This paper is part of a series of four Urban Policy Notes that provide a critical review on emergent challenges to Bhutan’s increasing urbanization and its ramifications for growth, livability and sustainability in line with the directives of the 12th Five Year Plan (FYP) and the Vision 2020. The four notes are: (a) Regional Development, (b) Municipal Governance and Finance, (c) Affordable Housing and (d) Urban Resilience. These notes build on the long engagement between the Royal Government of Bhutan (RGoB) and the World Bank on urban issues as well as the experiences of urban operations under Bhutan Urban Development Projects I (1999-2006) and II (2010-2019) and are intended to support the RGoB on key and emerging urban topics and guide Bank’s future analytical and investment support in the urban sector.

Executive Summary

1. Bhutan’s rapid economic growth and expansion of urban population have highlighted the need for improved urban governance and management and the demand for higher order urban services. The Royal Government of Bhutan (RGoB) has taken important steps, over the years, to strengthen the role and capacities of Thromdes, Dzongkhags and Gewogs in service delivery and citizen engagement. Nevertheless, municipal governments in Bhutan, especially the four Class A Thromdes, continue to face policy and institutional barriers that limit their ability to become effective, responsive and accountable in urban planning and management, service delivery, and local economic development.

2. Since the early 1980s, decentralization has been a key policy objective of the RGoB. Article 22, Section 1 of Bhutan’s Constitution states that “(P)ower and authority shall be decentralized and devolved to elected local governments to facilitate the direct participation of the people in the development and management of their own social, economic and environmental well-being”. Promoting a “Just, Harmonious and Sustainable Society through Enhanced Decentralization” is a central objective of the 12th Five Year Plan (FYP), which has defined decentralization as “Empowering local governments through provision of greater financial, planning and administrative responsibility and authority”.

3. Following up on this, the Gross National Happiness Commission (GNHC) has developed a framework to divide roles and delineate responsibilities amongst the central agencies, Thromdes, Dzongkhags and Gewogs based on three key principles: (a) assignment of expenditure responsibilities, (b) assignment of tax and revenue sources, and (c) intergovernmental fiscal transfers between the national government and local governments. Bhutan’s functional and fiscal assignments, which are a combination of devolution, delegation and deconcentration, are largely consistent with the norms followed in many smaller countries, but they have not been matched with concurrent expansion of resources, strengthening of local government systems and enhancement of local accountabilities, all of which would create the capabilities and incentives for better municipal government performance. Thus:

- There are no institutional platforms in Bhutan for systematic exchange of information and dialog between the central government, the Thromdes and other local governments, thus limiting avenues for intergovernmental coordination and cooperation. The prevailing financial management systems also do not provide information on operating and financial performance of the Thromdes to the central government and citizens, thus reducing their transparency and accountability.

- The Thromde Finance Policy (2012) states that Thromdes shall receive annual Current and Capital Grants until such time when they are able to sustain on their own resources. The intergovernmental fiscal transfer system for Thromdes, unlike those for Dzongkhags and Gewogs, is based on ad hoc grants from the national government. In the absence of objective, equitable and transparent criteria
for grant allocation to Thromdes, the outcomes are dependent on bargaining power and influence of Thromde representatives. The ad hoc nature of the process reduces predictability in budgeting and incentives for greater own revenue collection for the Thromdes.

- On average, the Thromdes are dependent on the national government for 32.5 percent of their current expenditures and about 78 percent of their capital expenditures. Weak revenue mobilization is partly due to issues with the existing revenue management system, among them: limited revenue authority of Thromdes, including the lack of authority to raise tax rates on their own; absence of incentives to strengthen revenue collection since Thromdes are considered budget agencies just like other government ministries and agencies; and the limited institutional capacity of Thromdes to assess and administer local taxes.

- Currently there is no dedicated staff for Thromdes and the staff who get posted to Thromdes are from the general civil service cadre. This has resulted in frequent turnover of staff with hardly any specialization on issues relating to local government administration. Further, avenues for training and capacity building of staff who work in local governments exist but are rather limited.

- Although permitted by law, private sector participation in the delivery, management or financing of urban services is nascent and rather limited presently. This is due to a combination of issues, among them, limited capacities of Thromdes and the private sector and the absence of an enabling regulatory and financing framework that incentivizes the stakeholders, including ways to assess and appropriate risks and returns across the public and private sectors.

- Accountability systems, both upward to the central government and downward to citizens, while improving over time, can be further strengthened. For example, local governments are audited regularly, but there are no sanctions for receiving adverse or disclaimed audits. Performance audits of local governments are not backed up by incentives for the leading performers or sanctions and follow ups for the lagging ones. Avenues for direct citizen accountability are also limited presently.

- Finally, Bhutan’s decentralization policy, while having a central place in the 12th FYP, is not fully coordinated with or supported by other important policy and program initiatives of the Government, for example, in areas such as economic growth, regional development, infrastructure, agriculture, trade and skill development. This reduces its effectiveness.

4. As Bhutan gets more urbanized, Thromdes and other municipal governments will become key institutional actors to ensure good quality services, attract private investments to cities and provide proximate and accountable outreach to citizens. A flexible and incremental roadmap of further reforms is necessary to deepen RGoB’s policy of decentralization and strengthening local governments. This would include key policy and institutional considerations, both at central and local levels, as noted below.

5. **Asymmetric model of local autonomy**: Bhutan’s decentralization strategy should complement its strategies in economic and human development, as well as inform its public investment programs. Consistent with the Regional Development paper’s proposal for three tiers of settlements, Bhutan could consider an asymmetric model of decentralization and local autonomy. This would entail two critical policy imperatives. First, encouraging greater population consolidation, with a view to improve quality and reduce cost of service provision, as well as to enhance safety, resilience and economic agglomeration. While this is already happening organically, RGoB could support this process through improving connectivity to and infrastructure in key cities and towns. Second, imparting greater powers, responsibilities and resources to Tier I (Thimphu and Phuentoshling) and Tier II municipal governments (e.g. Gelephu, Samdrup Jhonkar
and Mongar) to set them on a path of greater fiscal and administrative self-reliance and direct citizen accountability, and enabling them to better utilize their local social and economic endowments.

6. **Clarifying local responsibilities and authorities:** In line with the above, and with the establishment of more Thromdes, institutional roles and responsibilities between the deconcentrated administrative set up (Dzongkhags reporting to the Ministry of Culture and Home Affairs) and the decentralized local governments (Thromdes) as well as that of Central Government units, such as the Ministry of Works and Human Settlements, GNHC and Ministry of Finance, would need to be clarified to ensure coherent governance arrangements.

7. **Establishing intergovernmental institutional modalities:** More decentralized form of local governance would require institutional modalities to ensure vertical and horizontal coordination and cooperation across the different levels of governments. In establishing institutional modalities for intergovernmental dialog and coordination, keeping in mind the relatively small size of its local government sector, RGoB could consider one of three institutional models of intergovernmental cooperation that exist in other decentralized countries: independent grants commission (India, Uganda, South Africa), intergovernmental forum (Canada, Germany) and administrative bodies/arrangements (the Philippines).

8. **Strengthening municipal finances:** With greater devolution, there is a need for a stronger local government financing system. Considerations for establishing such a system include a clear policy on vertical fiscal balance and equalization, to not only strengthen the local government system, but also serve as a positive policy for regional convergence; adoption of fiscal and institutional incentives, such as performance transfers, hard budget constraints and service delivery benchmarking, for greater own source revenue collection, more efficient public expenditures, and transparency and predictability in the fiscal regime. To strengthen own source revenues of Thromdes, regulatory empowerment as well as systems and capacity support are required, which can be complemented with incentives such as performance transfers. Finally, ensuring regulatory and administrative ease of managing such a system is critical, since the overall size of the local government system is small and the capacities are limited.

9. **Improving municipal institutional capacities:** As authorities and responsibilities of Thromdes and other municipal governments increase, issues of staffing and human resource capacity building need to be addressed. A differentiated approach between the four Thromdes and other smaller urban Dzongkhags may be merited to address the higher order needs of the larger municipal governments. RGoB may consider a trained cadre of municipal staff, especially focusing on core competencies such as revenue, expenditure and financial management, urban management, service delivery, etc., as well as flexible models for staffing through which the larger Thromdes, are able to provide better incentives and to tap the market for higher level technical skills in a flexible manner.

10. **Reinforcing citizen accountability in municipal governance:** As Thromdes become fully functional municipal governments, they would need to strengthen accountability to their constituents as part of enhancing the overall social contract. Appropriate structures for effective citizen engagement would need to be bolstered in the Thromde governance system. To the extent such participatory forums and processes can be embedded within the local government systems and processes and complement upward accountability arrangements such as public expenditure and financial management systems, these have greater chance of success and sustainability.

11. **Strengthening information systems:** Finally, there is a need to strengthen information systems for informed decision making. This involves strengthening standards, systems, modalities and personnel to collect, catalogue, analyze and transmit key data on local governance, service delivery and local economic development to key public and private stakeholders.
I. Introduction

1. Although the population of the Kingdom of Bhutan is small (around 735,000 in 2017), its urban population growth rate (2.5 percent annually) is among the highest in South Asia. According to the most recent census data, 37.8 percent of the total population is estimated to be urban. The capital city, Thimphu, is the largest urban agglomeration followed by Phuentsholing, Gelephu and Samdrup Jongkhar are the other urban areas in Bhutan.

2. Since the early 1980s, decentralization has been a key policy objective of the RGoB to empower people and ensure balanced and equitable socio-economic development. Proving further impetus to this, in 2008, the ideals of democratic and decentralized governance were formally enshrined in the Constitution. Article 22 of the Constitution of Bhutan establishes the principles of decentralized governance. It “provides for direct participation of the people in the development and management of their own social, economic and environmental wellbeing through decentralization and devolution of power and authority”. It also provides for the formation of local governments for the development, management and administration of areas under their respective jurisdiction. Per Article 22, Section 1 of the Constitution “Power and authority shall be decentralized and devolved to elected local governments to facilitate the direct participation of the people in the development and management of their own social, economic and environmental well-being”.

3. Decentralization policy is expected to get a boost in the 12th FYP. The Gross National Happiness Commission (GNHC) has announced that the objective of the 12th FYP is to promote “Just, Harmonious and Sustainable Society through Enhanced Decentralization”. The 12th FYP has defined decentralization as “Empowering local governments through provision of greater financial, planning and administrative responsibility and authority”. The process is expected to unfold mainly in three areas of policy, budget and human resources. In support of the objective of enhancing decentralization, resources have been doubled for local governments in the 12th FYP compared to 11th FYP, resulting in an equal share of capital resources as the Central Agencies. Additionally, a revised division of responsibilities framework also provides for greater decentralization of roles, functions and authority to local governments.

4. Today, local governments – particularly Thromdes, which are urban local governments – face many constraints limiting potential. As Bhutan urbanizes, Thromdes will play a more prominent role in governance, service delivery and local economic development. To empower them, it is important to continue the current trajectory of deepening decentralization and strengthening local governments. This paper identifies the key constraints facing local governments (Thromdes in particular) and presents critical policy choices that can enable them to play their parts in Bhutan’s development.

II. Legal Frameworks and Structure Governing Local Governments

5. A number of acts and regulations define the policy mandates for local governments, among them:

- The Local Government Act of Bhutan, 2009 - The institutional structure, responsibilities, and powers of the local governments have been enshrined. Subsequently, the Local Government (Amendment) Act of Bhutan 2014 included 30 amendments in various sections.
- The Public Finance Act of Bhutan, 2007 - Governs the financial management aspects of the functions of local governments.
- The Thromde Rules of the Kingdom of Bhutan, 2011

1 PHCB 2017, pg. 62.
• The Thromde Finance Policy, 2012 - Enables Thromdes to effectively carry out their responsibilities based on sound financial management principles.

6. Local governments in Bhutan include Thromdes, Dzongkhags and Gewogs. Clause 1 of Article 22 of the Constitution states that power and authority shall be decentralized and devolved to elected local governments. Clause 2 further specifies that Bhutan shall have local governments in each of the twenty Dzongkhags (districts), comprising of the Dzongkhag Tshogdu, Gewog Tshogde and Thromde Tshogde. The objective of local government, as specified in Clause 4 (b) of Article 22 of the Constitution, is to ensure the provision of services to communities in a sustainable manner.

7. The Local Government Act, 2009 provides the legal for establishing local governments in each of the twenty Dzongkhags (or districts), These are overseen by the Ministry of Home and Cultural Affairs. The Act tasks all local governments with a variety of objectives, including promoting Gross National Happiness, providing democratic and accountable government, preserving culture and tradition, promoting development, protecting public health, and discharging any other duties specifically created by any other law. Local governments are headed by a Chairperson and a Deputy Chairperson who lead, represent, and manage their respective administrations, each answering to the body above it and to the Parliament. All local governments are administrative divisions and are prohibited to make laws; however, they are empowered to make rules and regulations consistent with law as established by the Parliament. Members of all local governments are in office for five-year terms, or until the local government is dissolved.

8. Thromdes are urban local governments. Per the Local Government (Amendment) Act, 2014, the Parliament shall declare a certain geographical or administrative or economic area of the country as Thromde based on the recommendation by the government. The demarcation of Thromde boundary shall be carried out in consultation with the National Land Commission Secretariat (NLCS), the concerned local authority, and land owners. Currently, there are four ‘class A’ Thromdes in Bhutan: Thimphu, Phuentsholing, Gelephu, and Samdrup Jongkhar. Although some steps were taken to declare all the district towns as thromdes, this process has been on hold following a Supreme Court order in August 2016.

III. Key Functions of Local Governments

9. A division of responsibilities framework (DoRF) between local governments and the national government was initially developed by the GNHC in 2012. This provided a division of roles and delineation of responsibilities amongst the central agencies, Class “A” Thromdes, Dzongkhags and Gewogs based on the following key principles: (a) assignment of expenditure responsibilities, (b) assignment of tax and revenue sources, and (c) intergovernmental fiscal transfers. The DoRF has been amended in the 12th FYP, based on the following principles:

- Decentralize expenditures for assigned functions based on efficiency, proximity and competency factors to allow greater local autonomy and flexibility in terms of priority setting and choices for enhanced planning, implementation and provision of efficient public goods and services;
- Strengthen coordination and implementation of policies, plans and programs amongst different levels of government by providing optimum clarity of roles and distinct division of responsibilities;
- Provide a basis for resource sharing between Central agencies and the LGs for funding functions and provision of an “investment menu”12 for all levels of government; and
- Determine, plan and implement other aspects of decentralisation such as i) size, levels and capacities of functional burden, and ii) human resource and staff allocation for functions.

10. Following subsequent changes to this framework, the most recent assignment of responsibilities in key sectors as per the 12th FYP is noted in Table 1.
Table 1. Functional Assignments under the 12th FYP

<table>
<thead>
<tr>
<th>Function</th>
<th>Central</th>
<th>Thromde</th>
<th>Dzongkhag</th>
<th>Gewog</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community centers, bus stops, bus terminals, taxi parking</td>
<td>Regulate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Gewog center roads</td>
<td>Regulate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Farm roads, mule tracks</td>
<td>Coordinate</td>
<td>Inter-Gewog</td>
<td>Intra-Gewog</td>
<td></td>
</tr>
<tr>
<td>Waste management</td>
<td>Regulate</td>
<td>Maintain</td>
<td>Maintain</td>
<td></td>
</tr>
<tr>
<td>Water source protection</td>
<td>Regulate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Market sheds</td>
<td>Coordinate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Farm shops</td>
<td>Coordinate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Human wildlife conflict management</td>
<td>Regulate</td>
<td>Manage</td>
<td></td>
<td></td>
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<tr>
<td>Irrigation channels/river protection works</td>
<td>Coordinate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Rain water harvesting</td>
<td>Coordinate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Livestock, agriculture, horticulture farms</td>
<td>Coordinate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Electric, solar fencing</td>
<td>Regulate</td>
<td></td>
<td>Construct and maintain</td>
<td></td>
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<tr>
<td>Veterinary hospitals</td>
<td>Construct</td>
<td>Maintain</td>
<td>Maintain</td>
<td></td>
</tr>
<tr>
<td>District hospitals</td>
<td>Construct</td>
<td>Maintain</td>
<td>Maintain</td>
<td></td>
</tr>
<tr>
<td>Rural water supply schemes</td>
<td>Regulate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Eco-tourism</td>
<td>Regulate</td>
<td>Undertake</td>
<td>Undertake</td>
<td></td>
</tr>
<tr>
<td>Higher, middle and lower secondary schools</td>
<td>Regulate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Primary schools, extended classrooms, ECCD, non-formal education</td>
<td>Regulate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Disaster adaptation and mitigation</td>
<td>Regulate</td>
<td>Implement</td>
<td>Implement</td>
<td></td>
</tr>
<tr>
<td>Drongs</td>
<td>Construct</td>
<td>Maintain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monasteries and temples</td>
<td>Regulate</td>
<td>Construct and maintain</td>
<td>Construct and maintain</td>
<td></td>
</tr>
<tr>
<td>Small, cottage and medium industries</td>
<td>Regulate</td>
<td>Initiate</td>
<td>Initiate</td>
<td></td>
</tr>
</tbody>
</table>


11. These functional assignments, which comprise a combination of devolution, delegation and deconcentration, are largely consistent with the norms followed in many smaller countries, wherein the central government stipulates standards and regulates the services while local governments manage service provision, either directly or through other service providers. The functional assignments also distinguish between different types of local governments—Thromdes, Dzongkhags and Gewogs—but the distinctions are rather limited. This is due to the small size and limited capacities of all types of local governments. Further, from these assignments, it is unclear if the functions are devolved, deconcentrated or delegated. In
this regard, one issue that is highlighted by recent assessments is the ‘deposit-work system,’ whereby the activity may be budgeted with a central ministry, but its execution is delegated to the Dzongkhag/Gewog administration. This creates three issues. One, the capacity of Dzongkhags and Gewogs gets stretched since they are not provided additional staff for such delegated services. Two, Dzongkhags and Gewogs local governments do not get credit for the delegated activities in their performance measurement as these are accounted in the books of the central ministry. Three, many of these activities are actually local; so those should have been devolved in terms of planning, budgeting and implementation.

**Box 1. Different Forms of Decentralization**

**Deconcentration** is the redistribution of decision making authority and financial and management responsibilities among different levels of the central government. It is often considered the weakest form of decentralization and is used most frequently in unitary states. Within this structure policies and opportunities for local input vary: deconcentration can merely shift responsibilities from central government officials in the capital city to those working in provinces or districts, or it can create strong field administration or local administrative capacity under the supervision of central government ministries.

**Delegation** is a more developed form of decentralization wherein central governments transfer responsibility for decision-making and administration of public functions to semi-autonomous organizations not wholly controlled by, but ultimately accountable to, it. This is done by creating public enterprises or corporations, housing authorities, transportation authorities, special service districts, semi-autonomous school districts, regional development corporations, or special project implementation units that usually have a great deal of discretion in decision-making.

**Devolution** is the transfer of authority and responsibility for services to local governments that elect their governors/mayors and local councils, raise their own revenues, and have independent authority to make investment decisions. In a devolved system, local governments have clear and legally recognized geographical boundaries over which they exercise authority and within which they perform public functions.

Bhutan’s approach to decentralization combines all the above forms of decentralization. While there is an effort to devolve greater authorities, resources and capacities to the four Thromdes, in the case of Dzongkhags and Gewogs, the RGoB has pursued a policy of delegation and deconcentration. This mixed model in itself is not problematic—and in some ways, may be well suited for Bhutan—but its application should be based on clarity in policy and incremental reform, rather than ad hoc steps. Thus larger cities and regions with significant endowments may benefit from more devolved approaches, while smaller towns could be better supported through more effective deconcentration of service delivery. In select areas or sectors, on a case by case basis, delegation of certain functions can prepare the ground for greater devolution.

Source:

### IV. Legal and Policy Foundations of Local Government Finance

12. **Article 22 of the Constitution outlines the financial powers and entitlements to local government institutions.** The relevant clauses, Clauses 18 (b) to (f) of Article 22, state that local governments are:
   - Entitled to levy, collect and appropriate taxes, duties, tolls, and fees, in accordance with the procedures and subject to limitations, provided for by Parliament by law.
   - Entitled to adequate financial resources from the Government in the form of annual grants.
   - Allocated a proportion of national revenue to ensure self-reliant and self-sustaining units of local self-government.
   - Entitled to own assets and incur liabilities by borrowing on their own account, subject to such limitations as may be provided for by Parliament by law.

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13. The Thromde Finance Policy (2012) formulated by the MoWHS states that Thromdes shall receive adequate financial resources from the government in the form of annual grants until such time when they are able to sustain on their own resources. The grants shall be in the form of Current and Capital Grants. These grants shall be used for carrying out ‘own services,’ while for any ‘agency services,’ Thromdes shall receive grants from the respective agencies.

14. The Policy further states that Thromdes shall receive Current Grants to cover the operating deficit for own services, and that such grants shall be phased out based on an agreement signed between the Ministry of Finance and the Thromdes. In addition, Thromdes shall receive Capital Grants to the extent they cannot be financed from own revenues. Capital Grants shall be used for development of urban infrastructure and, where possible, Thromdes shall provide matching contributions. Thromdes shall submit justifications along with the sources and application of funds. Any unutilized balance of Capital Grant shall be adjusted from subsequent Capital Grants to the Thromdes.

15. The Municipal Finance Policy details the ranges for various tax rates which can be set by the Local Government. The Policy also provides for the setting of a ‘Thromde Finance Committee,’ which shall provide the institutional framework for more transparent sharing of resources between the Central Government and Thromdes.

V. Intergovernmental Fiscal Transfers to Local Governments

16. Article 22, Clause 18, sub-clauses (c) and (d) of the Constitution state that local government institutions are entitled to a share of the national revenue in the form of annual grants to achieve financial self-sustenance. Section 218 of the Local Government Act of 2009 states that local governments shall be allocated a proportion of the national revenue to ensure self-reliance and sustenance, for undertaking programs, activities, and for managing and maintaining infrastructure and delivery of services. Section 63 (a) of the Act further states that the Thromde Tshogde shall review and approve the annual budget to be met from its resources and review and endorse budget proposals for submission to the Ministry of Finance (MOF) for RGoB funding, where necessary. Although these provisions of the Constitution and the Local Government Act, 2009 allow local governments to approach the national government for funds to meet their expenditures, there is some ambiguity as to whether these provisions are valid for both current and capital expenditures or only for capital expenditures.

17. Resource allocation to local governments is based on the overall resource availability of the RGoB, the Budget Policy and Fiscal Framework Statement (BPFFS), macroeconomic framework and debt sustainability. Based on the resource envelope projected by Macroeconomic Fiscal Coordination Committee (MFCC) and after the assessment of the bottom-up resource requirement of local governments, Dzongkhags and Gewogs are allocated Capital grants for the five-year period. Subsequently, they receive annual grants directly from the government based on annual allocation for plan outlay. The formula-based mechanism is discussed in the next section. Formula based transfers from GNH are only applicable to Dzongkhags and Gewogs, and not yet to the Thromdes.

18. **Allocation of capital grants under the 11th FYP:** Five-year Capital grant ceilings for individual local governments were determined by the GNHC after taking into consideration the resource envelope projections given by the MFCC and bottom-up assessment of capital resource requirement of local governments, which is based on local government plans, implementation capacity, devolution of powers and responsibilities, past trends and needs of the local communities. The local government plans were formulated based on the Local Government Act 2009, the 11th FYP preparation guidelines, the Local Development Planning Manual, the Thromde Structural Plans, the Local Area Plans and the indicative five-year resource envelope. The process involved close consultations with communities to assess their needs and aspirations. These were further discussed at the Gewog Tshogdes, Dzongkhag Tshogdus, and Thromde
Tshogdus before being finalized and approved. The draft local government 11th FYP was then submitted to the GNHC for further discussion and coordination at the national level. Once the five-year capital resource outlay was decided by GNHC, the Department for National Budgeting (DNB) provided the annual ceilings to the local governments in the budget call for submission of budget proposal for the coming year.

<table>
<thead>
<tr>
<th>Table 2. Capital Grant Allocations under 11th FYP</th>
<th>Amount (billion Nus)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Capital Budget</td>
<td>92</td>
</tr>
<tr>
<td>Share of local governments</td>
<td>25</td>
</tr>
<tr>
<td>Share of Dzongkhags</td>
<td>9</td>
</tr>
<tr>
<td>Share of Gewogs</td>
<td>6</td>
</tr>
<tr>
<td>Additional allocation to Dzongkhags and Gewogs</td>
<td>5</td>
</tr>
<tr>
<td>Total allocation to rural local governments</td>
<td>20</td>
</tr>
<tr>
<td>Share of Thromdes</td>
<td>5</td>
</tr>
</tbody>
</table>

Source. GNHC

19. In addition to the Nu. 25 billion earmarked as capital allocation to the local governments, a provision of Nu. 4.5 billion was kept under Ministry of Education for Dzongkhag Education Services. The allocation under the targeted poverty intervention programs are also over and above the local government allocation. Moreover, many centrally executed plans and programs ultimately benefit the local governments and communities, although the resources are reflected under the sector concerned. It must be noted that while other sectoral activities at the local level are prioritized and planned by local governments, the planning for education activities is centrally coordinated by the Ministry of Education, given the strategic importance of the education sector and to ensure that all children across the nation have equal access to quality, adequate, efficient and cost-effective education services. The implementation is done by the local governments with resources provided by the Ministry of Education.

20. Based on the DoRF, past expenditure trends, and resource availability, the Capital Grants for Dzongkhags, Gewogs and Thromde ‘A’s for their 12th FYPs have been doubled to Nu. 50 billion from Nu. 25 billion in the 11th FYP. With this quantum increase in capital grants, it is important for the RGoB to ensure that the enhanced amounts are used in ways that advance the objectives of the 12th FYP on decentralization. Towards that, there may be a need to review and strengthen, as appropriate, the norms and guidelines for the allocation, modalities, use and accounting of these grants, and also scale up efforts to build capacities at the local government level for effective use of the enhanced resources.

VI. Intergovernmental Fiscal Transfers to Dzongkhags and Gewogs

21. Allocation of Current Grants: Allocation of Current Grants is subject to the criteria determined by the DNB, while earmarked funds are allocated based on norms of the concerned central agencies and departments. Current Grants are allocated to Dzongkhags and Gewogs based on the annual ceilings given by DNB in the budget call circular. These ceilings are based on past expenditure by the Gewogs and Dzongkhags. Since revenue generating capacities of these local governments are negligible, nearly all of their recurrent expenditure is financed through DNB. The proposal is submitted by the Dzongkhags and Gewogs and after deliberation with DNB officials the allotment is made.

22. Allocation of Capital Grants: Allocation of Capital Grants to Gewogs and Dzongkhags is based on the principles of equity, transparency and objectivity. A formula-based resource allocation mechanism was first launched in the 10th FYP. The formula was finalized by the GNHC after discussions with
representatives of Dzongkhags and Gewogs. The criteria and their weights are subject to review and refinement from time to time depending on the current conditions and changes in development situation. The new system of resource allocation has provided greater predictability and higher flexibility to local governments.

23. The total resources provided for local governments are assigned on a 60:40 ratio between Dzongkhags and Gewogs. Following this ratio, the capital grants are allocated based on the following four factors with different weights attached to them:

- **Size of population**: In the 10th FYP, 70 percent of the total resource allocation was allocated based on population, but in the 11th FYP allocation this has been reduced to 35 percent.

- **Geographical size**: Local governments which have larger areas have higher service delivery costs due to longer distances. This is factored into the allocation formula; thus, 10 percent of the total resource allocation is determined by the geographical size of the local governments.

- **Multidirectional Poverty Index**: Poverty incidence which had a weightage of 25 percent of the total resource allocation was replaced by a refined measurement of multidimensional poverty index with a weight of 45 percent. The objective was to provide extra support to local governments with higher levels of poverty.

- **Transport Cost Index**: A new criteria on transport cost index with a weight of 10 percent has been included to account for high cost of investments in interior and remote Dzongkhags and Gewogs that face higher transportation costs.

24. Annual capital grants have been falling over the period, while current grants have been steadily increasing. This is because comparatively less Capital Grants are released in the initial phase of a FYP as the inception reports and utilization plans are prepared in the earlier years of the Plan period while execution is undertaken in the later years of a FYP. For example, more capital grants were released in 2010-11 to 2012-13, which were the final years of 10th FYP, compared to 2013-14 and 2014-15, which were the initial two years of 11th FYP. This approach is not desirable for Capital Grants as there is limited capacity to utilize the funds around the end of a FYP. It is better to release more resources in the initial plan period to promote better planning and budgeting, and improved utilization.

**VII. Intergovernmental Fiscal Transfers to Thromdes**

25. The 2011 Thromde Rules mandate the establishment of democratically elected local governments with an enhanced autonomy and accountability with regards to planning, staffing, finance and budget. The Rules introduce classification of urban areas based on their socioeconomic profiles, such as population and economic activities, and assigns clearer responsibilities based on the classification. Thromdes are administered independently by a Thromde Tshogde if sufficiently developed and populated (Class ‘A’ Thromdes) or directly by Dzongkhag Administration or the Gewog Administration, as decided by the Government (Class ‘B’ Thromdes and Yenlag Thromdes). Each Thromde Tshogde is composed of seven to ten elected members and is headed by a Thrompon (mayor).

26. Currently, there are four Class A Thromdes in Bhutan -- Thimphu, Phuentsholing, Gelephu and Samdrup Jongkhar. Thromde Tshogdes are empowered to levy taxes on land, property, property transfer (sales tax) and "betterment", to regulate advertising, and to enforce public health and safety rules. Thromdes are also authorized to levy special taxes on vacant and underdeveloped land to encourage development and to raise and spend money to promote local economic development.
27. Prior to the demarcation of Class A Thromdes, Thimphu and Phuentsholing city corporations were under the Ministry of Works and Human Settlement (MoWHS) and received their shares as part of the MoWHS budget. At present, all four Thromdes function autonomously and submit their budget requirements to the MoF directly. The resource allocation to Class A Thromdes are not formula, but need-based, mainly due to their social, economic and environmental diversity and complexity. The grants are fixed based on their requirements and the availability of funds with the RGoB. Although the central government tries to fill the financing gap of Thromdes, it is very much ad-hoc and not based on any specific principles. There is a widely-held view that the four Class A Thromdes should eventually become self-reliant and meet their recurrent expenditures from their own revenues.

28. Allocation of Current Grants: Current Grants are allocated to Thromdes annually through negotiation between the MoF and the respective Thromde during budget preparation. The ceilings to the Thromdes are decided by the DNB. The ceilings for a particular financial year are based on the actual withdrawal made by the Thromdes in the previous year and these ceilings are sent with the budget call. Given the ceilings, Thromdes submit their budget proposal to DNB with justification for proposed requirements. Thromdes submit their audited accounts to estimate their current account deficits. In the final stage, negotiations are held between DNB and Thromdes regarding filling the deficits in meeting recurrent expenditure. While approving the allocation, DNB takes into consideration the following key factors:
   - Trends in past recurrent expenditure
   - Disallowing any wasteful expenditure
   - Incentivizing Thromdes to generate own revenue through better management and reforms in tax administration.

29. Current Grants to the Thromdes during four financial years (FY 12-15) show that, among the four class A Thromdes, as of 2014-15, only Phuentsholing has been able to cover its recurrent expenditures with its own internal revenues during the last four fiscal years (see Table 3). On the other hand, Thimphu is unable to finance its operating expenditures from its own sources and hence requires current grant support from the RGoB. The other two class A Thromdes, Samdrup Jongkhar and Gelephu, were established relatively recently and have limited resources and institutional capacity. At present Samdrup Jongkhar and Gelephu are able only to meet 31 percent and 35 percent respectively of their recurrent expenditure from their own resources. As such, these two Thromdes will require more substantial RGoB support to meet their recurrent (as well as capital expenditures) for the foreseeable future.

<table>
<thead>
<tr>
<th>Year</th>
<th>Thimphu Capital</th>
<th>Thimphu Current</th>
<th>Phuentsholing Capital</th>
<th>Phuentsholing Current</th>
<th>Samdrup Jhonkar Capital</th>
<th>Samdrup Jhonkar Current</th>
<th>Gelephu Capital</th>
<th>Gelephu Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-12</td>
<td>145.485</td>
<td>69.449</td>
<td>67</td>
<td>0</td>
<td>45.3</td>
<td>14.541</td>
<td>86.289</td>
<td>24.407</td>
</tr>
<tr>
<td>2012-13</td>
<td>67.16</td>
<td>20</td>
<td>75.6</td>
<td>0</td>
<td>70.68</td>
<td>14.895</td>
<td>25.22</td>
<td>26.5</td>
</tr>
<tr>
<td>2013-14</td>
<td>114.45</td>
<td>41.531</td>
<td>95.668</td>
<td>0</td>
<td>58.7</td>
<td>24</td>
<td>33.5</td>
<td>21.509</td>
</tr>
<tr>
<td>2014-15</td>
<td>110</td>
<td>40</td>
<td>100</td>
<td>0</td>
<td>100</td>
<td>25</td>
<td>90</td>
<td>22</td>
</tr>
</tbody>
</table>

Source. DNB

30. Allocation of Capital Grants: On Capital Grant allocations, once the FYP outlay ceilings are given by the GNHC, the annual ceilings are determined by the DNB. These ceilings are conveyed to the respective Thromdes in the Budget Call Circular. Given these ceilings, the Thromdes respond with their proposals containing the planned projects over the coming year. In the final stage, negotiations are held between the GNHC, the DNB, and individual Thromdes for approval of capital grants. Over the fiscal year, the funds for capital projects are released by the DNB to the respective Thromdes as and when the proposal
is submitted by the Thromdes. A certain degree of freedom is given to Thromdes with respect to utilization of capital grants as per their requirement; therefore, these capital grants can be classified broadly as untied grants. Such authority is not available to Gewogs and Dzongkhags.

31. In the 11th FYP, the total Capital Grants given to Class ‘A’ Thromdes was Nu. 5 billion. Out of this, Nu. 2 billion was earmarked for Thimphu due to its area and population. In addition, Thimphu being the capital has also received additional resources. The other three Thromdes were allocated Nu. 1 billion each. An additional allocation of Nu. 5 billion was earmarked for municipal infrastructure and services for the four class “A” Thromdes. Although Thimphu Thromde received largest total allocation, in per capita terms, it received the lowest share among the four Thromdes, as seen below.

**Figure 1. Annual Per Capita Grant Allocations**

![Bar chart showing annual per capita grant allocations for Thimphu, Phuentsholing, Sandup, and Gasa for 2011-12, 2012-13, 2013-14, and 2014-15.]

*Source. World Bank staff calculations*

32. **Key issues with respect to fiscal transfers to Class A Thromdes:**

- The intergovernmental fiscal transfer system for Thromdes is not principle-based but dependent on ad hoc grants from the DNB for both recurrent and capital expenditures. While there are specific guidelines and criteria for making transfers to Dzongkhags and Gewogs, no such guidelines are available for the Thromdes. Neither the Local Government Act, 2009 nor the Thromde Rules, 2011 have any definite formula or rule for transfers to Thromdes. The Municipal Finance Policy, 2012 states that the grant for meeting operating deficit would be reduced gradually for Class A Thromdes, while Thromdes build up their revenue base.

- At present, the Thromdes feel that, in the absence of transparent and predictable transfer mechanism, the outcomes are dependent on bargaining power and influence of their representatives. There should be objective, equitable and transparent criteria for grant allocation to Thromdes that would provide predictability in budgeting and strengthen incentives for greater own revenue collection.

- There is an absence of monitoring and evaluation mechanisms to assess the level of utilization of grants at the Thromde-level. The utilization of past year’s Current Grant is not reviewed during the allocation of Current Grants for the next year. Only the quarterly amount withdrawn during the past year is available with the DNB. There is a need to enhance the monitoring and evaluation system to ensure that grants are utilized in an efficient manner.

- There are no institutional platforms for a systematic exchange of information to communicate the priorities and needs of the Thromdes to the DNB and for the DNB to understand the real resource
requirements of Thromdes. The discussions during the time of the budget formulation often tend to be negotiations between the Thromdes and the DNB, with each side not well informed about each other’s requirements and constraints.

- The prevailing municipal financial and management systems do not have the necessary capacity to convey information on operating and financial performance of the Thromdes to the DNB and stakeholders to increase the transparency of Thromdes and reduce the risks arising from asymmetric information that drives budget and plan discussions at present.

VIII. Own Revenues of Local Governments

33. Generally, all types of local governments are heavily dependent on the central government for their revenues. This is particularly so for Dzongkhags and Gewogs given their low share of economic activities. Section 57 of the Local Government Act empowers Gewogs to levy selected taxes, such as land tax, building tax, cattle tax, grazing tax and entertainment tax (Table 4 and Box 2). However, in practice, these local governments are fully dependent on the central government for financing their budget. Their local tax bases are small and mostly untapped. At present, there is no locally generated revenue financing the budget expenditures. For example, in FY 2016-17, fiscal transfers made up 86.6 percent of Dzongkhag financing, with the balance 12.7 percent coming from grant funding and 0.7 percent from loan financing.

34. The Local Government Act, 2009 codified the status of the Thromdes as the third level of administrative division and reaffirmed their authority to levy taxes. The list below gives an overview of tax and non-tax revenue sources.

<table>
<thead>
<tr>
<th>Table 4. List of Tax and Non-Tax Revenue Sources for Local Governments</th>
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</thead>
<tbody>
<tr>
<td><strong>Type of Own Revenue Source</strong></td>
</tr>
<tr>
<td>Tax revenue</td>
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<tr>
<td>Non-tax revenues - fees</td>
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<tr>
<td>Non-tax revenues - charges</td>
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<td></td>
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<tr>
<td>Source</td>
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</tr>
<tr>
<td>Connection charge</td>
</tr>
<tr>
<td>Solid waste</td>
</tr>
<tr>
<td>Pipe realignment</td>
</tr>
<tr>
<td>Essential charges</td>
</tr>
<tr>
<td>Housing</td>
</tr>
<tr>
<td>Other Service Charges</td>
</tr>
</tbody>
</table>

35. Success in improving capacity for local revenue mobilization has been uneven. Apart from Phuentsholing Thromde, which has been able to meet recurrent expenditures with own source revenues, other Thromdes have made limited progress in mobilizing own source revenues. At present, all four Thromdes are fully dependent on the Government budget for their capital works. Even on the current expenditures, there is a high dependence on the budget support. On average, they are dependent on the budget for 32.5 percent of their current expenditures and about 78 percent.³

36. Weak revenue mobilization is partly due to issues with the existing revenue management system, among them. While all local governments are impacted, the case of Thromdes merit special attention.

- **Limited revenue authority**: Thromdes have no control over several local revenue sources, even if those are generated within their area. An example is taxes levied on vehicles. About half of the total vehicle population in Bhutan is stationed in Thimphu, but the Thromde does not get any share of the sales tax, customs duty and green tax levied on these vehicles, even though they are the major contributors to the damages incurred on the roads and drains in the Thromde area.⁴

- **Lack of incentives**: Thromdes are considered budget agencies just like other government ministries and agencies, and hence they have little incentive or motivation to enhance their own revenue sources.

- **Regulatory issues**: A major regulatory hurdle faced by Thimphu and other Thromdes is the lack of authority to raise tax rates on its own. Even though the Local Government Act allows local governments to increase taxes, the final authority to approve the same is with the Parliament. For example, the main source of Thromde revenue is taxes on land and buildings. The existing tax rates have not seen any revision in the last 25 years. An attempt to revise the rates in FY2016/17 budget did not receive Government endorsement. Unless Thromdes can alter their tax rates, they will not achieve effective autonomy or accountability. Moreover, local tax rate setting gives them the flexibility to change rates in response to varying circumstances.

- **Institutional capacity**: Thromdes have limited capacity to assess and administer taxes. There is no proper revenue and budget management section, which can monitor collections and project revenue and budgetary requirements for the Thromde. The method of assessment is not transparent across the various sections. Most of the sections operate independently. The sharing of information across various sections is only on a need basis.

- **Operational issues**: The tax administration system in the Thromdes has been relatively primitive. The Thromde posts information and notice of tax payments in the local print media and the

³ UNDP and UNCDF (2011).
⁴ Ibid.
taxpayers are expected to make the requisite payments in the Thromde office revenue collection window. This process has resulted in many instances where the taxpayer has defaulted in payments.

### Box 2: Role of property taxes in local revenues

Across several countries, land and house or property taxes generally contribute much more than what is prevalent in Bhutan. As these are ‘immobile taxes’, they are also among the most predictable sources of revenues for local governments. For example, in the USA, state and local governments collected a combined US$488 billion in revenue from property taxes, or 17 percent of general revenue in 2015. While state governments collected US$15 billion or 1 percent of state general revenue from property taxes in 2015, local governments collected US$473 billion or 30 percent of local government general revenue in property taxes, surpassed only by government transfers, which were 36 percent of general revenue (Urban Institute, 2016). In OECD countries, in 2015, property taxes comprised 5.8 percent of total government revenues across all levels of government. In countries such as UK and Korea, this was as high as 12.6 and 12.4 percent respectively (OECD 2018).

There are major advantages to collect property (land and house) taxes by local governments, among them:

- Because these are immobile taxes, property taxes are among the most predictable sources of revenues for local governments. Due to the high demand for urban land and housing, these are usually buoyant revenue sources.
- Because they do not affect decisions to supply labor and to invest (including in human capital) and innovate, property taxes are more efficient and less distorting than several other types of taxes.
- They also help strengthen local accountability between the local governments and the residents.

To strengthen property (land and house) taxes among Thromdes in Bhutan, the following measures could be considered:

- Establishing and updating a sound, reliable register of properties, starting with the four Thromdes. The tax base must be fully covered and mapped using a GIS-based three-dimensional mapping system so that it captures all essential features of the properties.
- Determining the appropriate model of valuation is important. Computer-assisted Mass Appraisal systems are best practice solutions but can be difficult due to intense data needs and limited capacities for regular updating. Other valuation methods that may be more appropriate to the ground realities include After Repair Value, Area Based and Income-based models.
- Strengthening the capacity of the local government for assessments, including building on systems, processes and capacities installed under the Bhutan Urban Development Projects (BUDP), but focusing on introduction of new digital technologies that will allow greater efficiency and transparency in land and property management.

37. These issues were exemplified in the case of Thimphu Thromde, which had no comprehensive database and updated data on physical or asset inventory. The total number of land holdings or buildings in Thimphu was not known because of which the Thromde’s tax base was untested. The taxes were calculated manually, often resulting in computation errors. In case the tax payer did not get the previous tax receipt, it was difficult to locate revenue assessment sheet for any specific land holding. Defaults were not tracked adequately since there was neither a proper database of taxpayers and nor proper coordination between the various revenue generating divisions that can pool together the information to track the tax payments/defaults. Further, the revenue collection mechanism has large human interface in handling cash, which created a possible environment for corruption.

38. Land Tax and Urban House Tax, which are recurrent, together contributed around eight percent of the total revenues of the Thimphu Thromde (then the City Corporation) in 2010-11; these are one of the top seven contributors to the Thromde’s revenue. A detailed analysis of these taxes has revealed that there is considerable scope for improving revenue collection.
IX. **Interventions to Strengthen Urban Governance and Finance⁵**

39. Under BUDP2, several local government finance issues are being addressed, among them:
   - Computerization of the tax and non-tax records and the asset registers of the Thimphu and Phuentsholing Thromdes are currently underway. This activity has now been extended to Gelephu and Samdrup Jhonkar Thromdes.
   - Improving Municipal Financial Management Systems (including financial reporting, performance reporting, capital budgeting practices, internal control procedures etc.)
   - Strengthening local revenue administration through business process re-engineering.

40. Significant institutional development improvements have been achieved through BUDP2:
   - Both Thimphu and Phuentsholing Thromdes have managed to digitize their property tax records and use these digitized records for sending tax invoices to citizens in a timely manner. The digitization of property tax records is starting in Gelephu and Samdrup Jhonkar and is expected to be completed in 2019.
   - There has been a marked increase in the collection of property tax in Thimphu Thromde as the digitization of property tax records and the timely sending of tax invoices has improved the efficiency of property tax collection.
   - Both Thimphu and Phuentsholing have digitized their asset inventory records while Gelephu and Samdrup Jhonkar are starting the same process. This will help all Thromdes in efficient asset management.
   - Thimphu and Phuentsholing Thromdes have prepared Annual Performance Reports and displayed these in their websites. They have also prepared Annual Financial Statements and are currently in the process of preparing the Thromde Balance Sheets.

41. In addition, with World Bank support, the RGoB has put in place a transparent, formula-based fiscal transfer system for allocating Annual Plan Funds to Thromdes, similar to the GNHC’s formula-based allocation of Plan Funds to Dzongkhags and Gewogs. The GNHC is planning to adopt this approach for the allocation of funds under the 12th FYP. These reforms are intended to change the nature of the intergovernmental fiscal relationship between the RGoB and Thromdes, reflecting the intention of the Government to empower Thromdes to become fully functional local governments.

42. Recognizing the increasing urbanization, the RGoB is planning to charter 16 new Thromdes in the near future, although their establishment is now on hold. These new Thromdes are expected to be in areas that are currently part of Dzongkhags and do not have the necessary administrative and physical infrastructure to deliver municipal services. The municipal finance and management reforms in the four Thromdes provide a good foundation for asymmetric treatment and greater empowerment of these Thromdes and for extending these measures to new Thromdes, when they are established. The institutional and financial management systems currently operational in the four Thromdes would need to be replicated and rolled out to new Thromdes to make them fully functional local governments.

X. **Expenditures of Local Governments**

43. Limited information exists on expenditure patterns of local governments. Dzongkhags and Gewogs are often unable to utilize their budget allocations fully. Data from 2011 to 2015 suggest that, Dzongkhags and Gewogs were able to spend almost the entire budget allocated current expenditures, but only 89 percent of the allocated capital expenditures. The four Thromdes, on the other hand, were able to spend the entire budget allocated under the current and capital heads of expenditure. This may be due to capacity differences

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⁵ The World Bank-supported BUDP-2 has been supporting the four Thromdes to address key finance issues governments.
between more rural local governments and Thromdes. However, as the UNDP report (2017) notes, this may also be more of a systemic issue. The unutilized budget of Dzongkhags and Gewogs lapse at the close of the financial year, but Thromdes are not required to return the unutilized funds at the end of the year to the Ministry of Finance.

XI. Administration and Management in Thromdes

44. Currently there is no dedicated cadre of staff for Thromdes and the staff who get posted to Thromdes are from the general civil service cadre. This has resulted in frequent turnover of staff with hardly any staff specialization on issues relating to local government management. The capacity building support provided through BUDP2 has been constrained due to the frequent turnover of staff, due to which Thromdes have not been able to build up core competencies in critical areas such as financial management, urban management, service delivery, etc. Avenues for training and capacity building of local government staff exist but are rather limited.

45. Thimphu Thromde is the apex example of the administrative and management set-up for Thromdes. The elected Thrompon (mayor) heads the Thromde and administers through the Executive Secretary, who is posted (as are most of the mid-level staff) at the Thromde through the Royal Civil Service Commission. There are six main divisions of the Thromde covering the core functions. Among these, the Administrative and Finance Division includes the Finance and Revenue sections and the Customer Service section. With BUDP 2 support, the focus of upgrading the municipal finance and management systems have been on improving the functions of these sections and their interface with citizens.

46. Irrespective of their size and population, Dzongkhags have similar staff strength and pattern. The Dzongkhag administration is based on sectoral ministries and agencies at the central level. Sectors include health, education, urban development, etc. with crosscutting sectors like planning, finance and administration, HRD, registration, survey and land records, culture, etc. The UNDP report notes that the staff working in these sectors are functionally under the Dzongkhag, but their administration is controlled by the respective central agencies. Recently, promotion of staff has been decentralized but the Dzongkhag has very limited control over the training or transfers of sector staff. Further, many Dzongkhags also face an acute shortage of qualified and capable civil servants, especially in technical areas.

47. The main human resource and capacity challenges of the local government system are:
   • Fixed staffing numbers and patterns and lack of flexibility to seek temporary or market-based skills, especially for the Thromdes.
   • Limited technical capacity of local government staff, especially in priority areas like engineering, financial management, project management, etc.
   • Limited training and capacity building avenues, and loss of capable staff due to frequent turnover.

XII. Audits

48. Local governments undergo three types of audits: annual, performance and environmental audits:
   • Annual Auditing is mandatory and conducted by the Royal Audit Authority (RAA) on an annual basis corresponding to the financial year (July to June). It covers all activities carried out within the selected year. While the emphasis is on financial aspects, it also covers technical and planning aspects as well.
   • Performance Auditing is carried out on a random basis by the RAA. The frequency is typically once in two years. A performance audit of the Thimphu Thromde was carried out recently.
   • Environmental Auditing is carried out by the National Environment Commission (NEC) on an ad hoc basis and the frequency is typically once in 3-4 years.
49. At present, audit findings are followed up through further observations and memos till the issues are resolved. Any outstanding audit opinion that is not resolved in a reasonable period of time is typically included in the RAA’s final report. However, there are no ‘sanctions’ against local governments that receive adverse or disclaimer audits. Further, performance audits are not backed up by incentives for the leading performers or sanctions/follow ups for the lagging ones. In the absence of such remedial actions, audits tend to become less effective as a control or incentive instrument. Finally, at present, Bhutan does not have any form of social auditing of local governments.

XIII. Service Delivery in Urban Areas

50. The Thromdes are chartered to provide several urban/municipal services for the town-dwellers, including water supply and sewerage, solid waste management, roads and sidewalks, street lighting, public spaces, and overall safety and beautification in the Thromde area. The Thromdes also provide for urban planning and development control services in the cities. The construction of new municipal infrastructure is provided through capital grants from different sources while a Thromde is expected to meet the operations and maintenance of such services.

51. Overall, the coverage of these basic urban services varies among the four Thromdes, including variation in the quality and quantity within Thimphu Thromde. As noted in the Regional Development paper, while the government has been very successful in ensuring that basic services are equitably distributed across the country, there are differences between urban and rural areas, both in access and in quality of service, remain both within and across Dzongkhas.

52. A Citizen Report Card survey, undertaken by Helvetas in 2015, provides valuable insights on the decentralization process, the enhanced role of local governments and service delivery. Overall, the report notes that, citizens in the surveyed communities exhibited high appreciation of the functions that local governments are carrying out but had low awareness on the minimum standards of service. While there was a high level of satisfaction with access to services, ratings on the quality of services were lower. Further, communities also noted the absence of complaints and redressal mechanism, which prompted them to address their complaints through a wide variety of channels, often with limited effectiveness.

53. Although permitted by law, private sector participation in the delivery, management or financing of urban services nascent and rather limited currently. This is due to a combination of issues, among them, limited capacities of Thromdes and the private sector and the absence of an enabling regulatory and financing framework that incentivizes the stakeholders, including ways to assess and appropriate risks and returns across the public and private sectors. Thromdes like Thimphu have been testing out private sector provision in a limited way. An example of this is the recent development and management of an integrated parking system including two new multi-level car parks with at least 550 parking spaces as well as the upgrading and management of about 1,000 off-street and on-street surface parking in Thimphu City on the basis of a design, build, finance, operate and transfer concession model with IFC support.

XIV. A Roadmap for Supporting Decentralization and Strengthening Municipal Governments

54. As Bhutan becomes more urbanized and its economy becomes more urban centric, Thromdes will become key institutional actors in ensuring good quality services, attracting private investments to cities and providing proximate and accountable outreach to citizens. A flexible and incremental roadmap to support RGoB’s policy of decentralization and strengthening local governments could include the key

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policy and institutional considerations, both at central and local levels, noted below. Table 5 provides a summary of key reforms across different tiers of government and with a timeline and sequence.

Policy considerations

55. **Considering an asymmetric model of local autonomy:** Differences among local governments in terms of economic and natural endowments as well as financial and human resources provides a strong rationale for the adoption of asymmetrical arrangements for subnational governments. In many countries, large cities often have powers of taxation and regulation that smaller cities lack. New York City and Washington D.C., for example, have their own income and sales taxes. They also have greater remit over utilizing their local resources and endowments to catalyze local economic development. In Japan, for example, seventeen designated cities with larger populations and economic base have been provided greater powers — equivalent to that of a prefecture, in nineteen key policy areas — by the central government. Similar experiences are prevalent in a number of countries, including China and Indonesia (for Jakarta).

56. Overall, it would be important for Bhutan’s decentralization strategy to accommodate and complement its regional development strategy. The Regional Development paper presents a framework for responding to regional development prospects of Bhutanese cities and towns. Accordingly, it has organized three tiers of settlements. In Tier I settlements, such as Thimphu and Phuentsholing, efforts should focus on improving livability and catalyzing private sector investments by reducing disparities in access to services, improving land use planning and management and addressing critical congestion factors of urbanization. In Tier II settlements, such as as Gelephu and Samdrup Jongkhar, the approach should be on improving conditions for private investment and link to potential markets in competitive sectors and industries. While addressing soft constraints, these cities also need to boost capacity for urban planning and land administration in addition to strengthening service delivery to accommodate new growth and ensure basic equity and efficiency in coverage and quality of access. In both cases, an enabling decentralization and intergovernmental fiscal framework plays critical role in achieving these policy objectives.

57. Specifically, an asymmetric model would imply two critical policy imperatives. First, encourage greater population consolidation, with a view to improve quality and reduce cost of service provision, as well as enhance safety, resilience and economic agglomeration. With rapid urbanization, this is happening organically. The RGoB could support and reinforce this natural process through a positive policy of strengthening cities and towns, by improving their connectivity, infrastructure and service delivery and enhancing the local governance structures and systems in these centers. Second, imparting greater powers, responsibilities and resources for the Tier I, which are the four large Thromdes, and Tier II cities, with a view of setting them on a path of increasing fiscal and administrative self-reliance and direct citizen accountability, and enabling them to better utilize their local social and economic endowments. With regard to smaller Dzonkhags and Gewogs, ensuring appropriate forms and adequate levels of fiscal and administrative support while enhancing their capacity incrementally would allow improved services in these localities. As noted previously, a mixed model of three Ds (devolution, delegation and deconcentration) may work well for Bhutan’s local governments, but it should be based on sound policy rather than ad hoc administrative decisions.

58. **Clarifying functional assignments and local responsibilities and authorities:** With the establishment of more Thromdes, the institutional roles and responsibilities between Dzongkhags and Thromdes would need to be clarified. As new Thromdes are set up with the aim of providing municipal services, the dividing lines of roles and responsibilities between the deconcentrated administrative set up (Dzongkhags reporting to the Ministry of Culture Home Affairs) and the decentralized local governments (Thromdes) as well as that of Central Government units, such as the MoWHS, GNHC and MoF, would need to be clarified to ensure coherent governance arrangements.
59. Any review of local government responsibilities and authorities should also take into consideration the above observation about asymmetric arrangements across different tiers of cities and towns. It is important that the functional assignments and local authorities enable larger and more capable Tier I Thromdes to have a greater say in matters such as land use planning and land management, service delivery planning and management, including to set tariffs and to contract the private sector within specified rules, norms and standards, as well as to better utilize their local endowments and assets. In this context, the reform of the intergovernmental fiscal framework and the assignment of revenue-expenditure responsibilities and authorities could be seen as a medium-term roadmap for both current and future Thromdes, with prioritized and incremental improvements along the trajectory.

60. Enhancing sustainability of local government finances: As and when Thromdes get established and as demand for urban services increases, sustainable sources of financing would need to be put in place. The MoF and GNHC plan to put in place a formula-based sharing of resources for financing the FYPs and Annual Plans. The long-term view of the MoF is to have the plan financing restricted to capital investments and have the Thromdes finance recurrent expenditures from their own source revenues. As the number of Thromdes increase, the MoF and GNHC will have to put in place a strong intergovernmental fiscal and local government financing system. This is particularly important in the context of the emphasis on fiscal decentralization in the 12th FYP. Key considerations for establishing such a system include:

- Vertical and horizontal fiscal gaps and imbalances that necessitate revenue sharing and equalization arrangements. A clear policy on fiscal balance and equalization will not only strengthen the local government system but also serve as a positive policy for regional convergence;
- Fiscal and institutional incentives—for example, performance transfers, hard budget constraints, service delivery benchmarking, etc.—for greater own source revenue collection and more efficient public expenditures, transparency and predictability in the fiscal regime. To strengthen own source revenues of Thromdes, regulatory empowerment as well as systems and capacity support are required, which can be complemented with incentives such as performance transfers;
- Regulatory and administrative ease of managing such a system, since the overall size of the local government system is relatively small and capacities are limited.

Institutional considerations

61. Improving institutional capacities within local governments: As the number of Thromdes increase and their roles and responsibilities get enhanced, issues of staffing and human resource capacity building need to be addressed. A differentiated approach between the four Thromdes and other smaller urban Dzongkhags may be merited. The RGoB may consider trained cadre of local government staff, especially focusing on core competencies such as revenue, expenditure and financial management, urban management, service delivery, etc., so that the skills and experience once generated remains within the local government system. The Royal Civil Service Commission could also consider flexible models for staffing through which local governments, especially the larger Thromdes, are able to provide better incentives and to tap the market for higher level technical skills in a flexible manner.

62. Several countries have dedicated institutions for local government capacity development. Regional and nearby examples include the Kerala Institute of Local Administration in Kerala, India, the National Institute of Local Government in Bangladesh and the Local Government Academy of the Philippines. While Bhutan’s small size may not warrant a dedicated institution for local government capacity development of local governments, clear policy and dedicated resources are warranted. Partnerships with public and private academic institutions, such as universities and professional training institutes, could be employed to support local government institutional development.

63. Establishing institutional modalities for intergovernmental dialog and coordination: Moving away from a centralized and top down administrative set up towards a decentralized form of local
governance would require arrangements to ensure coordination and cooperation between the different tiers of local governments. Such arrangements are relatively informal now, but, as and when the establishment of more Thromdes materializes, these issues would need to be addressed. The Thromde Finance Policy allows for a Thromde Finance Committee to establish a coordination model, a study of these different options was recently completed by Deloitte. There are three institutional models of intergovernmental cooperation that Bhutan could consider — independent grants commission (India, Uganda, South Africa), intergovernmental forum (Canada, Germany), and administrative bodies/arrangements (the Philippines).

64. **Reinforcing citizen accountability as a foundation for a responsive local government system:**
As Thromdes become fully functional urban local governments, they would need to strengthen local accountability to their citizens and stakeholders as part of enhancing the overall social contract. Bhutan has already become a well-functioning democracy, having successfully managed the conduct of free and fair elections twice as well as ensured a peaceful transfer of power between successive governments both at the national and local levels. As the role of local governments increase in terms of efficient delivery of municipal services and being accountable institutions, adequate formats and structures for effective citizen engagement (such as, genuine consultative process) would need to be bolstered in the Thromde governance system. To the extent participatory forums and processes can be embedded within the local government systems and processes and work to complement upward accountability arrangements such as public expenditure and financial management systems, these have greater chance of success and sustainability.

65. Finally, the RGoB could also strengthen information systems pertaining to local governments, local planning, service delivery and local economic development. Norms, systems, modalities and personnel to collect, catalogue, analyze and transmit key data to stakeholders related to local governance is a priority and efforts are being made by the Government in this regard. Nevertheless, the full scope of opportunities offered by new digital and disruptive technologies, including big data, artificial intelligence, robotics and others, could be more systematically pursued, as also greater transparency in sharing the information across stakeholders.

**Table 5. Timelines for Key Reforms on Decentralization and Local Governments**

<table>
<thead>
<tr>
<th>National level</th>
<th>Short to medium term</th>
<th>Medium to long term</th>
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<td>Clarifying functional and fiscal assignments of local governments with a view of empowering Thromdes and making the more capable, resourced and accountable, while also strengthening delegated and deconcentrated assignments at the Dzongkhag levels.</td>
<td>Moving towards and asymmetric and differentiated model of decentralization strategy that is also consistent with the country’s economic, regional development and demographic policies and strategies.</td>
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<td>Formula-based transfers for Thromdes addressing key issues of fiscal gaps, predictability in transfers and incentivizing own source revenue enhancement.</td>
<td>Establishing dedicated institutional modalities and systems for local government capacity building.</td>
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<td>Establishing institutional modalities for intergovernmental dialog and coordination between central government and thromdes as well as other devolved units of government.</td>
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<td>Strengthening information systems across all levels of government and introduction of new technologies that aid greater transparency, efficiency and effectiveness in decision making and public expenditure process related to local governance and service delivery.</td>
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| Local level | • Deepening citizen interface and bottom up accountability of local governments through new norms, capacity building and testing of new modalities of social accountability (social audits, citizen assemblies, report cards, score cards, budget transparency, etc.).

• Strengthening local government training and capacity building modalities, especially focusing on core areas such as revenue-expenditure management, own source revenue collection, financial management and procurement, project management. |

Source. […] |