

**Development Partners Working Group on  
Local Governance and Decentralization**

**International Development Partner Harmonisation for  
Enhanced Aid Effectiveness**

**ALIGNMENT STRATEGIES IN THE FIELD OF  
DECENTRALISATION AND LOCAL GOVERNANCE**

**Country Study of Practices and Experiences**

**NEPAL**

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## Acronyms and Abbreviations

ADB	Asian Development Bank
ADDC/N	Association of District Development Committees, Nepal
CBO	Community Based Organisation
CG	Central Government
CO	Community Organization
CPN(M)	Communist Party of Nepal (Maoist)
CP(UML)	Communist Party of Nepal (United Marxist Leninist)
DASU	Decentralisation Advisory Support Unit (Danida)
DDC	District Development Committee
DFDP	Decentralized Financing and Development Programme
DfID	Department for International Development
DIMC	Decentralisation Implementation Monitoring Committee
DLGSP	Decentralized Local Governance Support Programme (UNDP)
DIP	Decentralisation Implementation Plan
GRP	Governance Reform Programme (ADB)
GoN	Government of Nepal
HMGN	His Majesty's Government Nepal
IDP	Internally Displaced Person
LGs	Local Governments (i.e. VDCs, DDCs, Municipalities)
LBFC	Local Bodies Fiscal Commission
LDF	Local Development Fund
LDTA	Local Development Training Academy
LDO	Local Development Officer
LGP	Local Governance Programme
LSGA	Local Self-Governance Act, 2055 (1999)
MCPM	Minimum Conditions and Performance Measures
MLD	Ministry of Local Development
MoF	Ministry of Finance
MUAN	Association of Municipalities
NAVIN	National Association of Village Development Committees in Nepal
NCP	Nepal Congress Party
NCP-D	Nepal Congress Party - Democratic
NPC	National Planning Commission
NPD	National Programme Director
NPM	National Programme Manager
PDDP	Participatory District Development Programme
PPPUE	Private Public Partnership for Urban Environment
PRSC	Poverty Reduction Support Credit
SDC	Swiss Development Cooperation
SNV	Netherlands Development Organisation
TA	Technical Assistance
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VDC	Village Development Committee
VEP	Village Education Plan
WB	World Bank

## EXECUTIVE SUMMARY

### A. Country Background

The concept of decentralization and participatory development has a long history in Nepal. A significant process of decentralization was initiated with the enactment of the Decentralization Act in 1982 and the adoption of relevant regulations in 1984. These legal frameworks forwarded the process of de-concentration of functional responsibilities to the district level of governance. Formally, decentralisation was inscribed in the Constitution of the Kingdom of Nepal-1990 as a fundamental element of democracy. Three separate Acts — The District Development Committee (DDC) Act, the Village Development Committee (VDC) Act, and the Municipality Act — were enacted in 1992.

Based on the recommendation of a High Level Decentralization Coordination Committee formed under the Chairpersonship of the Prime Minister in 1996, the Local Self-Governance Act (LSGA) was enacted in 1999 to consolidate the three separate acts of 1992. The Act laid the foundation for a local self-governance system in the country. It has statutorily recognized the role of local self-governance and devolution to make Local bodies more responsive and accountable to their populace.

Nepal has a two-tier local governance structure with district development committees (DDC) (75) on the top tier and municipalities (58) and village development committees-VDC (3913) in the grass-roots tier. The DDC has become the focal institution of decentralized planning and coordination at the district level. These local self-government bodies have become prominent in implementation aspect of local development efforts where the people's representatives are involved in policy making planning and prioritization of development needs. At the grassroots level the Municipality and Village Development Committees are formed on the basis of popular voting. The elected local representatives practiced the local governance for two full terms after 1990 until their terms expired in July 2002. Furthermore, government dissolved elected local bodies in 2002 following the assumption of increasing powers by the monarch.

Decentralisation has been recognized in the overall national development plans (PRSP) as essential for poverty reduction. The Ninth Plan emphasized decentralized governance focusing on poverty reduction and rural development and the current Tenth Plan has considered decentralization as a cross-cutting sector reassuring commitment for fiscal, administrative and functional devolution along with capacity building initiatives focusing entirely on achieving the goal of poverty reduction.

Major milestones regarding the implementation of the decentralisation reforms have been could be achieved before both government and development partners focused their attention on the conflict situation and the momentum for the reform process was lost. The milestones include the approval of the Local Self-Governance Regulation and Financial Administration Regulations in 2000, the creation of a high-level Decentralization Implementation Monitoring Committee (DIMC) according to the provision made in the LSGA, the establishment of a common platform called Joint Coordination Forum for Decentralization (JCFD) involving government agencies, civil society, the private sector and donor representatives, the preparation of the Decentralization Implementation Plan (DIP) approved by the DIMC as well as the establishment of the Local Bodies Fiscal Commission (LBFC) and the setting up of the District Development Fund (DDF) as uniform funding window for local governments.

However, conflict and political crisis over the last decade have severely affected the progress in implementing the decentralisation reforms and a larger number of challenges remain to be addressed to make decentralisation effective. The interim constitution agreed upon by the interim government including the former government as well as the Communist Party of Nepal (Maoists) recognizes the role of local government for development and it is generally assumed that the decentralisation process will be resumed. However, the new constitution to

be elaborated by the Constituent Assembly will be decisive for deciding upon the future of local government. Recent policy debates tend to point to the maintenance of some kind of local governance system under the new constitution, perhaps framed by 'federalist parameters'. The next years will be a critical period for Nepal with the challenge of overcoming the decade of armed conflict and consolidating the peace process which is far from complete as demonstrated by the repeated outbreaks of violence in different parts of the country.

## **B. Findings**

### **Management of the decentralisation process**

The responsibility for managing the decentralisation process lies with the Ministry for Local Development. The MLD took an active role in promoting the decentralisation reforms in the late 1990s and the early 2000s and developed core elements of the overall legal and political framework for decentralisation and local governance with the support from different DPs. While decentralisation and local governance was still high on the overall political agenda of the government, important progress could be achieved. However, with the increasing attention of the government being drawn towards addressing the situation of conflict and political crisis, the decentralisation reforms were marginalized on the political agenda. The MLD continued work on the technical level, however whenever initiatives needed cabinet approval, it became apparent that the political clout of the MLD was not sufficient to put local government and decentralisation issues as a priority back on the political agenda. The high level coordination forums created to conduct dialogue on decentralisation and local governance engaging government, civil society and development partners lost their relevance shortly after their creation. Also activities of the Decentralisation Implementation Management Committee (DCIM) and the related working committee and the proceedings related to decentralisation coming out of the National Development Forums were not taken forward due to the shift in political priorities.

With the formation of the interim government bringing together the former 7-party government with the Communist Party of Nepal (Maoist) after a decade of armed conflict, a new policy environment has established itself. The local government system in Nepal has been severely affected by the conflict with the narrowing of the development space within which local government could operate. Many people have lost their confidence in national and local government and their capabilities to deliver good services in an effective and efficient manner. The interim constitution recognises the role of local government for development and it is expected that the new constitution will also provide for maintaining a local government system in Nepal. However, the political process for resuming the implementation of the reforms is not only dependant on the overall policy orientation to be provided by the new constitution, but also affected by the dynamics arising from the conflicting priorities and the rivalry for political attention and external funding between the Ministry of Local Development headed by a minister from the Maoist faction and focusing on decentralisation and local governance and the Ministry for Peace and Reconstruction focusing on implementing programmes targeting peace dividends. Currently the government of Nepal is in a transition phase and both the priority given to the decentralisation process on the political agenda as well as the support within government for the reforms still have to be clarified.

### **Development Partner coordination mechanisms**

The government established a Joint Coordination Forum (JCF) for local governance in July 2001, involving various ministries, local government associations, development partners, civil society and the private sector, to begin reviewing the situation for policy improvement. The JCF identified five thematic areas — sectoral devolution, organization and structure of LGs, fiscal decentralization, institutional development and capacity building, monitoring and policy feedback. Based on the thematic areas identified, Thematic Groups were organized and contributed to the elaboration of the Decentralisation Implementation Plan (DIP). At the time,

the DIP provided a clear framework for implementation the decentralisation reforms addressing the core challenges and constraints but also provided a platform on which DP support programmes could be coordinated. However, government leadership for the coordination process weakened due to the situation of conflict and political crisis described above and the Joint Coordination Forum is no longer functional as a coordination mechanism between government and DPs. Currently the limited role of government with regard to coordination DP support is shared between the MLD for thematic coordination of intervention based on the existing strategy documents and the Ministry of Finance for overall territorial coordination.

The sub-group on decentralisation currently provides the platform for the exchange of information between those DPs considering themselves to be supporting the decentralisation process. The group has a good tradition of exchanging information and promoting coordination. A first initiative for setting up a comprehensive support programme for decentralisation and local governance in 2003 was undermined by the assumption of increasing powers by the monarch and the subsequent withdrawal of core DPs from the reforms. Coordination however has taken place in the context of several DPs combining their resources in one combined programme. A new initiative for setting up a broad support programme that will prepare the ground for a comprehensive national programme is the Decentralised Financing and Development Programme II under preparation by UNDP, UNCDF and DFID.

Within the sub-group on decentralisation, the DPs jointly undertook studies on the existing development space in the conflict situation. These initiatives as well as the elaboration of the basic operating guidelines undertaken jointly the DPs provide a valuable platform for strengthening coordination and harmonisation in the future.

However, DPs supporting either macro-reforms highly relevant for decentralisation, such as the public financial management reforms, targeted programmes (poverty reduction, in future: peace dividends) or the sectoral support programmes do not systematically participate in the sub-group on decentralisation. In order to promote coherence between the different support programmes intervening at local level and / or reforming the national legal and regulatory framework, the coordination mechanisms needs to be more inclusive and horizontal (to sector and thematic groups) and vertical (to macro reforms and national development programmes) linkages strengthened.

### **Alignment of DP support to country strategies**

Alignment of DP support to country strategies has only partly been achieved in Nepal. One reasons for the variety in DP support is the lack of a clear strategic framework provided by government which DPs could align their support to. The Decentralisation Implementation Plan was a promising initiative providing a detailed outline of reform activities, responsibilities and time frame; however the political situation undermined the development of the DIP into a comprehensive framework for alignment.

A second relevant issue is the co-existence of several development strategies in Nepal that are not necessarily fully coherent with the provisions of the Local Self-Governance Act. This is both valid for the national 10th Plan (PRSP) which is not explicit enough with regard to the key role of local governments for poverty reduction and thus allows for targeted poverty reduction programmes to align themselves to the PRSP but sidelining local government in the implementation und thus undermining the decentralisation reforms to a certain extent. Given that local elected governments were abolished in 2002, the potential conflict arising from these diverging implementation policies have so far not had major negative implications for the decentralisation reforms, with the institution of interim local bodies the need for improving coherence would arise. The same is valid for sector strategies and support programmes that are also not fully compliant with the local self-government act.

However, alignment has been improved over the last years with different 'building blocks' of the national framework being put into place. The establishment of the DDF as a decentralised one window funding framework has provided important incentives to the DPs for channelling external funding through this mechanism instead of maintaining diverging parallel system. The DDF is one of the building blocks for strengthening harmonisation and alignment of DP support to local governments.

### **Modalities of DP support**

Decentralisation and local governance has been supported by DPs through various programmes and projects over the last years. Donor support to decentralization has been directed at policy initiatives, legal reform, equity promotion, fiscal decentralization, LG capacity building, participatory planning and poverty reduction. These programmes are characterised by specific aid modalities regarding governance structure, funding flows, approaches to capacity building etc. However, the regional and thematic focus of most programmes as well as the increasing level of cooperation of several DPs in the context of one programme (co-financing, joint programmes, etc.) has helped to avoid conflicting modalities.

However, not only the project and programmes directly targeting decentralisation have a bearing on local governments, but also targeted and sector programmes. Harmonisation of support modalities with these programmes has received less attention so far, both from government as well as from DP organisation.

Currently, several new support initiatives for decentralisation and local governance are under preparation, including the DFDP II to be supported by UNCDF, UNDP and DFID, the DLGSP to be supported by UNDP and NORAD. The current initiatives clearly integrate efforts for harmonising support modalities between the different programmes.

Whereas the perspective for harmonising support modalities among those DPs support decentralisation and local governance are positive, the communication with other sectoral or macro initiatives has yet to be initiated to provide a the basis for improving the coordination of the different approaches and to advance the harmonisation of support modalities. However, the commitment of several DPs to supporting post-conflict reconstruction and recovery programmes with their specific objectives and interventions logics is a challenge for harmonisation as these programmes tend to work with parallel structures without reference to local governments.

### **C. Lessons learned and perspectives**

The assessment of alignment and harmonisation in the field of decentralisation and local governance in Nepal has to take into account the conflict situation which has had a major impact on all dimensions of development in the last years. The following lessons learned and perspectives have been derived from the analysis:

- **High-level political commitment for decentralisation essential, in particular in difficult political set-up:** After important progress in implementing the decentralisation reforms in the late 1990s and early 2000s, the reform process lost momentum and was marginalized on the political agenda due to the primacy of the conflict situation. In order for the decentralisation process to gain momentum again, high-level political commitment from government is essential. However, the rivalry for political clout and external funding between decentralisation (Ministry of Local Development) and peace building (Ministry for Peace and Reconstruction) on the other together with the discussion regarding the future form of government and the governance structure of the state put the advancement of the decentralisation reforms at risk.
- **As the revising and updating of the legal and political framework for decentralisation and local governments will be a lengthy process, an interim vision is required to maintain government and DP commitment to supporting local governments:** The risk of marginalization of the decentralisation reforms both by

government and DPs due to the political priority given to the peace building initiatives in the post-conflict situation is increased by the ongoing reflexion on the governance structure of the state and the subsequent need for a revision of the legal and political framework for decentralisation and local governments. In order to keep local governments on the political agenda, it seems essential for the Ministry of Local Development to develop an interim vision and a clear road map for the decentralisation reforms.

- **Lack of government commitment rendered initiative for high-level coordination forum non-functional:** The lack of government commitment due to shift in political priorities (conflict) rendered the high level joint coordination forum ineffective shortly after its creation. The coordination of DP support by government was therefore focusing on territorial coordination as most DPs are targeting specific regions with their support as well as – up to a certain extent - thematical coordination based on the Decentralisation Implementation Plan.
- **Coordination needs to be enhanced vertically and horizontally to address the challenge of decentralisation more comprehensively:** The sub-group on decentralisation currently provides the platform for the exchange of information between those DPs considering themselves to be supporting the decentralisation process. This, however does not include DPs supporting either macro-reforms highly relevant for decentralisation, such as the public financial management reforms, nor the targeted programmes (poverty reduction, in future: peace dividends) or the sectoral support programmes. In order to promote coherence between the different support programmes intervening at local level and / or reforming the national legal and regulatory framework, the coordination mechanisms needs to be more inclusive and horizontal (to sector and thematic groups) and vertical (to macro reforms and national development programmes) linkages strengthened.
- **Joint studies of the DPs are conducive to strengthening coordination and harmonisation:** The DPs engaged in the sub-group on decentralisation jointly undertook studies on the existing development space in the conflict situation. These initiatives as well as the elaboration of the basic operating guidelines undertaken jointly the DPs provide a valuable platform for strengthening coordination and harmonisation.
- **The establishment of the District Development Fund (DDF) as a treasury of the district has provided the basis to regularising fund flows and enhancing financial transparency at local level:** Setting up the DDF as a decentralised one window funding framework has provided important incentives for channelling external funding through this mechanisms instead of maintaining diverging parallel system. The DDF is one of the building blocks for strengthening harmonisation and alignment of DP support to local governments.
- **DFDP II as a framework for harmonising DP support for decentralisation and local governance:** Based on the policy and legal framework of local government and local governance the comprehensive DFDP II provides the framework for harmonising the current project based support to financing the delivery of local infrastructure and services and the initiatives for local capacity building. The DFDP II builds upon the existing DDF for providing block grants to the districts and contributes to the development of uniform national systems and harmonised DP procedures by establishing common reporting, control and auditing requirements and systems.
- **Step-by-step harmonisation of local capacity building:** By subscribing to a common strategy for local capacity building and – insofar as these already have been developed – also applying a common set of procedures (e.g. use of same local planning and procurement procedures, training materials, etc.) government together with DPs can take a first step towards harmonising the different support initiatives. The current practice of targeting specific districts or regions could be maintained for some time provided that mechanisms for coordination at local and national level are established and/or

strengthened. The second step would be based on an approved strategy for local capacity-building and consists of providing pooled funding to a capacity-building basket for local government and local governance. This basket should be managed by government according to an agreed strategy and plan, where donors have a monitoring and oversight role.

## I. INTRODUCTION

This report has been prepared as part of a study commissioned by the Development Partners Informal Working Group on Local Governance and Decentralisation and sponsored by the German Ministry for Economic Cooperation and Development (BMZ) and the Danish International Development Agency (Danida). The objective of the overall study is to provide detailed insight into current practices in view of proposing common good practices / guidelines for Development Partners (DP) support to decentralisation and local governance that will enhance aid effectiveness. To that effect, country practices and experiences with regard to harmonisation and alignment strategies in the field of decentralisation and local governance were analysed in four selected countries: Tanzania, Benin, Nepal and Nicaragua. The terms of reference for the review study including the countries studies is annexed to the main report. The main report with the lessons learned and perspectives derived from the country studies will be presented at a workshop of the Development Partners Group in Berlin in September 17<sup>th</sup> and 18<sup>th</sup>, 2007.

The country studies were carried out using the analytical framework with the four thematic issues presented in the conceptual framework for the study. The four issues address those aspects and dimensions of the decentralisation process in the partner countries that are inherently related to alignment and harmonisation of DP support to the reform process:

- (i) management of the decentralisation process,
- (ii) DP coordination mechanisms,
- (iii) alignment of DP support to country strategies and
- (iv) the modalities of DP support.

The country study in Nepal was carried out from April 12 to 27, 2007. The findings and conclusions presented in the report are based on a documentary study and the interviews conducted with representatives of government, development partners and civil society. A debriefing held on April 26<sup>th</sup>, 2007 provided the opportunity for the consultant to present the preliminary findings (Annex 1) and discuss the lessons learned and perspectives with both government and DP representatives.

The mission was greatly facilitated by Ms Ingrid Schwörer and her team and Mr. Shanker Pandey, KfW Local Expert. We take the opportunity to express our gratitude to all persons who made themselves available for interviews and participated in the discussions.

## II. BACKGROUND TO THE DECENTRALISATION PROCESS

### II.1 Milestones for decentralisation and local self-governance

Since the early 1990, Nepal has made significant progress in decentralization. Political developments in the country however have slowed down the momentum in the last few years. The results of decentralization efforts so far have been mixed. The legal and institutional framework for local governance has been created, some devolution of functions and responsibilities to local bodies has been made, and promising results in the form of improvements in the delivery of essential social services to rural communities are already evident. Nevertheless, it is also possible to point out several shortcomings: weak expenditure management, inadequate coverage and low quality of expenditure reporting, the need for improved accounting and transparency arrangements etc. Also, revenue mobilization by local bodies is very low; and there is little incentive for them under existing arrangements to improve their capacity and performance.

#### **The decentralisation process in Nepal**

The initial efforts to promote peoples' participation in development started in the early 1960 under the Panchayat system, when elected district, village and municipality level Panchayats were given limited responsibilities for undertaking local level programs and levying local taxes. However, the Panchayats remained very largely extensions of the central government, and were primarily centrally driven. Later reforms in the 1980s introduced further progress by putting all district level line agencies under the umbrella of district level Panchayats; but, it gave little emphasis to promoting local governance and fiscal decentralization. Moreover, many of the key issues with regard to decentralization, such as the roles and tasks of local bodies, their relationships with the line agencies, overlaps in functions and responsibilities, and accountability arrangements remained unresolved.

The main impetus for decentralization came with the success of the Democracy Movement and the promulgation of a **New Constitution in 1990**. The latter explicitly recognized "wider participation of the people in the governance of the country and by way of decentralization" as an explicit state policy. It also created the legal and organizational structure for decentralization. Three separate Acts in 1992 created a two-tier local government structure of District Development Committees (DDC) at the higher level, and Village Development Committees (VDC) and Municipalities at the lower level; and local elections were held in 1992. However, it did little to clarify the roles and responsibilities of local bodies, to improve their decision making powers, or to realign implementation responsibilities from sectoral / line agency levels to local bodies. Nevertheless, it helped to create a strong constituency for decentralization—representatives of local government associations, elected officials, national level political parties who saw potential benefits (at least for themselves) in furthering decentralization, and a growing body of other (Nepali as well donor) stakeholders, who increasingly viewed participatory local level development as an effective alternative to an inefficient central government.

Increasing pressure by such groups led to the creation in 1996 of a **high level Decentralization Coordination Committee** chaired by the Prime Minister. Based on the recommendations of the Committee, (the Ninth Plan in parallel recommended greater devolution of powers to local bodies, along with adequate supporting mechanisms and increased role for the private sector and civil society), the **Local Self Governance Act (LSGA)**, was promulgated in 1999. The LSGA, its associated regulations and follow up government actions provided the enabling framework within which the local government system evolved over the next few years.

In general terms, looking back over the past decade and a half, there has been noteworthy progress. The importance of, and the need for, decentralization has been clearly recognized; and explicitly incorporated in the development strategy of the Government and by

development partners; the legal and institutional framework for decentralization has been created, (political decentralization); some of the expenditure/service delivery functions which are particularly important for rural areas have been transferred to local bodies and communities, (administrative decentralization); and their resource base has been improved to some extent, (financial decentralization). In addition, several initiatives are under way to strengthen the capacity of local bodies, and to more generally accelerate the decentralization process.

### **System of local government in Nepal**

Nepal has a two-tier system of local governance, with village and municipal bodies as the lower tier and district bodies as the higher. The village bodies are called village development committees (VDCs) with municipalities serving the same function in town areas. The district bodies are the district development committees (DDCs). These are the units of local government. Currently there are 3913 VDCs, 58 Municipalities and 75 DDCs in Nepal.

- All VDCs are divided into nine wards. Municipalities are divided into a minimum of nine wards but the maximum number is not specified. Wards are the smallest units of local governance. Each district is divided into from nine to seventeen llakas, which cover clusters of VDCs and municipality. Each ward has a committee (WC) made up of the five elected members, one of which must be a woman. VDC committees and municipal committees run LGs' affairs.
- Village councils (VCs) and Municipal councils (MCs) meet biannually to approve or question VDC and municipality policies, programmes and budgets. VDC chairpersons, vice-chairpersons, ward members and six nominated members representing women and DAGs form the village councils. Municipal councils (MC) have a similar structure but the number of nominated members can be a maximum of twenty.
- Each district has a district council (DC), which serves the same role as VCs and MCs, and an executive committee (DDC). The DCs meet annually and are made up of mayors and deputy mayors of municipalities, VDC chairpersons and vice-chairpersons, DDC chairpersons, vice-chairpersons and members, the district's MPs and six nominated members.
- The Ministry of Local Development (MLD) appoints LG secretaries. At DDCs it deposes additional professional staff such as accountants, engineers and planners. LGs generally appoint lower level staff, although, some DDCs have started to appoint professional staff themselves.

The DDC have become the focal points of decentralized planning and coordination, (most of the DDC prepare their own periodic development plans), and implementation of development activities involving people's participation at the district level. A single window financing framework, (the District Development Fund), has been set up as envisaged in the LSGA, to institutionalize and manage all funds received at the district level. And, capacity building at both DDC and VDC levels has been carried out, with extensive financial and technical support from several external donors, and by the Government.

Local government elections were organised in 1992 and 1997, but since 2002 the absence of elected local governments has had a negative impact on local fully establishing the system of local self-governance in Nepal. The five-year term of elected local bodies (DDC, VDC and Municipalities) expired in July, 2002; and local elections have not been held since, initially because of the conflict and later also because of the dissolution of the Parliament and ensuing political instability.

## **II.2 The current political environment for decentralisation**

After the significant progress in decentralisation recorded in the first years of the reforms, the political developments in the country however have slowed down the momentum in the last few years. A decade of armed conflict between the Government and the Communist Party of

Nepal has severely affected the local government system in Nepal. The most important aspects of the recent development are:

### **Absence of elected local governments since 2002**

The five-year term of elected local bodies (DDC, VDC and Municipalities) expired in July, 2002; and local elections have not been held since, initially because of the conflict and later also because of the dissolution of the Parliament and ensuing political instability.

### **Impact of the conflict on the local governments**

The spread of the conflict has proved highly damaging for the local self-governance system. Local bodies, as well as central government agencies, could not function effectively in areas which were controlled or contested by the Maoists; and the extent of such areas increased steadily during the conflict situation. Infrastructures at both district and village levels (including office buildings, as well as administrative files and records, health centres, schools, local power and telecommunications installations etc) were destroyed by the Maoists in many areas; and many (ex as well as incumbent) functionaries of local bodies (most of whom are associated with political parties) have been killed.

The VDCs have become the most apparent victims of the current insurgency. About 50 percent of the 3,913 VDC offices have been bombed, burnt down or locked-up by Maoists. The majority of VDC secretaries, being not only the administrative head of the VDC, but also function as a chairperson appointed by the government, did not work in or visit their offices due to fear of the Maoists. They conducted the VDC affairs in most cases from the district headquarters or from centres around the district.

For their part, Municipalities have recently been elected, but with all the major opposition parties boycotting the election and under 20 per cent of the eligible voters participating in the election. For many seats there were no candidates. Those elected tended to maintain a low profile for fear of the Maoists. In such a situation it is very questionable as to whether it is possible to have an active and well functioning system of local governance in the municipalities.

### **Royal Proclamation in 2005**

After the royal proclamation in February 2005, certain institutional changes have been made on the basis of royal ordinances: Zones created under the pre-democracy movement Panchayat era have been revived and Zonal Administrators appointed with the mandate of coordinating, supervising, directing and monitoring the functions of Local Bodies; Regional Offices have been upgraded and Regional Administrators directly appointed by the King with powers over the Local Bodies. It is important to note that the powers given to both the Zonal and the Regional Administrators do not come under the purview of LSGA and raise serious questions concerning the autonomy of the local government bodies.

In the absence of elected representatives, the Government (His Majesty the King) has appointed officials to administer the local bodies. While the local bodies continue to function under their leadership, a number of problems which have a direct impact on the decentralization process are evident:

- The moral legitimacy conferred by the electoral process is obviously lacking. Moreover, in the absence of elected local officials or their associations who used to be the major advocacy/lobbying groups for decentralization earlier, the demand for faster decentralization and devolution is missing.
- The administered local bodies more or less function like the centrally appointed bodies of earlier days. The degree of accountability of appointed officials and boards to local communities has been significantly reduced; such boards are also more amenable to domination by local elites; generally, financial accountability and transparency is low; and reported incidences of irregularities and leakages have increased.
- An increasing body of anecdotal and other evidence relating to these new officials actions towards Chief District Officers (CDO) and Local Development Officers (LDO), their use of

local government funds and assets for activities not covered by the LGSA, apparently with the acceptance of central government, has had a significant impact on the functioning of the local bodies and on local level civil servants in particular. The representatives of the DDCs nominated by the government appear also to have accepted these irregularities as part of the new conditions for working in local government.

### **Decentralisation process on hold**

These developments have had a severe disruptive effect on the activities of local governments. In conflict affected areas, the operational effectiveness of local governments has been significantly reduced. Likewise, several donors as well as the government cut back their development/capacity building activities in such areas, thus undermining the capacity building efforts of local bodies, which are critical for promoting successful decentralization. As noted above, the absence of elected participatory local governments has also reduced accountability and transparency at the local level. Thus, the decentralization process is effectively on hold.

### **Perspectives for Decentralisation and Local Governance in Nepal**

The interim constitution agreed upon by the interim government including the former government as well as the Communist Party of Nepal (Maoists) recognizes the role of local government for development and it is generally assumed that the decentralisation process will be resumed. However, the new constitution to be elaborated by the Constituent Assembly will be decisive for deciding upon the future of local government. Recent policy debates tend to point to the maintenance of some kind of local governance system under the new constitution, perhaps framed by 'federalist parameters'. The next years will be a critical period for Nepal with the challenge of overcoming the decade of armed conflict and consolidating the peace process which is far from complete as demonstrated by the repeated outbreaks of violence in different parts of the country.

In the future, the policy on decentralisation will need to return to the existing problems of legislative coherence, fiscal decentralisation, civil service reform including transfer of staff to the districts, and restructuring of local bodies, especially DDCs (this includes the size of future VDCs, 'districts', and the creation of new municipalities). In particular it will be necessary to work towards reversing the present tendency towards delegation and return to a clear devolution agenda based upon accountable and transparent local governance in which popular control and political equity for the citizens of Nepal are emphasised.

## **II.3 Key issues for decentralisation and local governance**

In the first study carried out by the informal group that sponsored this study, five key issues were identified concerning the decentralisation process. These five preconditions were considered minimum elements for a national decentralisation strategy in order for it to be conducive for successful decentralisation and coordinated and harmonised DP support to decentralisation and local governance:

- legal framework for decentralisation;
- financial resources for local governments;
- human resources and adequate institutional strengthening to comply with municipal competencies;
- transparency and accountability and
- institutional arrangements in support of the decentralisation process from central level.

In the following key aspects related to each of the first four issues are described. Regarding the fifth issue, a more detailed assessment is made in chapter 3.

### Legal framework

The LSGA marks a major milestone in the decentralization process in Nepal. The LSGA and its administrative (Local Self Governance) Regulations of 1999 built on and improved the existing legal framework for decentralization. Some of its major features and contributions/achievements include the following<sup>1</sup>:

- It legitimized the concept of self governance and the devolution of (expenditure and revenue raising) functions to local bodies, including most of the proposals espoused in the Ninth Plan in this regard, as well as the structure of local level institutions for political governance.
- For the first time, it enumerated the objectives, principles, duties and responsibilities and inter-agency relationships for local governance in the country. For example, it defined the tasks/responsibilities of the central government for furthering the decentralization process (implementation of policy, providing financial support, monitoring, supervision, capacity building etc); and conferred *in principle* wide sectoral authority (for example, for delivering local level healthcare, education and agricultural extension services, raising revenue through local levies, and local level planning and programming of service delivery activities) to local bodies. It also empowered local bodies to undertake periodic local level expenditure planning, prepare their programs on the basis of local priorities, and set up organizational structures, (for example, setting up District Technical Offices within DDC), to carry out these activities.
- It provided for financial support to local bodies through revenue assignments, central government grants and domestic borrowing; operational autonomy to set up organizational structures/positions; for accountability and transparency mechanisms, for setting up a local government service cadre, and for ensuring representation of women and disadvantaged groups, among others.
- It helped develop a “Decentralization Implementation Plan” (DIP), with short and long term actions aimed at speeding up the decentralization process; and a Decentralization Implementation Monitoring Committee (DIMC) was set up under the chairmanship of the Prime Minister, together with a Working Committee (DIMWC) to oversee its implementation.
- It also provided for a Local Bodies Finance Commission, to make recommendations to promote fiscal autonomy and fiscal decentralization.

However, the LSGA has a number of deficits which have been identified in the Joint HMGN-Donor Review cited earlier, and are briefly summarized below:

- The LSGA did not go far enough in providing a clear and strategic framework and a time bound action plan for implementation.
- Several inconsistencies between LSGA and other existing laws and guidelines, (as well as contradictions between decentralization policy and prevailing practices), hampered effective implementation.
- The actual devolution of expenditure functions/responsibilities to local bodies (local level service delivery in primary education and basic healthcare, and agricultural extension services) was far more limited than envisaged in the LSGA; and even that did not actually happen till much later (see below). There was also considerable overlap and duplication of functions between the line agencies and local bodies;
- Funding was inadequate for carrying out even the devolved functions, in part due to budget constraints of the central government; while necessary technical support was not provided by line agencies; and

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<sup>1</sup> The following section is based strongly on: Nepal: Public Finance Management Assessment, Asian Development Bank, December 2005

- Capacity building efforts have been inadequate and uncoordinated. While some of these problems have been partially addressed since, many of them and other weaknesses remain.
- Despite donor/government efforts to help build capacity of local bodies, technical capacity of such bodies to plan, design and implement devolved activities remains highly inadequate.

### Financial resources for local governments

An important indicator of recent progress in decentralization is the degree of vertical imbalance in the mobilization and use of resources by the central government and by local bodies. The LSGA makes provision for the government to share locally generated revenue with DDCs. However, when functions and activities were actually devolved to local bodies, this was often done without transferring adequate budgets and technical resources (especially trained manpower) to carry out such tasks, (for example, in the case of assignment of land revenue taxes, or agricultural extension activities). Frequently, local bodies were not prepared to take over such tasks. Sometimes, devolution simply meant the transfer of line agency budgets for assigned tasks to the District Development Funds (DDF); and the DDC promptly channelled the funds back to the line agency, effectively hiring the latter to implement the task, with the DDC in theory being responsible for the 'devolved' activity, (as, for example, in rural roads). While this situation has improved somewhat recently, the transfer of technical resources and manpower remains a problem.

The effectiveness of revenue sharing has been hampered by a lack of clear implementation procedures for revenue sharing in forestry, tourism, natural resources and electricity generation. HMGN handed over the collection of land revenue to LGs but decreases in the fees for land registration - a major source of DDC revenue – has caused losses to DDCs and shows how the central government often fails to co-ordinate its actions with DDCs.

The establishment of the LBFC and the recent amendments to the LSGA regulations have been positive developments. However, many problems persist; such as the government's system for allocating grants to LGs lacks transparency and fails to follow clear criteria. Whilst LGs remain dependant on government grants, they have failed to make sufficient use of their taxation powers. The absence of consolidated nation-wide data for all local bodies makes it difficult to provide precise estimates in this regard. But, it should be noted that internal generation of resources by local bodies is quite low in Nepal, and that most of their resources (over 90% on average) are obtained from the central government as unconditional grants (freely spendable) and conditional grants (which are tied to specific activities) channelled through the Ministry of Local Development (MOLD). Thus the annual budget allocations and expenditures of MOLD are a good proxy for the trends in local bodies' finances.

### Expenditures on Local Development

Year	Total Govt. Expenditure	Allocations to Local Bodies <sup>a</sup>	(Rs million)		Local Dev. as % of Govt. Expenditure
			Channelled Through MLD <sup>b</sup>	Total Local Development	
FY90/91	23,549	-	328	328	1.39
FY92/93	30,898	nab.	666	666	2.16
FY94/95	39,060	1,752	654	2,406	6.16
FY95/96	46,542	2,643	722	3,365	7.23
FY98/99	59,579	2,755	1,082	3,837	6.44
FY01/02	80,072	3,056	1,120	4,176	5.22
FY02/03	84,006	2,966	1,603	4,569	5.44
FY03/04	92,107	2,958	2,733	5,691	5.52
FY04/05 <sup>c</sup>	111,690	2,966	3,197	6,163	7.00

### **Local Government Finances**

Vertical imbalances between central and local levels are even greater with regard to revenue generation; local bodies currently generate only about 1–2% of total government revenue. The revenue base of local bodies has been traditionally very small, both because of lack of revenue assignments (in a strongly centralized system) and the very weak capacity at local levels. Until a few years ago, the Octroi—a transit tax on goods entering jurisdictions of municipalities—accounted for about 70% of the self generated revenue of such bodies; but it was abolished a few years ago because of its distortionary effects on trade and investment. Although the central government transferred some additional sources of revenue, such as land and property taxes, to local bodies, (but without providing the necessary staffing and technical resources to administer them), collections from new revenue sources have declined. Local bodies presently lack trained revenue staff, properly maintained cadastral and revenue records and experience and knowledge with regard to property valuation in order to effectively exploit these new revenue sources. Moreover, the current revenue sources assigned to local bodies, such as property and vehicles taxes and professional tax, are not very elastic. The government's efforts to supplement local bodies' revenues through revenue sharing (of centrally collected electricity royalties, tourism and trekking fees etc, which are then passed on to local bodies), will help to provide some additional resources; but they will not help build local capacity for administering local taxes.

The current fiscal transfer system also does not provide incentives to local bodies to increase revenue mobilization or to enhance capacity building. This is because local bodies can continue to depend on central government grants to meet not only their development/capital needs but also their recurrent expenditures. On average, over half of unconditional grants to local bodies and most of their internally generated resources are spent on administrative overheads and other recurrent expenditures. The proportion is even larger—as much as 80%—in the case of smaller VDC. This in turn weakens expenditure discipline and financial management, particularly in the absence of timely (and accurate) expenditure reporting and effective monitoring and supervision. Recognizing these problems, as noted, unconditional grants have been more or less frozen over the past few years, and additional resources are being provided increasingly as conditional grants.

The current transfer system also does not address the problems of horizontal imbalances and fiscal equalization. There are wide disparities among DDC, VDC and Municipalities in terms of level development, resource generation capacity and project/program implementation and expenditure management capacity. The larger and better-endowed local bodies located in economically better off areas are able to hire better qualified/trained staff, as well as additional staff to carry out their functions more effectively; but the smaller units, as well as those located in less developed areas, are less able to do so. Providing equal amounts to all DDC and VDC (as in the case of unconditional grants) does not help address the (equalization) needs of the poorer and backward districts and VDC. Accordingly, the Government is now experimenting with a new formula-based approach for providing grants to districts. The new formula has weights of 50% for the level of development of districts, based on the district level Human Development Index, 20% for population; 10%, for area, and 20% for the district-wise Cost Index. Thus, the new grant formula gives priority and more resources to the less developed districts and the more remote areas where the cost of construction/development activities are generally higher. Depending on how the new approach works out, the Government expects to eventually extend it to cover all districts.

Source: Nepal: Public Finance Management Assessment, Asian Development Bank, December 2005

### **Human resources and capacity building**

The lack of capacity of many local governments to effectively carry out their primary function—planning, implementation and management of devolved functions; compliance with required standards for accounting, financial reporting and auditing; and ensuring accountability and transparency has been recognised as the biggest obstacle to faster decentralization/devolution. Therefore, a number of training/capacity building programs carried out with financial and technical assistance from external donors over the past few years have helped to improve the situation in several DDC and VDC. Most DDC now prepare their periodic plans and have set up their internal audit units, as well as sectoral units to carry out their key activities. Notwithstanding these improvements, there are persisting deficiencies:

- A large number of VDC have not been covered by donor assisted capacity building/training programs;
- Accounting and reporting formats are not consistently followed and record keeping and periodic reporting are not adequate in coverage and quality, (many local bodies do not provide information on how they utilize internally generated resources);
- Expenditure norms set by MLD for the use of grant funds, (for example, the limits set on the use of such funds for financing recurrent expenditures, or the requirement that they spend 25% of such funds on the social sectors), are not adhered to; among others. The expenditure allocation process at local levels leaves much to be desired; and project selection and prioritization need considerable improvement. Whenever there is significant community participation, (largely the result of training and capacity building and involvement of Support Organizations), however, accountability and transparency have been better.
- Furthermore, in the absence of elected local bodies, financial discipline and accountability have reportedly deteriorated.

### **Effective mechanisms for local accountability**

The absence of any elected local governments and the appointment of government officials to administer the local bodies have seriously affected local accountability. Direct electoral accountability of the DDCs to their citizens through elected representatives and indirectly through the VDCs will continue to be lacking as long as this situation prevails. Moreover, in the absence of elected local officials or their associations who used to be the major advocacy/lobbying groups for decentralization earlier, the demand for faster decentralization and devolution is missing.

In the case of the recently elected Municipalities, the Mission found their electoral accountability to be extremely questionable due to an insufficient number of candidates contesting the elections, the boycott by the opposition parties, and the low level of electoral turnout.

It is clearly the case that weak or no elected representation seriously weakens popular control over local bodies and reduces political equality amongst the citizens in such areas as planning, budgeting, implementation, and monitoring of the government's delivery of services, resources and development programmes generally in Nepal. The administered local bodies more or less function like the centrally appointed bodies of earlier days. The degree of accountability of appointed officials and boards to local communities has been significantly reduced; such boards are also more amenable to domination by local elites; generally, financial accountability and transparency is low; and reported incidences of irregularities and leakages have increased.

Some positive examples for alternative accountability modalities have been identified that continue to be practiced with respect to various functions for which local government bodies continue to be responsible. These include the bottom-up-planning introduced in some sectors as well as the performance based funding mechanisms. However in line with the

growing lack of policy coherence at the national level associated with the temporary 'demise' of the DIMC and the Local Bodies Fiscal Commission the Mission finds that these remain yet to be generalised or harmonised practices within and across local government bodies and therefore remain programme or project specific. This weakens their implementation and thereby the accountability and transparency gains that could be attained with respect to local government process and practice.

The lack of accountability is further exacerbated by such factors as inflexible character of the resources provided to the DDCs and the uncertainty attached to the provision of funds from central government (timing and final amounts). These further reduce a DDC's sense of control and responsibility with respect to utilisation of the funds available. To this must be added the problem of a marked decrease in local resources available for development activities at DDC level in the districts visited and the fact that several examples were found of the available resources being utilised for activities outside the scope of the LGSA. This points very much to the need for greater accountability in DDC financial management and the ways in which the conflict can exacerbate entrenched problems of management responsibility.

#### II.4 DP support to decentralisation

A number of different projects and programmes have supported decentralisation and local governance over the last years. The initiatives have covered most dimension of the reform process and the support has been directed at policy initiatives, legal reform, equity promotion, fiscal decentralization, LG capacity building, participatory planning and poverty reduction. Most support programmes had either a thematic or a regional focus, thus contributing to a largely complementary DP landscape. Some of the most important programmes and project are shortly characterized below:

- UNDP has a long tradition of supporting decentralisation and local governance in Nepal. The **Participatory District Development Programme (PDDP)** and the **Local Governance Programme (LGP)** were twin projects supported by UNDP for the period 1995-2001. PDDP/LGP aimed to empower people to participate in decision-making that affects their lives and to enhance their capacity to mobilise and channel resources for poverty alleviation. To achieve this objective the PDDP/LGP initiated support at three levels. Locally it supported the management of Village Development Programmes (VDPs) through community organisations (COs), through facilitating social mobilisation and self-reliance for multi-sectoral grassroots development. At the district and village levels, it supported DDCs and selected VDCs in 60 districts in participatory planning and management to promote local level sustainable human development. At the central level it supported the capacity building of MLD and NPC to enable them to better implement decentralized and participatory development.
- The **Local Development Fund (LDF)** is a project supported by the United Nations Capital Development Fund (UNCDF) from 1999 onwards. The eight districts selected for LDF implementation, with four from PDDP and four from LGP are Dolakha, Terathum, Achham, Kaski, Kabhre, Rupandehi, Dhanusha and Udayapur. LDF built on the human, social and economic capital generated under PDDP/LGP and their organisational set-up. LDF aimed to alleviate poverty through rural infrastructure income earning and human resource development opportunities. It aims to involve community identification of small-scale rural infrastructure and other public investment needs. To achieve this LDF worked to institutionalise a transparent project selection process within the participatory planning framework. This included the preparation of a handbook to outline the criteria for successful community development projects and on the size and nature of LDF to be implemented in the districts. LDF also aimed to institutionalise the financial management and reporting capacities at the district and sub-district levels and deliver, operate and maintain LDF financed investments. The most important aspect of LDF is to promote the process of decentralized fiscal transfer to the LGs by building their capacity in financial management, monitoring and evaluation.

- The **Decentralised Financing and Development Programme (DFDP)** co-funded by UNCDF and DFID works in 20 districts. DFDP is designed to build upon and strengthen the participatory planning process, delivery capacity and overall accountability of the DDCs and the VDCs. The programme provides block grants to the DDCs for small scale infrastructure projects, aimed at increasing access to basic public infrastructure for poor people living in remote and rural areas. However, and more importantly, DFDP also aims to leverage institutional change within the local government system, by improving the local government capacities in planning, infrastructure delivery and management, financial management, and overall accountability and responsiveness. This is reinforced by an incentive mechanism, whereby block grants to DDCs are linked to an annual review of their compliance with Minimum Conditions, derived from basic Local Self-governance Act (LSGA) and financial accountability provisions, and an annual assessment of overall. DFDP was originally scheduled to end by 31<sup>st</sup> December 2005. However, in May 2005, a UNCDF strategic review mission recommended that the programme be extended for an additional 9 months, until September 31<sup>st</sup> 2006.
- The **Decentralised Local Governance Support Programme (DLGSP)** supported by UNDP works in 60 districts and 662 VDCs. The programme supports to enhance effective participation of people in the governance process and ensures improved access to socio-economic services to disadvantaged groups including Dalits as envisaged in the Tenth Plan/Poverty Reduction Strategy Paper. It focuses on capacity building of local bodies at the district level to make the devolved sectors operational. At the community level it strongly focuses on improving livelihoods to empower the ultra poor, women and ethnic minorities through social mobilisation and other skill development activities. DLGSP builds on the lessons learnt from Participatory District Development Programme, Local Governance Programme, the PDDP/LGP Bridging Phase Programme and other local governance Programmes. The Programme supports poverty reduction efforts through Village Development Programme by introducing pro-poor and positive discriminatory policies to address the issues of social inclusion.
- The United Nations Development Programme (UNDP) and United Nations Capital Development Fund (UNCDF) have, over the last few years, implemented separate local governance support projects in Nepal, working in somewhat different ways. In line with an overall policy commitment to harmonise their support for decentralisation and local governance, UNDP and UNCDF have now decided to establish **DFDP 2** as a joint programme, which will constitute a unified approach to supporting local governance in Nepal. The approach of DFDP 2 will reflect a strategic focus on building the capacities of local bodies, and of their financing arrangements, to promote more effective delivery of basic infrastructure and services
- Danish support to decentralization at national level began with DALAN's (**Danish Support to Local Authorities in Nepal**) programmes, which ran from 1993-98. DALAN supported the High Level Decentralization Coordination Committee (HLDCC) to prepare Nepal's decentralization policy, which became the basis for LSGA. After reviewing these programmes the Danish government decided to initiate a long term, 15 to 20 years, programme of support to human rights, good governance and decentralization in Nepal. The **Decentralization Advisory Support Unit (DASU)** was established to oversee programme support and to liaise with the government. Under DASU, support to decentralization focused on: 1) policy development, 2) capacity building and service provision, and 3) strengthening LG institutions. Programmes are running to enable the holding of free and fair elections; creating awareness of legal rights and making legal information more accessible; supporting NGOs to raise public awareness; support to trade unions; and legislation formulation and implementation. It also supports LGs to become more capable of planning, implementing and monitoring activities and mobilising resources. At the national policy matters, DASU has supported MLD through the Working Committee, the Secretariat of DIMC, and also LGFC and ADDCN to carry out decentralization studies, legal reform and advocacy. DASU has also supported the

twinning arrangement between ADDCN and National Association of Local Authorities in Denmark (NALAD) and continued support to the Local Development Training Academy (LDTA). Currently, DANIDA is providing support to decentralisation and local governance in the context of the **Human Rights and Good Governance Programme (HUGOU)**. In order to address the issues of human rights and good governance at different levels, the Programme includes support to state institutions as well as to civil society organisations as partners. The programme is comprised of seven components. In order to maintain the experiences of 10 years of support to decentralisation, a Local Governance Component was in early 2006 incorporated in the current Human Rights and Good Governance Programme. The Component will strive to become a centre of excellence on matters relating to local governance in the current context of Nepal.

- SNV has supported the **Mechi Hill Development Programme (MHDP)** since 1987. In the first two phases of MHDP, SNV supported infrastructure building, particularly drinking water supply and irrigation schemes, and sustainable community development. The final phase (1998-2000) focussed on strengthening district level institutional capabilities in planning and implementation of local initiatives. The programme objectives of the third phase of MHDP were, to strengthen district-based NGOs to assist village groups to analyse problems and potentials to take initiatives to address them; and to enhance the capacity of DDCs and VDCs to plan, monitor, coordinate and support development in which local initiatives are integrated. Marginalized people, district based NGOs and COs, and DDCs and VDCs are the target groups for MHDP, covering 47 VDCs in Ilam, Panchthar and Taplejung districts. Currently, SNV is supporting district planning and monitoring jointly with UNDP.
- GTZ, encouraged by the positive experiences of the 1974-86 Bhaktapur Development Project, initiated the **Urban Development through Local Effort (*udle*) programme** in 1987. The assistance provided by *udle* focuses the municipalities. Recognising that technical and financial assistance is of limited value unless the target groups are enabled to take initiatives themselves, *udle* has worked to increase the capability of municipalities to plan and manage urban development. The *udle* programme has provided the following advisory services to municipalities: Financial Management and Administration (FiMA), Municipal Organisation and Development Administration (MODA), Urban Hygiene and Environmental Education (UHEEP), and Integrated Action Planning (IAP). It has also supported training activities for municipalities. *udle*'s programme and activities have addressed the central level institutions. Through the Ministry of Local Development (MLD), and the Ministry of Physical Planning and Works (MPPW), UDLE contributed to drafting the Municipality Act 1992, the LSGA 1999 and Regulations and to task forces on solid waste management, the abolition of octroi (a tax on incoming goods), and administrative reform in the Kathmandu valley. UDLE in its fourteen years has made major achievements in building the capacity of Nepal's municipalities. One significant achievement has been the creation of a database to facilitate decision-making processes on issues such as taxation. Another major success has been that of TDF; it is being considered whether it is feasible to upgrade it to an urban development bank authorised to act in the capital market.
- The **Town Development Fund (TDF)** is an autonomous municipal financing institution established by the TDF Act to manage financial support provided to municipalities. The TDF was originally founded as a board with a World Bank loan and GTZ grant assistance. In addition, it is managing the grant fund provided through the German Development Bank (KfW). *udle* provides technical assistance to the TDF as well as to the municipalities who receive loans. TDF provides financial support to municipalities to install street lighting, waste treatment plants, public libraries, and roads, and income generating infrastructure projects such as commercial complex, Bus Park, and drinking water systems.

- The Swiss Agency for Development and Cooperation (SDC) has supported decentralization through two programmes. SDC has supported the “**Local Self-Governance and Decentralization Programme**” in partnership with the Nepal Law Society (NLS) since 1992. SDC support to “**Strengthening DDC Kabhre in Local Governance through Training and Support of Village Technicians**” began in 1998. Both programmes were conceptualised and proposed by the partner institutions themselves. The ownership of the programme rests on respective implementing institutions and their partnership arrangements with SDC and cooperating central government line agencies.

### III. PRACTICE OF AID HARMONISATION AND EFFECTIVENESS

For the purpose of the review, the specific situation in Nepal was analysed using the four thematic issues proposed by the conceptual framework. The four issues address those aspects and dimensions of the decentralisation process in the countries that are inherently related to alignment and harmonisation of development partners support to the reform process: (i) management of the decentralisation process, (ii) DP coordination mechanisms, (iii) alignment of DP support to country strategies and (iv) the modalities of DP support. The following chapters discuss these thematic issues and present the findings and conclusion for improving alignment and harmonisation for effective decentralisation in Nepal.

#### III.1 Management of the decentralisation process

The underlying policy and strategy documents for the decentralisation process as well as the overall orientation of the government as expressed in broader reform programmes, poverty reduction strategies and national development initiatives set the context for the implementation of decentralisation and local governance reforms. The institutional arrangements for the management of the decentralisation reform process, in particular with regard to the leadership role within government for the process, the implication of core stakeholders and the interrelation of the management structures for the decentralisation process with the arrangements for the management of a broader public administration reform.

##### **Institutional Set-up for managing the decentralisation process**

Major milestones regarding the implementation of the decentralisation reforms have been achieved before both government and development partners focused their attention on the conflict situation and the momentum for the reform process was lost. The milestones include the approval of the Local Self-Governance Regulation and Financial Administration Regulations in 2000, the creation of a high-level Decentralization Implementation Monitoring Committee (DIMC) according to the provision made in the LSGA, the establishment of a common platform called Joint Coordination Forum for Decentralization (JCFD) involving government agencies, civil society, the private sector and donor representatives, the preparation of the Decentralization Implementation Plan (DIP) approved by the DIMC as well as the establishment of the Local Bodies Fiscal Commission (LBFC) and the setting up of the District Development Fund (DDF) as uniform funding window for local governments.

The responsibility for managing the decentralisation process lies with the **Ministry for Local Development**. The MLD took an active role in promoting the decentralisation reforms in the late 1990s and the early 2000s and developed core elements of the overall legal and political framework for decentralisation and local governance with the support from different DPs.

The capacity of MLD—the apex ministry which is responsible for overseeing progress of local bodies—to effectively supervise and monitor them is inadequate. MLD does not have the staff, skills and the capacity both to monitor local bodies and to implement a rapidly expanding program of activities. Part of the problem of non compliance of reporting and accounting standards by local bodies lies in the fact that MLD's own capacity to supervise and monitor them is limited. These deficiencies and capacity constraints in turn are perceived negatively by line agencies, who use such shortcomings and the lack of readiness of local bodies as a potent argument for slowing down the devolution process.

The **Decentralization Implementation and Monitoring Committee (DIMC)** has been a key body chaired by the Prime Minister to drive the decentralisation reform agenda forward; it designed and approved the Decentralization Implementation Plan (DIP); secured the gradual transfer of the programmes of three sectors (primary education, health and agriculture) in a phased manner. However, the decreasing lack of commitment from government was reflected in the functioning of the Decentralization Implementation Monitoring Committee (DIMC) itself. Set up directly under the Prime Minister to monitor progress and to make

appropriate recommendations for accelerating decentralization, DIMC has not met for the since 2002.

The national political environment for decentralisation and local governance has been seriously set back; the former political leadership provided by the Prime Minister's Office, with its central role in the DIMC, has been replaced by a political leadership with a very different agenda. The instruments for coordinating the relevant ministries in support of the decentralisation are no longer functioning and the national civil bureaucracy finds itself in a situation without clear direction despite the authoritarian nature of the political regime.

At the political level, while elected governments recognized the benefits of decentralization for building political support for themselves at the local level, some sought to strengthen DDC while others favored VDC; and this in turn created considerable ambivalence in supporting programs championed by others. At the bureaucratic level, there has been considerable reluctance on the part of line ministries and agencies to let go of their traditional functions and sources of power; and in the absence of a clear implementation plan, each line ministry/agency interpreted the national commitment to decentralization in its own way.

For their part, the Association of District Development Committees in Nepal (ADDCN), National Association of Villages in Nepal (NAVIN) and Municipal Association of Nepal (MUAN) have been established and became focal points for policy dialogue with the central government and lobbies for accelerating the decentralization process. They emerged to play important roles, in particular:

- Placing pressure on the central government to move proactively and more quickly in support of the decentralization process and
- Transferring skills and knowledge to the local government bodies and community organizations with respect to the implementation of the LSGA and associated reforms and practices.

However, without elected local governments to represent at central level, the associations have also experienced a certain deadlock in continuing their activities.

While decentralisation and local governance was still high on the overall political agenda of the government, important progress could be achieved. However, with the increasing attention of the government being drawn towards addressing the situation of conflict and political crisis, the decentralisation reforms were marginalized on the political agenda. The MLD continued work on the technical level, however whenever initiatives needed cabinet approval, it became apparent that the political clout of the MLD was not sufficient to put local government and decentralisation issues as a priority back on the political agenda. The high level coordination forums created to conduct dialogue on decentralisation and local governance engaging government, civil society and development partners lost their relevance shortly after their creation. Also activities of the Decentralisation Implementation Management Committee (DCIM) and the related working committee and the proceedings related to decentralisation coming out of the National Development Forums were not taken forward due to the shift in political priorities.

### **Current political environment for the decentralisation reforms**

With the formation of the interim government bringing together the former 7-party government with the Communist Party of Nepal (Maoist) after a decade of armed conflict, a new policy environment has established itself. The local government system in Nepal has been severely affected by the conflict with the narrowing of the development space within which local government could operate. Many people have lost their confidence in national and local government and their capabilities to deliver good services in an effective and efficient manner. The interim constitution recognises the role of local government for development and it is expected that the new constitution will also provide for maintaining a local government system in Nepal. However, the political process for resuming the implementation of the reforms is not only dependant on the overall policy orientation to be

provided by the new constitution, but also affected by the dynamics arising from the conflicting priorities and the rivalry for political attention and external funding between the Ministry of Local Development headed by a minister from the Maoist faction and focusing on decentralisation and local governance and the Ministry for Peace and Reconstruction focusing on implementing programmes targeting peace dividends. Currently the government of Nepal is in a transition phase and both the priority given to the decentralisation process on the political agenda as well as the support within government for the reforms still have to be clarified.

### **III.2 Development Partner coordination mechanisms**

After some positive initiatives from Government for coordinating DP support for decentralisation and local governments in the early years of the decentralisation process, the political developments weakened government ownership for the process. Currently the limited role of government with regard to coordination DP support is shared between the MLD for thematic coordination of intervention based on the existing strategy documents and the Ministry of Finance for overall territorial coordination. At the same time, the different DPs involved in supporting decentralisation and local governance strengthened the coordination between them within the framework of the sub-group on decentralisation.

#### **Government initiatives for coordination DP support**

The joint peer review undertaken in 2000 by of the government of Nepal and the DP representatives to determine the status of decentralisation. A steering committee for the review was formed under the chairmanship of a representative from the National Planning Commission and included the chairman of the ADDCN as the representative from the three LG associations, representatives from the Ministry of Local Development, the Ministry of Finance, and from four development partners - the UNDP, DANIDA, DFID and the World Bank.

The **Joint HMGN – Donor Review on Decentralisation in Nepal** identified government direction for donor involvement as one of the key areas for immediate action, together with the formulation of an implementation strategy for the LSGA and the development of a suitable local governance finance system. With regard to donor coordination the review stressed that effective decentralization needs fully co-ordinated donor support and recommended that government should establish a forum where HMGN, donors and stakeholders can discuss key issues concerning donor programmes. A single national institution should be established to take lead in identifying specific areas for peer review to assess each other's contribution. Furthermore, the review recommended that DPs and other stakeholders should strive to activate and strengthen DIMC so that it can become more active.

Based on the recommendations of the joint review, the government established a common platform called **Joint Coordination Forum for Decentralization (JCFD)** in July 2001, involving government agencies, civil society, the private sector and donor representatives, to begin reviewing the situation for policy improvement.

The JCFD identified five thematic areas — sectoral devolution, organization and structure of LGs, fiscal decentralization, institutional development and capacity building, monitoring and policy feedback. Based on the thematic areas identified, Thematic Groups were organized and contributed to the elaboration of the Decentralisation Implementation Plan (DIP). At the time, the DIP provided a clear framework for implementation the decentralisation reforms addressing the core challenges and constraints but also provided a platform on which DP support programmes could be coordinated.

However, government leadership for the coordination process weakened due to the situation of conflict and political crisis described above and the Joint Coordination Forum is no longer functional as a coordination mechanism between government and DPs. Currently the limited role of government with regard to coordination DP support is shared between the MLD for

thematic coordination of intervention based on the existing strategy documents and the Ministry of Finance for overall territorial coordination.

Several recent studies on decentralisation and local governance in Nepal recommend to work for a stronger development partner dialogue as well as joint development partner – GoN (MLD) dialogue on the future strategy, plans, support initiatives and actual operations within the field of decentralisation and local governance, to ensure less overlap and more synergy. A first initiative to restart the dialogue between government and development partners was undertaken by the newly appointed Minister for Local Development in April 2007 by inviting the DPs to a meeting on the MLD strategy on decentralisation and an exchange of information. However, it is too early to assess the perspectives for the future set-up and functioning of the dialogue between government and DPs.

### **DP Coordination mechanisms in Nepal**

The sub-group on decentralisation currently provides the platform for the exchange of information between those DPs supporting the decentralisation process. The group has a good tradition of exchanging information and promoting coordination:

- A first initiative for setting up a comprehensive support programme for decentralisation and local governance was undertaken in 2003, however later on undermined by the assumption of increasing powers by the monarch and the subsequent withdrawal of core DPs from the reforms.
- Coordination and harmonisation of aid modalities has increased over the years in the context of several DPs combining their resources in one combined programme.
- Within the sub-group on decentralisation, the DPs jointly undertook two **joint studies**, in 2005 and 2006, to explore how the ongoing conflict and the changes in government affected the development space in Nepal. These initiatives provide a valuable platform for strengthening coordination and harmonisation in the future.
- A new initiative for setting up a broad support programme that will prepare the ground for a comprehensive national programme is the Decentralised Financing and Development Programme II under preparation by UNDP, UNCDF and DFID.
- Recently, DPs have also launched an initiative for promoting government participation and eventually government leadership for the coordination mechanism.

However, DPs supporting either macro-reforms highly relevant for decentralisation, such as the public financial management reforms, targeted programmes (poverty reduction, in future: peace dividends) or the sectoral support programmes do not systematically participate in the sub-group on decentralisation. In order to promote coherence between the different support programmes intervening at local level and / or reforming the national legal and regulatory framework, the coordination mechanisms needs to be more inclusive and horizontal (to sector and thematic groups) and vertical (to macro reforms and national development programmes) linkages strengthened.

### **III.3 Alignment of DP support to country strategies**

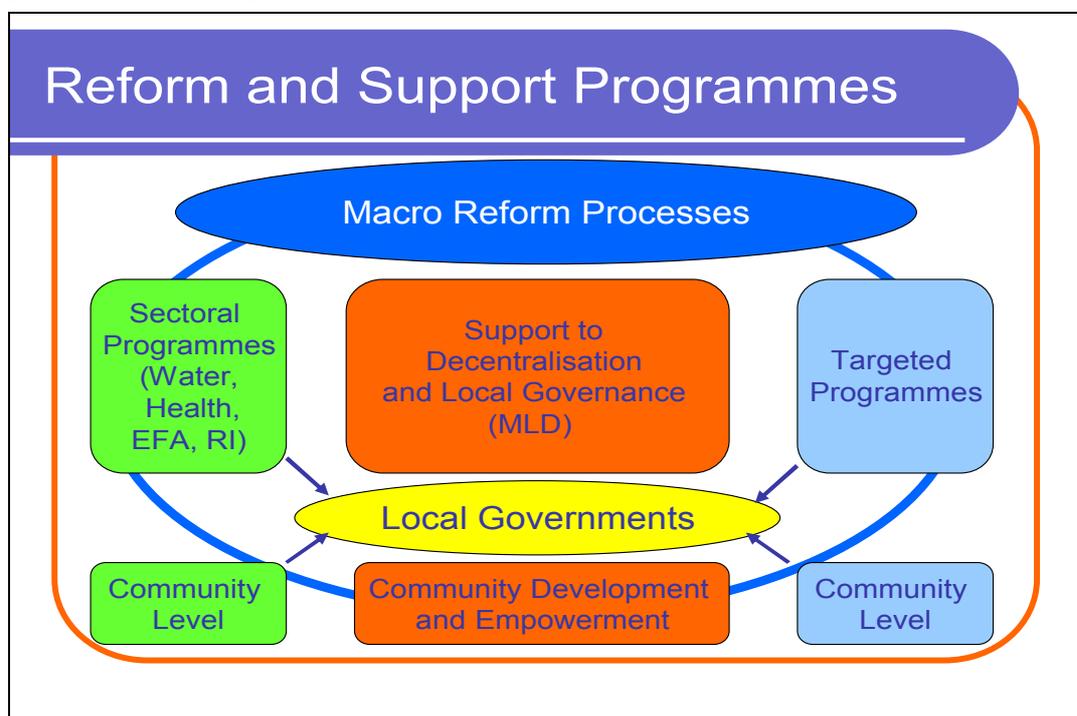
As the government's policies and strategies were so broadly formulated, the different DP support programmes generally matched the overall decentralisation policy objectives. However, alignment of DP support to country strategies has only partly been achieved in Nepal. One reasons for the variety in DP support is the lack of a clear and detailed strategic framework provided by government which DPs could align their support to. The Decentralisation Implementation Plan was a promising initiative providing a detailed outline of reform activities, responsibilities and a time frame for their implementation; however the political situation undermined the development of the DIP into a comprehensive framework for alignment.

### National policy framework

Generally, the different national strategies and policies provide various frameworks to which DPs are currently aligning their support. These include the overall national development strategy presented in the 10<sup>th</sup> Plan, but also sectoral strategies and the legal and policy framework for local self-governance.

However, these national development strategies in Nepal are not necessarily fully coherent with the provisions of the Local Self-Governance Act. This is valid for the national 10th Plan (PRSP) which is not explicit enough with regard to the key role of local governments for poverty reduction and thus allows for targeted poverty reduction programmes to align themselves to the PRSP but sidelining local government in the implementation and thus undermining the decentralisation reforms to a certain extent. Given that local elected governments were abolished in 2002, the potential conflict arising from these diverging implementation policies have so far not had major negative implications for the decentralisation reforms, with the institution of interim local bodies the need for improving coherence would arise.

The same is valid for sector strategies and support programmes that are also not fully compliant with the local self-government act. To improve coherence between the macro-reform processes, the sectoral programmes as well as the targeted programmes (currently mainly poverty reduction, in future primarily post-conflict reconstruction and recovery) will be a challenge to be addressed once the reforms for decentralisation and local governments will gain momentum again in the context of the discussions on the new constitution.



### Building Blocks for Alignment

However, alignment has been improved over the last years with different 'building blocks' of the national framework being put into place. The development of these national mechanisms has been strongly supported in the context of different DP projects and programmes, but they have not yet been consolidated into one comprehensive framework for supporting decentralisation. The most important building blocks include:

- The establishment of the DDF as a decentralised one window funding framework has provided important incentives to the DPs for channelling external funding through this mechanism instead of maintaining diverging parallel system. The DDF is one of the

building blocks for strengthening harmonisation and alignment of DP support to local governments.

- The development of performance-based funding supported in the context of the DFDP will be followed-up in the new DFDP II. The mechanism provided for DDCs to have access to programme block grants provided that they fulfil a set of minimum conditions and to additional funding conditioned upon performance indicators. The government has indicated its commitment to scaling-up the performance-based assessment to the entire country and thus integrating it as part of the national systems and procedures.
- The DFDP II programme proposed to work on establishing and implementing systems and procedures that substantially reduce the fiduciary risk at the local government level which has to be considered the major constraint to future basket funding and local budget support. This will include aligning the grant transfer mechanisms to local government in the programme area with government's own budget and treasury procedures.
- Furthermore, DFDP II will support the improvement of procedures for local government financial management. As soon as these improved PFM procedures and systems are identified and tested, the programme will facilitate their 'roll-out' on a widespread basis throughout the local government system in Nepal. This will be an important element in the overall strategy of moving towards on-budget funding support.
- Developing and implementing a national capacity building strategy for local governments will provide a further incentive and 'building block' for DPs to align their support to. Currently, the different capacity building activities supported in the context of the various programmes and projects have not been developed against the background of a comprehensive national strategy. Therefore, a great diversity of approaches and methodologies of the trainings for the different aspects of local governance can be observed. The DFDP II proposes to support the formulation and implementation of a nation-wide and sustainable capacity development strategy for local governments in Nepal.

#### **III.4 Support modalities for DPs**

Decentralisation and local governance has been supported by DPs through various programmes and projects over the last years (see overview in II.4). Donor support to decentralization has been directed at policy initiatives, legal reform, equity promotion, fiscal decentralization, LG capacity building, participatory planning and poverty reduction. These programmes are characterised by specific aid modalities regarding governance structure, funding flows, approaches to capacity building etc. However, the regional and thematic focus of most programmes as well as the increasing level of cooperation of several DPs in the context of one programme (co-financing, joint programmes, etc.) has helped to avoid conflicting modalities.

The joint review carried out in 2000<sup>2</sup> analysed seven donor supported decentralisation programmes and although the situation of DP support has changed in recent years, some of the main findings still valid:

- Duplication and contradictions were not observed in the donor programmes reviewed. Synergy effects have been created as donor programmes have contributed to different aspects of decentralization. The different types of LG capacity building programmes enhance LGs' planning competence and ability to deliver services. However, with the absence of a national framework to streamline donor support, donors are separately experimenting with their approaches.
- The government has yet to provide consistent guidelines for donor involvement in decentralization to direct and specify support focus areas. This has led to a thin, random spread of donor support. The lack of co-ordination has resulted in GoN blaming the

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<sup>2</sup> Joint HMGN-Donor Review on Decentralisation in Nepal, 2001

donors for setting conditions and wanting to fund programmes directly, whilst the donors have been blaming GoN for too much bureaucracy and weak performance.

- Donors have kept each other informed about their activities and priorities by sharing their reports and holding review meetings and workshops. Study tours have been arranged for LG members to share their experiences.
- Programme sustainability depends upon many factors, including joint programme design to encourage ownership, agreement on mutual roles and responsibilities, and well-designed phasing out stages. Sustainability is greatly enhanced when recipients co-fund programmes and receive full programme information. Education is important for sustainability as it raises awareness and enables people to develop their communities themselves. Participation of beneficiaries is equally important and social mobilisation greatly this. All the donor programmes reviewed have a fair degree of sustainability, but some lack a clear phasing-out strategy to allow the main stakeholders time to take them over.

However, not only the project and programmes directly targeting decentralisation have a bearing on local governments, but also targeted and sector programmes. Harmonisation of support modalities with these programmes has received less attention so far, both from government as well as from DP organisation. Donors supporting decentralization should ensure that their sectoral programmes conform to the aims and processes of decentralized governance and should guide their Nepali counterparts to respect and abide by LSGA provisions.

#### **Donor Support to Basket Fund Arrangements in Nepal**

In preparing for the new Decentralised Financing and Development Programme (DFDP 2), the experiences from basket fund arrangements in other sectors in Nepal have been analysed to inform the design of the basket fund arrangement for the DFDP 2. The core findings of a mission report<sup>3</sup> providing input for the new programme were:

- It takes time to fully elaborate these systems, and on-budget funding requires strong system development,
- It requires a good “home-work” and detailed assessments of systems and procedures, support required to introduce this,
- The support is typically linked up with a strong policy, a strategic medium term implementation plan and annual (and sometimes quarterly) plans and detailed budgets,
- There is formal review mechanism, both in terms of annual, quarterly and/or monthly meetings and in terms of assessments/midterm reviews,
- It is not an easy task to harmonise the requirements (planning, budgeting, accounting, reporting, auditing etc. ) from the development partners, although the GoN systems should be the point of departure,
- The support modalities can vary from component to component, e.g. support to investments will typically be on-budget prior to more soft components like capacity building support and TA,
- It has required significant support in terms of TA and CB support to establish the on-budget funding mechanisms,
- Long term advisers in the Ministries should have a clear ToR, which is to support the GoN in its implementation, but should not be placed as “safeguards” and/or voice of the development partners. If there is weak capacity in core areas of e.g. the PFM cycle, it is better to be open in the design of programmes and establish or continue the interim arrangements in form of smaller efficient *programme units* with some clear responsibilities and joint management systems, combined with a clear strategy and time-plan for gradual mainstreaming with government systems,

<sup>3</sup> See Jesper Steffenson, Draft Mission Report, March 2007, p.9

- Weaknesses in the reporting systems and procedures (including quality and delays) have continued to be a challenge and is an area for tense discussions between GoN and the development partners under the basket fund arrangements and pulled funding – without strong reporting systems, it is hard to measure the impact of any support,
- Although most funds are transferred through a pulled funding arrangement/ basket funding system using the GoN Treasury system in the few core sectors using a SWAp, some development partners have kept a certain budget aside for prioritised areas or as contingency to support special reviews and capacity building efforts, which are believed not to be sufficiently targeted in the GoN's plans and budgets. This may also provide a certain flexibility and possibility to mobilise funds for urgent matters,
- The monitoring arrangements typically encompass a kind of overall steering committee with one or few meetings during the year, and some of these arrangements entail more technical coordination systems beneath this. Technical committees established discuss the quarterly plans and budgets of the support and ensure current monitoring and follow-up,
- The development partners use various approaches, ranging from: 1) full integration in the joint funding arrangement, 2) partly integration and 3) vary degrees of linkages, outside of the basket/pulled funding arrangements, and this may vary from case to case and sector to sector.
- The process towards harmonisation of donor approaches with joint basket funding procedures has been stronger than the alignment with Government procedures,
- The lack of a clear GoN PFM Action Plan (to be developed) has made it difficult to have a coherent development and phasing in of the alignment process with clear benchmarks and targets and gradual mainstreaming to GoN systems when these targets are achieved. This also tends to lead to a piecemeal approach where each basket establishes their own special accounting and reporting procedures, draining the limited capacity and creating problems consolidating the overall resources. The lack of an overall, consolidated, and coherent PMF Action Plan with strong GoN commitment to champion this reform is a major constraint for the possibilities to reduce the fiduciary risks of any budget support in the country, particularly in a cross-cutting area such as decentralisation/local governance with absence of an overall strategy and implementation plan.

### **Future Support to Decentralisation in Nepal**

Currently, several new support initiatives for decentralisation and local governance are under preparation, including the DFDP II to be supported by UNCDF, UNDP and DFID, the DLGSP to be supported by UNDP and Norad. The current initiatives clearly integrate efforts for harmonising support modalities between the different programmes:

- The DFDP II is designed as a comprehensive programme of support for local governance covering not only DDCs and VDCs but also municipalities. This commitment to a comprehensive and joint programme by a small group of DPs will help to lay the foundation for an eventual national programme as local government policy in Nepal becomes clearer. This national programme could provide the framework for multi-donor assistance in the area of local governance.
- The DFDP II seeks to develop the mechanisms and establish the preconditions for harmonised DP support to local government. This will imply working on establishing and implementing systems and procedures that will substantially reduce fiduciary risk at local government level – the major constraint to future basket funding and local budget support.
- The concept for the new DFDP II programme sets the course for a limited basket fund arrangement which will in the beginning be funded by a core group of development partners (UNDP, UNCDF and DFID). However the concept already provides for the up-scaling of the funding arrangement and the integration of support from other partners.

- Clear linkages and synergies between different programmes are being integrated into the programme design and the division of labour between the initiatives and DPs is also being enhanced. An example is the division of labour and tasks between the DFDP-II and the coming DLGSP: the DFDP II should focus on the supply side of local governance/ decentralisation, including the grants to LGs, the systems and procedures to enhance the LGs capacity to deliver public services and the capacity of central bodies to support these systems, including the entire PFM cycle, whereas it is suggested that the DLGSP focuses on the demand side, such as community involvement, mobilisation, organisation, etc.
- Partnerships between the DPs supporting decentralisation are currently being strengthened in the context of the development of the new programme approaches, by building upon existing complementarities and by initiating new partnerships. Currently, synergies are being strengthened between the programmes supported by the UN system.

Whereas the perspective for harmonising support modalities among those DPs support decentralisation and local governance are positive, the communication with other sectoral or macro initiatives has yet to be initiated to provide a the basis for improving the coordination of the different approaches and to advance the harmonisation of support modalities. However, the commitment of several DPs to supporting post-conflict reconstruction and recovery programmes with their specific objectives and interventions logics is a challenge for harmonisation as these programmes tend to work with parallel structures without reference to local governments.

#### IV. LESSONS LEARNED AND PERSPECTIVES

The assessment of alignment and harmonisation in the field of decentralisation and local governance in Nepal has to take into account the conflict situation which has had a major impact on all dimensions of development in the last years. The following lessons learned and perspectives have been derived from the analysis:

- **High-level political commitment for decentralisation essential, in particular in difficult political set-up:** After important progress in implementing the decentralisation reforms in the late 1990s and early 2000s, the reform process lost momentum and was marginalized on the political agenda due to the primacy of the conflict situation. In order for the decentralisation process to gain momentum again, high-level political commitment from government is essential. However, the rivalry for political clout and external funding between decentralisation (Ministry of Local Development) and peace building (Ministry for Peace and Reconstruction) on the other together with the discussion regarding the future form of government and the governance structure of the state put the advancement of the decentralisation reforms at risk.
- **As the revising and updating of the legal and political framework for decentralisation and local governments will be a lengthy process, an interim vision is required to maintain government and DP commitment to supporting local governments:** The risk of marginalization of the decentralisation reforms both by government and DPs due to the political priority given to the peace building initiatives in the post-conflict situation is increased by the ongoing reflexion on the governance structure of the state and the subsequent need for a revision of the legal and political framework for decentralisation and local governments. In order to keep local governments on the political agenda, it seems essential for the Ministry of Local Development to develop an interim vision and a clear road map for the decentralisation reforms.
- **Lack of government commitment rendered initiative for high-level coordination forum non-functional:** The lack of government commitment due to shift in political priorities (conflict) rendered the high level joint coordination forum ineffective shortly after its creation. The coordination of DP support by government was therefore focusing on territorial coordination as most DPs are targeting specific regions with their support as well as – up to a certain extent - thematical coordination based on the Decentralisation Implementation Plan.
- **Coordination needs to be enhanced vertically and horizontally to address the challenge of decentralisation more comprehensively:** The sub-group on decentralisation currently provides the platform for the exchange of information between those DPs considering themselves to be supporting the decentralisation process. This, however does not include DPs supporting either macro-reforms highly relevant for decentralisation, such as the public financial management reforms, nor the targeted programmes (poverty reduction, in future: peace dividends) or the sectoral support programmes. In order to promote coherence between the different support programmes intervening at local level and / or reforming the national legal and regulatory framework, the coordination mechanisms needs to be more inclusive and horizontal (to sector and thematic groups) and vertical (to macro reforms and national development programmes) linkages strengthened.
- **Joint studies of the DPs are conducive to strengthening coordination and harmonisation:** The DPs engaged in the sub-group on decentralisation jointly undertook studies on the existing development space in the conflict situation. These initiatives as well as the elaboration of the basic operating guidelines undertaken jointly the DPs provide a valuable platform for strengthening coordination and harmonisation.
- **The establishment of the District Development Fund (DDF) as a treasury of the district has provided the basis to regularising fund flows and enhancing financial**

**transparency at local level:** Setting up the DDF as a decentralised one window funding framework has provided important incentives for channelling external funding through this mechanisms instead of maintaining diverging parallel system. The DDF is one of the building blocks for strengthening harmonisation and alignment of DP support to local governments.

- **DFDP II as a framework for harmonising DP support for decentralisation and local governance:** Based on the policy and legal framework of local government and local governance the comprehensive DFDP II provides the framework for harmonising the current project based support to financing the delivery of local infrastructure and services and the initiatives for local capacity building. The DFDP II builds upon the existing DDF for providing block grants to the districts and contributes to the development of uniform national systems and harmonised DP procedures by establishing common reporting, control and auditing requirements and systems.
- **Step-by-step harmonisation of local capacity building:** By subscribing to a common strategy for local capacity building and – insofar as these already have been developed – also applying a common set of procedures (e.g. use of same local planning and procurement procedures, training materials, etc.) government together with DPs can take a first step towards harmonising the different support initiatives. The current practice of targeting specific districts or regions could be maintained for some time provided that mechanisms for coordination at local and national level are established and/or strengthened. The second step would be based on an approved strategy for local capacity-building and consists of providing pooled funding to a capacity-building basket for local government and local governance. This basket should be managed by government according to an agreed strategy and plan, where donors have a monitoring and oversight role.

## Alignment Strategies in the Field of Decentralisation and Local Governance

### **Nepal Country Study Presentation of Preliminary Findings**

Susanne Hesselbarth - Kathmandu, April 26, 2007

## Overview

- Background and Objective
- Methodology
- Preliminary Findings
- Lessons Learned ?

## Background of the Study

- DP's Working Group on Decentralisation and Local Governance established 2006
  - > exchange of information
  - > strengthening of coordination
  - > promoting implementation of principles laid out in Paris Declaration
- Desk Study on individual DP strategies for supporting D + LG

## Objective of the Study

- Review Study on alignment strategies in the field of D + LG (Danida + KfW)
- 4 country studies: Benin, Nepal, Nicaragua and Tanzania
- Result: Principles for DP aid harmonisation in support of D + LG
- Presentation to DP Working Group in September 2007

## Methodology

- 4 Core Aspects to be analysed in the country studies:
  - > Management of the Decentralisation Process
  - > DP coordination mechanism
  - > Alignment of DPs support to country strategies
  - > Modalities of DP support
- Consolidation of country findings to general principles for coordination

## Management of Decentralisation

- => Effective Leadership over development policies and strategies
- MLD as main driver for decentralisation
- Milestones : 1990 - New Constitution  
1992 - Local Elections  
1999 - LSGA  
2002 - DIP
- Recognition of decentralisation in PRSP/  
10th plan

## Conflict Situation

- Momentum lost during conflict situation
  - Focus shifted from decentralisation issues to conflict
  - Reform implementation hampered at local level due to conflict / insecurity / absenteeism
- Current situation:
  - No elected local governments
  - Full sector devolution not implemented
  - Lack of human and financial resources at local level

## Way Forward ?

- **Political commitment to decentralisation (devolution?)**
  - > Interim Constitution recognizes autonomous local governments
- **Priorities at national and local level**
  - > Reconstruction / Peace dividends – quick impact and improvement of service delivery
- **Transition Context**
  - > Medium-Term: Constitutional Assembly -> Restructuring of the State
  - > Short-Term: Interim Local Bodies

## Challenges

- D + LG reflected as priorities on the political agenda => risk of marginalisation by focus on post conflict issues and reconstruction/service delivery
- High-level support within government for full devolution needed => Decentralisation as a cross-cutting issue
- Need for new national framework for decentralisation integrating core issues

## DP Coordination Mechanisms

- => Country leadership for coordinating development actions (ownership)
- => DPs' actions are more harmonized and transparent (harmonization)

## GoN - Coordination

- **Coordination Initiatives**
  - Joint Peer Review (2000)
  - NDF (2004) – DP harmonisation
  - DIMC (2002)
- **Practise of Coordination**
  - MoF / MLD focus on territorial coordination
  - MLD for thematic coordination (DIP)
- **Guidance on Harmonisation**
  - No strong guidance from MLD / GoN on harmonization/coordination
  - Lack of harmonisation within GoN (sector legislation – full devolution)

## DP Coordination

- **Sub-Group on Decentralisation**
  - Initiatives for coordination and harmonisation
  - Tradition of Bilateral Cooperation Agreements
  - Move towards basket funding
- **Shift of focus due to conflict situation**
  - Joint studies on analysis of development space
  - Basic Operation Guidelines
  - Relative Shift
- **Room for improving comprehensiveness**
  - Coordination remains largely at a 'sector level', not yet addressing decentralisation as cross-cutting issue
  - Potential synergies from vertical coordination not yet exploited (PFM)

## Challenges

- Make Coordination more comprehensive
  - include sector and macro initiatives and link them to decentralisation issues
- DP level:
  - WB, ADB macro initiatives
  - Sector initiatives
  - Targeted programmes (poverty, peace, inclusion..)
- GoN level:
  - Devolution as a cross-cutting issue
  - Clear framework for coordination (new DIP?)
  - Take on Leadership for coordination

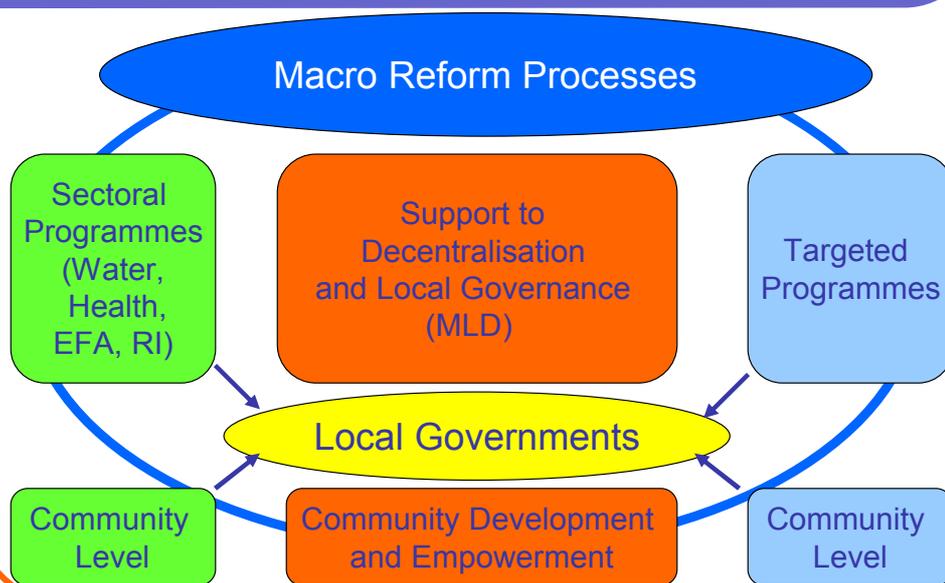
## DP Alignment

- => DPs base their support on national strategies, institutions and procedures
- 10th Plan / PRSP still valid as core framework for DP support
  - LSGA / DIP were accepted as a clear framework for alignment

## Current National Framework

- Shift from decentralisation to conflict on GoN and DP side  
-> reference framework changed
- Lack of coherence of national framework, reforms and support programmes  
-> broad choice of strategies to align to

## Reform and Support Programmes



## Challenges

- Fully-fledged National Strategies will only develop over the next years
  - state restructuring
  - devolution as cross-cutting issue
- High-level support within government for full devolution needed – but temporarily other priorities on the political agenda

## DP Support Modalities

=> DPs's actions are more harmonized and transparent (harmonization)

- Specific support to D + LG:  
Variety of projects and programmes supporting MLD, local bodies, communities and civil society, (capacity building, infrastructure, empowerment, ...)

## Support Modalities

- Variety of support modalities for D + LG: Project/Programme Support
- Initiative for moving towards joint funding mechanisms (DFDP II)
- Horizontal and vertical coordination with sectoral support programmes and 'community-based governance' programmes yet to be strengthened

Sectoral support: Mode of delivery has strong implications on decentralisation and local bodies

Macro support: Core and underlying reform processes set the framework for decentralisation and local governance (PFM)

## DP Funding Modalities

### **Funding not standardized:**

- DDF as building block:
  - Fund flows through the DDF – but not all
  - Fund flows not always linked to spending authority
  - Earmarked Programme Funding
- Scope of Donor Funding:
  - Increasingly through DDF, however with earmarking
  - But still important funds off-budget and outside DDF, directly to communities

## Challenges:

- Focus on Reconstruction and Peace Building (quick impact)
- High-level support within government for full devolution needed
- Lack of clear guidance from GoN
- Institutional constraints / DP agendas  
=> Need for Process Approach

## Lessons Learned ?

- Relevant Context:  
Conflict Situation and Transition Period
  - Reform processes lost their momentum and were marginalized on the political agenda
  - Efforts from Gov and DPs focussed on managing / dealing with short-term urgent issues
  - Focus on peace building / peace dividends and improvement of services
  - Clear framework for decentralisation and local governance only in the medium term

## Lessons Learned ?

- Coordination and harmonisation requires national framework
- Country ownership and guidance as prerequisite for comprehensive coordination and harmonisation
- Clear vision on step-wise approach to extend coordination and harmonisation to sector support and macro processes