

Volume 3 Number 1, September 2024

# An Analysis of the Economic Performance of Nepal's Provinces

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Article Type: Research Article

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Received: 01 December 2023; Accepted: 27 April 2024; Published: 30 September 2024

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## Abstract

*This study analyzes the economic performance of Nepal's provinces by employing descriptive approach. Secondary data related to the key indicators showing economic performance of provinces, i.e. economic growth, per capita income, contribution to gross domestic product, expenditure and receipt were examined for the period 2018/19-2022/23. The findings reveal a concerning trend of weak economic growth across Nepal's provinces. The per capita income of most of the provinces is low while provincial transfer dependency is high. Provinces were found to allocate relatively higher proportion of their budget to capital expenditure compared to recurrent expenditure. Among the provinces, Bagmati, Gandaki and Koshi have relatively better economic performance compared to other provinces in terms of indicators considered.*

**Keywords:** Economic growth, provincial expenditure, provincial receipt, subnational governments, transfer dependency

## Introduction

Federalism is a multi-tiered system of governance. Usually, there are three tiers of government in such system: federal, provincial/state and local. Responsibilities are distributed among these tiers of government. However, distribution of power is uneven across the federal countries. In some countries like Australia and India, local levels have very limited responsibilities compared to states/provinces (Brown, 2007; Koutsogeorgopoulou, 2007; Akhter 2006; Morris, 2007; Rao, 2007; Rao & Singh, 1998; Williams & Machinetyres, 2006) whereas in other countries, local levels have significant responsibilities, like in Nepal (The Constitution of Nepal, 2015). These responsibilities include both exclusive and concurrent. All levels of government have certain expenditure and revenue responsibilities.

The Constitution of Nepal (2015) has transformed the country from a unitary state to the federal one. It was a big bang reform in Nepal's governance system (Bahl et al., 2020). Nepal has three tiers of government: federal, provincial and local. There are 7 provinces and 753 local levels. The Constitution of Nepal (2015) has recognized both tiers of subnational governments (SNGs): provincial and local. Constitution has assigned responsibilities to both tiers of SNGs. Constitution has envisioned a strong local level as there is less scope for direct control by federal and provincial governments (Bahl et al., 2020). In spite of distribution of responsibilities to both levels of SNGs, their economic performance is not same. One of the inherent features of federal countries is that there exists horizontal fiscal imbalance (HFI). HFI is significant in Nepal as well. The economic performance varies across the SNGs in Nepal.

SNGs have been advocated on the ground that optimal performance of representative democracy is observed when the government is in close proximity to its constituency and various segments of the population possess the legitimate authority to request varying kinds and amounts of public services (Ekpo, 2008). However, in practice, effectiveness of SNGs depends on their economic performance. For this, there is the necessity of studying how SNGs are performing. In this context, this paper has the objective of analyzing economic performance of provinces of Nepal. This offers insights into the functioning of Nepal's provinces, potentially serving as a valuable resource for making timely improvement on the concerned issues.

This paper consists of five sections. Section 1 introduces the study, defines the objective and highlights the importance of the study. Section 2 reviews the literature related to subnational issues. Section 3 describes the methodology of the study. Section 4 presents the result and discusses it. Finally, section 5 concludes the study.

## Literature Review

Baskaran and Feld (2013) analyzed the relationship between fiscal decentralization and economic growth in 23 Organization for Economic Co-operation and Development (OECD) countries. Study was conducted by using panel data for the period 1975-2008. Economic growth was the outcome variable, which was measured by using growth rate of real GDP per capita. Fiscal decentralization was the variable of interest, which was measured by using subnational tax share and subnational own tax decentralization. Study found that while using

subnational tax share as proxy variable for fiscal decentralization there was no significant relationship between decentralization and economic growth. On the other hand, while using own tax decentralization as proxy measure, there was significantly negative relationship between decentralization and economic growth. Measuring fiscal decentralization by using own tax decentralization is better measure as it takes into account of revenue raising power of SNGs. In such context, the conclusion of this study is that fiscal decentralization does not lead to more economic growth, instead it reduces the economic growth. The conclusion of this study is similar to the conclusion of Davoodi and Zou (1998), where authors found negative relationship between fiscal decentralization and economic growth. This study was conducted by using panel data of 46 countries over the period 1970-1989. However, the conclusion of Iimi (2005) is different from the conclusion of Baskaran and Feld (2013), where author found significantly positive relationship between fiscal decentralization and economic growth. This study was conducted by applying instrumental variable (IV) technique on the data of 51 countries for the period 1997-2001. Thus, the empirical evidence on the relationship between fiscal decentralization and economic growth is inconclusive.

Libman (2013) analyzed the impact of subnational political institution on the effectiveness of natural resources in driving economic growth in Russia. Study was conducted by applying panel data model on the data of 72 Russian regions for the period 2000-2006. Author found that natural resources can only play a role in fostering economic growth in the situations where political systems are not democratic. The conclusion derived by the author is similar to the conclusion of Collier and Hoeffler (2009), where authors had analyzed the effect of democracy on economic performance in resource-rich countries by applying panel data model for the period 1970-2001. Authors found that in developing countries high natural resource rents and open democratic systems have been growth reducing. Libman's conclusion is applicable to those non-democratic systems which are characterized by efficient and non-corrupt bureaucracies. The author asserts that the findings of this study should not be interpreted as advocating for autocracy over democracy in terms of facilitating the growth impact of resources. It significantly pertains to weak democracies and does not extend to well-established democracies with strong checks and balances. Thus, resource-rich weak democracies need strong checks and balances in order to promote their economic growth.

Pradhan and Zohair (2015) analyzed the determinants of subnational export performance of India. Study was based on two states: Tamil Nadu and Uttar Pradesh. Logit model was applied. Study was based on 861 firms of Tamil Nadu and 394 firms of Uttar Pradesh. Firm's export was the outcome variable. A number of independent variables i.e., firm age, firm size, research and development intensity, external technology purchase, product differentiation, affiliation to foreign firm, business group affiliation, fiscal benefits and sectorial dummies were used in the analysis. Study found that firm age, firm size, research and development intensity, product differentiation, affiliation to foreign firm, business group affiliation and fiscal benefits were determinants of export in both provinces while external technology purchase was determinant of export in Uttar Pradesh only.

Elven (2019) analyzed the determinants of subnational per capita income in Indonesia by using panel data of 33 provinces. Study was based on the data of 2006-2015. Gross regional domestic product per capita (GRDP) was the dependent variable. Study found that investment ratio as the stock of physical capital, education level as the stock of human capital, population growth, decentralization and trade across provinces had significantly positive impact on GRDP while government expenditure and the proportion of adherents to the Islam religion had significantly negative impact on GRDP. In a similar study, Naude and Krugell (2006) analyzed the determinants of subnational economic growth in South Africa by applying dynamic panel data model. Study was based on the data of 354 magisterial districts for the period 1998-2002. Economic growth was measured by using growth of per capita income of magisterial districts as proxy indicator. Study found that initial education and export share had significantly positive impact on growth rate of per capita income while initial capital stock and population density had significantly negative impact.

Paschoalotta et al. (2022) analyzed the performance of state governments in health service delivery in Brazil during COVID-19 pandemic. Study was based on the data of inpatient beds and number of nurses, physiotherapists and doctors in Brazilian states over January-December 2020. Conclusion was derived by using descriptive method of study. Authors found that there was exponential growth in health care infrastructure and human resources led by state government investment and the state government was the primary response mechanism to the pandemic in Brazil. Study concludes that state government was leading actor in health service delivery in response to COVID-19. In contrast, private sector exhibited less response in providing health actions and services during that period.

## Research Methods

This study employed descriptive approach in order to analyze the economic performance of provinces of Nepal. Economic performance of provinces was analyzed in terms of economic growth, per capita income, contribution to gross domestic product (GDP), provincial expenditure practices and provincial receipt. Study was based on the data published by Financial Comptroller General Office (FCGO), Ministry of Finance (MOF) and National Statistics Office (NSO) for the period 2018/19-2022/23. Thus, secondary sources of data were used in the study. Data are presented by using descriptive tools, i.e. percentage and tables.

## Results and Discussions

This section analyzes the economic performance of provinces of Nepal. There are 7 provinces (Koshi, Madhesh, Bagmati, Gandaki, Lumbini, Karnali and Sudurpaschim) in Nepal. These provinces are heterogeneous in terms of their economic performance.

### *Provincial Economic Growth*

Table 1 shows the economic growth rates of provinces for the period 2018/19-2022/23. Growth rates were calculated using the GDP measured at current prices. Data suggest that, over the study period, the average growth rate of Karnali province was highest (4%) followed

by Gandaki (3.8%), Sudurpaschim (3.5%), Koshi (3.4%), Lumbini (3.1%), Madhesh (2.7%) and Bagmati (2.6%). This shows that average economic growth rate of provinces is low in Nepal in last five years. Furthermore, in most of the fiscal years economic growth rate of some provinces was lower than provincial average growth rate. In 2018/19, growth rate of only Karnali, Madhesh and Koshi province was higher than provincial average growth rate while in 2019/20, Karnali, Sudurpaschim and Gandaki provinces had higher than provincial average growth rate. In 2020/21, most of the provinces (Bagmati, Karnali, Koshi, Lumbini and Sudurpaschim) had economic growth rate higher than provincial average growth rate whereas in 2021/22, only Gandaki, Bagmati and Koshi province had higher than provincial average growth rate. In 2022/23, only Gandaki and Koshi province had higher than provincial average growth rate. This shows weak growth performance of Nepal's provinces.

An interesting feature is that the growth rate of all provinces underwent similar changes. In 2019/20, growth rate of all provinces declined; in 2020/21, growth rate of all provinces increased; in 2021/22, growth rate of all provinces further increased; and in 2022/23, growth rate of all provinces declined. This might be due to the fact that national economic policies have a common impact on all provinces of Nepal. Furthermore, this might show the absence of distinct feature of provincial economies and lack of competition among them as well.

**Table 1**  
**Provincial Economic Growth of Nepal (%)**

Provinces	2018/19	2019/20	2020/21	2021/22	2022/23*
Koshi	7.2	-1.5	3.9	5.1	2.4
Madhesh	7.9	-3.8	3.4	4.2	1.9
Bagmati	5.1	-3.8	4.1	6.0	1.8
Gandaki	6.7	-1.2	3.6	6.1	3.7
Lumbini	6.7	-1.8	3.8	4.6	2.2
Karnali	8.3	0.9	3.9	4.9	2.2
Sudurpaschim	6.5	0.8	3.8	4.3	1.9
Average	6.9	-1.5	3.8	5.0	2.3

Note. MOF (2019, 2020, 2021, 2022, 2023), NSO (2023), \*provisional.

Economic growth rate was high in 2018/19 but in subsequent years it declined. Favourable monsoon, increase in reconstruction works, increase in tourist arrivals and improvement in business environment were the major reasons behind high growth rate in 2018/19 (Nepal Rastra Bank [NRB], 2019). In 2019/20, the Government of Nepal (GON) implemented a lockdown from March 24 to July 21, 2020, as a measure to address the challenges posed by the COVID-19 pandemic (Bhattarai & Karmacharya, 2022). This lockdown significantly reduced economic activities within the country, leading to significantly low or negative rate of growth in the provinces. With the relaxation of lockdown, economic activities increased in 2020/21, leading to improvement in economic growth compared to 2019/20 (NRB, 2019). However, second wave of COVID-19 infection still affected the economy in 2020/21. With the decrease

in effect of COVID-19, economic activities further increased in 2021/22 so that economic growth rate also increased. However, in 2022/23, higher rate of inflation due to increased oil price, increased interest rate due to contractionary monetary policy, low level of capital expenditure and contraction in real estate sector reduced the economic activities in Nepal, resulting in decrease in economic growth rate.

In conclusion, Nepal's provinces have, in general, low economic growth rate. To address this, it is crucial for them to enhance the investment climate through the improvement of essential infrastructure. Additionally, they should identify key projects that can significantly impact their economic landscape and allocate resources to them. For instance, in some provinces, tourism has potential to contribute to the growth (Bhattarai et al., 2021; Bhattarai & Karmacharya, 2022) while in other provinces, agriculture may play a significant role. As resource gap is a challenge of Nepalese economy (Bhattarai, 2013), efficient use of existing resource is equally important for Nepal.

### ***Provincial Share on GDP***

Data suggest that, in each year of the study period, Bagmati province has highest share on GDP followed by Koshi, Lumbini, Madhesh, Gandaki, Sudurpaschim and Karnali province. The average share of these provinces on GDP, in the study period, was 37%, 15.7%, 14.1%, 13.2%, 9.1%, 7% and 4.1% respectively. Only Bagmati and Koshi have higher than provincial average share (14.3%). Table 2 shows the provincial share on GDP. Bagmati province is contributing more than one-third in Nepal's GDP. It shows that economic activities are concentrated in Bagmati province. It may be due to relatively better business environment of this province, like more and better infrastructure and greater access to financial capital.

**Table 2**  
**Provincial Share on GDP (%)**

<b>Provinces</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23*</b>
Koshi	15.5	15.8	15.8	15.8	15.8
Madhesh	13.0	13.3	13.4	13.1	13.1
Bagmati	37.9	36.4	36.7	37.0	36.9
Gandaki	8.8	9.9	8.9	8.9	9.0
Lumbini	14.0	14.2	14.1	14.1	14.2
Karnali	3.9	4.2	4.1	4.1	4.1
Sudurpaschim	6.8	7.1	7.0	7.0	7.0

*Note.* MOF (2022, 2023), NSO (2023), \*provisional.

### ***Provincial Per Capita Income***

Table 3 shows the per capita income of provinces. Provincial per capita income data are available for two fiscal years 2021/22 and 2022/23 only. Data suggest that the average provincial



per capita income in 2021/22 was \$1,300 while in 2022/23, it was \$1,344. Bagmati province has highest per capita income followed by Gandaki, Koshi, Lumbini, Sudurpaschim, Karnali and Madhesh province. Per capita income exhibits a consistent trend in both years. Only Bagmati and Gandaki province have higher than provincial average per capita income. The higher per capita income of these two provinces implies that, in general, people in these provinces have relatively higher living standard.

**Table 3**  
**Provincial Per Capita Income (\$)**

Provinces	2018/19	2019/20	2020/21	2021/22	2022/23*
Koshi	-	-	-	1,267	1,299
Madhesh	-	-	-	868	875
Bagmati	-	-	-	2,430	2,455
Gandaki	-	-	-	1,437	1,593
Lumbini	-	-	-	1,103	1,126
Karnali	-	-	-	967	997
Sudurpaschim	-	-	-	1,031	1,063
Average				1,300	1,344

Note. MOF (2022, 2023), NSO (2023), \*provisional.

### **Provincial Expenditure**

Table 4 shows the composition of provinces' expenditure. Koshi, Gandaki, Lumbini, Karnali and Sudurpaschim have higher share of capital expenditure on total expenditure in each of the year studied. Madhesh province has lower share of capital expenditure on total expenditure only in 2019. Similarly, Bagmati has lower share of capital expenditure only in 2018/19. On average, the share of capital expenditure on total expenditure over the study period for Koshi, Madhesh, Bagmati, Gandaki, Lumbini, Karnali and Sudurpaschim was 56.7%, 54.3%, 54.0%, 66.4%, 58.3%, 58.7% and 54.0% respectively. Thus, each province exhibits a higher average share of capital expenditure in comparison to recurrent expenditure. Nevertheless, with the exception of Gandaki province, capital expenditure surpasses recurrent expenditure by a slight margin, on average. Although provinces' share of capital expenditure is higher than their share of recurrent expenditure, they need to further increase the share of capital expenditure. A larger share of capital expenditure is preferable because it promotes provincial economic growth and prosperity, ultimately benefiting the national economy as a whole (Bhattarai, 2024).

**Table 4**  
**Composition of Provincial Expenditure (%)**

Provinces	2018/19		2019/20		2020/21		2021/22	
	RE	CE	RE	CE	RE	CE	RE	CE
Koshi	46.1	53.9	40.1	59.9	43.2	56.8	43.8	56.2
Madhesh	43.9	56.1	54.3	45.7	38.3	61.7	46.4	53.6

Bagmati	53.7	46.3	43.9	56.1	43.8	56.2	42.8	57.2
Gandaki	37.4	62.6	31.5	68.5	31.3	68.7	34.4	65.6
Lumbini	40.3	59.7	42.1	57.9	42.4	57.6	42.1	57.9
Karnali	45.9	54.1	43.5	56.5	38.4	61.6	37.6	62.4
Sudurpaschim	48.9	51.1	47.3	52.7	45.1	54.9	42.8	57.2

Notes. Author's calculation based on MOF (2023).

CA = capital expenditure, RE = Recurrent expenditure

### ***Provincial Receipt***

Table 5 shows the composition of receipt of provinces of Nepal. In Bagmati province, internal income including revenue sharing has highest share in the receipt, followed by fiscal transfer received, cash balance and financing receipt respectively. Apart from Bagmati province, other provinces have highest share of fiscal transfer received (only Madhesh province has deviation from it in 2021/22). Thus, provinces' main source of income is fiscal transfer received from federal government (in exception to Bagmati province). On average, over the period 2018/19-2021/22, the share of fiscal transfer on Koshi, Madhesh, Bagmati, Gandaki, Lumbini, Karnali and Sudurpaschim province's receipt was 56.3%, 46.3%, 32.1%, 50.3%, 50%, 52.6% and 54.5% respectively. Apart from Bagmati and Madhesh province, fiscal transfer has more than or equal to 50% share on total receipt. This shows high transfer dependency of Nepal's provinces. Provincial fiscal situation becomes strong when they can finance their spending from their own sources. Unfortunately, currently it is not possible in Nepal. This is due to low level of revenue decentralization in Nepal. Furthermore, data suggest that provinces have huge amount of cash balance. This is due to their incapability to spend their resources. So, in such situation, there is the necessity of increasing spending capacity of provinces. Without spending resources, they cannot achieve prosperity.

**Table 5**  
**Composition of Provincial Receipt (%)**

Provinces	2018/19				2019/20				2020/21				2021/22			
	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
Koshi	1.2	36.6	62.2	0.0	7.8	34.4	57.8	0.0	4.0	40.9	55.1	0.0	11.1	39.1	49.9	0.0
Madhesh	1.7	37.1	61.2	0.0	21.8	31.0	47.1	0.0	26.7	33.2	40.1	0.0	25.9	37.2	36.9	0.0
Bagmati	2.2	53.0	44.8	0.0	21.1	44.5	34.4	0.0	28.3	43.8	27.4	0.4	32.2	46.1	21.6	0.1
Gandaki	3.7	38.9	57.3	0.0	26.1	26.0	47.9	0.0	20.6	32.7	46.6	0.0	10.2	40.3	49.5	0.0
Lumbini	2.9	36.0	61.0	0.0	21.9	28.3	49.8	0.0	21.8	32.9	45.3	0.0	13.1	43.1	43.8	0.0
Karnali	3.5	22.5	74.0	0.0	41.4	15.6	43.0	0.0	33.9	20.9	45.3	0.0	27.3	24.7	48.1	0.0
Sudurpaschim	3.3	30.3	66.4	0.0	23.8	24.5	51.7	0.0	23.9	27.1	49.0	0.0	18.5	30.7	50.8	0.0

Notes. Author's Calculation based on FCGO (2020, 2021, 2022, 2023).

1=Cash balance, 2=Internal income including revenue sharing, 3=Fiscal transfer, 4=Financing receipt



### **Comparison of Economic Performance across the Provinces: A Summary**

Table 6 synthesizes the provincial performance in terms of the indicators considered above, i.e. average economic growth, GDP share, per capita income, share of capital expenditure and share of internal income including revenue sharing on provincial receipt. In absolute term, economic growth rate of all provinces is low. Similarly, share of internal income including revenue sharing of the provinces, apart from Bagmati province, is also low. Comparatively, the data indicates that Bagmati province outperforms other provinces in most of the indicators considered, like share on GDP, per capita income and internal income including revenue sharing. Additionally, Gandaki and Koshi provinces exhibit relatively stronger performance across most of the indicators considered. In contrast, the rest of the provinces demonstrate weaker performance in majority of the indicators analyzed.

**Table 6**  
**Economic Performance across the Provinces**

<b>Province</b>	<b>Eco- nomic growth rate* (%)</b>	<b>Share on GDP* (%)</b>	<b>Per capita income** (%)</b>	<b>Share of capital expenditure*** (%)</b>	<b>Share of internal income includ- ing revenue sharing*** (%)</b>
Koshi	3.4	15.7	1,283	56.7	37.8
Madhesh	2.7	13.2	872	54.3	34.6
Bagmati	2.6	37.0	2,443	54.0	46.9
Gandaki	3.8	9.1	1515	66.4	34.5
Lumbini	3.1	14.1	1115	58.3	35.1
Karnali	4.0	4.1	982	58.7	20.9
Sudurpaschim	3.5	7.0	1047	54.0	28.2

*Notes.* Author's Conclusion

\*Average of 2018/19-2022/23, \*\*Average of 2021/22-2022/23, \*\*\* Average of 2018/19-2021/22

## **Conclusion**

Nepal is a federal country. It has three tiers of government: federal, provincial and local. Constitution has assigned responsibilities to all levels of government. In this context, this study analyzed the economic performance of provinces. There are 7 provinces in Nepal. Study found that economic performance of provinces is not same in Nepal. Provinces have low growth performance over the study period 2018/19-2021/22. On average, Karnali province has highest level of economic growth, followed by Gandaki, Sudurpaschim, Koshi, Lumbini, Madhesh and Bagmati province. Bagmati province has highest share on GDP followed by Koshi, Lumbini, Madhesh, Gandaki, Sudurpaschim and Karnali province. Over the study period, on average, only Bagmati and Koshi provinces have higher than provincial average share on GDP. Provincial per capita income data are available for 2021/22 and 2022/23 only.

The available data suggest that only two provinces (Bagmati and Gandaki) have higher than provincial average per capita income. On average, provinces have higher share of capital expenditure. They have high transfer dependency. Thus, Nepal's provinces have weak economic performance in most of the indicators considered. Among the provinces, Bagmati, Gandaki and Koshi have relatively better economic performance compared to other provinces in terms of indicators considered.

## Acknowledgements

The author is currently pursuing a Ph. D. in Economics at Tribhuvan University, specializing in Nepal's fiscal federalism. This paper is part of his doctoral research and has received financial support from the University Grants Commission, Nepal.

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