

# **An Assessment of Local government capacity for mobilizing revenue: A case study on Nepal**

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## **Abstract**

*Local governments cannot function effectively without adequate revenue generation. In newly federated Nepal, fiscal devolution involves generation of local taxes, charges and fees and external grant transfers from upper level governments. This paper assesses the capacity of the local governments to mobilize local resources for development and the delivery of local services. Two District Development Committees (DDCs) of Nepal were selected as cases based on Minimum Condition and Performance Measurement (MCPM), a criterionbased evaluation made by the Government of Nepal to rate local government effectiveness. The mixed method of sequential strategy was adopted for this study. The study finds that institutional capacity determines local resource mobilization, which in turn depends on the higherlevel tax base, efforts, effective compliance of devolved fiscal powers, and the greater extent of people's engagement.*

**Keywords:** *local government, revenue efforts, fiscal decentralization, local resource mobilization, Nepal*

## **1. Introduction**

A decentralized local government can play a key role in local economic development and in delivering basic services such as schools, hospitals, security, waste removal, parks and recreation, water, sewage among others. However, insufficient revenue is often cited as the main reason behind poor public service delivery and slow social and economic development (Radian, 1980:9). Therefore, revenue generation is an important policy objective for local governments to provide

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public services and foster socioeconomic development at the local level. Local governments of developing countries like Nepal, have often faced financial deficits that hinder their ability to achieve their development goals (Shrestha, 2017).

The government of Nepal carries the spirit of political, fiscal, and administrative decentralization to the local governments, enabling local government to generate internal revenue. Internal revenue is important to carry out local functions independently as well as to scale up performance.

Economic performance is directly related to institutional capacity (Evans and Harding, 1997 cited in Gibbs et al, 2001:107). In devolving fiscal system, revenue mobilization may vary according to the capacity of the local government and the efforts they put in. In fact, the government having low capacity tends not to collect much in the way of taxes (Brautigam, 2008:4). This means revenue collection can be different due to the capacity differences. In this context, to what extent the capacity of local government differs in internal revenue mobilization of local government in Nepal is a critical issue. The factors such as rule of law, administrative capacity and democratic participation can play important role in revenue mobilization (Haldenwang and Ivanyna, 2012:6). Moreover, local governments have made efforts to formulate and implement fiscal rule, human resource management based on organization structure and involvement of local people in planning and implementation; all of which could enhance willingness of taxpayers to pay tax/nontax. Higher level of willingness to pay tax is essential to increase revenue compliance. However, in general, little is known about tax compliance behavior in developing countries (D'Arcy, 2011 cited in Ali et al, 2013:4). In this context, this study explores the factors that determine revenue compliance of developing countries like Nepal. The key factors that are considered in study are the local fiscal policy, institutional capacity, and peoples' participation. Those factors are crucial to enhance the willingness of taxpayers so that revenue compliance is increased.

### *Local government in Nepal*

Since 1960, Nepal has been adopted principle of decentralization, consecutively, the power and structure of local government has been changed heuristically. After the restoration of multiparty democracy in 1990, the government enacted different laws for local governments such as District Development Act, Village Development Act, and Municipality Act, in 1992. Later, these three Acts were integrated and enacted as Local Self-Governance Act 1999 (LSGA, 1999). To operationalize the LSGA, 1999, the Local Self-Governance Regulation, 2000 (LSGR, 2000) was enacted. The Act and Regulation have been devolved various

sources of revenue to the local governments.

In 2000, the tenure of elected local government authority was ended but the new election could not be held for at least 17 years due to several reasons. During this vacuum (2000 to 2017), the Government delegated executive power to the administrative head who was the Local Development Officer (LDO) at each of the DDCs. As a result, the LDO had to exercise DDC's full power as like local people's representative along with implementation of DDC's plans and programs. However, local level recognized political party leaders were also consulted in the planning process of the DDCs. The internal revenue data shows that fiscal performance of DDCs for the fiscal years from 2006/07 to 2009/10 decreases by 12.41 percent, 11.54, 7.61 and 7.20 percent respectively (Local Body Fiscal Commission Secretariat (LBFCs, 2012). This institutional capacity for internal revenue mobilization has stood as major challenges for local governments. Since local governments are not able to influence the size of government grants, therefore, local bodies like DDCs do not have ways to fulfill investment gap. For this, the local government can enhance its own sources by mobilizing tax and nontax income along with the revenue sharing with other stakeholders such as forest consumer groups, cooperatives and the like.

The decentralization of power to local government alone is necessary but not sufficient condition for local resource mobilization. Adopting appropriate fiscal policies by utilizing the institutional capacity and enhancing participation among the concerned stakeholders are crucial to enhance local revenue generation and its mobilization to a greater extent. In this context, this study examines to what extent the institutional capacity of the local government enhances mobilization of local resources. Based on this question, the objectives in this paper are set to examine the local fiscal policy of DDCs; analyze the institutional capacity of DDCs; and to evaluate the mechanism of people's participation in DDCs.

Nepal's political development, particularly after the end of the Maoist insurgency in 2006, an assortment of 22 exclusive power and 15 concurrent power have been assigned by the constitution of Nepal to local governments (namely urban municipality and rural municipality). The power has been explained by Local Government Operation Act, 2017 and Intergovernmental Fiscal Management Act 2017 which are in practice only for the last couple of years. The formation of local bodies as per their mandated roles and people's expectation from the local bodies are enormously increasing. The local bodies can scale up their developmental and service delivery roles by enhancing their resource mobilization capacity. Howev-

er, there is a dearth of scientific study regarding local resource mobilization. This study therefore attempts to explore local resource mobilization in Nepal.

## **2. Local resource mobilization**

Resource mobilization refers to the scheme of collecting local government's revenue to finance local development plans (Jhingan, 1990:660). Revenue is sourced from internal and external sources (Bahl et al, 2003:71) where internal revenue involves collecting tax and nontax revenue locally while external revenue includes grants and other transfer from the central government. Local governments largely depend on internal revenue to finance functional activities (Briffault, 2007:86), making its collection essential to finance local government plans. Internal revenue is mobilized based on local economic resources such as natural, physical, human and so on. The activation of resources (consumption, production, distribution and exchange) related with total economy, which is reflected in the Gross Domestic Product (GDP). Therefore, local government mobilized internal revenue can be part of the GDP. In this context, the issue is - how effectively mobilized internal revenue by DDC of Nepal. The effectiveness refers to performance of local resource mobilization, which can be measured in percentage such as percent of revenue ratio (i.e. internal revenue/GDP).

Resource mobilization is a normative concept in which political, social and cultural aspects plays vital role. Therefore, acceptability of government authority and local taxpayers is important for effective local resource mobilization. It requires extractive capability of local government having with its desirable efforts. The level of compliance on decentralized sources of revenue shows the degree of combined efforts of local government authority and local taxpayers for collecting revenue. Therefore, better relationship between government authority and taxpayers ultimately would give good result in improved tax compliance (McKerchar and Evans, 2009 cited in Ali et al, 2013:7). The higher compliance level helps to increase the willingness to pay tax. Thus, higher percent of revenue collection is associated with tax compliance, which can be a proxy with better economic performance of local government.

In this context, level of compliance on decentralized sources is critical. LSGA (1999) has devolved various sources of tax and nontax to District Development Committee (DDC) of Nepal. During the study period, the local tax revenue of DDCs were infrastructure utilization tax, resource utilization tax, mine tax, forest, agriculture and animal tax, and the taxes on garbage collection (Kawadi). The nontax revenue sources of DDCs were service charge, local development fees and

others; the revenue sharing was locally available resources such as water, forest resources. In this study, compliance level of DDC's authority and taxpayers on devolved tax, nontax and revenue sharing sources is measured based on efforts of DDC.

### *2.1 Local tax revenue*

Tax is a compulsory payment; however, the taxpayer does not receive a definite and direct quid pro quo from the local government. It is levied by the local government to perform decentralized functions. The assigned functional activities performed based on revenue sources, which are characterized by canon of adequacy, equity, efficiency, acceptability (Boex and Martines-Vazquez, 2006:63). Each source of the local government's tax revenue depends on economic activities where tax is levied on individual economic activities considering revenue compliance. Revenue compliance is crucial to enhance willingness of taxpayers who may have differing views about objectives (Hawthorne and Jackson, 1987:771). Therefore, the local government has to be capable of determining the amount of tax revenue as per their investment plan. In this regard, the statement of US Supreme Court is quite relevant that "the power to tax is not only the power to destroy but also the power to keep alive" (US Supreme Court cited in Samuelson, 1958:127). As government cannot perform its functions without tax revenue, local government collects taxes from various sources including 'property tax' (Bahl, 2001:4), though local tax is considered as an additional tax on top of federal and state taxes.

The guiding principle to levy local taxes is based on public finance theory of "finance follows the function". In this regard, Musgrave (1959) opined that benefit principle of taxation is suitable for local taxation, which means that those who gets benefit more from the government expenditure should pay more tax to meet the expenditure. According to this principle, investment based on choice of people may raise the willingness to pay tax. Although tax compliance ensures greater amount of collected tax revenue, noncompliance is a continual and growing global problem (McKerchar and Evans, 2009 cited in Ali et al, 2013:9). Investment on public goods and services such as education, health, infrastructure development and so on can be vital to enhance tax compliance. Further, as local governments with low capacity tend collect less taxes (Brautigam, 2008:4), differences in state capacity can affect revenue collection.

## *2.2 Local non-tax revenue*

Nontax is another important source of local government revenue that includes local charges, fees, fines, contributions, realization under special acts and receipts from remunerative enterprises (Boex and Martines-Vazquez, 2006:100). The charges and fees are collected for the cost in rendering public services whereas levy is imposed on specific tax base as it aims to generate revenue for the local government. The charge generally has been determined based on the benefit principle. Fees, fines for granting permit and the like are considered as negative type of local revenue while charges for the use of roads, drinking water, sewerage, electricity etc. are known as positive type of local revenue.

Revenue compliance is more important than whether it is positive or negative type of revenue source. The revenue compliance is affected by perception of the taxpayers on concerned governmental department or employees and may have effects on performance of nontax revenue compliance. As maintained by Fjeldstad and Heggstad (2012:23), the performance of revenue collection depends on the strength and quality, political commitment and transparency of the local government.

## *2.3 Sharing revenue*

Revenue sharing is an alternative source of local government revenue (Kay and King, 1990:147). It is collected by one level of government and distributed to other levels of government based on the origin of resources. The internal revenue is determined by availability of size/volume of resources within the local government jurisdiction – it is generally distributed on derivation basis according to the share of national tax revenue funding rule. Further, local government revenue share is significantly related to economic development of a country (Bahl and Smoke, 2003:12). The natural resources such as forest, mines, natural beauty, geographical distinctness, etc. are important sources of revenue for developing countries. It can be of several forms in which the different levels of government allocate revenue sources horizontally or vertically. Moreover, local government has made administrative efforts to collect this source of revenue.

### **3. Determinant factor of local resource mobilization**

Rich countries collect more revenue than poor (Radian, 1980:26). The rich means simply a wealthier country and revenue is collected from the wealth. The volume or size of wealth is revenue potential which determines the revenue base (Musgrave and Musgrave, 1976:237). Therefore, revenue base is a determinant

factor for local resource mobilization, however, other variable may also affect under certain circumstances. In this regard, it is essential to understand why one local government mobilizes more revenues than another from a similar quantity of wealth. In fact, the revenues are raised by the act of government. It means ability of local government can play vital role to generate revenue. The ability refers to capacity of local government to administer taxes. The efforts made by local government to exercise full potential capacity is an important factor for revenue mobilization (Boex and Martines-Vazquez, 2006:67). The higher internal revenue to GDP ratio shows the effective efforts of local government based on its capacity. Therefore, the effort is associated with capacity of local government. Furthermore, Musgrave is of the view that LRM may be determined by the economic as well as ability of the government to implement its fiscal policy.

Thus, it can be said that local resource mobilization is determined by revenue base and efforts (Radian, 1980:24). The revenue base is generated through local economic activity and efforts has to be made by the local government through the utilization of potential capacity. There is functional relationship between local government revenue and revenue base, and efforts. It can be written in mathematical equation:

$$\text{Local Resource Mobilization (LRM)} = f(\text{base, effort}).$$

In this equation, there is a positive relationship between internal revenue mobilization; and revenue base as well as revenue effort. It means higher the revenue base higher the LRM and vice versa; similarly, higher the efforts higher the LRM and vice versa. The higher LRM means effective LRM. In mathematical formulation, one determinant factor can be explained by keeping other factor constant. In this study, revenue base is taken as a constant factor. Therefore, efforts of local government have been explained to assess the effectiveness of local resource mobilization. The determinant factor such as revenue base and effort is discussed below.

### 3.1 Revenue base

Local revenue base has been endowed to local government revenue fund. The volume or size of local resources for revenue generation depends on economic activities. The consumer's expenditure on production, consumption and distribution of goods and services should pay tax on each economic activity. All the expenditure are measured in terms of GDP. As a result, the government revenue increases with the increase in GDP (MoF, 2013:17). Therefore, GDP is an important factor of LRM which be measured by amount of internal revenue to

GDP ratio of local government (Singh, 2014:94). The higher percent of revenue to GDP ratio is considered effective local resource mobilization than lower one.

### 3.2 Revenue efforts

Local government has made efforts to mobilize local resources by using its potential capacity. The efforts refer to degree of intensity of local government's willingness to tap available resources, which can be manipulated by the local government (Radian, 1980:33). The efforts of local government are crucial to collect tax by increasing willingness of taxpayers. The willingness of local government authority and local taxpayers to generate revenue is an important for effective LRM. The level of willingness can be increased by formulating better fiscal policy; enhancing institutional capacity; and increasing people participation. In this regard, the efforts of local government has been measured based on the agreement of taxpayers and tax collectors. Local government unit in Nepal (for example, DDCs) were used to formulate better local fiscal policy, develop institutional capacity, and initiate people's participation in of their programs. In this context, the local government should try to mobilize local resources to the maximum extent based on its capacity. Thus, local fiscal policy, institutional capacity and peoples' participation are considered as determinant factors which is discussed below.

#### i. Local Fiscal Policy

Fiscal policy consists of revenue and expenditure policy of government (Singh, 2014:307). Internal revenue policy of the local government is directly related to local tax and nontax rate imposed by the local government. Both, local government authority and local taxpayers should comply on existing tax and nontax rate. Therefore, sound fiscal policy making is important to accept the rate for effective local resource mobilization. The sound means accepting on tax rate and base by taxpayer and collector. Therefore, the influence of local fiscal policy is measured based on level of agreement of local government authorities and taxpayers on existing decentralized tax and nontax policy.

Thus, the first hypothesis is: Sound local fiscal policy of DDC affects internal revenue mobilization positively.

#### ii. Institutional Capacity

An ideal institutional capacity entails a state with an effective bureaucracy (Brautigam, 2008:15). The effective bureaucracy organization structure and Human Resource Management (HRM) are important. The structure shows the

process of revenue collection and HRM shows the deputation of DDC personnel in revenue collection. It is measured based on the level of agreement on organization structure such as existing organizational chart, job descriptions and HRM such as planning, recruiting, wages and salaries, providing benefits and incentives, and resolving disputes.

Here, the second hypothesis is: Stronger institutional capacity of DDC raises the mobilization of internal revenue.

iii. Peoples' Participation

The involvement of local people in decisionmaking process of the local government is considered as people's participation. The participation in identification and determination of resource planning and implementation are important aspects (Dahal et al, 2002:120) of peoples' participation. It is important to increase willingness of taxpayers to pay tax. In fact, the level of participation provides extensive information to policymakers to formulate and implement the fiscal policy. Therefore, people's participation at the local level can play an important role to capture varied sources of revenue.

Finally, the third hypothesis is: Greater people's participation enhances the DDC's internal revenue mobilization.

**4. Analytical framework**

The relationship between dependent and independent variables have been explained by the following analytical framework.

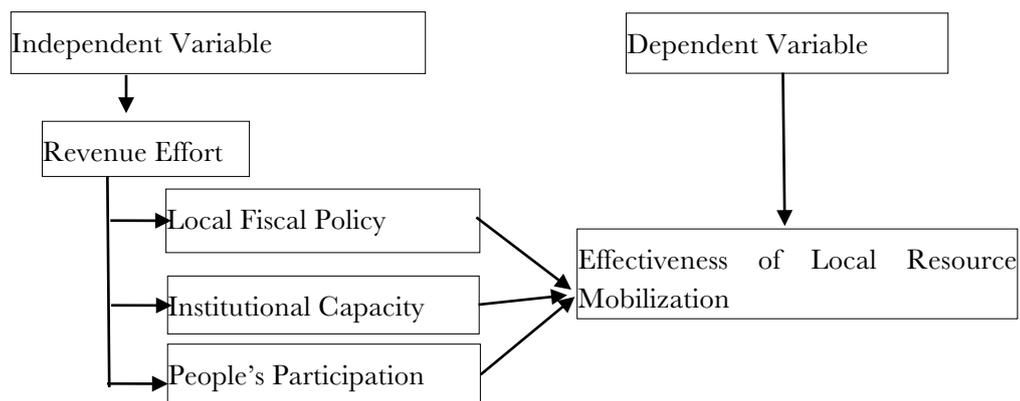


Figure 1: The relationship between dependent and independent variables.

Source: Author, 2020

## 5. Methodology

This article employed mixed method using sequential strategy. The benchmarking approach as developed by VazquezCaro and Bird (2011:9) has been adopted to analyze the quantitative and qualitative data.

### 5.1 Source of information

The secondary and primary sources of data were collected to analyze the capacity of the local government. The secondary sources of information were internal revenue of DDCs and GDP of 75 DDCs. The primary sources of information were survey questionnaire and Key Informant Interview (KII).

### 5.2 Selection of case DDCs

During this study period, there were only 75 DDCs among which two DDCs i.e. Tanahun and Rautahat were purposively selected based on fiscal resource mobilization capacity. The fiscal capacity of DDCs has been determined by the Government of Nepal based on Minimum Conditions and Performance Measurement (MCPM) approach. This approach was developed by the Ministry of Local Development, Government of Nepal (GoN) to assess the performance of DDCs based on annual planning, budgeting, and financial management. The performance measurement standard and criteria were determined by the Government of Nepal based on their ability to utilize performance measurement of government service program. The motivation behind the performance measurement was made to provide additional grants for higher performing DDC. For this, DDCs made efforts to get additional grants by using optimum level of capacity. According to the MCPM indicators of the DDCs, Tanahun DDC was placed at the highest whereas Rautahat was recorded as the lowest performer during 2007/08 to 2010/11 (LBFC, 2012:55). In this context, it is interesting to find what mattered the most in DDC's high or low performance regarding mobilization of local resources in Nepal.

### 5.3 Data collection

The data of seventyfive DDCs' internal revenue and GDP were collected from different public organizations in Nepal such as Local Body Fiscal Commission Secretariat (LBFC), Central Bureau of Statistics (CBS), and other concerned ministries.

Primary data were collected from the respondents of two DDCs through structured questionnaire. A total of 104 respondents were selected purposively from

each of the two DDCs (52 from each of the two DDCs) of which 35 were employees and 69 were taxpayers. The respondents were a cross section of the people with different professional backgrounds such as administrator, accountant, and contractors. Key Informant Interviews (KII) were taken with Local Development Officer (LDO), finance officials, planning officials and immediate past local representatives along with the taxpayers of the sample DDCs.

#### 5.4 Data analysis

The collected data were analyzed sequentially. First, revenue ratio was determined to find the constant effect. It was calculated by internal revenue to GDP of DDC for the fixed period. Second, the compliance level was determined based on the opinion of respondents. To find the efforts of DDC, following Bowen and Bowen (1999:57) we merge the responses 'strongly disagree' and 'partly disagree' into disagree and merge 'partly agree' and 'completely agree'. The response in higher number means better local resource mobilization. The relative weight was changed into scale variable from zero to hundred percent for the analysis of collected data. However, 'don't know' responses were omitted. In addition, Chisquare test was also employed to determine whether it is proved or disproved through the process of analytical generalization (Yin, 2014:21). The revenue ratios of these DDCs were juxtaposed with revenue compliance to identify the performance in terms of local resource mobilization. The DDC's capacity was analyzed by both quantitative and qualitative data. The qualitative data were presented based on perceptions and experiences of Key Informants.

## 6. Findings

The effectiveness of local resource mobilization has been explained by revenue base and efforts of DDCs. The effect of revenue base has been explained based on revenue ratio and revenue efforts has been explained based on opinion of respondent on existing fiscal power of DDCs. The level of efforts depends on capacity of DDCs. In this context, the higher capable DDCs can enhance revenue compliance so that internal revenue of DDC is increased. Therefore, a higher percent of revenue compliance on revenue sources was considered for better performance of the DDC. Considering this view, the findings of this study are presented as follows.

### 6.1 Effectiveness of local resource mobilization

#### A. Revenue base

The revenue base is calculated in terms of GDP of DDCs in Nepal. In this context, internal revenue ratio of the DDCs have been analyzed to find the performance of internal revenue mobilization. The revenue mobilization performance shows the capacity of DDCs in terms of revenue collection based on economic activity at the local level. The analysis was done by using the following formula, i.e.

$$\text{Revenue ratio} = \text{Internal Revenue of DDCs} / \text{GDP of DDCs}$$

Table 1: Revenue ratio of local government

<b>Local Government</b>	<b>Revenue Ratio in Percent</b>
Nepal	4.17
Tanahun DDC	4.12
Rautahat DDC	2.28

Source: Government of Nepal, FY 2011/12

According to this formula, internal revenue ratio of the 75 DDCs for the fiscal year 2011/12 was found to be 4.17 percent, which is much lower than the national average with 13 percent in general (MoF, 2013). The result shows that DDCs of Nepal have a poor performance in terms of local resource mobilization. Tanahun and Rautahat DDCs' revenue ratio of FY 2011/12 was found to be 4.12 percent and 2.28 percent respectively. It shows that highest capable DDC Tanahun has achieved higher performance in comparison to lower capable DDC Rautahat. Thus, the analysis of revenue data found that local resource mobilization capacity does matter in increasing internal revenue of the DDC.

#### B. Revenue efforts

The local governments have been collecting revenue from various sources from local taxpayers. The efforts have been made to mobilize local resources through higher compliance level on the decentralized sources of revenue. It is considered sufficient condition to increase willingness of the taxpayers to pay tax/non tax. Therefore, local resource mobilization has been explained through efforts of the DDC to make local fiscal policy, institution of DDC and people's participation. It may vary across the DDCs due to the capacity constraints. Moreover, better relationship between government and taxpayers ultimately result in improved compliance (McKerchar and Evans, 2009 cited in Ali et al, 2013:7). The degree

of revenue compliance is an important component to mobilize local resources, which is measured, based on respondent's level of agreement on sources of revenue. DDC's decentralized sources of revenue have been explained by Article 215 to 220 of LSGA, 1999. According to the Act, local tax revenue sources of DDCs consist of infrastructure utilization tax, resource utilization tax, mine tax, forest, agriculture, animal tax, and duped vessels (Kawadi) whereas nontax revenue source consists of service charge for providing physical services, fees for DDC's services, fine and sales; and revenue sharing source consists of tax and royalties collected based on the derivation approach from locally available natural and physical resources.

The level of agreement of DDC's authority and taxpayers on each revenue sources reinforces each other and boosts internal revenue of DDC. Those contractors who paid tax were selected through bidding process while non taxpayers were amongst service seekers. Their opinions regarding tax, nontax and revenue sharing were dichotomized into the 'agreed' and 'disagreed' forms. Thus, all respondents' opinions were put into the same basket based on the DDC. The agreed percentage shows the level of compliance on existing sources of revenue about local resource mobilization. The higher percentage agreement enhances compliance level, which raises willingness to pay taxes, fees, and other nontax payments. The following table shows on an average agreed percentage of respondents on revenue compliance by source of revenue.

**Table 2: Revenue compliance by sources of revenue**

<b>Sources of revenue</b>	<b>Level of Agreement in Tanahun (%)</b>	<b>Level of Agreement in Rautahat (%)</b>
Source of tax revenue	73	71
Source of nontax revenue	72	69
Source of revenue sharing	73	72
Average	73	71

Source: Survey data, 2015

Note: N=52

Table 2 shows respondents' opinion about level of revenue compliance on the DDC's rule and regulations about local resource mobilization. On an average, the level of agreement of Tanahun and Rautahat DDC on existing sources of revenue was found to be 73 percent and 71 percent respectively. It shows that revenue compliance of DDC's authority and taxpayers on sources of revenue was higher in Tanahun DDC in comparison to Rautahat.

Discussions were held with key informants of the two DDCs to understand institutional efforts to increase performance of revenue mobilization. They were of the view that the tax base has been cut down by the central government. For example, the power to levy tax on empty cold drink bottles has been cut down from fiscal year 2004. Furthermore, since fiscal year 2010, the export of stones, pebbles, sand from the DDC has been banned. In this regard, they opined that internal revenue can be increased by raising political power of DDC. Further, lack of elected representatives also hinders with revenue mobilization – respondents cited that frequent changes of the administrative chief i.e. LDO of the DDC also affects revenue mobilization. Moreover, I have found less transfer of LDO in Tanahun DDC in comparison to Rautahat DDC (3 to 4 LDOs have been changed within a fiscal year).

According to the survey data, transportation tax is levied by the DDC, but the authority does not take any initiative to improve road infrastructure. With regards the social aspect, the contractor of Rautahat DDC cited that local people create problems during the working period even though the tax has been paid to the DDC regularly. The former DDC Association President disclosed “the DDC does not take any initiation to solve these problems”. Furthermore, when asked whether contractors were satisfied with the process of payment or not, responses suggest that they were satisfied. They noted if taxpayers pay contract amount in advance, they could get ten percent benefit for the payments

### *6.2 Factor affecting local resource mobilization*

The local government's revenue effort is an important factor in local resource mobilization of the DDC. Revenue effort is considered noneconomic activity that is undertaken by the authority of the DDC. It is essential to increase the compliance level of taxpayers for fiscal rules. The proper implementation of fiscal rule is essential to increase the willingness of taxpayers to pay tax. Therefore, the local government has made efforts to enhance level of revenue compliance in order to increase internal revenue. In this paper, the opinion of respondents regarding the DDC's revenue efforts to increase revenue compliance on decentralized sources of revenue has been explained. In this regard, different local governments may make different efforts in order to collect internal revenue. The effort may vary according to capacity of DDC which affects local resource mobilization. The relationship between each element of revenue efforts such as local fiscal policy, institutional capacity and peoples' participation; and local resource mobilization based on respondents' (respondents: Tanahun<sup>52</sup> and Rautahat<sup>52</sup>) views are discussed below.

### 6.2.1 Relationship between local fiscal policy and local resource mobilization

The local government needs to formulate and implement fiscal policy considering characteristics of a good revenue system. As regards local resource mobilization, each element of the characteristics of local fiscal policy is complementary, not contradictory. Therefore, complementarity of all characteristics of local fiscal policy such as revenue adequacy, elastic, fairness (equity), acceptability, correspondence and administrative feasibility is mutually reinforcing. Here, better fiscal policies signify the characteristics of good tax and nontax policy. Good fiscal policies refer to a higher percentage in compliance level of local government authority and taxpayers. The higher percentage in compliance level means higher level agreement on existing DDC's fiscal rules and regulations regarding tax policy and nontax policy. Therefore, the level of agreement of the local government authority and taxpayers on existing tax and nontax policies and revenue compliance for local resource mobilization is given below.

**Table 3: Relationship between local fiscal policy and local resource mobilization**

<b>Component of fiscal policy</b>	<b>LRM in percent in Tanahun</b>	<b>LRM in percent in Rautahat</b>
Tax policy	97	89
Nontax policy	94	79
Local fiscal policy	96	84

Source: Survey data, 2015

Table 3 shows the level of agreement of local government authority and taxpayers on existing tax and nontax policies and local resource mobilization. Among the total respondents, level of agreement of Tanahun and Rautahat DDC on existing tax policies are 97 percent and 89 percent respectively. It shows that Tanahun DDC has formulated better tax policies than Rautahat DDC. Similarly, the level of agreement of Tanahun and Rautahat DDC on existing nontax policies are 94 percent and 79 percent respectively. It also shows that Tanahun DDC has formulated better nontax policy than Rautahat DDC.

First, does local fiscal policies help in mobilizing local resources in the DDC? The resultant data shows that the level of agreement on local fiscal policy of Tanahun and Rautahat DDC were found to be 96 and 84 percent respectively. It means respondents were of the positive view on local fiscal policy which can have positive effect on local resource mobilization.

The significance level has been determined by chisquare statistics at 5 percent level to test the hypothesis. The first hypothesis was better as local fiscal policy helps to collect more internal revenue. The p value of Tanahun and Rautahat DDC was found to be 0.00 and 0.02 respectively. Therefore, the test statistics is significant. It means it rejects the null hypothesis  $H_0$  and concludes that the local fiscal policy and internal revenue of DDC are not independent. Thus, local fiscal policy affects on DDC revenue generation.

### *6.2.2 Relationship between institutional capacity and local resource mobilization*

The institutional capacity refers to the tax administration of local government in the sense of effective compliance level by the taxpayers. The tax administration can be effective, if its administration tasks are made simpler, stable and predictable (Fjeldstad and Moore, 2008:237). The tasks are accomplished based on its organization structure and human resource management. Therefore, in devolving form of local government making of good organization structure and proper human resource management is crucial for local resource mobilization. In Nepal, LSGA, 1999 has devolved the power and responsibility through building institutional mechanism and functional structure of DDCs. For this, DDC has made efforts good organizational structure and fulfillment of competitive human resources for effective local resource mobilization. Proper organization structure without proper human resource management or good human resource management without good organization structure cannot increase compliance level.

In this context, the Act has explained based on the values and norms with definite organization structure and human resource management system of DDC. Moreover, within the given guideline, the DDC has constructed its own organization structure for the local functions. Additionally, LSGR 1999 has provided human resource acquisition, development, utilization and retrenchment power to the DDC. These components are mutually correlated. Therefore, institutional capacity of DDCs to mobilize local resources is evaluated based on respondents' opinion. The level of agreement of local government authority and taxpayers on existing organization structure and human resource management is given below.

Table 4 shows the level of agreement of local government authority and taxpayers on existing organization structure and human resource management to mobilize local resources. Among the total respondents, level of agreement of Tanahun and Rautahat DDC on existing organization structure is found to be 86 percent and 73 percent respectively. It shows that Tanahun DDC has good organizational structure than that of Rautahat DDC. Similarly, the level of agreement of Tana-

hun and Rautahat DDC on existing human resource management are 78 percent and 77 percent respectively. It also shows that Tanahun DDC has better human resource management than Rautahat DDC.

Table 4: Relationship between institutional capacity and local resource mobilization

<b>Component of Capacity</b>	<b>LRM in percent in Tanahun</b>	<b>LRM IN percent in Rautahat</b>
Organization structure	86	73
Human resource management	78	77
Institutional capacity	82	75

Source: Survey data, 2015

Secondly, how does institutional capacity of DDC contribute in mobilizing local resources? The level of agreement on institutional capacity of Tanahun and Rautahat DDC were found to be 82 and 75 percent respectively. It means institutional capacity of Tanahun DDC is higher in comparison to Rautahat DDC.

The second hypothesis was stronger institutional capacity of DDC raises internal revenue. The p value of Tanahun and Rautahat DDC was found to be 0.00 and 0.00 respectively. Therefore, chi-square test statistics is significant. It indicates that institutional capacity and internal revenue of DDC have strong relationship. Thus, it rejects the null hypothesis H0 and concludes that institutional capacity and internal revenue of DDC are not independent. Thus, institutional capacity is essential in revenue generation.

### *6.2.3 Relationship between people's participation and local resource mobilization*

People's participation refers to the involvement of local people in the process of planning and implementation for local resource mobilization. It is argued that local people's attitude is best seen as sources of participation (Crook and Manor, 1998:7). Therefore, the local government should involve the local people in the revenue mobilization process of planning and implementation. In this process, combined effort of local government authorities and civil society organizations is crucial to enhance willingness of the taxpayers to pay tax or nontax. If they are involved in the process of identification of revenue base and determination of rate with good intention, a local government can increase its revenue compliance.

In Nepal, LSGA 1999 has made a provision of the involvement of local people regarding the identification of local revenue base and determination of tax rate. This Act has given great importance to people’s participation and explains in the preamble that "participation of all the people in mobilizing the means which is local resource..." in order to increase local government revenue. Therefore, DDC has formulated and implemented revenue plans according to the legal provision. The Act has clearly explained for involving the local government authorities as well as the chamber of commerce, community organizations in the planning and implementation process. It is explained that planning process has to be inclusive and has to follow a consensus based decision-making approach. In this regard, respondents’ opinion has been taken to know their level of agreement on participation process for local resource mobilization, which is given below.

**Table 5: Relationship between peoples' participation and local resource mobilization (LRM)**

<b>Component of participation</b>	<b>LRM in percent in Tanahun</b>	<b>LRM in percent in Rautahat</b>
Participation in planning	84	75
Participation in implementation	97	89
People participation	91	82

Source: Survey data, 2015

Table 5 shows the level of agreement of local government authority and taxpayers on existing planning and implementation process to mobilize local resources. Among the total respondents, level of agreement of Tanahun and Rautahat DDC on existing planning process is found to be 84 percent and 75 percent respectively. It shows that Tanahun DDC has good good planning process than Rautahat DDC. Similarly, the level of agreement of Tanahun and Rautahat DDC on existing implementation process are 97 percent and 89 percent respectively. It also shows that Tanahun DDC has more implementation than Rautahat DDC.

Thirdly, how has people’s participation contributed to local resource mobilization? The level of agreement on people’s participation of Tanahun and Rautahat DDC were found to be 91 and 82 percent respectively. It means the local people’s participation in Tanahun DDC is higher in comparison to Rautahat DDC.

The third hypothesis was greater people’s participation enhances the DDCs’ internal revenue. The p value of Tanahun and Rautahat DDC were found to be 0.00 and 0.1 respectively. Therefore, test statistics is significant. It indicates that people’s participation and local resource mobilization of Tanahun DDC has a

strong relationship. Thus, people's participation affects in revenue generation. Hence, all hypotheses are accepted that revenue efforts affect local resource mobilization.

In sum, it has shown the significant level of agreement of local people with respect to the national parameter. The chisquare value of all the component of noneconomic factors is significant in local resource mobilization. Thus, effect of noneconomic factor can be coined with economic factor i.e. GDP with respect to national as well as DDC level data. The significance level of survey data is coupled with national parameter of revenue data. Thus, the performance of internal revenue collection and respondents' compliance on sources of revenue were found to be identical. Tanahun DDC has a higher level of compliance in comparison to Rautahat DDC, making local government capacity an important factor for local resource mobilization.

## 7. Discussion

Decentralization refers to the transfer of power and functions from the upper level to subordinate levels. It brings the government "closer to the people" which enhances fiscal performance of local governments. The survey data shows that fiscal decentralization is applicable in the context of Nepal. It is because all the hypothesis have been proved from the empirical survey data. It means that decentralized fiscal power plays a significant role for effective local resource mobilization. In the context of interface, the DDC has lateral relationship with roughly equal power. Such vertical and horizontal relationship is important to identify the revenue base on which local government can impose tax or nontax for collecting revenue. Therefore, fiscal devolution is applicable variously in different local government in order to generate internal revenue.

The positive effect in the economy raises the revenue base that is essential for a greater amount of internal revenue collection. Likewise, higher internal revenue is an essential condition for fiscal autonomy and strengthening local government. However, despite devolution of fiscal power, revenue ratio is poor and per capita revenue is low in Nepal. As it also differs across local governments, transfer of resources alone may not be applicable for all local governments.

The higher compliance level is also important for broadening the tax base. However, the political, economic and sociocultural condition may vary in different places. The perception of people may also be different for identified tax base in different local government. In this regard, fiscal decentralization has provided the

room for people to comply with tax and nontax payments according to their preferences. In such a context, the local government can apply its own method of revenue collection. In this regard, key informants opined that since the enactment of LSGA 1999, DDC has started to collect tax revenue through the bidding process, thereafter the revenue increased tremendously. However, due to the lack of elected representatives, internal revenue of DDC has diminished. Moreover, LDO opined that the local government is not as strong as we think. There are policy contradictions, for example, Forest Act and LSGA, 1999, river-based revenue base such as sand, stone, pebble which both (DDC and VDC/Municipality) claim for revenue collection. Contractors opined that they do not have permission to use heavy equipment to pick up stones and sand hence, they are facing problems and losses. The significant improvement in leasing process through e-bidding, good coordination with contractors, exploration and identification of new resource base, and establishment of political mechanism at the people's level are reported as positive aspect for effective resource mobilization. Furthermore, key informants opined that capacity of DDC can play a significant role to mobilize local resources. DDC's efforts for participation of stakeholders for the promotion of their values, treating their individual strengths are the driving force for an autonomous capacity to mobilize resources.

Freedom to select the method of revenue collection is found to be more effective. The degree of intervention depends on culture of democratic practices in the local government. For example, a local government can collect revenue by bidding process or themselves. Furthermore, in the survey period, there was an absence of elected political representatives, however LDO was authorized with the power of an elected representative. Moreover, the recognized political party representatives were also involved in decision-making and implementation process informally. According to key informants, interference of central government in revenue base cannot be applicable for effective local resource mobilization. Hence, transformation of the principle of decentralization in the practical sense to local government is applicable to enhance its institutional capacity.

## **8. Conclusion**

This study finds that the DDC collects internal revenue through a decentralized revenue base each fiscal year. However, the contribution of internal revenue is found to be merely 16 percent entailing poor fiscal performance by the DDC. Furthermore, the internal revenue collection is highly volatile. Hence, it can be concluded that the amount of local government's internal revenue collection is

not satisfactory.

For the study, the quantitative data were adapted to the fiscal decentralization theory based on institutional practices of the DDCs. Considering the research question for mapping relationship between independent variables and the dependent variable; this study tries to find out whether fiscal decentralized governance is helpful for local resource mobilization. From the findings of the data, it is concluded that decentralization of revenue efforts such as local fiscal policy, institutional capacity and people's participation play a significant role in local resource mobilization. The decisionmaking power of local executives also plays a significant role for revenue collection. The result of the comparison of factors affecting local resource mobilization shows that institutional capacity of local government is vital for effective local resource mobilization.

The issues, agendas and needs are varied from central to local government as well as across local governments. Hereby, the study explores the idea of local resource mobilization based on theoretical foundations and empirical observations. Conclusively, transferring of the resources has a positive effect on the internal revenue of DDCs. However, transferring of the resources alone is not sufficient for effective local resource mobilization. Benchmarking by institutional practice shows that strengthening of local government is as vital as transferring the resources. Therefore, it is a matter of challenge for the practitioners and professionals working on the issues of effective local resource mobilization.

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