

**LOCAL GOVERNMENT INFRASTRUCTURE AND SERVICE DELIVERY  
A CASE STUDY OF THE DECENTRALISED FINANCING & DEVELOPMENT  
PROGRAMME – NEPAL**

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## Abbreviations and acronyms

CO	Community Organisation
CSO	Civil Society Organisation
DADC	District Agricultural Development Committee
DAG	Disadvantaged Group
DANIDA	Danish International Development Agency
DASU	Decentralisation Advisory Support Unit
DDC	District Development Committee
DFID	Department for International Development
DFDP	Decentralised Financing and Development Programme
DIMC	Decentralisation Implementation & Monitoring Committee
DTO	District Technical Office
FY	Fiscal Year
HDI	Human Development Index
HMGN	His Majesty's Government of Nepal
ISD	Infrastructure and Service Delivery
LBFC	Local Bodies' Fiscal Commission
LDF	Local Development Fund
LDO	Local Development Officer
LG	Local Government
LGP	Local Governance Programme
LPP	Local Planning Process
LSGA	Local Self-Governance Act
M&E	Monitoring and Evaluation
MC	Minimum Condition
MLD	Ministry of Local Development
MTE	Mid-Term Evaluation
NPC	National Planning Commission
NR	Nepali Rupee
O&M	Operations and Maintenance
PDDP	Participatory District Development Programme
PFM	Project Funding Matrix
PM	Performance Measure
PMC	Project Management Committee
PMU	Project Management Unit
PRSP	Poverty Reduction Strategy Paper
TA	Technical Assistance
UC	User Committee
UG	User Group
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
VDC	Village Development Committee

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## EXECUTIVE SUMMARY

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### I. BACKGROUND

1. Nepal's system of local government in rural areas comprises two levels – Villages, for which the relevant local executive body is the Village Development Committee (VDC) and Districts, with District Development Committees (DDCs) as their executive organs. The country is made up of 75 Districts and almost 4,000 Villages. The powers, responsibilities and functions of these LGs is defined by the Local Self-Governance Act (LSGA) enacted in 1999; a range of regulations and policy initiatives (notably the devolution of some health, education and agriculture functions) complete the basic institutional framework provided by LSGA.

2. The Decentralised Financing and Development Programme (DFDP), jointly funded by UNCDF and DFID, currently operates in 20 Districts – 8 Districts since programme start-up in 2001, and 12 new Districts since 2003/2004. DFDP provides DDCs with access to annual block grants, the use of which is largely discretionary – although limited to capital (rather than recurrent) expenditure. Eligible investments include: the construction/rehabilitation of schools, roads, bridges, health posts, community buildings; improvements to water supply systems (for both drinking and irrigation purposes); natural resource management initiatives; etc. The available annual funding pool is roughly US\$ 1.7 million, allocated among Districts (since 2003/2004) on the basis of an HMGN-endorsed formula.

3. Beneficiary Districts use their capital grants from DFDP to fund micro-projects identified through a participatory local planning process (LPP), directly supported by other donor-funded programmes (such as UNDP's PDDP/LGP). In principle, micro-projects are championed by "socially mobilized" community organizations (COs), endorsed by their respective VDCs and then screened, prioritised and finally selected at DDC level. Provisional approval (for inclusion in the DDC's annual budget) is made by District Councils; final approval of selected micro-projects is subject to endorsement by DFDP.

4. Projects that exceed a given cost (roughly US\$ 7,000) or that provide benefits to the citizens of more than one VDC are classified as District-level – such District-level projects are not to exceed 40% of the total DFDP allocation. DFDP funding is conditional upon the mobilization of matching contributions by DDCs, VDCs (but not in the case of District-level projects) and local communities (whose contribution is usually in kind, rather than in cash).

### II. INNOVATIONS AND ISSUES

5. DFDP has introduced a number of innovations into LG ISD and, through its implementation, has raised a number of issues about existing practices and procedures for ISD.

#### (a) FINANCE

6. In terms of finance, DFDP has:

- introduced a system of regular, predictable and dependable fixed annual grants, aimed at providing LGs with the resources to fund ISD on largely discretionary basis. This is in contrast to the standard HMGN method for block grant allocations to DDCs, which is often irregular, unpredictable and subject to unreliable disbursements;
- although initial grants were made to DDCs on an equal shares basis (each DDC receiving the same grant, irrespective of population size, fiscal need or other criteria), DFDP is now moving towards a formula-based allocation system that factors in population size, poverty, surface area and relative cost. Whilst the current formula,

endorsed by HMGN, is far from satisfactory, it represents a step in a more equitable and rational direction;

- DFDP retains *ex ante* controls over the micro-project selection process, in contrast to HMGN practice (whereby DDCs and VDCs are largely left to their own devices). This may prove problematic and certainly appears to disrupt the planning-to-budgeting process;
- as mentioned above, DFDP funds are only made available if LGs and communities mobilise matching contributions. This is in sharp contrast to HMGN transfers, which are not conditional upon any kind of co-funding arrangement;
- DFDP funds flow through DDC-managed accounts and are thus more or less subject to HMGN financial management regulations;
- the ear-marking of 20% of DFDP funding for focused projects, for which the primary beneficiaries are expected to be women and disadvantaged groups (DAGs), is a major innovation in the Nepali context. Implementing this has not proven easy, but early experience has allowed DFDP to improve its definition of focused projects; DDCs are now demonstrating a clearer understanding of this;
- another significant innovation has been the technical assistance window (upto 6% of annual block grants), which has allowed DDCs to recruit additional staff for the purposes of design, costing and technical supervision of works;
- finally, DFDP (along with DANIDA) has provided support for policy reform in the fiscal decentralization area. Initial support has concentrated on better defining expenditure assignments, on capacity-building for LBFC (Local Bodies' Fiscal Commission) and on establishing performance-based assessments (with consequences for block grant allocations).

#### **(b) PLANNING**

7. Although DFDP does not include an explicit planning component, its implementation has raised several major issues linked to the existing local planning process:

- the need to “widen” the planning process so as to allow all VDCs within each District to propose micro-projects for DFDP funding, thus being more faithful to the spirit of LSGA;
- the limitations placed upon LG planning by the prescription that micro-projects must be identified/proposed by community organizations (COs). COs may not be well-placed to identify public goods – and this has raised questions about how the LPP should operate;
- the need to strengthen “downstream” aspects of the planning process (appraisal, screening, prioritisation, design and costing, etc.), and not just the participatory identification of needs;
- the likelihood that much of the LPP has been subject to elite capture, which has proven difficult to avoid in rural Nepal where traditional social elites remain politically dominant.

#### **(c) IMPLEMENTATION**

8. With regard to the actual implementation of micro-projects, DFDP has innovated and raised issues in a number of ways:

- given the difficulties of attracting private sector contractors to work in remote rural areas and a widespread dissatisfaction with existing procurement arrangements (and corrupt outcomes), DFDP-funded micro-projects have been exclusively implemented by local user committees/groups (UCs/UGs). Whilst this has not been particularly innovative in the Nepali context, it may provide valuable lessons for other countries;
- UCs/UGs, although capable of implementing many types of micro-project, do have their limitations, especially for more technically complex investments (e.g. roads, bridges). In addition, DFDP experience shows that UCs/UGs need considerable technical backstopping from DDCs;

- DFDP has provided UCs/UGs with capacity-building support, particularly for book-keeping and financial management;
- despite efforts to ensure adequate operations and maintenance arrangements, O&M remains a major issue in DFDP.

**(d) ACCOUNTABILITY AND TRANSPARENCY**

9. DFDP has introduced two important innovations with regard to accountability and transparency:

- DFDP has tried to ensure that as much information about annual grant allocations to DDCs is made publicly available. The programme has also encouraged DDCs to make public decisions made about micro-project selection;
- during the implementation phase, DFDP has insisted upon an ongoing social audit process – all micro-projects have signboards (indicating their designation, budget, and the UC/UG responsible for implementation); UCs/UGs keep project books (recording all relevant information, including costs, about project implementation); and disbursements are conditioned upon public meetings at which progress in implementation can be discussed.

**III. PRO-POOR OUTCOMES**

**(a) Policy orientation**

10. In its overall configuration, DFDP is explicitly designed to be pro-poor by:

- being limited to support in rural areas (municipalities are deliberately excluded), where the largest number of the Nepali poor live;
- ear-marking funds for women- and DAG-focussed projects. Women and DAGs are generally the poorest people;
- making larger per capita allocations to poorer Districts (measure in terms of their HDI).

**(b) Planning outcomes**

11. The range of micro-projects funded through DFDP has been considerable – and is (by all accounts) more diversified than the usual investment LG portfolio. This would tend to indicate a greater degree of inclusiveness in the planning process. Altogether, 677 micro-projects have been planned under DFDP – and include items such as roads, schools, irrigation schemes, water supply systems, biogas toilets. Such investments are potentially capable of having a pro-poor impact.

12. Women- and DAG-focussed projects do appear to have been specific to those social groups. Implemented focussed projects are dominated by drinking water improvements and irrigation schemes, followed by biogas/toilets. This is very different to the overall portfolio and tends to indicate a different targeting process.

**(c) Production and management outcomes**

13. The UC/UG implementation option appears to have had some positive outcomes. Evidence suggests that UCs/UGs are less prone to “leakages” (and thus more efficient than the contractor option, widely thought to be corrupt). DFDP’s insistence upon greater transparency in micro-project implementation - through project signboards, project books and social audits – also appears to have paid dividends.

14. However, UCs/UGs may be less satisfactory when it comes to the technical quality of infrastructure – despite DDC backstopping (which is, in any case, difficult in remote areas). This

is especially so for more complex projects. There is also some evidence that the quality of ISD may have been compromised by systematic under-funding – a result of low per capita allocations as a whole, and the tendency for DDCs to “spread” funds thinly so as to cover as many VDCs as possible.

15. UC/UG implementation is probably unavoidable in much of rural Nepal – not only because the private sector is under-developed in such areas or has few incentives to engage in small contracts, but also because widespread insecurity (resulting from a major Maoist-inspired insurgency) has made many rural areas of limits to all but local people.

16. O&M arrangements remain problematic – and may thus compromise the sustainability of DFDP-funded infrastructure investments. Evidence suggests, however, that O&M arrangements for smaller infrastructure items (such as water supply systems or irrigation schemes) are better than those made for larger items (e.g. roads, bridges).

#### **IV. LESSONS LEARNED**

##### **(a) Sectoral and functional issues**

17. The experience gained through DFDP provides a number of sector-specific lessons:

- roads and transport infrastructure have proved problematic areas for LGs. The need for these kinds of investment is self-evident, but the capacity of LGs to plan, implement, operate and maintain them is limited. On the basis of DFDP experience, the role of LGs in the provision of transport infrastructure needs to be carefully thought through. The lesson here is that subsidiarity has its limits.
- educational infrastructure appears to be within the capacity of LGs to implement, but the issue of the recurrent costs associated with schools remains problematic. Despite a deliberate policy of education sector devolution in Nepal, the overall situation is confusing, with expenditure assignments being especially unclear. The lesson here is that devolution of sector functions must be carefully thought through and then properly integrated into the LPP;
- water supply and small-scale irrigation investments appear to have been relatively well-managed. This would appear to be linked to both traditional expertise in managing water and to the relatively small and discrete public served by such investments. The lesson to be learned is that where ISD is small-scale and impacts upon a small and well-defined community of users, it is clearly appropriate for local level planning, management and implementation.

##### **(b) Financing lessons**

18. A key, and very simple lesson to be learned from the Nepali experience, is that injecting funds into the LPP is, of itself, insufficient. The TA window has helped, but many improvements could be made, both in terms of procedures/methods and skills/capacities. Capacity development, in the widest sense of the term, must accompany fiscal decentralization.

19. DFDP also shows that ring-fencing can work – the 20% allocation for women- and DAG-focused projects appears to have paid dividends in terms of pro-poor outcomes. However, such ear-marking needs to be well thought out and clearly understood by LGs if it is to achieve its policy target.

##### **(c) Planning lessons**

20. DFDP shows that ISD planning – if it is to deliver equitable and sustainable outcomes – must be more than just the participatory identification of needs. Much more is involved –

appraisal, transparent and rational screening and selection, sector involvement, design and costing, etc.

**(d) Production/implementation of ISD**

21. Another important lesson from DFDP is that – under certain circumstances – the UC/UG option can replace the more orthodox private contractor/tendering option. Indeed, in remote rural areas, UC/UG implementation may be the only option. There are plenty of lessons (both positive and negative) to be learned about this from DFDP - UC/UG implementation is best-suited to simple projects, requires adequate technical backstopping, capacity-building, and so on.

22. Finally, DFDP shows that promoting adequate O&M is easier said than done and that a range of techniques and approaches are needed – such as incentives for establishing O&M arrangements, funding conditionalities based on evidence of O&M costs being budgeted for, and the institutionalisation of maintenance planning methods.

**(e) Accountability and transparency**

23. DFDP's use of signboards, project books and social auditing has shown that project implementation can be made more transparent – and that this probably leads to greater efficiencies through fewer “leakages”. However, transparency based on written media/methods has its limitations, particularly when the poorest are usually the least literate – a lesson learned, then, is that more oral (or visual) methods of promoting transparency may be needed in rural areas if they are to allow the poorest to voice themselves and to benefit.

# LOCAL GOVERNMENT INFRASTRUCTURE AND SERVICE DELIVERY

## A CASE STUDY OF THE DECENTRALISED FINANCING & DEVELOPMENT PROGRAMME – NEPAL

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### Nepal .. at a glance

Geography – Nepal is a land-locked country, with a population of around 23.2 million people. Nepal's total surface area of 147,000 km<sup>2</sup> is conventionally divided up into three major ecological zones – the mountainous Himalayas, running across the north; the Hills, running on an east-west axis in the middle of the country; and the Terai, a region of floodplains lying to the immediate north of the Nepal-India border.

Society – Nepal is a socially diverse country. In addition to a widespread caste hierarchy system that provides a framework for a marked degree of social stratification, Nepal's population also includes Tibetan and other ethnic groups. In general, the higher caste groups (Brahmins and Chettris), along with higher caste Newari groups based in the Kathmandu valley, tend to be socially and politically dominant. Lower caste and “untouchable groups”, as well as a number of ethnic minorities, constitute the most socially disadvantaged section of the population. Women, in all social categories, tend to be the most disadvantaged people in the country.

Economy – agriculture remains the single most important sector in the Nepali economy, accounting for approximately 40% of GDP and providing a livelihood for some 80% of the population. In the Kathmandu valley and other urbanized areas, manufacturing and service industries have developed over time, but remain relatively unimportant. Tourism has become one of Nepal's largest earners of foreign exchange, but is currently undergoing a recession as a result of insecurity in large parts of the country.

Polity – since 1990, Nepal has been a constitutional monarchy, although the King, as head of State, is vested with rather more than merely symbolic powers (as demonstrated by the current political situation). At national level, the people are (or were) represented through a two-tier, multi-party, parliamentary system. Administratively, the country is made up of 75 Districts, 58 municipalities and 3,913 Villages, local corporate bodies providing for popular representation. In 2002, however, a series of inter-related political crises led to the dissolution of both national and local governments.

## 1. BACKGROUND: NATIONAL POLICY AND THE INSTITUTIONAL CONTEXT FOR DECENTRALIZATION AND LOCAL INFRASTRUCTURE AND SERVICE DELIVERY

### 1.1. Legal and policy framework – key normative elements

The statutory framework for local government in Nepal is largely defined by the following key texts:

- the 1990 constitution (article 25.4);

- the Local Self-Governance Act (LSGA) of 1999, which broadly spells out the “rules of the game” (representation, powers, responsibilities, functioning, structure, etc.);
- the Local Self-Governance Regulation (2000), which fleshes out in greater detail some of the provisions of LSGA.

In addition to this formal, juridical, framework, a number of other policy initiatives also have a significant bearing on the overall framework for decentralization, *inter alia*:

- the establishment of a high level Decentralization Implementation Monitoring Committee (DIMC), chaired by the prime minister, responsible for overseeing the progressive implementation of LSGA;
- the Decentralization Implementation Work Plan, a road map spelling out time-bound and specific phases in the implementation process;
- the setting up of a Local Bodies Fiscal Commission (LBFC), responsible for examining the fiscal aspects of decentralization;
- the issuing of sector devolution guidelines by the Ministries of Health, Education and Agriculture.

## 1.2. Local government in Nepal – theory and practice

### 1.2.1. Theory

#### (i) General functions and characteristics

Local government in Nepal is made up of two levels – Villages and Districts. The following table provides a synopsis of the main governance features of these.

Table 1: Villages and Districts – governance features

Governance feature	Villages	Districts
Legal status	Autonomous and corporate body	Autonomous and corporate body
Population size	Smallest = less than 1,000 people; Largest = over 20,000 people; Average = around 3,500 people	Smallest = less than 20,000 people; Largest = more than 700,000 people; Average = around 30,000 people
Representation	- Villages made up of 9 wards, represented by Ward Committees (5 members = Chair, 1 woman, 3 others. all directly elected for 5 years by ward population); - "legislative" functions of Village = Village Council, made up of 53 members (composed of VDC Chairperson and VDC Vice-Chairperson [directly elected for 5 years by Village population], all Ward Committee members [9 x 5 = 45], and 6 persons nominated by Village Council [including at least 1	- "legislative" functions = District Council, made up of a varying number of members (Chairpersons and Vice-Chairpersons of all constituent VDCs, Mayors and Vice-Mayors of all Municipalities, DDC members, local members of National Assembly and House of Representatives [ex-officio members], and 6 members nominated by the District Council from the general public [including at least 1 woman and DAG representatives]);

Governance feature	Villages	Districts
	woman and representatives of Disadvantaged Groups (DAGs)); - "executive" functions of Village = Village Development Committee (VDC), made up of 13 members (Chairperson, Vice-Chairperson, 9 Ward Chairs, 2 Village members [selected by Village Council and including at least 1 woman]).	- "executive" functions = District Development Committee (DDC), made up of a varying number of members (Chair and Vice-Chair [both of whom are elected by and from constituent Village and Municipal Councils], Ilaka/area members [elected by and from constituent Village and Municipal Councils]), local members of the National Assembly and the House of Representatives [ex-officio members], and 2 members nominated by DDC from District Council [including at least 1 woman]);
Administrative and functional issues	- wide range of responsibilities attributed to VDCs for local management of sectors and general administration (agriculture, water, roads, education, public infrastructure, health, forestry, by-laws, dispute resolution, etc.); - coordination role for local development (formulation of Village Development Plans, etc...); - annual planning and budgeting (for which VDCs enjoy considerable autonomy). Planning processes are described in considerable detail by LSGA, which provides for a 14-step planning process (to be followed by VDCs and DDCs).	- as with VDCs, but at a higher geographical level and covering more sectors, DDCs are assigned wide ranging responsibilities for local administration and service delivery; - responsible for drawing up District periodic plans and for annual planning and budgeting; - DDCs have statutory responsibilities to provide VDCs with technical backstopping and to undertake audits of VDC accounts.
Fiscal issues	- several sources of own revenue for VDCs (land and house taxes, market taxes, service charges/user fees, borrowing, sale of assets); - LSGA also provides for transfers from DDCs and HMGN.	- DDCs are empowered to raise a range of taxes on products (wool, herbs, etc.) as well as on some natural resources (gravel, stones, sand, etc.). Some of these taxes are to be shared with VDCs; - also user fees for roads etc.; - DDCs are empowered to undertake borrowing, sale of assets, etc.; - fiscal transfers from HMGN.
Staffing	- VDC secretary (paid by MLD) - no other staff	- LDO and senior staff (paid by MLD); - technical and other staff (engineers, planners, administrative staff) paid by DDC.

**(ii) Sector-specific functions of local government**

Villages and Districts, according to the provisions of LSGA, have sector specific responsibilities. The following table provides a summary of VDC and DDC responsibilities (as defined by LSGA) in five key sectors – health, education, water supply, roads, and agriculture.

Table 2: sector specific responsibilities of Local Government

Sector	DDCs	VDCs
Education	<ul style="list-style-type: none"> <li>- setting priorities for establishing new schools in District</li> <li>- supervision of schools in District</li> <li>- contribute to O&amp;M of schools in District</li> <li>- formulation of District-level policies for adult and non-formal education</li> </ul>	<ul style="list-style-type: none"> <li>- planning &amp; approval of pre-primary schools</li> <li>- supervision &amp; operation of schools in Village area</li> <li>- assist in provision of primary school education</li> <li>- formulate and provide adult education programmes in Village area</li> <li>- establish and operate libraries</li> </ul>
Health	<ul style="list-style-type: none"> <li>- operation &amp; management of District level health posts, hospitals, clinics, dispensaries, etc.</li> <li>- formulation &amp; implementation of family planning, child welfare, vaccination and public health programmes</li> <li>- approve opening of sub-health posts in VDCs (subsequently, inspection &amp; monitoring of those sub-health posts)</li> <li>- ensure the supply of medicine, materials and equipment</li> <li>- control of articles/products injurious to public health in District</li> </ul>	<ul style="list-style-type: none"> <li>- operate &amp; manage village level health/sub-health centres &amp; posts</li> <li>- prepare and implement public health programmes (health education, sanitation, etc.)</li> <li>- launch family planning, maternity and child care programmes</li> </ul>
Water	<ul style="list-style-type: none"> <li>- formulation and implementation of drinking water schemes for &gt; 1 VDC</li> </ul>	<ul style="list-style-type: none"> <li>- prepare, implement and maintain drinking water schemes in village area</li> <li>- construct, repair, &amp; maintain wells, ponds, etc.</li> </ul>
Roads	<ul style="list-style-type: none"> <li>- formulation of District master-plan for District-level roads</li> <li>- build, operate and maintain approved District level roads</li> <li>- plan, construct and maintain/repair suspension bridges</li> </ul>	<ul style="list-style-type: none"> <li>- prepare, implement and operate/maintain rural roads, tracks and trails in village area</li> <li>- maintain/repair bridges, culverts, embankments</li> </ul>
Agriculture	<ul style="list-style-type: none"> <li>- formulate and oversee implementation of District level policies on agriculture and livestock development</li> <li>- ensure provision of agricultural inputs</li> <li>- provide agricultural extension services</li> </ul>	<ul style="list-style-type: none"> <li>- implement agricultural development programmes</li> <li>- organise weekly markets</li> <li>- provide veterinary services</li> <li>- prepare and implement irrigation projects within village area</li> <li>- prepare and implement soil erosion and river control schemes</li> </ul>

Sector	DDCs	VDCs
	<ul style="list-style-type: none"> <li>- manage agricultural marketing</li> <li>- protect and promote use of common lands</li> <li>- plan/implement inter-VDC irrigation schemes</li> <li>- formulate plans for SWC</li> </ul>	<ul style="list-style-type: none"> <li>- generate &amp; distribute electricity</li> </ul>

Since 2002, HMGN has been in the process of implementing its sector devolution policy. This has included the following sectors: health, education, agricultural extension and postal services.

### (iii) Oversight, support, supervision and control

As noted in table 1, VDCs are expected to benefit from DDC mentoring and backstopping, particularly with regard to technical issues (design and costing, implementation, etc.). They are also subject to DDC-supervised audits.

According to LSGA provisions, the central government is responsible for ensuring local government compliance with LSGA provisions, for monitoring local government efforts in favour of women, children and disadvantaged groups, and for monitoring the impact of local government activities on the environment. In addition, the Auditor General's office is expected to audit DDC expenditure and revenue accounts.

Of considerable importance to note is that LSGA's initial preamble on "principles and policies" (Art. 3) includes the statement that HMGN shall "[devolve] .. such powers, responsibilities, and *means and resources* as are required to make the Local Bodies capable and efficient in local self-governance." (author's emphasis). More specifically, HMGN (Art. 236) ".. shall have to provide the Local Body each year with minimum grant prescribed and also with additional grants on such basis as population, level of development, possibility and capability of mobilising revenues, necessity of financial resources, regular record keeping of incomes and expenditure, situation of auditing and financial discipline of the concerned Local Body." LSGA thus provides – in a very explicit way – for fiscal transfers from the centre to LGs.

### 1.2.2. Practice

As in many other countries, the reality of local government in Nepal diverges somewhat from the normative framework as provided for and prescribed by LSGA and other policy instruments. The following sections attempt to highlight and to describe and explain some of these differences.

#### (i) Contextual factors

Local government practice and statutory prescription/policy orientation vary considerably in Nepal, due to a number of factors:

- **difficulties of communication:** in a largely hilly and mountainous country, compounded by poor communications and transport infrastructure,

- communication constraints make it difficult to monitor and enforce compliance with LSGA provisions;
- **a highly stratified society:** the hierarchy of caste and other sources of inequality profoundly affect all aspects of public life in Nepal, including local government. Traditional local elites are the dominant figures in much of the LG system;
  - **an incomplete statutory framework:** a number of "silences" and ambiguities within the statutory framework. In addition, current sector devolution guidelines remain somewhat unclear and in some instances contrary to LSGA provisions – none of which makes their implementation easy;
  - **capacity issues:** weak capacity at the local level, particularly in VDCs, but also in many of the remoter, more isolated Districts;
  - **insufficient financial resources:** budgetary constraints at all levels (central, District and Village), particularly within a context of increasing expenditure on security/military issues and declining overall revenues (see below);
  - **insecurity and insurgency:** an ongoing Maoist-inspired insurgency that began in 1996 and continues (despite two cease-fires and the holding of talks between HMGN and the rebels). Much of rural Nepal - particularly in the west, but on an increasingly widespread basis - is under the *de facto* control of the Maoists, who have conducted a systematic campaign against LGs (especially VDCs, but also DDCs - as witnessed by armed attacks on several District capitals since 2000). This has inevitably led to an effective breakdown of LG in many parts of the country.
  - **politics:** the decision by HMGN, taken in July 2002, not to extend the mandates of existing elected LG bodies and to transfer LG management to centrally-appointed civil servants. A decision largely motivated by party political considerations, this has resulted in the effective suspension of many (if not most) of LSGA's provisions, and has probably diluted existing mechanisms for downward accountability.

## (ii) Local government realities

In a number of areas, the practice of local government in Nepal is at some variance with policy prescriptions and intentions.

### **Representational issues:**

- **ineffective oversight by councils:** until their dissolution in mid-2002, there is much anecdotal evidence indicating that councils at Village and District level were prone to rubber-stamping – and that considerable *de facto* powers were exercised by the VDCs and DDCs, with relatively little effective oversight exercised in practice by a large number of councils. In 2001 (see UNDP 2001) it was estimated that nearly 75% of Ward Committees never meet, which implies little oversight by Wards over VDCs;
- **unheard voices:** the statutory presence of women and DAG representatives in both the legislative and executive branches of local government has not always been translated into effective voice for under-privileged groups. Only rarely have women or DAG representatives been actively involved in DDC/VDC executive affairs (UNDP 2002);

- **capacity:** the low capacity of representative bodies (resulting from high illiteracy rates, low educational levels, out-migration from rural areas of the "best and the brightest") has limited their ability to play a decisive role in LG affairs.

***Transparency and downward accountability:***

- **literacy levels:** low levels of literacy among citizens (especially in rural areas and particularly among women and poorer and more disadvantaged groups) imply that written media are of limited use as a way of making information publicly available;
- **disengagement and information flows:** apparently high levels of representation at both Village and District levels disguise a tradition of low participation in public affairs (often linked to caste, hierarchy and modern Nepali social history), compounded by an equally well-entrenched culture of information retention on the part of elected and appointed authorities. A donor-led and HMGN-supported focus on social mobilisation and community organisations (COs) has not always catalysed the emergence of genuine civil society organisations (CSOs) – engaged in the more general political process of issue-based negotiation – but has given rise to individual project “champions”;
- **absence of elected bodies:** the downward accountability provided for by LSGA (albeit weak in practice) through representative organs has taken a severe body blow since July 2002, when elected councils were dissolved by central government.

***Functional issues:***

- **small LG units :** in terms of service delivery, the size of Villages and Districts is often sub-optimal<sup>1</sup>. Villages can number only a few hundred individuals (although the average population is roughly 3,500 people); some Districts have a population of less than 20,000 (although the average population size of Districts is roughly 30,000 people). This does not lend itself to efficiency (Shrestha 2002). However, it is important to note the existence of Ilakas, a nascent level of LG that brings together several VDCs for planning purposes;
- **scattered populations:** relative to their populations, some LG units cover huge areas, making communication and interaction between citizens and LG extremely costly (both financially and in terms of transaction costs);
- **sector devolution:** LSGA provisions regarding sectoral responsibilities are not always clear, and are not backed up by more detailed directives or decrees that make a clearer distinction between respective responsibilities for recurrent and capital expenditure. Sector devolution has been slow and fitful, and often only reluctantly undertaken by Line Ministries. Guidelines for sector devolution have usually been incomplete and frequently inconsistent with the provisions of LSGA. It remains very unclear as to how far (if at all) LGs exercise authority over the performance and activities of sector staff, even though they are becoming

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<sup>1</sup> the geographical boundaries of VDCs and DDCs date back to the pre-1990 *panchayat* system, which was largely aimed at diffusing political tensions through ensuring a degree of popular representation at all levels. LG units in Nepal, then, may be seen as being primarily shaped and determined by political decentralization, rather than by a devolution of service delivery functions by the central government.

- increasingly responsible for the payment of salaries (paid out of conditional sector grants);
- **approaches to planning** : much of the local planning process (LPP), largely pioneered by donor agencies, has tended to “by-pass” VDCs and their constituent Wards; the LPP in Nepal is more "civil society" focussed than in most other countries, with a greater emphasis being placed on "socially-mobilised" community organisations and user groups/committees (UCs or UGs) as the sponsors, initiators and managers of local development. LGs sometimes operate as rubber stamps for development projects that are identified, implemented and subsequently managed by COs and UCs;
  - **staff turnover and capacities**: given the apparently high mobility of key senior DDC staff (especially Local Development Officers and others employed by MLD), capacity development remains a problem in Nepal (where every educated person would prefer to be posted to the Kathmandu Valley, rather than to isolated and remote Districts in the Terai, middle hills and mountains). There is also the issue of limited numbers of staff (particularly LDOs and VDC secretaries) in the field, often (but not exclusively) a result of the insurgency and security issues.

### **Fiscal issues:**

- **weak LG revenue base**: the revenue base for LG is relatively small, resulting in considerable dependence on central government transfers – although this is not necessarily a problem, if CG transfers are adequate and well-designed. VDCs, for example, rely on DDC and central government transfers for almost 80% of their revenues. Local governments (VDCs and DDCs), as a whole, are dependent for 75% of their total revenues on transfers from the central government;
- **no incentives for improved revenue efforts**: there are few, if any, incentives for LGs to improve their fiscal effort and to thus increase own-source revenues;
- **characteristics of inter-governmental fiscal transfers**: central government fiscal transfers to DDCs and VDCs have been unpredictable, inequitable and inadequate. For DDCs, the annual divisible pool is *ad hoc*, allocations from it are determined without reference to clear criteria, and actual transfers are often less than budgeted for (Shrestha 2002). VDCs, on the other hand, are allocated equal shares annual block grants (of between 250,000 and 500,000 NR, depending on funds) on a regular basis (although actual transfers have often been erratic) – this is inequitable given that allocations are made irrespective of population size, fiscal need, and relative poverty;
- **discretion in the use of grants**: although there are conditional grants from central government (for administration, roads, and suspension bridges) LGs do appear to enjoy a fair degree of discretion in the use of both of their own locally generated revenues and general block grants from the centre. On average, general block grant accounts for almost a third of total grants made to DDCs by the central government (Shrestha 2002). Central government grants to VDCs are largely discretionary, with only an upper limit (of 25%) placed on administrative and human resource development expenditure;
- **low levels of LG expenditure**: during the period 1998-2001, local governments accounted for only 4% of total public expenditure in Nepal, reflecting not only their limited capacity to raise their own revenues, but also the continued dominance of central government line agency service provision. The largest

proportion of LG expenditure takes the form of minor capital items (Shrestha 2002);

***Support, mentoring and oversight:***

- **audits:** according to LSGA, VDC audits are expected to be sponsored by DDCs – there is, however, little evidence that this is done a systematic or regular basis;
- **weak backstopping:** in general, there appears to be insufficient DDC backstopping of and mentoring for VDCs, resulting in poor delivery of infrastructure and services at the local level. Much of this can probably be attributed to a lack of qualified staff, inadequate budgets and insufficient resources, as well as weakly anchored procedures;
- **central government monitoring/oversight:** although audits of DDC accounts are fairly regular, central government oversight is – in general – weak. MLD, for example, is not necessarily aware of the quality of management in all DDCs; the Ministry’s M&E capacity is limited, a deficiency that is compounded by the high transaction and other costs associated with poor communications and difficulties of access to many DDCs. All of this has clearly been exacerbated by the Maoist insurgency.

***Sectoral devolution:***

- **confusion:** given the recentness of sector devolution, it is perhaps unsurprising that most of the actors (DDC and VDC officials, Line Ministry staff) involved remain confused about responsibilities and modalities. This confusion can also, in part, be attributed to the contradictory and inconsistent nature of sector devolution guidelines (issued by respective Ministries);
- **different sectors, different approaches:** there is considerable variation in the extent to which different sectors have implemented devolution. In the case of agricultural extension, devolution appears to have been relatively well thought out – District Agricultural Development Committees (DADCs), bringing together DDC officials and all agriculture sector agencies (including those, such as research, that remain under central government control), have been established; agriculture extension and service budgets (for both recurrent and capital expenditure) are now drawn up at District level, within the framework of budget ceilings determined by the Ministry; Districts are free to determine sector priorities within hard budget ceilings. In the education and health sectors, however, the tendency has been to establish parallel local management arrangements, with only formal and somewhat desultory links to LG authorities<sup>2</sup>. In the education sector, devolution to Districts only concerns primary education – and, even then, has been limited to the responsibility for managing the salaries of some teachers and the procurement of some school materials (text books etc.). The entire education sector capital budget, however, remains a Line Ministry, rather than LG, responsibility;

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<sup>2</sup> “The approach used by Health and Education largely bypasses Local Bodies, ignores the provisions of LSGA, the Decentralisation Implementation Plan and [the] 10<sup>th</sup> Plan .. and focuses on a deconcentrated approach where responsibility for running Sub-Health Posts and Community Managed Schools (CMS) is delegated to lay communities who are provided with limited resources ... and little authority to influence the situation they have been made responsible for.” (DASU/DANIDA 2003: 5).

- **LG impotence:** in practice, sectoral budgetary devolution has not translated into effective LG control. Central government sector allocations are routed through DDCs, and then passed onto District Agriculture, Education and Health Offices. DDCs have supposedly delegated expenditure responsibilities to District sector offices; in reality, DDCs have not understood (or been allowed to understand) their sectoral responsibilities and prerogatives;
- **degraded budgets:** the devolution of sector budgets to DDCs appears to have coincided with drastic reductions in grants and delayed disbursement (see DASU/DANIDA 2003) – although whether this has been a direct (if unintended) consequence of sector devolution or a result of HMGN’s current budget constraints (largely caused by substantial increases in security-related expenditure and reduced revenues) is not known;
- **VDCs:** finally, sector devolution has had few, if any, ramifications for VDCs. The formal role of VDCs in the three “devolved” sectors appears to be minimal.

### ***Current arrangements and the lack of locally elected bodies***

- **mandarins in, politicians out:** since mid-2002, Nepal’s system of locally elected government has been put into a state of “suspended animation”. Village and District Councils have been dissolved; VDCs and DDCs are currently entirely managed by civil servants, even though many ex-chairpersons continue to be consulted about decisions and LG activities. At the time of writing, however, the Government is in the (controversial) process of appointing new LG chairpersons for municipalities and DDCs.

### **1.2.3. Policy constraints**

Generally speaking, LSGA and related statutory texts seem fairly comprehensive and, if correctly implemented, do appear able to provide for a relatively high degree of representation, downward and upward accountability, and a healthy dose of transparency. The problem, then, is largely one of *implementation*, rather than the overall policy framework in itself.

Nonetheless, LSGA could probably be improved upon, particularly (but not exclusively) with regard to:

- the assignment of functional responsibilities and expenditures to different levels of local and central government;
- a more explicit and more detailed statement of DDC responsibilities vis-à-vis VDCs (mentoring, backstopping, technical support, etc.);
- the definition of the local tax base, which remains overly restricted;
- provisions allowing for a greater degree of transparency on the part of local governments. LSGA, for example, is insufficiently prescriptive about the obligation of LGs to make publicly available information about the planning/budgeting process, approved budgets and actual expenditure. Citizens are not expected – as a matter of law – to be provided with comprehensive information about LG affairs.

With regard to fiscal reform, the LBFC (supported by donors – UNCDF among them) does appear to be making progress. However, its initial proposal for the introduction of a formula for the allocation of DDC block grants must be seen as

somewhat inappropriate, as the formula is overly influenced by poverty considerations and does not adequately take into account service delivery needs (expressed through population size), fiscal effort, or the absorptive capacity of Districts.

## 2. LOCAL DEVELOPMENT PROGRAMME: ANALYSIS OF THE DECENTRALISED FINANCING AND DEVELOPMENT PROGRAMME (DFDP) IN NEPAL

### 2.1. Background and overview

Originally named the Local Development Fund Programme (LDFP), the Decentralised Financing and Development Programme (DFDP) became effectively operational at the beginning of 2001. DFDP was initially fully funded by UNCDF (\$ 5 million), but since early 2003 DFID has provided additional co-funding (approximately \$ 5 million). To date (October 2003), DFDP has provided support for ISD over 3 annual planning/budgeting cycles in 8 Districts and is in the process of providing capital budget support to a further 12 Districts for 2003-2004<sup>3</sup>. The following table provides basic data on the 8 Districts that DFDP has worked with since 2001.

Table 3: District profiles for initial DFDP-supported Districts

District	No. of VDCs	Population			Per rural capita annual allocations (US\$) from DFDP
		Rural (in VDCs)	Urban (in municipalities)	Total	
Terhathum	32	113,111	-	113,111	0.82
Udaypur	44	232,398	55,291	287,689	0.40
Dhanusha	101	597,172	74,192	671,364	0.16
Dolakha	51	182,313	21,916	204,229	0.51
Kavre	87	332,766	52,906	385,672	0.28
Kaski	43	182,846	197,681	380,527	0.51
Rupandehi	69	580,466	127,953	708,419	0.16
Accham	75	231,285	-	231,285	0.40
Totals		2,452,357	529,939	2,982,296	0.30

Source: DFDP Annual Progress Report 2002

DFDP is institutionally housed in MLD (the National Project Director is an MLD civil servant), but is managed on a day-to-day basis by a small Project Management Unit (PMU) based in Kathmandu, along with a new sub-office in Nepalganj (set up in 2003), responsible for facilitating activities in the 12 western and mid-western Districts covered by the programme<sup>4</sup>.

<sup>3</sup> the Nepali financial year runs from July to June.

<sup>4</sup> the professional and technical section of the PMU is composed of a Programme Manager, an M&E specialist, and two staff (an infrastructure specialist and a financing & planning specialist based in Nepalganj. This small team is supported by administrative staff (accountant, secretary, drivers).

DFDP initially worked with 8 Districts; with DFID co-funding, the programme has been expanded to include a further 12 Districts (mostly in the West and Mid-West of Nepal). The programme therefore now covers 20 of Nepal's 75 Districts. Within those Districts, DFDP funding and support is only provided to rural areas – no municipalities are supported by DFDP.

According to DFDP's logical framework, the programme's objectives and expected outputs are as follows:

- Development objective: poverty reduced in 8 [now 20] pilot Districts through provision of rural infrastructure and human resource development opportunities;
- Immediate objective: the local authorities (DDCs, VDCs) and grassroots institutions (UCs, COs) in the (8, now 20) pilot Districts implement and maintain small-scale rural infrastructure and other public investments in an effective, responsive and accountable manner;
- Outputs:
  1. Transparency in project selection processes for LDF projects is strengthened within the participatory planning framework (LSGA);
  2. Financial management and reporting capacities of DDCs, VDCs and UCs are improved;
  3. Management capabilities of DDCs/VDCs for the implementation and maintenance of LDF funded infrastructure enhanced;
  4. Monitoring & evaluation system of DDCs and VDCs strengthened.

In addition to direct financial and other support for Districts, DFDP has also provided policy level support to HMGN, most importantly in the area of fiscal decentralisation. This constitutes a fifth, tacit output for DFDP. Through DFDP, UNCDF (in collaboration with DANIDA) provides technical and other support to LBFC in 4 specific areas (all of which are drawn from LBFC's own work plan):

1. Clarifying expenditure assignments for different levels of central and local government;
2. Clarifying revenue assignments and inter-governmental fiscal transfers;
3. Designing incentive tools and improving M&E;
4. Building LBFC capacities.

## **2.2. DFDP operational processes and principles – general outline**

DFDP is supposed to work within (rather than parallel to) the framework of the existing institutional architecture of Nepal, thus striving to provide an experiment in the full implementation of HMGN's decentralisation policy. As far as possible, then, DFDP works with and through existing structures and in accordance with prescribed procedures.

The programme provides DDCs (but not VDCs) with access to predictable, annual block grants for the financing of capital investments in rural infrastructure and service delivery – by both DDCs themselves and by their constituent VDCs. Up until recently, annual allocations to all DDCs have been set at roughly US\$ 90,000, irrespective of their population size or any other criteria; from (Nepali) FY 2003-2004, however, DDC annual block grants will be determined according to the allocation formula endorsed by LBFC (see below). For the initial 8 Districts, average annual per

rural capita allocations have averaged around US\$ 0.30. Annual allocations are announced prior to the start of the fiscal year; in principle, both DDCs and VDCs are provided with information about annual allocations.

Annual allocations from DFDP to DDCs can be used to fund two basic types of project:

- VDC-level projects, which are not to exceed a DFDP contribution of 500,000 NR (roughly US\$ 7,000). Such VDC-level investments are assumed to lead to ISD for which the eventual beneficiaries or users will be predominantly citizens of the VDC in question;
- DDC-level projects, for which the DFDP contribution exceeds 500,000 NR, but does not go beyond 1,200,000 NR (between US\$ 7,000 – 16,000). However, any project that provides benefits to the citizens of more than one VDC is also classified (by DFDP) as being a DDC-level project<sup>5</sup>.

Although DFDP's Operations Directives (2003) do provide an indicative list of the kinds of infrastructure and service that can be financed out of annual allocations, DDCs are given considerable discretionary powers over how and where such block grants are spent. Nonetheless, DFDP does require that DDC allocations follow a two simple "rules":

- DFDP's overall contribution to DDC-level projects should not exceed 40% of the total annual allocation. At least 60% of DFDP block grants, then, is expected to be used for funding VDC-level projects;
- at least 20% of the value of DFDP allocations is to spent on "focussed" projects, for which the principal beneficiaries or users will be either women or members of disadvantaged groups (such as *dalits*).

DFDP has retained (and continues to retain) a degree of *ex-ante* control over finalised micro-project selection through the Programme Management Committee's (PMC) approval of Project Funding Matrices (PFMs), submitted by participating DDCs. The PMC has the power to reject project proposals that are seen to be contrary to the "spirit" of DFDP, and to ensure compliance with prescriptions concerning eligible investments, the ratio of DDC-level to VDC-level project funding, and the inclusion of affirmative action projects deliberately targeted at women and disadvantaged groups.

The investments funded out of DFDP block grants are expected to be identified through regular planning processes (as specified by LSGA) - starting at Ward level, then moving onto VDC, Ilaka and DDC levels, before being finally approved by District Councils (prior to 2002). DDCs select from a pool of VDC prioritised micro-projects submitted to them for funding from the DFDP "window" in their annual capital budgets. In practice, however, only DDC-level projects follow the entire LSGA planning process; VDC-level projects are submitted directly to the DDC.

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<sup>5</sup> for FY 2003-2004, however, the ceilings for VDC- and DDC-level projects have been modified to take into account new Districts and differing costs (varying according to remoteness). Thus, those in Districts where infrastructure costs are relatively high, ceilings have been increased.

DDCs are permitted to use up to 6% of their annual block grants from DFDP for purposes of technical assistance (TA)<sup>6</sup>. This usually implies the recruitment (by DDCs) of Field Officers and overseers, responsible for providing technical backstopping for the implementation of DFDP-funded micro-projects, at both DDC and VDC levels - although other options are possible (e.g. short term contracts for private sector consulting engineers, etc.). This programme-funded TA is intended as a supplement to any existing DDC technical capacity (in the form of District Technical Offices).

DFDP funds are made available to DDCs and VDCs on a cost-sharing, or matching grant, basis. The programme requires that:

- DDCs contribute (in cash) 10% of the value of DFDP's contribution to any type of project whether it is of DDC-level or VDC-level status;
- VDCs contribute (in cash) 10% of the value of DFDP's contribution to VDC-level projects (but not for DDC-level projects);
- local communities or user groups make an unspecified contribution (in kind or in cash) to the financing of any project (DDC or VDC level).

Disbursement of DFDP funds takes place through DDCs, initially channelled to District Development Fund accounts and then to programme specific bank accounts. DFDP funds are released once DDC/VDC matching grants are effectively mobilised. DDCs transfer funds, wherever feasible, to VDCs (who then disburse to UCs/UGs).

In accordance with its project document, DFDP is expected to introduce performance-based incentives in the form of minimum conditions (MCs) and performance assessments (PMs). These have been pioneered elsewhere by UNCDF (e.g. Uganda, Tanzania, Mali, Bangladesh), generally resulting in improved LG performance. Very briefly:

- MCs are the essential conditions that must be met by LGs if they are to benefit from annual block grants. They are generally based on statutory provisions, and ensure that LGs comply with nationally-defined rules about representation, functionality, etc.;
- PMs are indicators of LG performance in a variety of areas (e.g. development planning, financial management, transparency, M&E, etc.). LG units that demonstrate good performance are eligible for increases in their block grant allocations; poor or worsening performance, on the other hand, is subject to the sanction of decreases in block grant allocations.

### **2.3. DFDP: innovations and issues**

DFDP is in a continual process of innovation, adjustment and experimentation – informed by both experience within Nepal and by UNCDF's programmes elsewhere. In addition, the implementation of DFDP raises a range of critical issues. These are described in the following three sections and summarised in the inset below.

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<sup>6</sup> there has been some recent discussion about increasing the TA fund to up to 8% of the annual DDC allocation for the more isolated Districts (although this is somewhat controversial given that such Districts will benefit from substantially larger capital grants than the more accessible Districts – see below).

## DFDP – innovations, issues

### Finance:

- regular, predictable and dependable fixed annual grants, the use of which is largely left to LG discretion;
- *ex ante* controls over LG use of grants;
- equal shares allocations to DDCs moving towards a multi-criteria formula system;
- support to LBFC for establishing a performance-based allocation system, using minimum conditions and performance measures;
- matching contributions from DDCs, VDCs and local communities;
- fund flow through regular HMGN channels;
- 20% earmarked window for focussed projects, targeting women and socio-economically disadvantaged groups (*dalits*);
- use of up to 6% of annual grants for procuring technical assistance;
- support for fiscal decentralisation reform.

### Planning & budgeting:

- through capital funding, adding substance to the local planning process and thus highlighting problem areas;
- the persistent issue of elite capture and the inclusiveness of local level planning in Nepal.

### Implementation:

- construction of infrastructure by Users' Committees/Groups (UCs/UGs);
- the advantages and limitations of UC/UG implementation modalities;
- some capacity-building for UCs/UGs;
- O&M as a perennial issue.

### Accountability & transparency:

- informing actors of DFDP allocations;
- signboards, project books and social audits for DFDP-funded micro-project implementation;

## 2.3.1. Financing of ISD

### (i) Block grants for capital investments

Like most other UNCDF local governance programmes, DFDP provides local government with access to regular, predictable, pre-announced, and fixed annual block grants, the use of which is largely left to the discretion of local bodies. However, the innovatory nature of this financing needs to be tempered in the case of Nepal, where HMGN provides VDCs (but not DDCs) with such grants. What clearly distinguishes DFDP allocations is their certainty – as long as micro-projects are planned and implemented according to pre-established procedures and in line with DFDP prescriptions (such as the provision of matching funds from LG), capital budget funds are effectively disbursed. This is often not the case for HMGN grants, as Shrestha observes: "...local governments live in uncertainty until they receive the money .. adversely affecting their planning of the program and budget." (Shrestha 2002: 32).

However, as noted above, DDC project proposals are subject to vetting and final approval by the PMC, representing a relatively high degree of *ex ante* control over micro-project selection (even though the proportion of rejected projects is small). This, in the Nepali context, is new – the use of HMGN grants is generally not subject to *ex ante* (or *ex post*) assessment.

## **(ii) Allocation modalities**

To date, DFDP block grants have been allocated on the basis of equal shares (roughly US\$ 90,000 per annum) - thus all Districts receive the same capital grant from DFDP, irrespective of their populations or other considerations (relative poverty, fiscal need, varying investment costs, etc.). This is identical to the procedure used for the allocation of VDC grants by HMGN, but is very different to DDC grants from the central government, the calculation of which is *ad hoc*. However, for FY 2003-2004 DFDP allocations to Districts have been calculated on the basis of a formula developed and adopted by LBFC. This innovative use of a formula for allocations divides the total DFDP annual funding pool (approximately US\$ 1.7 million) for 20 Districts into the following components:

- 20% for population size, such that more populous Districts will receive a proportionately larger grant;
- 50% for poverty (as defined through the Human Development Index), such that poorer Districts will receive larger allocations;
- 20% for costs, taking into account the considerable variation in the cost of materials between Districts. Districts in mountainous areas (where transport costs are very high) will receive larger grants than those in the Terai plains (where costs are lower);
- 10% for area, reflecting the additional burden borne by Districts with low population densities

Although the recourse to a formula-based system for the allocation of DDC grants represents, in itself, both an improvement upon existing DFDP practice and a potentially more equitable way of dealing with the “horizontal gaps” between Districts, it needs to be noted that the end result (in terms of total allocations to Districts) is remarkably similar to the equal shares system (see annex 1 for details). This – it must be said – does imply that the weighting of the elements of the formula may have been deliberately manipulated to maintain the status quo. The allocation formula, whilst it clearly tries to take into account a range of important factors, is far from ideal, with relative poverty (unweighted by population size) exercising an overwhelming influence over the size (both total and per capita) of DDC allocations.

## **(iii) Performance-based incentives**

Unlike many other UNCDF-funded LDPs, DFDP has not (to date) applied minimum conditions of access to block grants or *ex post* performance assessments to provide incentives for improved LG performance. For FY 2003/2004, however, the programme has just introduced interim MCs (tailored to the specific - and presumably temporary - circumstances following the dissolution of elected bodies in July 2002). DFDP also intends to pilot the introduction of *ex post* performance assessments for FY 2004/2005 (these are currently being defined and finalised by LBFC and other major stakeholders with UNCDF and DANIDA technical assistance). The introduction of MCs

and performance-based assessments (as the basis for deciding on access to capital grants and increases or decreases in annual allocations) will be a fundamental innovation in the Nepali context.

**(iv) Matching funds from LGs and local communities**

In contrast to HMGN’s existing system of fiscal transfers, DFDP’s block grants to local governments are conditional upon the mobilisation of matching funds. The following table provides information on funding sources for completed micro-projects financed through DFDP.

Table 4: DFDP and matching contributions (2001-2002) for ISD (000s Nepali Rupees)

Year	Micro-project cost sharing					Total
	DFDP	DDC	VDC	Other	Community (in kind)	
2001	15,060,756	1,551,681	2,167,859	173,485	11,099,968	30,053,749
2002	36,168,201	3,797,766	3,366,266	1,110,405	24,087,465	68,530,103
Total	51,228,957	5,349,427	5,534,125	1,283,890	35,187,433	98,583,852
% of total	52.0	5.4	5.6	1.4	35.6	100.0

As can be seen from the table, DFDP funds leverage substantial local contributions – amounting to almost a half of the total value of all investments.

**(v) Disbursement**

DFDP disbursements have been channelled through District Development Funds, managed by DDC financial offices, and thus subject to regular HMGN accounting procedures. This is very different to the disbursement method used by most other donor programmes (with the exception of DANIDA’s support in 2 Districts), which have established parallel mechanisms for funding local and community development. In so doing, DFDP has deliberately sought to strengthen local government management capacities – and has accompanied this with training and the testing out of financial management software.

**(vi) Focussed projects’ funding window**

One of the most innovative elements of DFDP’s funding has been the special (affirmative action) financial window created for “focussed” projects, targeted directly at women and disadvantaged groups. This is clearly in keeping with the “spirit” of LSGA and is entirely consistent with Nepal’s PRSP, which singles out the need for targeted programmes to reduce severe poverty (see NPC 2003). Early conceptual problems with this kind of targeting have been progressively resolved through discussions between DFDP and DDCs. It is now better understood that “focussed” projects are intended to generate benefit streams that directly and predominantly impact upon women and DAGs. In addition, DFDP has become clearer about who DAGs are by explicitly referring to the National Dalit Commission’s official listing of disadvantaged communities, rather than leaving DDCs to determine such groups.

## **(vii) Technical assistance and support**

Another innovative aspect of DFDP's financing facility has been the latitude given to DDCs to spend up to 6% of their annual allocations on technical assistance (TA). As mentioned earlier, this facility has been used to pay for Field Officer and overseer salaries, with such staff being responsible for design and costing of micro-projects, as well as for the supervision of any works. The TA fund was created by DFDP in order to take into account weak technical capacity in LGs and thus represents an explicit recognition of the fact that capital funds alone are not enough. It is thus a way of strengthening weak capacity and compensating for low staffing levels in DTOs – which are especially under-resourced in remote rural areas, where educated staff are reluctant to be posted and where supervision is made doubly difficult by the long distances that need to be covered on foot. The fact that all Districts have opted to recruit full-time staff, rather than buying in short-term TA from private sector consulting firms, also points to the added difficulties of working in rural areas that offer few incentives for the private sector.

## **(viii) Policy reform**

Through the support it has provided to LBFC, DFDP (along with DANIDA) has pioneered a process of upstream policy reform. Of particular note has been technical assistance aimed at helping LBFC develop a rational basis for expenditure assignments for different levels of government and an incentive-based system for the allocation of fiscal transfers from central to local government.

### **2.3.2. Planning and budgeting for ISD**

#### **(i) Highlighting planning gaps**

Within the UNCDF-funded portfolio of LDPs, DFDP is unusual in that it does not explicitly address local planning issues - it was formulated as a largely financial instrument intended to complement ongoing UNDP-funded programmes (PDDP and LGP), which provide support for the local planning process in Nepal. Nonetheless, and through force of circumstance, DFDP has - over time - become increasingly involved in planning at the DDC and VDC levels.

The injection of capital funds by DFDP has, in itself, highlighted a number of problems in the existing planning process (piloted by PDDP/LGP and subsequently incorporated into the provisions of LSGA), *inter alia*:

- **widening the planning process:** the need to make the LPP a genuinely *local government* planning process, with full involvement by all LG units (and not just the VDCs that have benefited from PDDP/LGP-sponsored "social mobilisation") - as provided for by LSGA. DFDP has therefore "widened" its audience to include, as far as possible, all VDCs within participating Districts - although ISD micro-projects continue to be promoted by community organisations (as prescribed by PDDP/LGP) through Wards and VDCs;
- **public goods and community organisations:** whilst DFDP has continued to foster a "community-based" approach to planning through its insistence on micro-project proposals being championed by recognised (or "mature") COs, experience in the field has shown that this is not always consistent with LG

- planning. In many instances, COs established for specific purposes (for example, managing micro-finance) have proposed public goods projects such as roads, bridges, schools and health centres, even though there is no self-evident reason for a community organisation to be identified with such investments. VDCs, unable to meet such needs from their own budgets, have obviously “used” COs as project sponsors so as to access DFDP funding. This is gradually leading to a rethinking of the local planning process;
- **pro-poor planning approaches:** despite the fact that many DDCs (with UNDP support) have developed useful databases (resource and poverty maps, VDC profiles, etc.) there is little evidence that these are being incorporated into the planning process;
  - **screening, prioritisation and appraisal:** the need to foster and pilot transparent and robust project selection methods. The hard budget ceilings provided through DFDP block grants now oblige VDCs and DDCs to prioritise investments, rather than generate “wish-lists” via the participatory local planning process. Under DFDP, there is the real possibility of getting micro-projects funded, and this - in turn - raises the issue of which micro-projects to fund from an inevitably limited funding pool. As it became apparent that prioritisation processes were far from transparent, and based on no explicit or consistent criteria, DFDP has encouraged Districts to establish more formal (and more transparent) ways of deciding on priorities. In addition, because DFDP provides DDCs with a predictable and dependable but hard budget ceiling, it has helped raise issues linked to the opportunity cost of different types of ISD – and thus highlighted the need for a better and more rigorous appraisal process in the screening of micro-project proposals.

It has to be said that DFDP is only now beginning to provide (or to devise) innovative solutions to some of the weaknesses observed in the LG planning process in Nepal. But in the context of Nepal, DFDP – as an innovative instrument for funding local government ISD – has clearly been instrumental in drawing attention to the need for local level planning to go beyond the identification of needs and potential micro-projects.

## (ii) **Elite capture and inclusion/exclusion**

The recent Mid-Term Evaluation of DFDP has also highlighted the problem of elite capture and inclusion/exclusion (see MTE 2003) in Nepal’s local planning process. Local government tends to be dominated by higher caste individuals, who are not necessarily representative of the population as a whole – nor predisposed towards the active promotion of pro-poor development programmes, targeted at lower caste or disadvantaged groups (such as *dalits* and minority ethnic groups). The influence of such traditional rural elites, in a country like Nepal, is not to be under-estimated.

Using the alternative planning method of working with and through COs (as project owners) only partially makes up for this – COs themselves are often dominated by the same rural elites or their kin/affines. But COs do (according to the MTE) seem more likely to include the poor or under-privileged, unlike VDCs and Ward Committees, and working through them may therefore provide DFDP (and other sources of finance) with a more inclusive planning process. This, however, remains a hypothesis.

### **2.3.3. Implementation/production of ISD**

#### **(i) User committee implementation**

With explicit support from MLD, DFDP has promoted micro-project implementation by User Committees or User Groups (UCs/UGs<sup>7</sup>), to which DDCs and VDCs have channelled DFDP grant disbursements as well as their own matching contributions. Very little, if any, use has been made of more orthodox tendering/bidding arrangements and private sector contractors – both MLD and DFDP are highly sceptical of the ability of such arrangements to avoid corruption, kick-backs and the like. UC/UG micro-project implementation has its advantages - increased ownership, use of local labour (both skilled and unskilled), greater local accountability, reduced costs, etc. In addition, in the more remote areas (sometimes as much as several days walking distance from urban centres) private sector contractors are either non-existent or (when available elsewhere) unwilling to undertake small-scale public or community works. In the Nepali context, where it is often the preferred way of building infrastructure, the UC/UG option has not been particularly innovative – but it may provide other countries with valuable lessons in micro-project implementation in remote rural areas. It also has its drawbacks - sometimes poor technical design and implementation (particularly in the context of weak DDC backstopping and low skill levels at the local level), and a tendency to focus on very small investments.

#### **(ii) Capacity-building**

Recourse to UC/UG implementation for DFDP-funded ISD has been accompanied by capacity-building efforts, mostly in the form of training for UCs/UGs in record-keeping and financial management. This is in contrast to general LG practice, which rarely includes any attempt at providing UCs/UGs with management skills.

#### **(iii) Operations and maintenance**

DFDP has made several provisions (in its guidelines) for operations and maintenance (O&M) – and this has been in itself innovatory within the context of most local planning in Nepal, where O&M is rarely given much attention by local government. However, this aspect of ISD (as in many other LDPs) remains a bugbear – a recent study commissioned by DFDP<sup>8</sup>, for example, notes that O&M is one of the weakest elements in the DFDP implementation process.

### **2.3.4. Accountability and transparency - general issues**

DFDP has placed a great deal of emphasis on the need to inform the public about LG activities - overall DDC allocations have been publicly available through meetings, VDC authorities have been informed (by letter) about the availability of DFDP funds, and DDCs are required to make public the list of approved micro-projects (and will soon be expected to make public the list of rejected micro-projects). Within the Nepali context, where information is retained rather than diffused, this has been innovative.

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<sup>7</sup> sometimes called construction committees.

<sup>8</sup> “Review of Government Rules and Regulations for the Implementation of Micro-Infrastructure Projects”, Development Collaborator (Pvt.) Ltd./HMGN/DFDP, February 2003.

However, much remains to be done to make information available to as many citizens as possible.

More specifically, DFDP has piloted the use of signboards at micro-project sites (providing basic information on budgets, UC/UG members responsible for project implementation, expected completion date, etc.), thus providing the general public with (unprecedented amounts of) information about ISD. This has been highly innovative in the Nepali context. General LG practice makes no provision for the systematic use of signboards for publicly funded micro-projects. In addition, DFDP has introduced the use of "project books" by UCs/UGs. All micro-project issues (decisions, costs, payments, technical aspects, etc.) are expected to be recorded in project books, which are open to public consultation. Project books also provide the basis for "social audits", regular public meetings during which UCs explain and account for progress (or the lack of it) in project implementation - and which are mandatory (according to DFDP guidelines) for the initial and subsequent release of funds to UCs/UGs. Again, this has been highly innovative in the Nepali context - and goes well beyond the provisions of LSGA in promoting transparency in public affairs. Of all the specific features of DFDP, this is the one that is most remarked upon by DDC and VDC officials, all of whom openly state that the use of signboards, project books and social audits makes the implementation of DFDP-funded projects considerably more transparent than other local government ISD.

With regard to upward accountability, DFDP has not introduced any significant innovations (although the introduction of financial management software at DDC level will probably make a significant contribution to the meaningfulness of audits and inspections). The introduction of minimum conditions and performance-based assessments (with financial repercussions) will also go a long way towards establishing a greater degree of upward accountability on the part of DDCs.

### **2.3.5. DFDP limitations and issues**

Although it is beyond the scope of this case study to provide an exhaustive insight into the (intrinsic and programmatic) limitations of DFDP and its approach, it is nonetheless worth briefly noting a few of the "gaps" in the programme's design and in the framework within which it operates.

#### **(i) Finance issues**

A number of issues merit mention with regard to DFDP financing arrangements:

- **low funding levels:** per capita funding levels are, by the standards of other LDPs, very low. This, as will be discussed below, may have resulted in some negative outcomes, particularly in terms of under-funding for specific projects. However, the low level of per capita funding may have the virtue of being potentially replicable (by HMG or other donors), whilst still delivering pro-poor benefits;
- **DDC and VDC levels:** the distinction made between DDC- and VDC-level projects is somewhat problematic in that it is not anchored in a sound division of responsibilities/functions, but largely as a function of cost (to DFDP). In the absence of an unambiguous set of expenditure assignments, it has proved difficult to make a meaningful distinction between DDC- and VDC-level ISD functions. This is important to resolve, as clear guidance needs to be given on

- the kinds of investment that VDCs can be expected to approve on their own and those that require higher level approval (e.g. projects that have recurrent cost implications that VDCs cannot be expected to bear, such as new secondary schools or the like);
- **performance-based incentives:** DFDP is belatedly introducing performance-based arrangements, and has thus provided little in the way of incentives for improved LG performance/capacity or sanctions in the event of deteriorating performance/capacity.

## (ii) Planning

- **inclusion and participation in a rural environment:** the possibilities of elite capture of and the exclusion of some people from the planning process highlight the considerable difficulties of working in remote rural areas (where the transaction costs associated with widespread participation are not be underestimated) where traditional hierarchies have remained robust – the latter is probably in marked contrast to urban areas, where greater economic development has often led to an erosion of the power and influence of traditional elites;
- **community-based planning:** in line with PDDP/LGP, the programme has relied upon a community-based planning process. This has many virtues, but it also has drawbacks, especially when it comes to planning for genuinely public goods. LGs have found ways of getting around this, by “manipulating” COs into proposing projects that go well beyond the interests of small communities or user groups. In other cases (see MTE 2003), there is evidence that some COs – by being or becoming largely coterminous with Ward or even inter-Ward populations – do constitute large publics and thus propose projects of a public good nature. Nonetheless, it remains the case that the existing system does not lend itself (without distortion) to delivering public goods, and is more likely to lead to the delivery of semi-private/public goods and services, raising the issue of whether *government* (rather than the market) should be providing these;
- **discrete budgets:** anecdotal evidence from several Districts suggests that DFDP co-funding for LG projects continues to be treated and planned for in a “discrete” way, rather than being perceived as an integral part of the planning/budgeting process. This is reinforced by the *ex-ante* control exercised by DFDP over investment decisions. All of this reduces the chances of the genuine institutionalisation of DFDP modalities;
- **missing links in the planning chain:** DFDP, through its linkages to PDDP/LGP (as specified in the project document), is not providing direct support to the local government planning process provided for in LSGA. VDC-level project proposals, for example, are not expected to go through screening at the Ilaka and sector levels. The latter is particularly worrying, especially given recent policies aimed at devolving sector functions to local government. The integration of sector and LG planning is an important challenge in Nepal, and one that DFDP has not really faced head on;
- **going beyond needs assessments:** the planning process promoted by PDDP/LGP is largely dominated by a preoccupation with the participatory identification of needs. While this is laudable, an emphasis on the “up-front”, participatory, aspect of planning does little to foster better “technical” planning – such as appraisal, cost-benefit analysis, design and costing.

## 2.4. Pro-poor outcomes of LG ISD

### Poverty in Nepal – a synopsis

Nepal, by any measure, is a poor country. GNP per capita is only US\$ 220 per annum. An estimated 38% of Nepal's population lives below the nationally-defined poverty line. One-fifth of the population is without access to an adequate supply of drinking water; other health indicators make for equally sombre reading. As elsewhere, poverty in Nepal is multi-dimensional. Such aggregate indicators of poverty are similar to those of many other LDCs.

However, what is startling and particular about poverty in Nepal is its social and spatial specificity – and the glaring disparity between the better off and the desperately poor. Poor people are largely rural dwellers, whilst the urban population is – in general – considerably better off. In addition, poverty is concentrated in the mid- and far-western “development” regions of the country, where 72% of the population lives below the poverty line – these regions have been historically by-passed by any economic growth and public investments, and – not surprisingly – have been and remain the heartland of the Maoist-inspired insurgency. Poverty is also particularly widespread among a number of socially disadvantaged, low status, groups (*dalits*, who lie at the bottom of the hierarchy of caste, and some *janajati* – or minority ethnic groups). Finally, poverty is gender-biased – women are generally poorer, more vulnerable, and politically weaker than men.

### 2.4.1. Pro-poor policies and DFDP

There are a number of aspects of DFDP that can be described as being pro-poor – these are, so to speak, “intentions”, deliberate attempts to shape programme outcomes. Although they do not necessarily translate into genuinely pro-poor outcomes (and can be criticized on a number of grounds) it is worth taking note of them.

Firstly, and in line with the geographical incidence of poverty in Nepal, DFDP only targets rural areas and expressly excludes urban municipalities. Two indicators point to the predominantly rural nature of poverty in Nepal:

- the urban HDI in Nepal is calculated as being 0.616; for rural areas, the HDI is only 0.446, considerably lower (see UNDP 2001);
- 44% of the rural population (which makes up 80% of the total population) is considered to be income poor; in contrast, only 23% of the urban population lives in income poverty (see NPC 2003).

Moreover, the extension of the programme (with DFID funding) to an additional twelve Districts has been largely targeted at the poorest regions in Nepal – the Mid- and Far-West – which have also been the most affected by the Maoist insurgency and armed conflict. DFDP, then, strives to fund ISD in those areas of the country where poverty is chronic and widespread.

Secondly, DFDP's funding includes a specially earmarked window, reserved for financing ISD among the some of the most disadvantaged social groups/categories in Nepal – women and DAGs (mainly *dalits*). At least a fifth of all DFDP funds are targeted explicitly at women and DAGs, again signalling a clear pro-poor policy that takes into account the specificity of Nepal's poverty profile.

Thirdly, the new formula (agreed upon by LBFC) for annual DFDP allocations to Districts is heavily weighted in favour of the poorer Districts. Over 50% of the total DFDP funding pool is reserved for allocation on the basis of poverty, with poorer Districts receiving substantially larger per capita allocations than better-off Districts – regardless of their population size or absorptive capacity. Again, this reflects DFDP’s pro-poor policy focus.

## 2.4.2. Programme outcomes

### (i) Planning processes and outcomes

As mentioned above, DFDP does not directly intervene in the local planning process. Instead, the programme relies upon a prevailing system of planning, based on the PDDP/LGP methodology and thus predicated on the identification and sponsorship of project proposals by COs, operating through the LG system.

The extent to which this planning process has been inclusive, allowing room for the poor to voice themselves and to put their priorities on the local development agenda, is extremely difficult to determine. DFDP monitoring does not yield systematic data on the inclusiveness of the local planning process. It is only possible to deduce inclusiveness in the planning process from its outcomes (defined in terms of ISD micro-project types) and other indirect indicators.

The following table provides a sectoral breakdown of planned micro-projects for 2001 and 2002 in the initial 8 Districts involved in DFDP.

Table 5: planned micro-projects by sector (and DFDP contribution)

Type of micro-project	No. of projects	Planned DFDP contribution (NRs)			
		2001	2002	Total	% of total
Biogas/toilet	2	-	279,350	279,350	0.2
Bridge/culvert	41	3,587,194	3,774,546	7,361,740	6.3
Community building	76	5,295,313	8,758,311	14,053,624	12.0
Drinking water supply	85	5,094,834	4,833,004	9,927,838	8.5
Health post	13	1,316,167	1,610,074	2,926,241	2.5
Improved water mill	4	118,364	204,540	322,904	0.3
Irrigation	104	4,906,980	8,448,005	13,354,985	11.4
Micro-hydroelectric	16	2,871,016	306,825	3,177,841	2.7
Others	67	4,226,157	6,058,760	10,324,917	8.8
Road	113	10,170,217	19,663,503	29,833,720	25.5
School	137	10,289,635	12,295,233	22,584,868	19.3
Toilet	11	24,351	1,437,945	1,462,296	1.3
Trail	6	252,000	750,214	1,002,214	0.9
Training	2	-	162,626	162,626	0.1
Totals	677	48,152,228	68,582,936	116,775,164	100.0

As can be seen from the table, over three-quarters of all projects (by value) were accounted for by road construction/rehabilitation, school construction/rehabilitation,

small-scale irrigation schemes, community buildings and drinking water supply systems. To some extent, this does differ from what has been described as the regular outcome of VDC planning processes – which usually results in the construction or rehabilitation of roads and culverts, and rarely includes spending on education infrastructure<sup>9</sup>, agriculture and women-focussed investments, such as community buildings (see NAVIN, n.d.). Although road construction/rehabilitation continues to be the biggest single item in the DFDP portfolio, school construction and small-scale irrigation schemes are also significant expenditure items. Anecdotal evidence also tends to point to a greater diversity in the types of micro-project that DFDP finances – VDC officials often claim that the expenditure items for DFDP finance are different to those met out of regular VDC budgets. All of this tends to indicate that the DFDP portfolio is more diversified than is usually the case, and this may be interpreted as indicating a wider range of consultations – and thus a greater likelihood of the poor being included in the planning process.

The majority of ISD investments undertaken through DFDP are, *a priori*, of potential benefit to the poor. The only “administrative” investments funded through DFDP take the form of community buildings – and these can often be women-based CO projects, providing savings and credit groups with a place to meet. Most micro-projects fall into the following categories – social services (education, health), transport infrastructure (roads, culverts, bridges), agriculture (irrigation) and drinking water supply and sanitation – all of which can be viewed as being pro-poor in one way or another.

Generally, DDCs have respected the DFDP affirmative action of requiring that 20% of funds be spent on women- and DAG-focussed projects. Almost 30% of all projects have been “focussed”, representing a fifth of total expenditure. In the first year of the programme, however, there was considerable confusion (sometimes suspected of being disingenuous) on the part of DDCs, which occasionally tried to argue that micro-projects such as school fencing were focussed on women or that any micro-project proposed by a women’s CO (often after some VDC prompting) was therefore focussed. There was also a tendency to focus on women, rather than on DAGs. In addition, there was some confusion over the definition of DAGs, with some Districts arguing that certain ethnic groups were disadvantaged. The programme has since provided some clarification by:

- providing an indicative menu of focussed and non-focussed projects;
- insisting upon a 10% allocation for DAGs and 10% for women;
- using the official listing of DAGs (as drawn up by HMGN);
- planning to integrate DDC compliance with DFDP’s affirmative action policy as an element of performance-based assessments.

As a result of this process of clarification, focussed projects for 2002 (dominated by drinking water improvements and irrigation schemes) do appear to be much more likely to provide women and DAGs with genuine benefit streams. How far this reflects female and DAG “voice”, however, is impossible to determine. Nonetheless, the nature of focussed projects does tend to be different to that of non-focussed projects.

It might be assumed that DFDP’s reliance on a community-driven planning system, within which socially-mobilised and mature community organisations are expected to be the promoters of ISD proposals, would imply a greater degree of

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<sup>9</sup> although VDC budgets often include provision for the payment of teachers’ salaries.

inclusion than the regular LG planning process (through Wards, then VDCs) and thus a more pronounced pro-poor focus. The evidence for this, however, is hard to come by – in Kaski District, for example, where PDDP has undertaken a survey of CO membership, the representation of the poorest in COs is limited (see MTE 2003). A recent study, conducted by UNDP/UNCDF in Dolakha and Kavre Districts, also indicates that the poorest of the poor are largely under-represented in COs (and, indeed, in most local government institutions)<sup>10</sup>. In addition, anecdotal evidence suggests that many VDCs have simply “manipulated” the CO requirement to their own needs by designating certain COs as the champions of certain projects.

As has been experienced elsewhere in UNCDF programmes, LGs have shown a tendency to “spread” their DFDP-financed investments across as many VDCs as possible. In 2001, for example, Kaski DDC used DFDP funds to finance micro-projects in all 43 of its constituent VDCs, while Dolakha DDC planned 107 micro-projects in its 51 VDCs. Spreading DFDP funds in such a way is an understandable political attempt to satisfy as many constituencies as possible, but the resulting flat distribution of DFDP funds has probably led to a predisposition towards very small projects and, perhaps more worryingly, to substantial under-funding for certain types of infrastructure (especially roads) – a problem compounded by DFDP’s low per capita allocations. As a result, it is sometimes the case that design and costing are reversed – design is tailored to cost, with predictable consequences. In addition, under-funding from DFDP, DDC and VDC sources appears to have led to sometimes excessive, and unpredictable, community contributions – and, indeed, local contributions to some DFDP-financed projects (particularly roads and bridges) can be characterised as a form of “picking up the tab”.

## **(ii) Production & management outcomes**

General opinion in Nepal is that DFDP’s reliance upon UC/UG implementation of micro-projects has resulted in relatively efficient outcomes. This has - by all anecdotal accounts - resulted in less corruption and “leakage” than might otherwise have been the case (e.g. through private sector contractors and the bidding process, which is subject to notorious abuse in public expenditure programmes in Nepal). The closeness of UCs/UGs to beneficiary communities (but not necessarily to the community organisations that promote specific projects) is said to allow for a greater degree of public oversight in the implementation process, making it harder for abuses to go unobserved and uncontested. In addition, there is a high degree of unanimity over the outcome of DFDP’s insistence on project signboards, project books and social auditing – these are all perceived as adding to the transparency of UC/UG implementation management. However, this is not easy to demonstrate in any empirical way. But what is clear is that UC/UG implementation and DFDP-promoted measures to maximise transparency do increase the likelihood of greater citizen oversight – those citizens who do wish to question or challenge implementation decisions or activities are in a better position to do so by dint of having access to more information.

This aspect of UC/UG efficiency, on the other hand, may be negated by the weak technical capacity of strictly local implementation arrangements. While UCs/UGs appear to be capable of successfully implementing relatively simple micro-projects (e.g. gravity-fed water supply systems, minor irrigation schemes, buildings, etc.), they are manifestly

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<sup>10</sup> Arjuna Parakrama, personal communication.

less qualified for constructing more complex infrastructure (e.g. roads, bridges, etc.). Technical backstopping from DDCs can partially make up for this – but given intrinsic constraints (distance, remoteness, insecurity due to Maoist activities, etc.) and (despite DFDP’s TA fund) staffing limitations, such DDC support is not always sufficient. As a result, the quality of ISD is variable, depending on the type of infrastructure.

Technical deficiencies associated with UC/UG implementation of certain types of infrastructure have probably been compounded by a tendency for under-funding. With cash contributions from DFDP, DDCs and VDCs scaled down to a minimum (so as to allow for maximum spread), UCs/UGs are often faced either with the problem of under-designed works or with the need to mobilise substantial (perhaps excessive) community contributions, which may not be possible. As a result, the quality of ISD has sometimes suffered<sup>11</sup>.

Nonetheless, it is clear that UC/UG implementation of ISD is often the only option available in Nepal. Firstly, private sector contractors are usually unwilling to operate in very remote areas (except at a prohibitive cost). Secondly, the Maoist insurgency has made contractors very reluctant to work in many rural areas of Nepal – at the same time, Maoist cadres have generally allowed UCs/UGs to implement micro-projects. In sum, for many parts of rural Nepal UC/UG implementation is the only way of delivering public or semi-public infrastructure.

Adequate operations and maintenance arrangements for infrastructure delivered through DFDP is obviously essential if benefits are to be sustained. DFDP’s operational guidelines clearly recognise this. But, as noted earlier in this case study, on-the-ground O&M arrangements have been of variable adequacy – anecdotal evidence suggests that smaller-scale and simpler infrastructures (such as gravity-fed drinking water supply systems) with an easily defined user public are often better maintained and operated than are larger, more complex, and more “public” items (such as roads and bridges). The inset on the following page provides two striking contrasts.

Again, under-funding of certain types of infrastructure (especially roads) has probably resulted in less than adequate design – which, in turn, has probably increased maintenance needs and costs. This, needless to say, has made any deficiencies in O&M arrangements even more serious.

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<sup>11</sup> one of the most flagrant examples of this is a 9 km rural road in Kaski District, for which the total cash contribution from DFDP, the DDC and Bharat Pokhari VDC was less than 1 million NR. As a rule of thumb, community-built roads in Nepal require roughly 1 million NR per kilometre (see MTE 2003)

## O&M in practice

### Gravity-fed water supply system in Balam VDC, Kaski District

DFDP has provided funding for the construction of a small (60,000 litre capacity) water tank (fed by a spring), the installation of a rubber pipeline from the tank to the nearby (downhill) settlement, and feeder pipes (equipped with taps) leading to a total of 15 outlets-taps. The system provides drinking water to 76 households in Ward number 3. Little maintenance is required for this system, except for the taps – the maintenance of which is the responsibility of benefiting households (roughly 5 per tap). However, a small monthly charge (of 100 NR) is levied on each tap – and although much of this is spent on paying the salary of the fee collector, a small amount is left over for eventual maintenance costs.

### Rural road and bridge in Dudrakshi VDC, Rupandehi District

With DFDP, DDC and VDC funding, a gravelled road and a motorable bridge (serving at least three Wards) have been built in Dudrakshi VDC. According to local informants, about 1,000 people and a few vehicles use the road and bridge on a daily basis. The bridge provides local people with access to a community forest (and thus to firewood and other forest products), as well as improving communications within the VDC. Although both projects were completed in 2002, no maintenance committee has yet to be established; in addition, no plan for raising maintenance fees has been drawn up (although there is some talk about establishing a toll for use of the bridge). Today (in late 2003), the road is visibly degraded, seasonal floods have already displaced some of the bridge's gabions and the immediate area downstream of the bridge shows obvious signs of erosion, which may undermine the bridge's base.

## 3. LESSONS LEARNED

A range of lessons can be learned from the experience and insights gained through the implementation of DFDP. Some are of a very general nature, while others are more specific to the Nepali context.

### 3.1. Sectoral and functional issues

Local governments have implemented a wide range of infrastructure items with co-funding from DFDP. The majority of these micro-projects have been VDC-level projects – and have included, among other things:

- transport infrastructure: construction/rehabilitation of roads, bridges and culverts;
- education sector: construction/rehabilitation of school classrooms, both for primary and secondary schools;
- water sector: construction of drinking water supply systems;
- agriculture and natural resources sector: implementation of small-scale irrigation schemes;
- social sector: construction of community buildings.

Implementation of these types of micro-project have accounted for over 75% of DFDP funding. Funding for health services has been minimal, accounting for only 2.5% of total costs.

### 3.1.1. Transport infrastructure

Local government involvement in transport infrastructure through DFDP has not been without its problems. In such a hilly and mountainous country, roads and bridges are clearly (and understandably) seen as being a high priority – and even in the Terai, this type of investment figures highly (in Rupandehi, for example, almost a half of all DFDP-funded projects have been roads/bridges/culverts). However, a number of key observations can be made about LG investment in transport infrastructure:

- under-funding (by DFDP, DDCs and VDCs) in this sector has had particularly negative outcomes, with roads and bridges often being of low quality;
- road and bridge construction are technically complex – perhaps more than most other types of micro-project in the DFDP portfolio – and may not therefore lend themselves to UC/UG implementation, the preferred option for infrastructure delivery in Nepal;
- the operations and maintenance of roads/bridges is technically demanding, managerially challenging, and often costly. In few observed cases have LGs established coherent O&M arrangements for roads/bridges; this shortcoming has probably been compounded by the low quality of works (thus increasing the costs of maintenance);
- despite the existence of road masterplans for all Districts, the local planning process for DFDP micro-projects has rarely paid much heed to them. VDCs have proposed and DDCs have approved rural roads that are not part of the District masterplans (and for which no maintenance provisions have been made);

Although LSGA does provide for VDC and DDC involvement in the implementation and maintenance of roads (see table 2 above), the lesson to be learnt from DFDP is that this may need to be carefully rethought, especially at the VDC level. It might, for example, be more reasonable to assume that the role of VDCs (with their slender financial resources) in the roads sector be limited to maintenance – and, indeed, a careful reading of LSGA shows that VDCs are only mandated to maintain/operate bridges, and not to construct them. Given VDC capacities (both technical and financial), it might be worth limiting their involvement in creating new transport infrastructure to the construction of improved trails/paths. Moreover, the UC/UG implementation modality for road/bridge infrastructure needs to be revisited (whichever level of LG is responsible) – both for construction and for maintenance purposes. Recourse to private sector contracting may be more expensive<sup>12</sup>, but is more likely to lead to higher quality and more sustainable infrastructure.

### 3.1.2. Education sector investments

In the education sector, LG capital investments have proved somewhat less problematic. Building school classrooms is less technically demanding than is the construction of roads/bridges – and appears to be a task well within the capacity of most UCs/UGs (with DDC support). And although there is little evidence from DFDP-funded investments in the education sector for sound maintenance arrangements, the fact that parent-teacher associations already exist and that the beneficiary public is relatively

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<sup>12</sup> although Nepal has a wealth of experience in efficiently combining local community labour inputs (often funded through food-for-work programmes) with private sector management of road construction, leading to relatively low construction costs (see MTE 2003).

circumscribed and well-defined implies that promoting local upkeep of school buildings and the like is plausible.

However, LSGA is very unclear about local government investment responsibilities in the education sector – no explicit mention is made of VDC or DDC involvement in the construction of any schools. To that extent, DFDP has provided VDCs and DDCs with co-funding that has allowed them to go well beyond their mandated functions by building classrooms and schools. There is clearly a need to rethink this given that there are few technical reasons for excluding LGs from such involvement.

Local government investments in education do, on the other hand, raise the issue of recurrent costs, especially teachers' salaries. Where investments have been made in rehabilitation, this is usually not a problem; but in the case of entirely new classrooms/schools, it is unclear whether the DFDP and local planning process systematically ensures that additional payroll costs are factored into investment decisions. A number of observations can be made in this respect:

- firstly, the planning system for VDC-level infrastructure projects funded through DFDP bypasses the planning process provided for by LSGA – and thus “skips” the crucial phase of screening by the DDC sectoral committee. Under existing DFDP arrangements (as with PDDP/LGP) VDC-level projects are submitted directly to the DDC for screening and approval – and this runs the risk of recurrent cost implications being neglected in the education sector;
- secondly, the recent devolution of education sector functions and responsibilities remains ambiguous. There is no clear allocation of recurrent expenditure responsibilities and assignments (for either primary or secondary education), and at the local level there is a high degree of confusion;
- thirdly, VDCs have often taken it up on themselves to pay primary school teachers' salaries out of their central government block grants, using the somewhat disingenuous pretext that this is subsumed within the human resource development allocation (25% of the block grant). However, anecdotal evidence suggests that VDC-financed salaries are often well in arrears and sometimes go unpaid (as a result of budget cuts and the like), thus raising the issue of how such recurrent costs should be properly covered.

Overall, there appears to be something of a “free-for-all” in the education sector, for which the rules of the game remain unclear or, in some cases, unwritten. Funding LG to deliver new education infrastructure may prove problematic in such a context – and the main lesson must surely be that careful thought needs to be given to all aspects of education in attempting to coherently devolve responsibilities to local government.

### **3.1.3. Water supply and irrigation sectors**

Most of the water supply and small-scale irrigation investments undertaken with DFDP funding have been community or user group based, providing benefits to relatively small and well-defined populations. Management of both construction and O&M has generally been delegated (whether consciously or otherwise) to communities/user groups. Inevitably, there have been some technical problems (especially with irrigation schemes – see MTE 2003), but the overall impression is that drinking water supply and irrigation are well-suited to LG- and community-level management and that these types of investment tend to be successful. This may be

partly attributed to a well-established Nepali tradition of local level water management (see Curtis 1991 and Ostrom 1992) in rural areas,

These are clearly sectors where devolution to LG and downward (to local communities and user groups) is appropriate. Given the intricacies of water management (equitable distribution arrangements, common property management, etc.) for both domestic and agricultural use and the specificities of many places (due to topography), local knowledge (both technical and social) is at a premium in this sector.

#### **3.1.4. General issues**

In general, the existing institutional framework for sectoral decentralisation in Nepal is insufficiently clear, and requires a substantial amount of fine tuning. LBFC's upcoming analysis and definition of expenditure assignments<sup>13</sup> (supported by UNCDF/DFDP and DANIDA) should make a valuable contribution to this process of clarification.

The key issue here is one of reconciling the bottom-up identification of sectoral ISD needs (a secondary school here, a road there, etc.) with the need to ensure that final decisions about approval and implementation are taken by the level of government best-suited for providing operations and maintenance. In theory, the planning process provided for by LSGA does take this into account; but in practice, because sector committees appear to be by-passed in the DFDP/PDDP/LGP planning process, full and formal sector involvement is the exception rather than the rule. But even were sector departments to play a more active role, ambiguities in expenditure and functional assignments would still – in all probability – result in some degree of confusion.

#### **3.2. Financing lessons**

One of the lessons learned through DFDP is that injecting capital funds into the LG system for investment purposes can be valuably complemented by also making funds available for technical assistance. The Field Officers and overseers hired by DDCs have made an important contribution to the implementation process – and, without them, it is difficult to see how already over-stretched and under-equipped District Technical Offices would have managed. Needless to say, there is room for improvement (through more systematic training of technical staff, upgrading their social development skills, and the like – see MTE 2003) – but the essential lesson is that providing LGs in Nepal with access to financial resources for capital investments is not the end of the story, and that capacity building (in whatever form) is a vital complement.

DFDP also shows that specially targeted funding windows – such as the 20% of DDC allocations earmarked for women and DAG focussed projects – can make a contribution towards achieving policy objectives. As has been seen, DFDP's focussed projects have been rather different to the non-focussed projects, reflecting the specific concerns and needs of the poorer. However, as DFDP experience shows, such ring-fencing needs to be clearly defined so as avoid confusion and manipulation.

#### **3.3. Planning and budgeting**

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<sup>13</sup> Considered by one observer to be “.. the first ‘pillar’ or building block of fiscal decentralization reform..” (Martinez-Vazquez 2001: 1).

A first and fundamental lesson to be learned from DFDP implementation is that planning is not just a question of participatory needs assessment. The orthodox rationale for decentralisation is that local level decision-making is likely to yield more appropriate service delivery, because LGs are assumed to be more responsive to local needs and more accountable for meeting them – and this clearly implies some kind of participatory and transparent planning system. However, delivering appropriate infrastructure also implies that other considerations need to be taken into account:

- how do some investments compare to others in terms of sustainability (both economic and otherwise) ?
- how do alternatives compare in terms of overall benefits delivered ?
- how are recurrent costs (salaries, operations & maintenance, etc.) to be adequately factored in ?
- good design and costing, so as to maximise the chance of high quality ISD, as well as to ensure that all stakeholders (including beneficiary communities) know in advance precisely what they are expected to contribute.

The planning process used by DFDP does not pay sufficient attention to such issues – and, as a result, questions can be raised about the appropriateness of some of the ISD financed through the programme.

The tendency for LG and other institutions (such as COs) to be subject to elite capture highlights the difficulty of promoting inclusive planning processes in countries like Nepal, where rural social structures are highly stratified (in terms of both status and wealth). In many ways, “modern” (or post-traditional) institutions such as VDCs, COs, and UCs/UGs are “old wine in new bottles”, reproducing pre-existing social hierarchies. This is not unique to Nepal, but gains an added significance in the caste-stratified societies of rural South Asia. Compensating for this – and the inevitable tendency for non-elite interests to be sidelined – may require special affirmative action measures (such as the earmarked funding windows promoted by DFDP) that reduce local discretion (as articulated by dominant elites) but ensure greater equity in planning outcomes.

### **3.4. Production/implementation of ISD**

Through its systematic use of UCs/UGs as implementing agents for the construction of infrastructure, DFDP has shown that a great deal can be done without recourse to tendering and competitive bidding aimed at procurement through the private, for profit, sector . This is a valuable lesson for LGs in remote rural areas, where private sector contractors are often notable by their absence and/or unwilling to take on sometimes very small works. The other side of the coin, however, is that UC/UG implementation does have its limits – more complex and costly infrastructure (such as roads and bridges) may require more than local artisanal skills. The lesson here is to be pragmatic and to assess implementation options in a non-dogmatic way.

In addition, recourse to UC/UG implementation does imply the need for support – training in book-keeping and financial management, technical supervision to ensure a degree of quality control, the provision of standardised designs/costings, and (although DFDP has not done this) technical training for specific types of work. This, in turn,

implies the need for a capacity-building strategy, not only for LGs and their staff, but also for UCs/UGs.

As in many other LDPs, DFDP has yet to satisfactorily address the issue of operations and maintenance. If ISD is to prove durable and of lasting benefit to local people, provision must be made for O&M, and those responsible for it need to ensure that they do meet their responsibilities. The experience from DFDP is that more thought needs to be given to this. A number of possibilities suggest themselves:

- linking O&M to funding levels (through performance assessments), thus providing incentives to LGs (and/or local communities) to establish adequate O&M arrangements;
- where appropriate, insisting upon clear evidence of provision for O&M costs in recurrent budgets (e.g. teachers' salaries, road maintenance funds, etc.) as a prerequisite for any capital budget support;
- introducing formal procedures for maintenance planning (and not just investment planning) as a way of keeping O&M on the agenda.

### **3.5 Accountability and transparency**

DFDP's piloting of social audits has been innovative and has probably contributed to greater transparency and efficiency in the implementation stage. Tying fund releases to phases of a social audit process is an apparently effective incentive for UCs/UGs to permit/encourage public scrutiny of their activities. However, it should be recognised that such social audits have their limitations – by definition, written records and signboards can only be read by the literate, who may well be few and far between among the poorest sections of any given community (see MTE 2003). This implies that the social audit process may sometimes need to be expanded to include an oral element, thus allowing non-literates to meaningfully engage.

DFDP has also tried to increase the amount of information made available to the public – by officially informing VDCs of annual block grants, through meetings, etc. However, more can and should be done to further spread information (through radios, for example), providing rural citizens with greater opportunities for informed “voice”. This is particularly so in Nepal, where literacy rates in rural areas are low and where disadvantaged groups are often excluded from public interaction.

## **4. Conclusions**

Despite the many improvements that can (and are being) made to both DFDP (and Nepali local government systems) in terms of pro-poor ISD, several key innovations stand out as being of particular importance:

- transparent formula for the allocation of LG grants by HMGN, which take into account horizontal gaps between Districts;
- earmarking of investment funds so as to actively promote investments aimed at women and other disadvantaged groups;
- social auditing procedures for micro-project implementation, providing the beneficiaries of ISD with the opportunity to oversee the efficiency and quality of works.

All of these innovations are policy relevant and are potentially replicable on a scaled up basis.

In addition, the experience gained through the implementation of DFDP has also highlighted a number of issues that policy-makers and pro-poor activists in Nepal should carefully analyse.

## **ANNEXES**

### Annex 1: DFDP annual block grant allocations (2003-2004)

District	Cost Scale	Cost Allocation	Area (km <sup>2</sup> )	Area Allocation	HDI 2000	Poverty Index	Poverty Allocation	Population	Population based Allocation	Total Allocation	Allocation %	Per capita Input
Darchula	3	22,800	2,322	8,219	0.286	0.714	51,968	121,996	8,220	91,207	5.33	0.748
Baitadi	2.5	19,000	1519	5,376	0.393	0.607	44,180	234,418	15,795	84,352	4.93	0.360
Bajhang	3	22,800	3,422	12,112	0.286	0.714	51,968	167,026	11,254	98,135	5.74	0.588
Kailali	1	7,600	3,235	11,450	0.425	0.575	41,851	616,697	41,554	102,455	5.99	0.166
Achham	2	15,200	1,680	5,946	0.393	0.607	44,180	231,285	15,584	80,911	4.73	0.350
Humla	3	22,800	5,655	20,016	0.322	0.678	49,348	40,595	2,735	94,899	5.55	2.338
Mugu	3	22,800	3,535	12,512	0.322	0.678	49,348	43,937	2,961	87,621	5.12	1.994
Jumla	3	22,800	2,531	8,958	0.322	0.678	49,348	89,427	6,026	87,132	5.10	0.974
Jajarkot	3	22,800	2,230	7,893	0.433	0.567	41,269	134,868	9,088	81,050	4.74	0.601
Rukum	2.5	19,000	2,877	10,183	0.433	0.567	41,269	188,438	12,697	83,149	4.86	0.441
Salyan	2.5	19,000	1,462	5,175	0.433	0.567	41,269	213,500	14,386	79,830	4.67	0.374
Rupandehi	1	7,600	1,360	4,814	0.435	0.565	41,123	708,419	47,734	101,271	5.92	0.143
Kaski	1.5	11,400	2,017	7,139	0.487	0.513	37,338	380,527	25,640	81,518	4.77	0.214
Kavre	1.5	11,400	1,396	4,941	0.510	0.490	35,664	385,672	25,987	77,993	4.56	0.202
Dolakha	2.5	19,000	2,191	7,755	0.437	0.563	40,978	204,229	13,761	81,494	4.77	0.399
Dhanusha	1	7,600	1,180	4,177	0.462	0.538	39,158	671,364	45,237	96,172	5.62	0.143
Solukhumbu	3	22,800	3,312	11,723	0.424	0.576	41,924	107,686	7,256	83,703	4.89	0.777
Udayapur	1.5	11,400	2,063	7,302	0.513	0.487	35,446	287,689	19,385	73,533	4.30	0.256
Terhathum	2	15,200	679	2,403	0.513	0.487	35,446	113,111	7,622	60,671	3.55	0.536
Taplejung	2.5	19,000	3,646	12,905	0.424	0.576	41,924	134,698	9,076	82,905	4.85	0.615
<b>Total</b>	<b>45</b>	<b>342,000</b>	<b>48,312</b>	<b>171,000</b>	<b>8.253</b>	<b>11.747</b>	<b>855,000</b>	<b>5,075,582</b>	<b>342,000</b>	<b>1,710,000</b>	<b>100</b>	<b>0.337</b>

Criteria	%	Available Budget in USD
Population	20%	342,000
Area	10%	171,000
HDI	50%	855,000
Cost Scale 20%	20%	342,000
<b>Sub total</b>	<b>100%</b>	<b>1,710,000</b>
Incentive	5%	90,000

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