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Agenda of Federal System in Nepal: Nexus of Fiscal Federalism and Controlled Corruption

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Abstract

This research critically assesses Nepal's fiscal federalism, focusing on the interconnectedness of budget allocation, spending, revenue generation, and corruption at the provincial level. Using a mixed-methods approach, the study combines quantitative data analysis with qualitative insights to evaluate how weaknesses in fiscal management erode public trust in federalism. The findings show that while decentralizing power and resources is a core objective of the federal system, provincial governments remain heavily dependent on federal transfers due to limited internal revenue generation. The study reveals that provinces fall short of meeting public expectations, primarily due to insufficient and poorly managed expenditure capacities, resulting in substantial underperformance. Additionally, the research identifies a significant correlation between increased budget allocation and corruption, highlighting that higher public spending often leads to financial misconduct. This is reflected in unspent budgets and frequent misuse of public funds, which amplify public dissatisfaction with the federal system. The study emphasizes the need for improved fiscal autonomy, stronger accountability frameworks, and more effective resource-sharing mechanisms to enhance the efficiency of provincial governments and address rising concerns about the viability of federalism.

Keywords: Federal system, corruption, decentralization, Nepal

Introduction

Nepal's political structure, transitioning from a monarchy to a federal republic, has encountered persistent challenges in delivering governance that aligns with citizens' expectations. The federal system, which theoretically promises decentralized power and better resource distribution,

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has not been fully effective in addressing socio-economic inequalities or ensuring local development. Critics argue that instead of resolving key issues faced by ordinary citizens, the federal structure has led to growing discontent, with opposition to the system intensifying. The dissatisfaction stems from perceived inefficiencies and the political system's inability to address daily governance concerns effectively (Acharya, & Zafarullah, 2020; Ghimire, 2018; Khanal, 2023).

At the core of federalism lies the distribution of power and resources across different levels of government, enabling shared authority between national and sub-national units (Schuck, 2000). Fiscal federalism, a critical element of this structure, emphasizes the allocation of resources to lower levels of government to improve service delivery and public welfare. However, in Nepal, the process of fiscal decentralization has been marred by inefficiencies, corruption, and bureaucratic resistance, particularly at the local and provincial levels. This misalignment between fiscal policies and practical governance has hindered the realization of federalism's intended goals, creating significant gaps in service provision and development outcomes (Inman & Rubinfeld, 1992). Nevertheless, the idea and practice of governance is a contentious issue in the global context in terms of policies and practices (Hachhethu, 2023).

The interplay between fiscal federalism and corruption further complicates Nepal's governance landscape. Corruption, often tied to the misuse of devolved power and resources, has become a significant barrier to effective federal governance (Stephenson, 2015; Odd-Helge, 2004). Despite the intention to create a more inclusive and accountable system, the decentralization of power has instead fostered opportunities for corruption at multiple levels, exacerbating inequality and eroding public trust. This introduction sets the stage for a detailed exploration of how fiscal federalism interacts with corruption in Nepal, highlighting the structural and governance issues that undermine the effectiveness of the federal system.

Major Issues and Analytical Components

Federalism is celebrated for its democratic qualities, including enhanced transparency and accountability, which are crucial for combating corruption. The principle of decentralizing power in federal systems is intended to reduce opportunities for corrupt activities by dispersing authority. Research suggests that decentralization, by spreading power, can limit the potential for abuse (Chalil, 2020; Choudhury, 2023; Fisman & Gatti, 1999), which is, however, less evidence in the case of federalism (Rao, 2016). Policy-level issues are also less explored (Hanf & Toonen, 2012). In Nepal, in a similar context, despite efforts to decentralize governance through a federal structure, the distribution of authority remains restricted. The constitution delineates specific powers for federal, provincial, and local governments, but provincial and local entities often find their authority limited and overshadowed by central political agendas (Acharya & Zafarullah, 2020; Bhusal & Breen, 2023; Chaudhary, 2019; Dhakal, 2023).

The primary issues within Nepal's federal system include challenges related to power transfers and budgetary reforms, which have contributed to the decentralization of corruption. This problem is evident at the grassroots level, where inefficiencies and increased costs in public service delivery are causing significant dissatisfaction among communities. The system's limitations and the persistent influence of national politics on local governance have raised concerns about its effectiveness in addressing corruption and delivering services efficiently (Bhul, 2024; Bhusal & Breen, 2023).

The objective of this study is to assess the success of fiscal federalism in Nepal, particularly in relation to corruption and fiscal transfers. By investigating the resource gap between different levels of government and the impact of political influences on decision-making, the study aims to determine whether the federal structure is exacerbating corruption issues and hindering effective governance. The findings are intended to provide insights into the practical challenges of federalism in Nepal and its implications for service delivery and governance.

Methods and Materials

This study adopts a mixed-methods approach, combining qualitative and quantitative analyses to comprehensively assess fiscal federalism in Nepal. It relies primarily on secondary data, including formal publications and scholarly sources. The quantitative analysis involves a systematic review of existing data on fiscal federalism. This includes examining financial reports, government documents, and statistical data to evaluate the efficiency of fiscal policies and identify any inconsistencies in resource distribution within Nepal's federal framework. By integrating these methods, the study aims to offer a detailed analysis of fiscal federalism in Nepal, highlighting both theoretical and practical aspects of its implementation, resource management, and the influence of corruption.

Qualitative analysis focuses on reviewing literature from both national and international sources to situate Nepal's federal system within a broader context of fiscal federalism. This involves exploring theoretical insights from scholars such as Grodzins (1960) on the significance of political parties in devolution, Halberstam (2004) on democratic governance and accountability, and Oates (2005) on the role of public choice theory and bureaucracy. The study also addresses contemporary critiques and models of fiscal federalism, incorporating viewpoints from Super (2004) on the alignment of federal and state objectives and Shah (2016) on enhancing revenue collection at subnational levels. Additionally, it examines perspectives on corruption and decentralization from Freille et al. (2007), and Amundsen (1997), to understand their impact on fiscal federalism in Nepal.

Discussion and Analysis

Constitutional Provision of Federalism in Nepal

Nepal's adoption of a three-tiered federal system under the 2015 Constitution signifies a strategic shift toward decentralized governance, explicitly aimed at promoting long-term peace, sound governance, and national prosperity. The preamble of the Constitution emphasizes that federalism is essential for achieving these objectives, with a focus on fostering development and economic growth (*The Constitution of Nepal*). Fiscal federalism, a critical component of this vision, prioritizes economic considerations over purely political ones in the process of nation-building (Acharya & Zafarullah, 2020; Sharma, 2018). The Constitution establishes a framework for resource distribution and fiscal management at the federal, provincial, and local levels, underscoring the system's role in driving development and prosperity.

The distribution of state power and responsibilities is meticulously defined through various constitutional provisions. Articles 56, 57, and 58, along with Schedule 5, detail the allocation of powers among the three levels of government, focusing on both political and financial aspects (*The Constitution of Nepal*). Article 59, in particular, outlines the financial management responsibilities at each tier, including budgeting and the formulation of fiscal policies. This decentralization of economic decision-making is pivotal to Nepal's fiscal federalism, enabling each level of government to design and implement fiscal plans and budgets (Bhul, 2024; Shah, 2019). The Constitution envisions a system where fiscal autonomy drives economic growth, directly linking financial governance to the federal structure.

The Constitution further specifies the revenue sources for each level of government, reinforcing the principle of shared taxation rights. Article 60 empowers federal, provincial, and local governments to independently collect revenue within their jurisdictions, based on distinct lists of powers (*The Constitution of Nepal*; Bhusal & Breen, 2023). These powers are detailed in Schedules 5, 6, 7, and 8, with Schedule 9 addressing concurrent powers across all tiers of government. This arrangement ensures that each level has access to revenue streams, including taxes, service charges, and other fiscal resources, necessary for local development (Sharma, 2020). Although fiscal rights at the provincial and local levels are more limited, they remain crucial for grassroots-level development initiatives. Together, these fiscal provisions form a comprehensive framework for financial governance, laying the groundwork for achieving the developmental objectives central to Nepal's federal system.

Fiscal Federalism in Nepal

Nepal officially adopted a federal system with the promulgation of its new Constitution on Ashoj 3, 2072 (September 20, 2015), making it one of the youngest federal democracies globally. The Federal Democratic Republic of Nepal operates on the principles of coordination, coexistence, and cooperation, with a three-tiered government structure consisting of federal, provincial, and local levels. The Constitution explicitly outlines the powers and responsibilities of these three levels, particularly in terms of expenditure obligations and revenue authority, forming the foundation of Nepal's federal governance (*The Constitution of Nepal*).

Drawing on the theoretical framework of federalism and global practices, the allocation of revenue sources tends to concentrate at the central level, while expenditure responsibilities are often delegated to lower levels of government. Nepal's Constitution mirrors this approach, centralizing major revenue streams while assigning significant expenditure duties to the provincial and local governments (Bhusal & Breen, 2023; Sharma, 2018). To ensure effective financial federalism, the Constitution highlights key areas such as clear delineation of work responsibilities, equitable revenue collection, and efficient financial transfers between levels of government. Additionally, the borrowing rights accorded to federal units are intended to strengthen their institutional capacity for sustainable development (Bhul, 2024; Dhakal, 2023; Shah, 019). Some of such constitutional provisions are summarized as follows:

- In Article 57 of the Constitution of Nepal, the rights of the Union in the matters mentioned in Schedule 5 of the Constitution, the rights of the provinces in the matters mentioned in Schedule 6, the common rights of the Union and the provinces in the matters mentioned in Schedule 7, the rights of the local level in the matters mentioned in Schedule 8, and the Union, Province And it has been arranged that the common rights at the local level will be in the matters mentioned in Schedule 9.
- In Article 59 of the Constitution, the union, state, and local levels have the right to enact laws, make annual budgets, make

decisions, prepare policies and plans, and implement them in matters related to economic rights within their authority.

- Article 60 of the Constitution provides that the union, state, and local levels can levy taxes on matters within their economic jurisdiction and collect revenue from those sources.
- The federal government has arranged to give four types of grants to state governments and local levels and state governments to local levels under intergovernmental financial transfer, namely financial equalisation grants, conditional grants, supplementary grants, and special grants.
- Provisions have been made to distribute revenue between the union, state, and local levels in a balanced and transparent manner.
- Part 10 of the Constitution of Nepal provides for the federal financial system, Part 16 for the provincial financial system, and Part 19 for the local financial system, and provides for the receipt, expenditure, management, and operation of the reserve fund.
- The National Natural Resources and Finance Commission has been provided for in Part 26 of the Constitution to make recommendations regarding financial subsidies and revenue sharing between the Union, state, and local levels.
- The government at all three levels has arranged that the final audit of the income and expenditure accounting done in accordance with the constitution and laws shall be done by the office of the auditor general in Part 22 of the constitution.
- Local Government Management Act, 2074 Intergovernmental Finance Management Act, 2074 National Natural Resources and Finance Commission Act, 2074 Economic Procedures and Financial Responsibility Act, 2076 Economic Procedures and Financial Responsibility Regulations, 2077 Public Procurement Act, 2063, and Public Procurement Regulations, 2064, as well as various related rules and laws, have been arranged.

Components of Fiscal Federalism

The effective implementation of fiscal federalism relies on several core components, which are outlined as follows:

(1) Expenditure Assignments: Expenditure assignment forms the foundation for establishing a decentralized fiscal system. It is essential to first define expenditure responsibilities before designing revenue and transfer mechanisms within an inter-governmental fiscal framework. Without proper assignment of expenditure responsibilities, the decentralization process weakens. The success of a decentralized system depends on aligning expenditure responsibilities with service delivery objectives, allowing decentralized bodies to be more accessible, responsive, and aligned with local needs. This proximity between citizens and government strengthens the sense of ownership and accountability within communities (Oates, 1999).

(2) Revenue Assignments: The success of fiscal federalism hinges on clearly defined revenue assignment mechanisms, ensuring that revenue collection, management, and distribution are properly delineated across federal, provincial, and local levels. The Constitution of Nepal provides each level with the authority to impose taxes and collect revenue within its jurisdiction, while matters of shared jurisdiction or unspecified areas fall under the federal government's purview to establish tax and revenue arrangements. Achieving transparent and balanced revenue distribution across all levels is crucial, factoring in service delivery needs, revenue capacity, regional disparities, and economic inequalities (Bird & Vaillancourt, 2006). Federal units have legislative autonomy to enact revenue-related laws, determine tax rates, and enhance their revenue mobilization strategies within the constitutional framework. The Inter-Governmental Finance Management Act of 2074 grants all levels of government—federal, provincial, and local—the power to collect both tax and non-tax revenues within their respective domains. For example, while the federal government collects customs duties, excise duties, and value-added taxes, provincial and local governments manage property taxes, vehicle taxes, and entertainment taxes (Government of Nepal, 2017).

(3) Revenue Sharing and Distribution Mechanisms: Revenue generated from royalties on natural resources such as hydropower, mining, and forestry is deposited in the Federal Dividend Fund. The royalties are then distributed, with 50% allocated to the federal government and 25% each to the provincial and local governments. Similarly, value-added tax (VAT) and excise duties on domestic production are shared, with 70% allocated to the federal government and 15% each to the provincial and local governments. Revenues collected by provincial and local governments are managed through separate funds and distributed according to the guidelines set by the National Natural Resources and Finance Commission (Acharya, 2021; Bhusal & Breen, 2023).

Inter-Governmental Fiscal Transfer

Inter-governmental fiscal transfer refers to the financial flow from one level of government to another. In Nepal, such transfers occur from the federal government to provincial and local governments, and from provincial governments to their subordinate local levels. These transfers aim to bridge the gap between the responsibilities assigned to various levels of government under the constitution and their respective revenue collection capacities. The transfers consist of four types of grants: financial equalization grants, conditional grants, supplementary grants, and special grants. These are briefly discussed below:

(1) Financial Equalization Grants: Financial equalization grants are designed to minimize the disparity between the expenditure needs and revenue capacities of different levels of government. In federal systems, lower levels of government often face a mismatch between their expenditure responsibilities and revenue-generating capabilities. Equalization grants help to address this gap. In Nepal, the federal government provides equalization grants to provinces and local governments based on recommendations from the National Natural Resources and Finance Commission, considering factors like revenue capacity and expenditure needs. Provincial governments also distribute these grants to local levels within their jurisdiction based on revenue capacities and expenditure requirements. The formula for these grants typically considers human development indices, economic inequalities, infrastructure needs, and performance indicators. The grants are provided as block grants, which, if unused by the end of the fiscal year, do not require repayment (*Inter-Governmental Finance Management Act, 2074*).

(2) Conditional Grants: Conditional grants are transfers provided by one level of government to another for specific purposes, with certain conditions attached. These grants come with defined budgets and programmatic requirements. If the allocated funds are not utilized according to the prescribed conditions, they must be returned to the source government at the end of the fiscal year. Conditional grants are commonly provided for programs in sectors like education, health, water supply, forestry, and resource management. The federal government distributes conditional grants to provinces and local levels, while provinces further distribute such grants to local governments under their jurisdiction (Acharya, 2021).

(3) Supplemental Grants: Supplemental grants are financial transfers provided by one level of government to another based on the cost-sharing ratio of a specific project. The federal government provides these grants at provincial and local levels, while provincial governments provide them at local levels. The grants are determined based on project feasibility, cost, expected returns, implementation capacity, and priority. The funds must be spent according to the approved cost ratio, and any unspent amount at the end of the fiscal year must be returned to the original level of government (Shrestha & Kafle, 2019).

(4) Special Grants: Special grants are provided for specific purposes, such as improving basic services like education, health, and water supply, addressing inter-regional imbalances, and supporting marginalized communities. The federal government can allocate special grants to provincial and local levels, and provinces can allocate them to their local levels. Unspent funds must be returned by the end of the fiscal year. These grants are particularly aimed at addressing disparities and fostering balanced development across regions (Pandey, 2020).

(5) Right to Borrow: The constitution grants all three levels of government—the federal, provincial, and local—the right to borrow funds to meet expenditure needs, improve service delivery, and cover budget deficits. Borrowing must occur within the limits set by the National Natural Resources and Finance Commission (NNRFC). While the federal government can directly engage in borrowing, provincial and local governments must seek approval from the federal government before taking loans. The borrowing proposal must include project details, expected returns, loan repayment plans, and information about the lending institution. If deemed feasible, the federal government can authorize borrowing. For the fiscal year 2078–079, the NNRFC recommended that internal borrowing be limited to 5.5% of the projected Gross Domestic Product (GDP) to maintain macroeconomic stability *(National Natural Resources and Finance Commission, 2021).*

Main Findings

Academic research consistently underscores the connection between governance structures and corruption. Increased financial autonomy has, in many cases, resulted in heightened corruption. This trend is further shaped by the interplay between state and society, where those who dominate these interactions often benefit from corrupt practices. In fiscal federalism, the annual budget serves as the primary document reflecting a state's financial management. Subnational governments, tasked with minimizing expenses while maximizing revenue, are expected to demonstrate fiscal responsibility. However, in Nepal, provincial governments rely heavily on federal resources due to limited revenue collection capacities. The timeline of budget releases highlights this dependency: the federal budget is published first, followed by provincial and local budgets, leaving subnational governments with little room for independent fiscal maneuvering.

The provinces' performance has been far from satisfactory. Analysis of three fiscal years reveals that, on average, only 66.59% of allocated budgets are utilized, indicating poor implementation. For example, out of a total budget of NPR 806.54 billion across three fiscal years, only NPR 536.31 billion was spent. This inefficiency has led to poorly managed projects and unmet public expectations. Additionally, provincial revenue collection remains inadequate, with only Bagmati province showing significant revenue generation. Provinces like Karnali and Sudurpashchim are almost entirely reliant on federal transfers, covering less than half of their expenditures through their own revenue.

The imbalance in fiscal capacity has weakened the bargaining power of provinces. The federal government controls key resources, while local governments have greater authority in implementation. Consequently, provinces struggle to assert their relevance, often focusing more on internal party politics than effective governance. This misalignment has led to increasing public dissatisfaction with the federal system, as unmet expectations and widespread corruption fuel grievances. The failure to deliver on public spending directly impacts citizens, with corruption exacerbating their frustrations. To understand the relationship between expected expenditure, actual expenditure, revenue collection, and corruption complaints, a multiple regression analysis was conducted. Expected expenditure served as the independent variable, while other factors were dependent variables. The R-squared (R^2) analysis over three fiscal years reveals a significant correlation, highlighting how poor fiscal management and corruption are linked in Nepal's provincial governance structure.

Data set: 1 Fiscal Year 2078/079

Table 1:Provincial budget, revenue, disallowance and corruption 2078/079

	Allocation of budget	Real expenditure	Revenue collection	Revenue share on real expenditure	Beruju	Beruju percentage	Corruption Complains
Koshi	34760853	29966436	15508470	51.75280103	1646312	3.36	1552
Madhesh	34887810	22260480	15249844	68.50635746	1163309	2.7	3552
Bagmati	57720927	37994936	33466848	88.08239077	1053104	1.37	3991
Gandaki	31352885	22043934	11297073	51.24798958	493557	1.24	1183
Lumbini	42941191	30054683	15490900	51.54238359	1498085	2.62	2366
Karnali	36546636	24281870	8335436	34.32781742	1688402	4.43	1116
Sudurp.	31475690	20877359	9449402	45.26148159	919573	2.58	1204

Source: 60th Annual Report, Auditor General and 32th annual report CIAA
**Amount in Rs: 000/ Corruptions Complaints in Number/Sudurp.: Sudurpashchim*

Test from data set: 1 :

- y4 = 326.889221 + 0.000116507 y2, Results of the multiple linear regression indicated that there was a very strong collective significant effect between the y1, y2, y3, and y4, ($F(1, 5) = 10.23$, $p = .024$, $R2 = 0.67$, $R2adj = 0.61$).

- R square (R2) equals 0.671801. It means that the predictors (Xi) explain 67.2% of the variance of Y. Adjusted R square equals 0.606162. The coefficient of multiple correlations (R) equals 0.819635. It means that there is a very strong correlation between the predicted data (ŷ) and the observed data (y)

Data set: 2 Fiscal Year 2077/078

Table 2: Provincial budget, revenue, disallowance and corruption 2077/078

	Allocation of budget	Real expenditure	Revenue collection	Revenue share on real expenditure	Beruju	Beruju percent age	Corru ption Comp lains
Koshi	40899947	27951261	13154888	47.06366557	1628613	3.56	1552
Madhesh	34269442	22545803	12595460	55.86609623	2130573	5.42	2907
Bagmati	51427494	35594842	26601317	74.73362854	1094410	1.6	3246
Gandaki	34842160	25623418	9809329	38.28267173	515448	1.27	972
Lumbini	39154164	32103042	13400649	41.7426143	642158	1.18	2009
Karnali	33741353	22751980	6910839	30.37467069	1601807	5.22	1096
Sudurpash chim	34431328	22843505	8528923	37.33631507	772481	2.18	1450

Source: 59th Annual Report, Auditor General and 31th annual report CIAA
**Amount in Rs: 000/ Corruptions Complaints in Number*

Test from data set: 2:

- R square (R^2) equals 0.653461. It means that the predictors (X_i) explain 65.3% of the variance of Y. Adjusted R square equals 0.584153. The coefficient of multiple correlations (R) equals 0.808369. It means that there is a very strong correlation between the predicted data ($\hat{y}$) and the observed data (y)

- $y4 = 461.643397 + 0.000109894\ y2$, Results of the multiple linear regression indicated that there was a very strong collective significant effect between the y1, y2, y3, and y4, ($F(1, 5) = 9.43$, $p = .028$, $R^2 = 0.65$, $R^2_{adj} = 0.58$)

Data set: 3 Fiscal Year 2076/077

Table 3: Provincial budget, revenue, disallowance and corruption 2076/077

	Allocation of budget	Real expenditure	Revenue collection	Revenue share on real expenditure	Beruju	Beruju percentage	Corruption Complains
Koshi	42200410	29833244	10706705	25.37	1265156	2.84	1671
Madhesh	44512618	18017192	9810133	54.4487343	1805918	5.64	4094
Bagmati	47607886	27050870	21525248	79.5732189	725229	1.42	3702
Gandaki	34842160	24623418	9809329	39.83739788	604100	1.96	1010
Lumbini	36418900	25407072	9217475	36.27917062	947485	2.39	1971
Karnali	34353425	16880204	5221708	30.93391525	834781	3.56	1018
Sudurpashchim	28162035	17611988	700800	3.979107867	575157	2.15	1422

Source: 58th Annual Report, Auditor General and 30th annual report CIAA

**Amount in Rs: 000/ Corruptions Complaints in Number*

Test from data set: 3 :

- y4 = 954.602711 + 0.00012249 y2, Reporting results in APA style Results of the multiple linear regression indicated that there was a strong collective non-significant effect between the y1, y2, y3, and y4, ($F(1, 5) = 3.06$, $p = .140$, $R2 = 0.38$, $R2adj = 0.26$).

- R square (R2) equals 0.379986. It means that the predictors (Xi) explain 38% of the variance of Y. Adjusted R square equals 0.255983. The coefficient of multiple correlation (R) equals 0.61643. It means that there is a strong correlation between the predicted data ($\hat{y}$) and the observed data (y).

Analysis and Discussion

Low budget expenditure significantly hampers the development process, as capital investment, which is vital for long-term economic growth, remains underutilized. The fiscal analysis of 2078/79 indicates a strong positive correlation of 0.8396 between the province's budget allocation and revenue generation. This suggests that as budget expenditures rise, revenues are also expected to increase. However, the provincial government has not effectively capitalized on this potential, leading to growing public dissatisfaction.

A multiple regression analysis for fiscal year 2078/79 reveals an R-squared (R^2) value of 0.6718, indicating that 67.18% of the budget allocation is influenced by real expenditure, revenue collection, mismanagement (*beruju*), and corruption. The findings demonstrate that higher provincial spending results in an increase in both *beruju* and corruption, highlighting a strong connection between public expenditure and corrupt practices. The coefficient of multiple correlation ($R = 0.8196$) reinforces a significant relationship between predicted and actual data, with *beruju* positively correlated with expenditure at 8.49%. Although *beruju* is not currently a

critical issue, there are warning signs that it could become a significant problem in provincial fiscal management in the near future.
Corruption is primarily driven by revenue mismanagement, with 67.18% of revenue-related corruption identified. The relationship between actual budget expenditures and corruption stands at 33.50%, suggesting that while expenditure is necessary, it also fuels corrupt activities. For fiscal year 2077/78, 65.34% of the budget allocation was influenced by expenditure, revenue, beruju, and corruption, with 26.13% of corruption linked to expenditure and 65.35% tied to revenue collection. These findings confirm that both increased expenditure and revenue lead to a significant rise in corruption, although the correlation between expenditure and *beruju* remains relatively low at 12.2%.

In the fiscal year 2076/77, only 25.59% of budget allocation was related to expenditure, revenue, beruju, and corruption. During this period, 38% of corruption was linked to revenue, while only 2% was connected to expenditure. The rapid escalation of corruption within a short timeframe is concerning, with *beruju* reflecting a similar trend.

According to the Auditor General's report, *beruju* is a major issue due to inefficient budgeting and non-compliance with legal frameworks during budget execution. The correlation between revenue collection and *beruju* is positive but not significantly impactful on income generation. Given that provincial operations only began in fiscal year 2074/75, these trends indicate potential fiscal challenges ahead, particularly for provincial and municipal governments.

Corruption remains a key factor behind growing public opposition to the federal system. The link between corruption and CIAA complaints is evident, with tax collection hampered by the misappropriation of public funds. CIAA complaints are significantly correlated with revenue misuse, with 82% of complaints attributed to income theft. The R-values of 0.8084 (fiscal year 2077/78) and 0.6164 (fiscal year 2076/77) point to a moderately positive relationship, confirming that corruption has been worsening over time.

Summary and Conclusion

Analyzing the various data relationships reveals that the government plays a significant role in generating opposition to the federal system in Nepal. Another crucial factor is corruption. Under political leadership, public expectations have grown, with many believing that federalism offers the ideal solution to national issues. However, these expectations have been derailed by poor governance and widespread corruption. The findings align with Amundsen’s (1997) assertion that the state consistently plays a central role in governance.

Improving the effectiveness of fiscal federalism is vital to addressing challenges within the federal system. Provinces and local governments need to expand their tax collection efforts across multiple areas. Currently, only a few provinces are generating revenue, with most relying on sectors like transportation. On the other hand, local governments are primarily focusing on housing and land management. The limited revenue capacity of subnational governments has led to increased dependency on federal support. Enhanced intergovernmental cooperation and resource sharing are essential to strengthening fiscal federalism. The data indicates that, on average, internal revenue within provinces covers less than half of their expenditures, even when including revenue transfers from the federal government.

Strengthening the expenditure capacity of subnational governments is a critical aspect of effective fiscal federalism. Higher revenue generation will naturally lead to more spending, which can better meet the needs of the public. However, corruption remains a significant challenge within Nepal's federal framework. The study’s results suggest that government inefficiencies have significantly contributed to public dissatisfaction and growing resistance toward federalism.

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