Nepalese municipalities and explores strategies for reducing financial risk to promote community development. Focus group discussions (FGDs) were conducted in Pokhara, Biratnagar, and Dhangadi as part of a qualitative research approach. Each group comprises eight to twelve participants. To ensure sustainable fiscal health, the study emphasizes the importance of enhancing capacity-building initiatives, diversifying sources of revenue, revising investment-related legislative frameworks, and improving tax collection. It also highlights the need for central and provincial policy changes to provide local governments to empower the local government with more control over their finances and governance. The study examines municipalities' financial circumstances and provides solutions for improving fiscal effectiveness and promoting the socioeconomic growth of municipalities in Nepal. Finally, the provincial and central governments must comprehensively reform policies to grant more autonomy to the local government in both governance and financial management practices to strengthen the fiscal health of urban municipalities in Nepal, supporting their contribution to the broader socio-economic development of the country

Keywords: Financial distress, fiscal policy, local government, municipality, revenue generation

Introduction

Nepal's 2008 transition to a federal democratic republic and subsequent implementation of full federalism in 2015 caused the financial stability of metropolitan municipalities. Local authorities now have increased autonomy, including more power over financial matters, resulting from Nepal's restructuring into seven provinces, 77 districts, and 753 local governments (Zafra-Gomez et al., 2009). The 2015 Nepalese Constitution defines financial autonomy as financial sharing between the federal and provincial governments and the financial autonomy of local governments, enabling them to control income, expenses, and resources (Ministry of Law, Justice & Parliamentary Affairs, 2015).

The sustainability and financial viability of local governments are still issues, especially in the new federal structure, even with the decentralization of financial powers. There is a dearth of empirical studies on Nepali municipalities' financial health, particularly because of the federal system. The challenge of evaluating the financial health of local governments is made more difficult by this lack of data, demanding the development of trustworthy instruments to track and assess financial management, including areas like resource allocation, taxation, and budgeting (Sohl et al., 2009). Since local governments are to provide vital services that impact the welfare of the public, their budgets must be effectively monitored.

A universally recognized approach or collection of indicators for assessing the financial health of local governments is lacking, rendering this a difficult task (Chaney et al., 2002; Kloha et al., 2005). Despite introducing several methods and metrics to evaluate municipal budgets, consensus on the indicators remains elusive. The capacity of local governments to execute their duties, formulate contingency plans, and efficiently allocate their resources influences their financial stability. The financial stability of local governments influences the political and social atmosphere within their jurisdiction, as well as the economic environment (Jacob & Hendrick, 2012). Local governments with robust finances can deliver essential services, hence fostering community development. This research thus aims to investigate financial hardship and potential strategies to mitigate financial risks, according to the perspectives of specialists, financial analysts, political representatives, and academicians.

The empirical study on the financial performance and fiscal decentralization of municipalities in Nepal identifies considerable obstacles and opportunities. Municipalities sometimes suffer financial restrictions, with insufficient budgetary resources to satisfy expenses, as emphasized by Pahadi (1997) and Lamichhane (2012). These limits have led to dependence on central government handouts and under used local resources, worsened by political instability and the absence of elected representation. Recurring concerns pertain to inefficiencies in revenue production and use. Research conducted by Bhandari (2010) and Shahi (2010) highlights the unexploited financial potential and excessive dependence on internal revenues, including fees and fines, whereas Timilsina (2005) observed that development expenditures are frequently neglected in favor of routine spending. Khatri (2013) advised using local tourism and methodical management of amenities to boost income streams. Fiscal decentralization has exhibited mixed outcomes; Shrestha (2020) and

Devkota (2020) emphasized advances in intergovernmental fiscal transfers since federalism, but criticized inefficiencies in horizontal allocation methods. Capacity and infrastructure limitations further restrict financial management and local income mobilization, as shown by UN-HABITAT (2015) and ADB (2022). Disparities in tax collection efficiency and administrative skills among municipalities show differential capacities. Kelly (2019) underlined the necessity of sustainable financial frameworks to boost municipal finances, while Sharma (2023) noted the need for tackling ecological and economic variables impacting financial situations. Last, Dahal (2021) pointed out issues in human resource and financial management, asking towns to investigate creative revenue streams to attain self-sufficiency. Collectively, these studies advocate for strategic planning, institutional capacity-building, fair fiscal transfers, and creative financial frameworks to address fiscal constraints and support sustainable local development.

However, there have been limited studies to assess the financial health of the municipalities in providing ideas on the issues and aspects of financial distress, which could be a medium to assess the financial performance of the municipalities. Most of the studies are quantitative and focus on financial performance rather than exploring the financial soundness and performances qualitatively. Thus, to address this gap, this study has been conducted, and therefore, it is an attempt to explore the qualitative aspects of financial health and soundness of municipalities.

This research investigates the probable ways of addressing the financial distress of municipalities in Nepal. It also assists the Nepalese municipalities in addressing the position of fiscal imbalances in different circumstances through focus group discussions (FGDs). The financial condition serves as a systematic tool to help local governments assess their finances, enabling early detection of distress signals, which can prevent crises and enhance service delivery (Tiwari et al., 2023). The findings of the study benefit various stakeholders; for local governments, it discloses the approaches towards improving financial decision-making and policy formulations. It helps identify financial gaps and strategies needed to strengthen local financial mechanisms. Similarly, the study contributes to central government agencies, particularly the Ministry of Home Affairs and the Ministry of Finance, by providing a base to determine the financial index to monitor local governments' financial health and guide financial and economic policy development. The study supports the successful implementation of fiscal federalism in Nepal by providing a clear framework for local governments elsewhere.

The government of Nepal promulgated a new constitution in 2015 and adopted three tiers of government; the federal, provincial and local levels. Local governments have been instituted with 293 urban municipalities and 460 rural municipalities. However, the government could not study the financial status of these municipalities. This study thus brings the qualitative aspects of financial distress in municipalities and focuses on a qualitative analysis of the situation and tries to assess the financial situation qualitatively. It is an empirical and a qualitative attempt to examine behavioral conditions and factors that might be hindering the financial sustainability of municipalities.

Literature Review

Financial health is a vital part of municipal governance because it impacts the ability of local governments to deliver basic services and infrastructure. Various studies analyzed the financial situation of municipalities in Nepal, noting their dependency on central government funds, ineffective resource mobilization, and difficulty in supporting local spending. Pahadi (1997) evaluated the financial performance of Janakpur Municipality and concluded that it lacked adequate budgetary resources to pay its expenses, demanding additional funding from the federal government and improved usage of local resources. Similarly, Timilsina (2005) analyzed Bhadrapur Municipality's financial position and discovered that a substantial percentage of resources were committed to routine expenses, leaving minimal cash for development efforts. Despite having a larger per capita income than spending, the poor allocation of resources proved averse to development and social fairness.

The challenges of fiscal decentralization are explored in several studies. Shrestha (2020) summarized Nepal's fiscal decentralization and discussed the interdependence of government institutions in financing local governments. The study also emphasized the existing issues and potential pathways for more effective decentralization. Lamichhane (2012) highlighted the low share of local expenditure, which accounted for only 4.84 percent of total national expenditure, making it difficult for municipalities to provide adequate public services. Political instability and the absence of elected representatives in local government institutions further exacerbated the problem, leading to unutilized or misused budgets. Shahi (2010) examined Kirtipur Municipality's revenue structure and found that internal revenue contributed significantly to total revenue, with major sources including fees, fines, property rentals, and local taxes. These studies emphasized the importance of a well-managed taxation system for improving municipal financial health.

The possibility of raising municipal revenue has been recognized in several studies. Bhandari (2010) did a case study of Dhanagadi Municipality and concluded that there were various untapped sources of revenue to local authorities had not appropriately targeted. A clear taxation policy was advocated to boost revenue collection. Khatri (2013) researched Kavilbastu Municipality and showed that revenue might be enhanced by promoting the municipality as a historical and religious location. The administration of services, such as bus parks and educational institutions, has also been suggested as a technique for increasing local incomes. The relevance of good fiscal policies in enhancing municipal financial health has been further stressed by Devkota (2020), who analyzed intergovernmental fiscal transfers in Federal Nepal. The analysis reveals that 33 percent of the overall federal budget and 11 percent of the country's GDP have been allocated to provincial and municipal governments since introducing federalism in 2017. However, vertical financial transfers were found to be rather effective, as horizontal distribution among municipalities was less successful, underlining the need for a fairer allocation system.

International perspectives on municipal finance further reinforce these findings. UN-HABITAT (2015) revealed that municipalities in developing countries struggle to provide adequate public services because of financial constraints, insufficient technology

infrastructure, and weak revenue-generation frameworks. Limited local financial capacity often results in urban inefficiency and economic stagnation. Kelly (2019) recommended the adoption of innovative and sustainable financial frameworks to strengthen municipal finance and fiscal systems fostering long-term urban growth. The importance of institutional capacity in resource mobilization has also been underscored, as mentioned in a study by Shrestha (2002). The study found that a strong tax base, compliance with fiscal regulations, and public participation significantly influenced local governments' ability to generate revenue.

Despite some positive developments, challenges persist in Nepal's municipalities. Dahal (2021) revealed that local governments are struggling with inadequate financial and human resources, making self-sustainability difficult. He recommended municipalities explore new sources of revenue generation to ensure financial stability. The Asian Development Bank (ADB) (2022) reported that while some municipalities had successfully implemented measures to enhance revenue collection—such as improving local business tax assessment—significant disparities remained across municipalities because of variations in tax collection efficiency, corruption control, and personnel skills. The report suggested that these gaps could be mitigated through targeted local efforts, support from higher government levels, and equalization grants. Sharma (2023) conducted a mixed-method study on local government's viability in Nepal and found that economic factors significantly influence municipal financial health. Financial conditions varied across ecological zones, highlighting the need for region-specific financial strategies.

While past studies have offered vital insights into the financial health of municipalities in Nepal, a considerable research gap exists in comprehending these issues from a qualitative viewpoint. Most studies have focused on quantitative financial assessments, budgetary allocations, and taxation policies, while limited research has been conducted on the life and behavioral experiences of municipal officials, challenges in financial decision-making, and governance-related factors affecting fiscal sustainability. There is a need to study how local governments see budgetary restrictions and opportunities within the framework of federalism. Addressing these gaps through qualitative research might provide a greater knowledge of the institutional, political, and administrative problems that municipalities confront, therefore presenting more comprehensive policy suggestions for improving financial health and governance at the local level.

Methods

Research Approach and Design

To analyze the factors that affect the financial condition of municipalities in Nepal this research has employed a qualitative research approach. Exploratory research design has been used to collect expert opinions on indicators of financial condition and their relative importance for assessing the financial soundness of urban municipalities of Nepal and their view on measures to be undertaken to improve

Context, Research Sites and Participants

There were three focus group discussions (FGD) held in Pokhara, Biratnagar, and Dhangadi. The sample for the FGDs has been chosen on purpose, further aiding the convenience and availability of the respondents. The number of participants in each of the three focus groups ranged from eight to twelve participants, depending on the availability and eligibility of respondents at the study sites. Participants in FGDs were government officials ranging from chief executives, department heads to officers representing various levels of government (local, provincial, and federal). They were chosen on purpose from the study area's separate sites. Professors and trainers who have been working in this field for a long time were specifically chosen. A significant focus was placed on the makeup of FGDs, which included specialists from government, non-government, and related fields. The active participation and cooperation of each member from various disciplines made the conversation quite convincing, and all participants voiced their opinions confidently and without hesitation. The participants were selected purposively based on purposive sampling. This sampling has been used in the study as those participants were aware of urban municipalities' financial condition or financial health.

Instruments for Data Collection

A checklist for FGDs is created by evaluating similar literature on the internet and through the secondary review. This checklist was distributed to two experts for comments, feedback, and suggestions (one municipal official working in the revenue sector and another qualitative research expert). The checklist was then refined by incorporating the experts' ideas. Before heading to the field, the checklist has been pre-tested in the Kaski district. The checklist's material was edited further before it was distributed to the other sites. Initially, the checklist was written in English. The back-to-back translation was used to translate the checklist into Nepali. The checklist included seven questions, including appropriate dimensions and indicators of municipal financial conditions, major factors affecting financial conditions, important sources of revenue and expenditure, the best approach to measuring financial condition, measures required to achieve financial sustainability, challenges, and future

Method of Data Collection

All study sites employed a single focus group discussion strategy. In this method, an interactive discussion was held as one group in one location between participants and a group of facilitators. The FGD was formalized into four interconnected sessions. The first session began with a welcome and introduction of all participants and the study team. The discussion then followed the explanation of the goal of the research and its societal benefits. In the following sessions, all participants were informed about their roles and responsibilities to be followed throughout the discussion, the time allotted for discussion, and the consent to audio and video recording of the discussions. Similarly, all respondents were asked to give their verbal approval to take part in the discussion. Ground rules were presented, and all participants agreed. The ground rules included listening carefully to

understand, being straightforward and succinct, not interrupting others, and the right to express oneself.

During the discussion, a series of open-ended questions (seven in total) were asked one by one. Finally, the team leader finished the discussion sessions by thanking the participants for their excellent contributions. The length of the conversation ranged from two and a half to three and a half hours, depending on the number of participants and the concerns discussed during the discussion in different locations. The discussions were facilitated by the team leader and three other team members, who were designated as moderators. The facilitator established a casual and pleasant atmosphere. The primary data collection methods included four complimentary activities, including note-taking, audio and video recording, and observation. Three team members took part in these activities. During the discussion and data collection process, no nonverbal information was noticed or recorded.

Method of Data Analysis

The data analysis method was preceded by a list of participants. The main people in that community identified the inclusion and exclusion criteria for participation at this stage. Coding (important ideas and themes as prepared in the checklist) was completed in the second step. The data was mostly examined using qualitative content analysis. The information has been organized systematically by carefully reading the manual notes and listening to the audio and video. Since a theory-based categorization somehow was lacking, inductive content analysis was constructed from raw data. Although the category is not found in theoretical propositions, Lincoln and Guba (1985) proposed control credibility, dependability, confirmability, authenticity, and transferability for the analysis of each control mechanism was conducted in the following procedure.

To maintain *credibility*, the research team first ensured that participants in focus groups were correctly recognized as the proper persons to get information about the financial conditions of local urban governments.

Similarly, *dependability* was noticed, as the replies were consistent (no new data were received) across time (FGDs were conducted (between June 2020 and September 2021) under the various settings

Confirmability (objectivity) was used to test the knowledge and answers of independent participants in various FGDs

Because the remaining one FGD was discarded after receiving similar pattern of information, the other criterion *transferability* (potential for extrapolation) was also maintained.

The final criterion, *authenticity*, was likewise met honestly and faithfully by creating a robust checklist that showed a variety of realities.

Exploring the Financial Health of Municipalities in Nepal

To ensure the checklist's credibility, a thorough review of narrative literature (previous studies published in standard journals, articles, and methodological books) was conducted first, followed by a presentation in front of qualitative research experts to improve the quality and coverage of the questions in the checklist. Finally, certain necessary changes were made to the checklist's content.

Ethical Issues

Proper care has been taken during the study to ensure that breaches of research ethics are not undertaken. Prior acceptance has been taken from the participants before approaching them to take part in FGD. The FGD checklist is accompanied by the reasons and objectives that explain the aim of the study: identifies the researchers and asks for the questionnaire to be completed, explains the nature and importance of the study, and assures participants that their responses would be treated confidentially. In addition, unethical activities, such as violating non-disclosure agreements, breaking participant confidentiality, and misrepresenting results, are avoided. To avoid discomfort, the number of follow-ups reminding them to take part in FGD through chat and telephone calls was made. All the information collected from the FGD participants during the study has been used for academics only and kept confidential. All the sources referred for this research have been properly cited and acknowledgement of the works of others has been made, too. This research maintains the highest level of objectivity in discussion and analysis throughout the research and hence the names used in discussion are disguised, too. Finally, incomplete, biased and inaccurate reporting of results has been excluded.

Results and Discussion

Based on the responses to the focus group discussion, the following themes were identified to achieve the research objectives of exploring measures required to enhance the financial condition of urban municipalities in Nepal:

Theme 1: Factors Contributing to Poor Financial Condition/Health

The FGD participants identified several factors that affect the financial condition of urban municipalities in Nepal. Some of the conversations and narrations are shortly presented below followed by their major outcomes: Harihar, a 48-year-old, financial officer said:

“I think the government is not paying too much attention to developing trained and skilled intellectual capabilities needed to address the financial challenges facing the municipalities. Most of the municipalities [.....] scanty professionals capable of understanding financial planning and sustainability.”

Shreya, a 38-year-old, Finance Head opined:

“The lack of proper indicators for measuring the financial health of the municipalities has resulted in the misallocation of the funds. The oral and equivocal orders from [.....] resulted in insufficient fund transfer, and improper financial allocations making it

cumbersome for the municipalities to allocate the financial resources precisely and properly.”

Bishnu, a 49-year-old, Financial Planning head stated:

“The major hindrance in the financial planning and execution is the stringent legislative system of our country. The legal frameworks that need to assist the flexible financial frameworks for business and public [.....] aren't business friendly which consequentially repels the investment and financial opportunities. The intrusive legal system of the country [...] developing biased and undesired financial parameters is resulting in the financial distress of municipalities.”

Raj Bahadur, 52-year-old, head of the economic development division said:

“Every kind of distress in financial planning in the country is because of the increasing corruption that leads towards inappropriate revenue management decisions which majorly influences financial planning and sustainability. In my opinion, one example could be the under-value rental revenue of government properties in municipalities. The financial corruption [.....] inappropriate macro-economic and financial frameworks that hampers the fiscal health and sustainability.”

However, the following significant factors could be deduced from the discussions with the participants that could be identified as influential factors for financial distress.

Lack of trained and skilled manpower

One of the major factors was the lack of trained and skilled manpower. Many participants reported that there is a shortage of qualified personnel at the local level who can effectively manage finances. This deficiency has created a significant challenge for urban municipalities in Nepal, as they require skilled professionals to manage their finances and ensure financial sustainability.

Insufficient transfer:

Another factor affecting the financial condition of urban municipalities in Nepal is the insufficient federal transfer. Participants reported that the federal government provides an insufficient amount of transfer to urban municipalities to effectively manage their finances. This makes it difficult for urban municipalities to undertake development activities and provide essential services to their constituents.

Absence of business-friendly legislative systems

The absence of business-friendly legislative systems was also identified as a factor affecting the financial condition of urban municipalities. Participants reported that the legislative system in Nepal is not conducive to business and entrepreneurship, making it challenging for municipalities to attract investment and develop their local economies.

Corrupt practices in rental revenue

Corrupt practices in rental revenue were also identified as a factor contributing to the poor financial condition of urban municipalities in Nepal. One participant reported that there is an under-value of rental revenues in all major cities of the country. The owner charges heavy rent to the businessman but pays less tax. So special rules are needed for controlling such corruption.

Theme 2: Sources of Revenue and Expenditure

The FGD participants discussed the sources of revenue and expenditure for urban municipalities in Nepal. One of the experts reported that the municipal authorities should focus on the coverage of tax (base) rather than the rate. Additionally, federal transfers were identified as a significant source of revenue for urban municipalities. However, the participants agreed that federal transfer is not sufficient, as per the need of the municipal authorities, in our context. Participants also reported that urban municipalities generate revenue from taxes, fees, fines, and rents. Similarly, participants also noted that there is a lack of transparency in revenue collection and that tax collection is not implemented efficiently. Participants suggested that there is a need to improve tax collection efficiency and transparency to ensure financial sustainability.

Shiva Ram, 56-year-old, head of the Financial Management division opined:

“Municipalities should stop considering federal transfers and allocations as the major financial source. The urge for strategic partnerships and financial alliances with global projects and funding agencies should be timely considered as other revenue sources. Similarly, [.....] on generating income through taxes, fees, fines and rentals with precise implementation of policies regarding rental and tax revenues too”.

Harihar, a 48-year-old, financial officer said:

“The pursuance of balanced financial planning and implementation is lacking in the municipalities. Our municipalities are primarily [.....] on physical infrastructures and public facilities that seem less revenue contributing to sustainable finances. Whereas, the focus should be on preparing financial investment plans to increase other revenue sources such as revenue from natural resources, royalties, property taxes, house and land taxes etc.”.

In terms of expenditure, participants reported that urban municipalities primarily spend on public infrastructure, including roads, bridges, water supply and other public facilities. However, there is a lack of investment in social services, such as education and health. Participants suggested that there is a need to balance investment in physical infrastructure, public works, public facilities and social services to ensure that all essential services are provided to the constituents. Devi Prasad, a 34-year-old, Account Officer stated

“The municipalities' dependence on federal and national funding is one of the major factors that impede proper financial planning. The mindset of status-quo is what it fertilizes. There are merely very less municipalities seeking and planning for other revenue sources of

Exploring the Financial Health of Municipalities in Nepal

sustainable financing and the ability to undertake development without negative impacts on the environment, and financial independence”

The FGD participants opined that new sources of revenue taxes are expanded, commitment to expenditure on services is varying and reforms and laws formulated and enacted to raise revenue are the convergence issues of municipalities. Whereas, municipal units are found, to some extent, generating revenue to cover their operating expenses to own revenue that is found a lesser amount of their ability to generate revenue to cover their expenses.

Furthermore, the participants in FGD stated that the municipal's style of imposing tax is classical and not capable of collecting tax properly, it is not able to broaden the base rather than concentrating on rates. Politicians and social activists claim that the municipalities depend on fiscal transfer from federal and provincial government and their dependency on the formulation of laws and regulation of municipalities is high with the federal government. Whereas, mechanisms that design self-sufficiency in formulating revenue-generating laws are less. Besides, tax system is still traditional due to which implementation of the new system is becoming difficult and not feasible. Similarly, the significant relationship between municipal economic factors and the financial condition highlights the influence of economic conditions in generating revenues for municipalities, including fiscal policy reformations, and planning of economic development and growth.

Theme 3: Best Approach to Measuring Financial Condition

The FGD participants discussed the best approach to measuring the financial condition of urban municipalities in Nepal. The majority of the participants agreed that the budget should be development-oriented but not distribution-oriented. They also reported that the system is not tax-payer friendly and municipal authorities are not professional in our context. Participants recommended a business-friendly legislative system and suggested that several unnecessary and discouraging provisions be removed to encourage taxpayers at the local level.

Participants suggested that there is a need to develop a comprehensive framework for measuring the financial condition of urban municipalities. The framework should include a range of indicators, such as revenue and expenditure ratios, debt levels, liquidity ratios, and capital investment ratios. Participants also suggested that the framework should be transparent and easily accessible to all stakeholders

“The budget allocation of our country primarily concentrates on the distribution as per the allocated budget heads which in the long term leads to dysfunctional financial implementations in cases of the existence of bureaucratic red tape. The lack of [.....] necessitates the government to determine indicators that transparently assist the municipalities and its governance units to design a framework that evaluates financial performance”

Shruti, 35-year-old, Head of the Administrative Division said:

“There is a need for a comprehensive framework that delineates how the financial health of municipalities is assessed. The reliance of municipalities in non-developmental activities has resulted in budgets being distribution-oriented which is not a good indicator of the financial sustainability of municipalities. The indicators of financial health [.....] by the government and the federal government are leading only to the compliance of standards with a mere focus on short-term survival and municipalities being distribution-oriented”.

Theme 4: Measures Required to Achieve Financial Sustainability

The FGD participants identified several measures required to achieve financial sustainability for urban municipalities in Nepal. One of the experts suggested that autonomous institutions should be converted into corporations, while another recommended that the legislative system should be business-friendly. The participants also suggested that there is a need for the development of attainable policies and plans to improve the financial sustainability of urban governments. Participants suggested that there is a need to improve tax collection efficiency and transparency and develop a comprehensive tax policy that encourages compliance and revenue generation. Sundarmani, a 45-year-old, Deputy Mayor of a municipality stated:

“It has been fifteen years I have been closely observing municipalities and their performance. I think the organization's culture is an imperative factor that contributes best to good financial behaviour. I have observed, in the past and in recent times, that the municipalities with leaders emphasizing maintaining and harnessing organizational culture are performing highly with regards to designing wide-ranging financial planning and executions”

Organizational Culture

The FGD discussions also led to the conclusive opinion that organizational culture not only is collective behavioural guidelines but is imperative in designing acceptable norms and standards for financial performance and planning. Standard parameters of financial performance are related to what the organization's culture determines imperative.

Use of resources

In the same manner, most of the FGD participants stated that the effective and optimal use of resources is primary for the attainment of financial reliability and sustainability. When the municipalities concentrate towards effective financial performance, the optimal use of the financial and physical resources are the key factors that help them towards financial sustainability. Most of the participants said that optimum resource utilization isn't only the route to cost effectiveness but also to precise financial and budgetary allocations. According to Bikash, a 46-year-old mayor, said

It is the focus of municipalities towards the accumulation of resources, both physical and financial, that are impeding the efficient financial and managerial operations of municipalities. The attentiveness [.....] is leading municipalities to have short-term

planning orientations of accumulating wealth and physical resources rather than using it with precision for effective results.

Proper governance

The participants also stressed that the political commitment of leaders in the federal and national government also significantly determines the effective financial performance of municipalities. They firmly stated that a committed leader with a clear strategic direction has standards of performance in comparison to a leader without it. Similarly, accountability and transparency at each bureaucratic level result in precise financial functioning ensuring the financial soundness of local governance, i.e. municipalities. According to Shruti, 35-year-old, Head of the Administrative Division;

In my observation, the lack of focus by municipalities and local authorities on proper and transparent governance is eroding public trust. This, in turn, is leading to short-term financial planning orientations. The limited expertise and knowledge of municipalities in accountable and transparent performance is resulting in improper financial planning and implementation.

Stakeholder Participation and Engagement

Most of FGD participants said that the problem relies in not listening and addressing the concerns of the public, who are the major component of service deliveries of municipalities. They discussed that the minimal focus of municipalities towards stakeholder participation and engagement is leading to planning short-sightedness which places the benefits of groups or leaders in strategic and financial implementations instead of public benefits. The participants further said that financial planning and implementations without a focus on stakeholder/public benefit may not result in viable plans. Chandraman, a 38-year-old Deputy Mayor;

I have been actively involved in assessing public engagement towards municipal services for the last twelve years. In my experience, it is the public and stakeholder concerns that municipalities should prioritize, rather than any political or federal government interests. I have observed that municipalities that focus on uplifting public standards through broader stakeholder engagement are more oriented towards financial and strategic sustainability.

Environmental Consciousness and Sustainable Performance

It is the ecological benefit and balance that are the hard-pressed challenges of organizations and municipalities in all spheres of the world. The participants stated that the interconnectedness of environmental sustainability and financial planning and allocations are becoming very evident as a noble cause for designing sustainable financial performance. The municipalities that incorporate the broader environmental and ecological benefits in their financial planning and allocations seems closer towards designing broader community benefits resulting in prolonged financial sustainability.

Discussion

The findings from the focus group discussion (FGD) on the financial conditions of urban municipalities in Nepal largely align with the insights provided by existing empirical research, highlighting various challenges faced by municipalities in managing their finances. One of the key themes that emerged from the FGD was the lack of skilled human resources and financial management capacity. Participants emphasized the shortage of trained professionals in financial planning, which directly contributes to the poor financial conditions of municipalities. This observation resonates with earlier studies by Khatri (2013), who highlighted the need for stronger local capacity in managing finances and using untapped resources. Similarly, research by UN-HABITAT (2015) and ADB (2022) pointed to infrastructure and capacity deficits as major obstacles to effective financial management and local revenue mobilization. The FGD's focus on the lack of qualified personnel further underscores the need for human resource development, a gap that has been consistently identified in the literature, including by Dahal (2021).

Another significant issue discussed in the FGD was the insufficient federal transfer to municipalities and their over-reliance on central government grants. This mirrors the concerns raised by Pahadi (1997) and Lamichhane (2012), who documented the fiscal challenges resulting from limited budgetary resources and dependence on federal allocations. The FGD participants also noted that such over-dependence on federal transfers discourages municipalities from exploring alternative revenue sources. This issue aligns with the findings of Shrestha (2020) and Devkota (2020), who observed inefficiencies in the allocation of intergovernmental fiscal transfers. The FGD's call for municipalities to seek other revenue sources and form strategic partnerships with global funding agencies reflects a growing consensus in the literature advocating revenue diversification to reduce dependency on central government support.

In terms of revenue generation and expenditure inefficiencies, the FGD participants pointed out several areas where municipalities struggle, including the undervaluation of rental revenues and failing to expand the tax base. These findings are in line with the studies by Bhandari (2010) and Shahi (2010), which highlighted the untapped financial potential of municipalities. The FGD noted inefficiencies in tax collection systems, with a lack of transparencies and accountability in financial management, which reflects concerns raised by Timilsina (2005). The FGD's recommendation to improve tax collection systems is echoed in Kelly's (2019) work, which stresses the importance of sustainable financial frameworks for enhancing the efficiency of municipal revenue generation.

The FGD also discussed the need for a business-friendly legislative system to encourage investment, a point that aligns with Khatri's (2013) suggestion to improve the local business environment for revenue enhancement. Participants in the FGD criticized the current legal framework for hindering investment and financial growth, a concern that raises the issues discussed by Shrestha (2020) and Devkota (2020) regarding the inefficiencies of fiscal decentralization in Nepal. This highlights the importance of legislative reforms to support local economic growth, which has been a consistent theme in both the FGD and the literature.

Exploring the Financial Health of Municipalities in Nepal

The FGD participants stressed the importance of organizational culture and good governance for financial sustainability. The role of political commitment and accountability in ensuring effective financial management was emphasized, which is consistent with the findings of Sharma (2023), who argued that municipalities with transparent governance are better able to manage their finances. This ties into the broader literature that advocates for the importance of civic engagement and transparent governance, as highlighted by Kelly (2019) and Dahal (2021), in achieving sustainable financial performance. Finally, the FGD also recognized the need to incorporate ecological and environmental considerations into financial planning, an aspect that was emphasized by Sharma (2023). Integrating environmental factors into municipal financial planning was observed as crucial for long-term sustainability, which aligns with the growing emphasis in the literature on balancing economic, ecological, and financial concerns. This conforms to Kelly (2019) and Dahal (2021), who advocated for sustainable financial practices that also consider environmental factors.

Conclusion, Implications and Future Research Directions

The findings from the focus group discussion (FGD) offer valuable insights into the financial challenges and opportunities for urban municipalities in Nepal, directly addressing the research aim of exploring fiscal sustainability in local governance. The FGD revealed that a significant barrier to financial sustainability is the insufficient availability of skilled professionals in financial management, which undermines the municipalities' capacity to plan and manage resources effectively. An over-reliance on federal transfers worsens financial instability, with municipalities struggling to generate their own revenue. The inefficiencies within the current tax system, limited business-friendly legislation, and the lack of integration of environmental sustainability into financial strategies further compound these challenges. The discussions also highlighted the importance of good governance, transparency, and accountability in fostering financial sustainability.

The present research findings have several implications. It suggests municipal authorities that to ensure long-term fiscal health, they must focus on improving tax collection mechanisms, expanding their revenue base, reforming the legal framework to encourage investment, and enhancing capacity-building programs. Policyholders need to incorporate environmental considerations into financial planning to achieve sustainable growth. Finally, the provincial and central governments need to comprehensively reform policy to provide more autonomy to the local governments in both governance and financial management practices to strengthen the fiscal health of urban municipalities in Nepal which finally supports their contribution to the broader socio-economic development of the country.

The present research is a qualitative exploration through focus group discussions (FGDs) with a limited group of stakeholders. Future research should adopt a mixed-methods approach to provide a more comprehensive understanding of the financial health and conditions of urban municipalities. While the current study focused on participants from local government institutions, it would be beneficial for future research to incorporate expert perspectives from provincial and central government officials, which could offer broader insights into the challenges and opportunities at different levels of governance. The present

Exploring the Financial Health of Municipalities in Nepal

research was limited to urban municipalities; to gain a more holistic view of local government financial health, future studies should include both rural and urban municipalities. This would allow for a comparison of the financial conditions across different municipalities and help identify strategies to improve financial efficiency at the local government level. Such an integrated approach could provide a more nuanced understanding of the financial challenges faced by local governments across Nepal and could suggest better policies and practices for enhancing fiscal sustainability.

Acknowledgements

The research was made possible with the generous funding provided by the University Grants Commission (UGC) of Nepal under the Collaborative Research Grants category (Grant ID CRG-74/75-Mgmt-01). We would like to sincerely thank the UGC for their invaluable support and express our heartfelt gratitude to the authorities for their continued assistance throughout the research process. Their commitment to advancing academic research has been instrumental in the completion of this study.

References

Alam, A. B. M. M., Alam, M., & Hoque, A. (2017). Measuring financial condition of urban local government: A study of municipalities in Bangladesh. *The Journal of Developing Areas*, 51(2), 71-84. A

Asian Development Bank [ADB] (2022). *Strengthening fiscal decentralization in Nepal's transition to federalism*. Asian Development Bank.

Bahl, R. W., Timofeev, A., & Yilmaz, S. (2022). Implementing federalism: The case of Nepal. *Public Budgeting & Finance*, 42(3), 23-40.

Beckett-Camarata, J. (2004). Identifying and coping with fiscal emergencies in Ohio local governments. *International Journal of Public Administration*, 27(8-9), 615-630. [https://doi.org/ 10.1081/PAD-120030258](https://doi.org/10.1081/PAD-120030258)

Bhandari, T. (2010). *Municipality finance in Nepal: A Case Study of Dhangadhi Municipality*. [Unpublished Master's thesis, Tribhuvan University].

Boex, J. (2001). *An introductory overview of intergovernmental fiscal relations*. Andrew Young School of Policy Study.

Boex, J. (2016). *Intergovernmental fiscal design in the context of the federal constitution of Nepal*. Ministry of Finance, MoFALD and Ministry of General Administration.

Carmeli, A. (2008). The fiscal distress of local governments in Israel: Sources and coping strategies. *Administration & Society*, 39(8), 984-1007. [https://doi.org/ 10.1177/0095399707309358](https://doi.org/10.1177/0095399707309358).

Channey, B. A., Mead., D. M., & Sherman, K. R. (2002). The new governmental financial reporting model: What it means for analyzing governmental financial condition. *Journal of*

Governmental Financial Management, 51(1), 26–31.
<https://proquest.com/docview/222438284?pqorigsite=gscholar&fromopenview=true>

Cohen, S., Costanzo, A., & Manes-Rossi, F. (2017). Auditors and early signals of financial distress in local governments. *Managerial Auditing Journal*, 32(3). <https://doi.org/10.1108/maj.2006.05121daa.001>

Dahal, G. (2021). Local governance in Nepal: A study of Machhapuchhre rural municipality, Kaski. *Journal of Political Science*, 21, 31-38. <https://doi.org/10.3126/jps.v21i0.35261>

Giroux, G., & McLelland, A. J. (2003). Governance structures and accounting at large municipalities. *Journal of Accounting and Public Policy*, 22(3), 203-230. [https://doi.org/10.1016/S0278-4254\(03\)00020-6](https://doi.org/10.1016/S0278-4254(03)00020-6)

Gomes, R. C., Alfinito, S., & Albuquerque, P. H. M. (2013). Analyzing local government financial performance: Evidence from Brazilian municipalities 2005 – 2008. *RAC Rio de Janeiro*, 17(6) (Online). <https://org.br/rac>

Gorina, E., Maher, C. , & Joffe, M. (2018). Local fiscal distress: measurement and prediction. *Public Budgeting and Finance*, 38(1), 72-94. <https://doi.org/10.1111/pbaf.12165>

Honadle, B. W, Costa, J. M., & Cigler, B. A. (2004). *Fiscal health for local governments: An introduction to concepts, practical analysis, and strategies*. Academic Press/Elsevier.

Jacob, B., & Hendrick, R. (2012). Assessing the financial condition of local governments. *Handbook of local government fiscal health*, 11, 11-40.

Jin, T., & Zhang, J. (2011). Effect of local government expenditure on the ratio of output to capital: Evidence from panel data at China's provincial level. *Frontiers of Economics of China*, 6, 249–270 (2011). <https://doi.org/10.1007/s11459-011-0131-7>

Jones, S., & Walker, R. (2007). Explanators of local government distress. *Abacus*, 43(3), 396-418.

Jung, C. (2008). Practices of assessing financial conditions and fiscal health in local governments in the United States. *Government Accounting Research*, 6(1), 89-116. <https://www.earticle.net/Article/A154105>

Jung, Y., & Sung, S. Y. (2012). The public's declining trust in government in Korea. *Meiji Journal of Political Science and Economics*, 1, 36–48. <http://mjps.meiji.jp/articles/files/01-04/01-04.pdf>

Kelly, R. (2011). Stock taking of fiscal decentralization policies (Nepal). Consolidated Report.

Kelly, R. (2016). Stock-taking of fiscal decentralization policy in Nepal. *Journal of Fiscal Federalism*, 1(1), 1–16.

Kelly, R. (2019). *Enhancing municipal finance in Nepal*. Town Development Fund.

- Kloha, P., Weissert, C. S., & Kleine, R. (2005). Developing and testing a composite model to predict local fiscal distress. *Public Administration Review*, 65(3), 313-323. <https://doi.org/10.1111/j.1540-6210.2005.00456.x>
- Lincoln, Y. S., & Guba, E. G. (1985). *Naturalistic inquiry*. Sage Publications.
- Litvack, J., & Seddon, J. (1999). *Decentralization briefing notes*. World Bank Institute.
- Marshall, John A. and David J.A. Douglas. (1997). *The Viability of Canadian Municipalities*:
- Martin Chautari. (2011). *Deadlines, democracy and a popular, democratic constitution*. Policy Paper No. 5, June. Martin Chautari.
- Martinez-Vazquez, J. (2001). *Intergovernmental fiscal relations and the assignment of expenditure responsibilities*. Georgia State University.
- Ministry of Finance. (2017). *Nepal's public management reform strategy/program*. Ministry of Finance, Public Expenditure and Financial Accountability (PEFA) Secretariat
- Ministry of Law, Justice & Parliamentary Affairs. (2015). *Constitution of Nepal, 2015*.
- MLD. (2008). *Ministry of local development: Key achievements in 2007*. Government of Nepal.
- Navarro-Galera, A., Rayo-Cantón, S., Lara-Rubio, J., & Buendía-Carrillo, D. (2015). Loan price modeling for local governments using risk premium analysis. *Applied Economics*, 47(58), 6257–6276. <https://doi.org/10.1080/00036846.2015.1068924>
- Navarro-Galera, A., M. P., Rodríguez-Bolívar, L., Alcaide-Muñoz, C., & López-Subires, M. D. (2015). Measuring the financial sustainability and its influential factors in local governments, *Applied Economics*, 48(41), 3961–
- Nepal Law Commission. (2007). *The Local Body (Financial Administration) Rules (2007)*. Nepal Law Commission.
- Nepal Law Commission. (2017). *Intergovernmental fiscal arrangement Act, 2074 (2017)*. (English version). <http://www.lawcommission.gov.np/en/documents/2015/11/36/24b88d9e3c3a4e4c455ff8a1d3a3bb63.pdf>
- Oates, W. E. (1977). *The political economy of fiscal federalism*. Lexington Books.
- Oulasvirta, L., & Turala, M. (2009). Financial autonomy and consistency of central government policy towards local governments. *International Review of Administrative Sciences*, 75(2), 311–332. <https://doi.org/10.1177/0020852309104178>
- Pahadi, B. (1997). *Municipality finance of Janakpur Municipality* [Unpublished master's Thesis]. Faculty of Management, Tribhuvan University.

- Ritonga, I. T., Clark, C., & Wikremasinghe, G. (2012). Assessing financial condition of local government in Indonesia: An exploration. *Public and Municipal Finance*, 1(2), 7-50.
- Ritonga, I. T., Clark, C., & Wickremasinghe, G. (2019). Factors Affecting Financial Condition of Local Government in Indonesia. *Journal of Accounting and Investment*, 20(2), 1-25. <https://doi.org/10.18196/jai.2002114>
- Robert, B., & Schramm, R. (1986). *The financial analysis of governments*. Prentice-Hall.
- Shah, A., & Shah, S. (2006). The new vision of local governance and the evolving roles of local governments. The World Bank.
- Shahi, R. (2010). Municipal finance in Nepal: A case study of Kirtipur Municipality [Unpublished master's thesis]. Central Department of Economics, Tribhuvan University.
- Sharma, D. L. (2023). Financial Viability of Local Government in Gandaki Province of Nepal [Doctoral dissertation, Rajasthan Technical University].
- Shrestha, M. (2002). Intergovernmental Fiscal Relation of Nepal: An International Working Paper, Georgia State University.
- Sohl, S., Peddle, M. T., Thurmaier, K., Wood, C. H., & Kuhn, G. (2009). Measuring the financial position of municipalities: Numbers do not speak for themselves. *Public Budgeting & Finance*, 29(3), 74-96.
- Timilsina, R. (2005). *Financial performance of Bharadpur Municipality* [Unpublished master's thesis]. Central Department of Management, Tribhuvan University.
- Tiwari, I. GC, S. B., Yadav U. S., Thapa, A., Sharma, D., Poudel, R. L. (2023). *Factors affecting financial condition of urban municipalities in Nepal*. Collaborative Research Report, University Grants Commission Sanothimi, Bhaktapur
- Trussel, J. M., & Patrick, P. A. (2009). A predictive model of fiscal distress in local governments. *Journal of Public Budgeting, Accounting & Financial Management*, 21(4), 578–616. <https://doi.org/10.1108/JPBAFM-21-04-2009-B004>
- Trussel, J. M., & Patrick, P. A. (2012). A survival analysis of U.S. municipalities in fiscal distress. *International Journal of Public Administration*, 35(9), 620–633. <https://doi.org/10.1080/01900692.2012.661189>
- Trussel, J. M., & Patrick, P. A. (2018). Assessing and ranking the financial risk of municipal governments: The case of Pennsylvania. *Journal of Applied Accounting Research*, 19(1), 81–101. <https://doi.org/10.1108/JAAR-05-2016-0051>
- UN-Habitat. (2015). *The challenges of local government financing in developing countries*. United Nation Human Settlement Programme. https://sustainabledevelopment.un.org/content/documents/1732The%20Challenge%20of%20Local%20Government%20Financing%20in%20Developing%20Countries%20_3.pdf

Exploring the Financial Health of Municipalities in Nepal

Wang, X., Dennis., & Tu, Y. S. J. (2007). Measuring financial condition: A Study of US states. *Public Budgeting & Finance*, 27(2),1-21. 10.1111/j.1540-5850.2007.00872.x

WCED. (1987). *Our Common Future*. Oxford University Press

World Bank. (2017). World development report 2017: Governance and the law. <https://www.worldbank.org/en/publication/wdr2017>

Zafra-Gómez, J. L., López-Hernández, A. M., & Hernández-Bastida, A.(2009). Developing a model to measure financial condition in local government. *The American Review of Public Administration*, 39(4), 425-449. <https://journals.sagepub.com/doi/10.1177/0275074008320710#:~:text=https%3A//doi.org/10.1177/0275074008320710>

Zafra-Gómez, José L., Antonio M. López-Hernández, and Agustín Hernández-Bastida. (2009a). Evaluating Financial Performance in Local Government: Maximizing the Benchmarking Value. *International Review of Administrative Science* 75(1), 151–167.