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Fiscal Decentralization Practices in Ethiopia: Oromia Regional State in Focus

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Abstract:

As one of the four dimensions of decentralization, fiscal decentralization has been practiced across the globe as a solution for the unaccountable and non-responsive problems of centralized governance system since the 1980s and since 1991 in Ethiopia. Since then, Ethiopia has been implementing decentralization; yet, little has been achieved so far if decentralization is understood as empowering lower level governments and addressing the needs and preferences of local people. The general purpose of this study was to assess the practices of fiscal decentralization in Ethiopia particularly in Oromia National Regional State. The study mainly employed quantitative approach based on a panel data on revenue and expenditure assignments between the federal government of Ethiopia and the national regional government of Oromia. It applied the two standard measures of fiscal decentralization: Expenditure Ratio(ER) and Revenue Ratio (RR). The major findings of the study show that fiscal decentralization trend in Ethiopia is so erratic that goes ups and downs with no smooth improvement. Though there has been an increase in the size of sub national governments, their expenditure share is better only in recurrent expenditure whereas the major share of capital expenditure has been under the control of the federal government. Regardless of bulk assignments of recurrent expenditure responsibilities and relatively little assignment of capital expenditure given to sub national governments, there has been huge vertical imbalance brought by the centralization of most productive tax sources by the federal government. The study found that, while the average share of sub national governments' expenditure was 39.4% (with an increasing trend), the average revenue share of sub national governments' remained stable around 28.3% in the fiscal years 2010/11 to 2015/16. This resulted in low fiscal autonomy of sub national governments making them heavily dependent upon federal transfer. Particularly in Oromia regional state, the average regional expenditure share of the country's total was found to be 11% while its average own revenue share of the country was 4.2%. From this, the region averagely covered only 24.4% of its total expenditure by its own revenue sources leaving the remaining 75.6% to be covered by federal transfer. Further, fiscal decentralization to Woreda level administration in Oromia region was found to be discouraging. The average Woredas' share of the regional expenditure was 50% and this figure is the least among the other regional states of the country. With regard to fiscal decentralization in revenue assignments, averagely, Woredas covered only 26.9% of their expenditure by their own revenue sources leaving the remaining 75.1% to be covered by subsidy from the regional government. The study concluded that although fiscal decentralization is promising in Ethiopia, therefore, in order to benefit from fiscal decentralization substantially, subnational governments should be empowered by assigning more capital expenditure responsibilities and adequate revenue sources that can help them to plan and work on developmental efforts to address the needs and preferences of local citizens.

Keywords: Decentralization, fiscal decentralization, revenue assignment, expenditure assignment, vertical fiscal imbalance.

1. Introduction

Fiscal decentralization is the enhancement of financial independence of local authorities by delimiting the functions of the local and central authorities in the public economic sector. It is the process through which specific levels of government decision-making and implementation responsibilities in public finance is redistributed to lower levels of government fiscal economy upward to downward. The main principle of distribution of financial resources at different levels of governing is expressed in the rule of fiscal decentralization. Hence, the concept of fiscal decentralization justifies the separation of the central and local government (Luiz and Mello, 2002).

Fiscal decentralization can be implemented in a smaller or larger extent in different countries. It is a transfer of financial power to the local institutions which may be subordinate to the central government completely or partly, but in both cases accountable to it. On the other hand, decentralization is implemented by transferring the financial management functions to the local government (Davulis, 2013).

Fiscal decentralization may induce more efficient debt and expenditure management by local governments and boost transparency and accountability in sub-national budgets. Traditionally a number of fiscal responsibilities associated with the central government have been progressively decentralized to sub-national, particularly local tiers of government. In a growing number of countries, local governments are now enjoying greater autonomy in budget execution, expenditure and debt management. In addition, it is associated with enhanced quality of government as measured by citizen

participation, political and democratic accountability, social justice, improved economic management and reduced corruption (Ibid).

Decentralization of responsibilities associated with the provision of public services makes budget spending more effective since it brings public authorities closer to the population, making the authorities accountable to the electorate and take better account of their preferences. Decentralization of budget revenue mobilization responsibilities makes it possible to define the specifics and composition of the tax (revenue) base thus ensuring higher tax and other revenue collections. By decentralization of certain public functions in the course of reform means the responsibility for its performance is transferred from central authorities' field branch to the sub-national (regional or municipal) public authorities (Andreeva, 2003).

Ulbrich (2003) defines budget as a plan of expenses that is based on expected income and setting priorities for the amount and worth of services to be delivered and/or the reassigned to be prepared. He also stated that the development of budgets comprises a plan of revenue, forecasts of spending and a mechanism of adjusting any gap between incomes and expenses. Budget implementation entails a number of choices regarding the execution of public policy in a wide variety of service delivery areas. Budget execution also consists of a range of control functions maintained by centralized staff departments, such as finance, purchasing and budgeting. In the same way that most local government processes of budget yield policy by default—that is, by not considering policies explicitly and simply ratifying the previous year's spending schemes—these control functions seek to maintain the policies manifested in the budget document by simply ensuring that spending follows budgeted authorizations. Good staff services alone do not make a good organization.

It is now almost two decades since the federal structure is set up in Ethiopia by adoption of the Transitional Charter in 1991 and the subsequent ratification of the Federal Democratic Republic of Ethiopia (FDRE) constitution in 1995. The constitution has also distributed the fiscal decision making powers between the federal government, the nine regional states and the two city administrations. The theory of fiscal decentralization, involves the assignment of responsibilities and functions between the federal governments and the sub-national governments and the assignment of taxation powers. However, it is usually contended that the expenditure responsibilities imposed upon sub-national governments far more exceed their revenue power which puts them in disadvantageous position by letting them substantially dependent on the central government at the expense of prejudicing their autonomy (Tegegne, 1998). In other words, the distribution of tax base (revenue power) of sub-national governments and the demand for public goods (their expenditure duties) does not follow equal pattern and this gives rise to the emergence of fiscal imbalances, vertical or horizontal.

A vertical fiscal imbalance occurs when own revenue and expenditure capacity of various levels of government within a federation are unequal. It is the result of an allocation of expenditure responsibilities with higher cost than the source of revenue assigned to sub-national governments. On the other hand, horizontal fiscal imbalance occurs when the own fiscal capacities of sub-national governments of the same level differ. It emerges usually as a result of tax base due to uneven distribution of economic resources and activity across region (Ibid). Hence, the purpose of the study is assessing the practice of fiscal decentralization in Ethiopia with particular emphasis of Oromia National Regional State.

1.1. Problem Statement

Decentralized forms of governance have been practiced across the globe as a solution for the unaccountable and non-responsive problems of centralized governance since the 1990s (Kundishera, 2009). Oosmmen (2008) explains that decentralization process is inoperative and meaningless without the proper functioning of one of its dimensions, fiscal decentralization.

In Ethiopia, the coming into power of the EPRDF rule in 1991 has brought the chance for the introduction of decentralized forms of governance (Chanie, 2009). This decentralization process in Ethiopian context has come into practice in to two separate phases. The first phase covers the period 1991 to 2001 which was characterized by the decentralization of powers from the central government to autonomous national regions. The second phase of decentralization came into exercise as of 2002 and is characterized by devolution of powers and responsibilities from regional to woreda level governments.

According to Smoke (2010), fiscal decentralization in developing countries is characterized by imbalance assignments of revenue sources and expenditure responsibilities to sub-national governments by the central government.

Gebre-Egziabher (2007) explained that decentralization in Ethiopia was at an embryonic stage which was characterized by limited fiscal autonomy of regional governments. Although there have been a number of research works on decentralization in Ethiopia, little has been done on fiscal decentralization especially in Oromia regional state in recent years. Therefore, this study attempts to explore the practices of fiscal decentralization in Ethiopia particularly in Oromia National Regional State.

Given the above problem, this paper tries to answer the following fundamental research questions:

- To assess the state of fiscal decentralization implementation practices,
- To examine the degree of autonomy in decision making in relation to revenue generation and expenditure assignments, and
- To examine the challenges and opportunities of fiscal decentralization.

2. Review of Related Literatures

Under this section, both theoretical and empirical literatures are reviewed as follows:

2.1. Concepts of Fiscal Decentralization

Fiscal decentralization is one component of decentralization that gives authority to local governments to collect revenue through taxes and responsibility over spending decisions. Even though fiscal decentralization has given revenue raising and spending decision powers to lower levels of government, the implementation process has often been overwhelming task for many local authorities in the developing world (Mbedz, & E., Gondo, 2010).

It is argued that if sub national governments are to carry out decentralized functions effectively, they must have adequate revenues raised locally or transferred from the central government, as well as the authority to make expenditure decisions.

- According to Kee (2003), there are three reasons for a renewed interest in fiscal decentralization as a reform.
- Central governments are recognizing that it is impossible for them to meet all of the competing needs of their various localities, and they are attempting to build local capacity by delegating responsibilities downward to their sub national governments.
- Central governments are looking to sub national governments to assist them on national economic development strategies.
- Sub national political leaders are demanding more autonomy and want the taxation powers that go along with them.

2.1.1. Pillars of Fiscal Decentralization

According to Bird (cited in Ebel & Yilmaz, 2001), the design of fiscal decentralization is based on four pillars namely expenditure assignment, tax assignment, intergovernmental transfers /grants, and sub national borrowing / debt.

2.1.2. Expenditure Assignment

Both theory and practice strongly suggest that expenditure responsibilities need to be stated as clearly as possible to enhance accountability and reduce unproductive duplication of authority and legal challenges. On this side, decentralization draws its argument largely on efficiency grounds, though it is also argued that lower level governments have some degree of distributional and stabilization roles. As the research is mainly related to this issue literature on the theory and principle of expenditure assignment is reviewed in the next section.

2.1.3. Tax Assignment

Tax assignment considers which level of government should tax what and how. The decentralization of expenditure responsibilities brings with it the need to decentralize revenue raising responsibilities. Otherwise, as many agree, the lower levels of government would be dependent up on funding from the central government and the full benefits of decentralized decision making and political accountability would not be achieved. Kim (2000), for instance, argued that when major portion of the locally determined expenditures is financed by the local tax, accountability to their voter's acts as a strong disciplinary primary force for rational decision making, and thus leads to efficient resource allocation.

2.1.4. Intergovernmental Transfer

An important reason for transfer is to enable sub national governments to undertake their functions satisfactorily when revenues assigned to them are found to be inadequate. The design of a transfer scheme depends on the purpose for which transfers are given. In a decentralized system the basic task of intergovernmental transfers include closing the fiscal gap, fiscal equalization, ensuring a minimum standard of public service, pricing externalities and achieving stabilization and political objectives. According to Hardy and Mihalijek (1972), it is possible to have reverse flows i.e. from lower level governments to the center (cited in Eshetu, 1994). For various reasons, however, both political and economic, central governments usually have greater revenue raising capacity than lower level governments.

2.1.5. Sub National Borrowing

Even with revenue and transfer arrangements in place, sub national governments may still find themselves with a short fall of revenue relative to expenditure. To bridge this gap the last resort is borrowing either in the open market or from governmental funds if such a pool is available. Sub national borrowing can be considered as an appropriate tool for sub national public finance because of three reasons: intergenerational equity, economic development, and synchronization of expenditure and revenue flows (Ebel and Yilmaz, 2001).

2.2. Emergence of Fiscal Decentralization in Ethiopia

Ethiopia has been enjoying the federal and decentralized system of governance since the end of 1990s almost after the overthrow of unitary 'Derg' regime. The country follows a federal system where the government power is divided between central government and nine regional states of governments as well as two special administrative cities. The regions are divided into zones, woredas/urban administrations, and kebeles (village areas, with an average population of 5,000).

The city administrations of Addis Ababa and Dire Dawa have different structures but are considered equivalent to regions. The zones in most regions are considered as the arms of the regional states of government whereas the Woredas are considered the key local government units in each region, with significant responsibilities for providing basic services. In connection with local governments, Article 50(4) of the Ethiopian constitution requires the regional states of government

to grant adequate power to lowest level units of government as to ensure direct participation of the people (Negussie, 2006).

In 2002/03 the government of Ethiopia initiated the second phase of decentralization with a series of legal, fiscal and administrative reforms beginning with four of the largest regions (Amhara, Oromia, SNNP, and Tigray), which together account for 87 percent of Ethiopia's population. It was during this phase that Woreda administrations and eventually urban administration with Woreda status became autonomous as local governments in Ethiopia (Garcia & Rajkumar, 2008; Gebre-Egziabher, 2007). This phase of decentralization seeks to empower communities to engage in development interventions, improve local democratic governance, and enhance the scope and quality of delivery of basic services at the local level.

2.3. Intergovernmental Fiscal Relations in Ethiopia

Fiscal imbalance refers to both vertical and horizontal regional imbalances. The former refers to imbalance between revenue means and expenditure needs at different levels of government while the latter refers to regional variations in correspondence between revenue base and expenditure requirement (Kibre cited in Tegegne *et al*, 2007). Though the formal based inter-governmental transfers system was introduced in Ethiopia in 1994/95 but it has been changed frequently basically on a yearly basis till 2006/07 since its introduction (Tegegne, 2009).

The policy of fiscal equalization is indicated in the proclamation No. 33/1992 in the form of subsidy to deal with vertical imbalance the proclamation states that the purpose of transfer (Subsidy are "to promote social services and economic development of the national/regional government, to accelerate the development of the neglected region, to narrow down the gap in per-capital income between regions, to support projects that help to control negative externalities, to encourage foreign currency earning project of national interest (TGE,1992).

The proclamation further states the procedures for obtaining grants from the central government. Regions are expected to submit to the ministry of finance and the ministry of planning and economic development, their subsidy requests and their total expenditure requirement. The two ministries review the request in accordance with the objectives set for allocating subsidy (TGE, 1992).

3. Research Methodology

3.1. Research Approach and Design

Usually many research studies depend on both quantitative and qualitative research approaches; this study also employed both of the approaches in collecting, analyzing and interpreting data.

As Kothari (2004) notes, research design is the conceptual structure within which a research is conducted; it constitutes the blueprint for the collection, measurement and analysis of data. To this end, this study, assessment of fiscal decentralization practices, attempted to find out complete and accurate information regarding the existing facts and characteristics of the phenomenon under consideration in the study area. Therefore, the study employed descriptive research design that depends on clear definition of measurements, methods, population and sample.

3.2. Data Types, Sources and Collection Methods

The research relied on both primary and secondary data types and sources. Primary data were collected from sampled officers of the following government organizations both at the regional and federal levels (BoFED, BoR, MoFEC, MoFA and FPC) using Key Informant Interview and Focus Group Discussion.

The Ministry of Finance and Economic Cooperation (MoFEC), Oromia Bureau of Finance and Economic Development (BoFED), Oromia Bureau of Revenue (BoR) and World Bank (WB) documents and reports were used as important sources of secondary data which are quantitative in nature. Besides, qualitative secondary data were gathered from the policies, guidelines and working manuals of relevant institutions.

3.3. Sampling Design

According to Trembley (1957), the selection of key informants and focus group discussants for an inquiry is made strategically considering the structure and nature of the population and the type of the study. Thus, sample was taken purposely not randomly. Hence, sample respondents were selected taking into account the specialized knowledge and skills they have regarding the subject of the study and their duties, responsibilities and decision making power in the implementation of the decentralization process.

Accordingly, sample key informants consisted eight individuals from Ministry of Finance and Economic Cooperation, Revenue and Customs Authority, Oromia Bureau of Finance and Economic Development and Oromia Bureau of Revenue two head officers from each office.

3.4. Methods of Data Measurement and Analysis

To investigate the research problem at hand, the study focused on measures of the following four variables: the existence of enabling environment, sub national government revenues, sub national government expenditures and intergovernmental transfer systems.

Thus, the study examined revenue assignments, expenditure assignments and patterns of transfers between the three levels of governments using ratio analysis. The ratio analysis between sub-national government expenditures or revenues

and the total government expenditures or revenues measures the fiscal aspects of decentralization whereas, the aspects of institutional decentralization was measured qualitatively.

4. Findings

This section of the paper presents the findings of the study in line with its objectives.

4.1. Fiscal Decentralization Trends to Regions

4.1.1. Pillar -1: The Existence of Enabling Environment

The existence of constitutional or legal privileges for some minimal level of autonomy, rights and responsibilities to lower level governments. In this regard, the Ethiopian constitution Articles 51 & 52 list the powers and functions of the federal and state governments respectively. With respect to revenue assignment, Articles 95 - 99 delineate the exclusive revenue sources for federal and states as well as the concurrent powers of taxation. Article 36 of proclamation 7/1992 & Article 7 (2-3) of proclamation 33/1992 state the intergovernmental transfer systems. Article 5 Proclamation 7/1992 recognizes the right of regional governments to borrow from domestic sources.

The expenditure assignments given to the federal and state governments are not explicitly defined unlike that of the revenue assignments - emanate from the powers and functions - Art. 51 and 52. The constitutionally given tax sources to regions are not according to the objectives of revenue sharing mentioned in proclamation 33/1992 art. 3. The concurrent power of taxation lacks clarity for shared responsibilities. Domestic borrowing is too procedural & has not been practiced.

4.1.2. Pillar -2: Expenditure Ratio Measurement of Fiscal Decentralization

Expenditure responsibility assignment refers to the assignment of resource allocation power to lower level governments. Of the four building blocks of fiscal decision making powers and management responsibilities to lower levels of a government, the amount of expenditure at the lower levels relative to the aggregate national expenditure is one of the means of measuring the degree of fiscal decentralization.

As it is presented in table 1 below, the expenditure ratio of sub national governments in Ethiopia, including the two special city administrations (Addis Ababa & Dire Dawa), reveals slight increases from the fiscal year 2010/2011 to 2015/2016. The expenditure ratio increased from 43.5% in 2010/2011 to 52.1% in 2015/2016. This gradual slight increases in the share of sub national governments' expenditure indicates that the size of state governments in Ethiopia has been increased over time. The average expenditure share of the regions from 2010/11 up to 2015/16 was 39.4% which is almost equivalent with the average share from 2004/05 to 2009/10, i.e. 39.1% (Diriba, 2015). This implies that during the 12 fiscal years from 2004/05 up to 2015/16, while the average expenditure share of the 11 sub national states was 40%, the federal government controlled 60% of the consolidated national expenditure. This shows that how infant expenditure decentralization in Ethiopia is.

With regard to the expenditure share of Oromia regional state relative to the entire national expenditure, it increased from 11.2% in 2010/2011 to 14.1% in 2012/2013. However, in the next three consecutive fiscal years, it had been erratic by decreasing to 13.7% in 2013/2014, increasing to 14.5% in 2014/2015 and again decreasing to 13.8% in 2015/16 that showed inconsistency and unpredictability character of the regional expenditure (Table 1). In all of the fiscal years, the share of Oromia was by far higher than the average share of one region in general, i.e. the average expenditure share of Oromia from 2010/11 to 2015/16 was 11% and the average share of a region during the same period was 3.6%. From this, one can infer that the size of Oromia regional state is by far bigger than the other sub national governments.

Fiscal Year	Federal Expenditure (1)	Block Grants to Regions (2)	Federal Expenditure Excluding Block Grants (3= 1-2)	Regions' Expenditure (4)	Oromia's Expenditure (5)	Total National Expenditure (6= 3+4)	Expenditure Ratio (%)		
							Federal (7= 3/6)	Regions (7= 4/6)	Oromia (8 = 5/6)
2010/11	77.23	24.16	53.07	40.83	10.5	93.90	56.5	43.5	11.2
2011/12	117.81	46.39	71.42	52.98	16.6	124.40	57.4	42.6	13.4
2012/13	137.84	56.56	81.28	72.72	21.7	154.00	52.8	47.2	14.1
2013/14	154.90	58.05	96.85	88.65	25.5	185.50	52.2	47.8	13.7
2014/15	178.57	66.52	112.05	112.4	32.6	224.90	49.8	50.2	14.5
2015/16	223.40	88.81	134.59	146.31	38.8	280.90	47.9	52.1	13.8

Table 1: Expenditure by Federal and Regional Governments and Expenditure Ratio (in Billion Birr)

(Source: Mofec; Bofed)

When the total regional expenditure of Oromia was segregated as recurrent and capital expenditures, the average share of capital expenditure over the consolidated regional expenditure from 2010/11 to 2016/17 was 33.5% while the recurrent expenditure was 66.5%. However, at the national level, the share of capital expenditure was higher than the share of recurrent expenditure.

4.1.3. Pillar -3: Revenue Ratio Measurement of Fiscal Decentralization

In terms of revenue ratio trend as a measurement of fiscal decentralization, the sub national governments' (including the two special city administrations) own revenue share of the consolidated national own revenue was extremely small (Figure 1) although the share has been risen relative to what it had been in the fiscal years from 2002/03 up to 2009/10. It was 11.8% in 2002/03 and rose to 19.9% in 2009/10 (Diriba, 2015). The average share of sub national governments own revenue from 2010/11 to 2015/16 was 28.3% which is higher than the 16.3% average revenue share of the regions from 2003/04 to 2009/10 fiscal years (Ibid). Averagely, the federal government share of the consolidated national own revenue was 71.7%. Thus, from revenue ratio dimension, fiscal decentralization in Ethiopia to the sub national government level is at an infant stage and it challenges the fiscal autonomy of sub national governments.

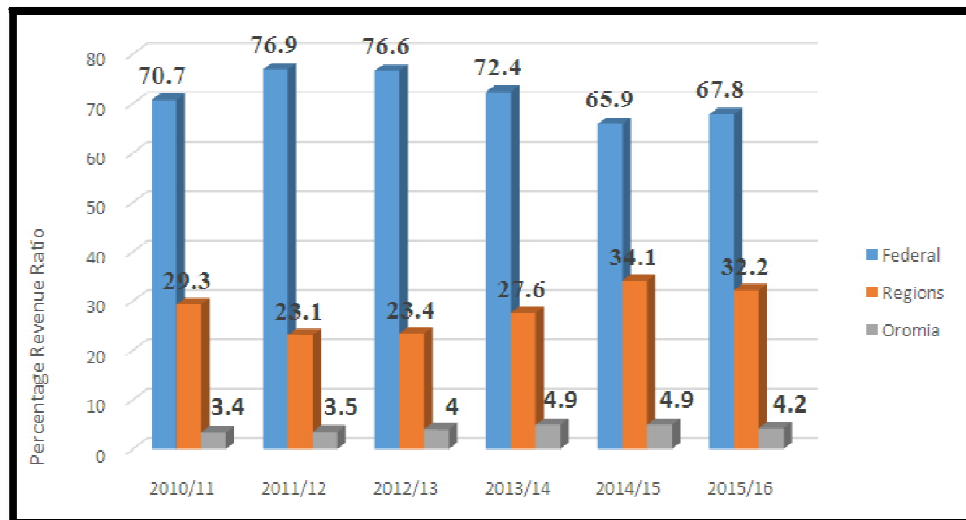


Figure 1: Revenue Ratio by Levels of Government in Percent
(Source: Mofec; Bor)

When we evaluate the own revenue generating capacity position of Oromia relative to the aggregate national and the average of the eleven sub national states, as the total regional revenue of Oromia got increased from 2.34 Billion Birr in 2010/11 to 9.8 Billion Birr in 2015/16, its share of the national revenue increased from 3.4% to 4.2% whereas, the average share of one sub national state with in the same fiscal years was 2.6%.

4.1.4. Pillar -4: Measurement of Fiscal Imbalance

Fiscal imbalance measures the mismatch between expenditure responsibilities and own revenue sources either by central or sub national governments. This fiscal imbalance tells us the level of fiscal autonomy of governments, i.e. the ability of different tiers of a government to cover own expenditure assignments by own revenue sources. Hence, in this part of the analysis, the fiscal autonomy of the federal government, the regional governments and Oromia are measured as follows:

As figure 2 shows, the capacity of the federal government to cover its total expenditure by own domestic revenue improved from 92% in 2010/11 to 117% in 2015/16. In 2010/11, it was only 8% of the expenditure which was not covered by own revenue. However, from 2011/12 up to 2015/16 it achieved more than 100% fiscal autonomy leaving the surplus amount transferred to regions as subsidy.

Regarding the capacity of regions (including the two special city administrations) to cover their total expenditure requirements by own revenue sources, it dropped from 49.6% in 2010/11 to 39.9% in 2012/13. Latter it improved from 39.9% in 2012/13 to 51.1% in 2015/16. Overall, the average fiscal autonomy of the regions from 2010/11 to 2015/16 was 47.8%. This figure could not cover their recurrent expenditure requirements let alone to contribute to capital expenditure. That means 52.2% of their expenditure depended on subsidy from the federal government.

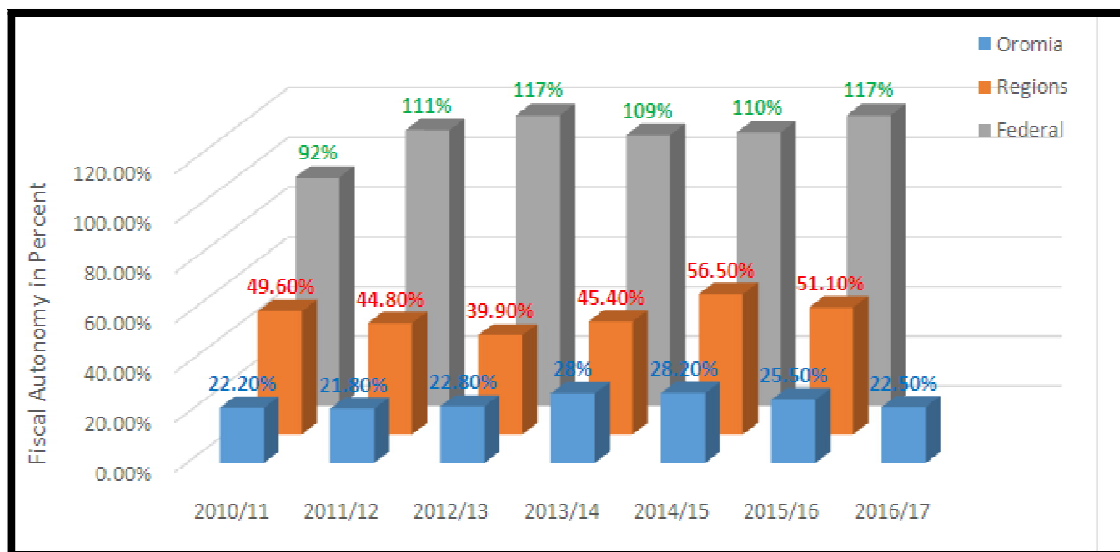


Figure 2: Fiscal Autonomy by Levels of Government in Percent

Source: Mofec, Bofed, Bor

The above presented fact shows that regions in the country were heavily dependent upon transfers from the federal government because of their limited share of the total government revenues. This vertical fiscal imbalance comes as a result of the mismatch between the expenditure responsibilities and the revenue capacity of regional governments. This usually represents the degree to which sub national governments rely on the federal government revenues to support their expenditure.

When we judge Oromia regional state in light of the above scenario, as it can be observed from figure 2 above, the capacity of the region to cover its total expenditure requirements by own revenue sources had been erratic. It had shown a slight capacity improvement from 22.2% in 2010/11 to 28.2% in 2014/15 and then dropped to 22.5% in 2016/17. Generally speaking, the average capacity of the region to cover its total expenditure by its own revenue from 2010/11 to 2016/17 was only 24.4% leaving the majority of its expenditure (75.6%) being dependent up on federal transfer. This capacity could not cover even the 30.3% average capital expenditure of the region.

4.2. Fiscal Decentralization Trends to Woredas in Oromia Regional State

Under this topic, fiscal decentralization from the regional states of Ethiopia to the third level of government (Woredas) is going to be discussed by focusing on Oromia regional state.

4.2.1. Pillar -1: The Existence of Enabling Environment

The primary legal source of intergovernmental fiscal relation is the regional constitution 2001. The structure of the regional state and division of power is stated under Article 45 of the regional Constitution. Powers and responsibilities are detailed in Article 47(2) (a-g) while assigned revenue sources of the region are detailed in (h-q). Article 70(1) presents functions of Zonal Administration and 71(1-3) presents Zones as Administrative unit established below regional state comprising of certain districts to support and coordinate activities of districts. Article 76 recognizes District Administration as a council organized below the regional council. Article 79(g) mandates Districts to ensure the proper collection of taxes. Block grant remained a single instrument to cover their expenditure responsibilities.

4.2.2. Pillar -2: Expenditure Ratio Measurement of Fiscal Decentralization in Oromia Region

With regard to the share of Woredas' expenditure from the total regional expenditure among the four pioneering regions of the country, there had been slight increases per every fiscal year in Oromia region from 52% in 2005/06 to 60% in 2008/09 (Diriba, 2015). As to Diriba, in this measurement of fiscal decentralization, Oromia regional state was the least among the other regions of the country. However, that trend was reversed by decreasing from 63.2% in 2010/11 to 44.9% in 2012/13, and then it showed gradual increases in the next four consecutive fiscal years and reached 60.7% in 2016/17 (Figure 3). Overall, on average a 50:50 percent share of woredas and Bureaus expenditure in the region showed that expenditure fiscal decentralization to woreda level is unsatisfactory as it is against the principle which says significant responsibilities should be given to lower level governments for efficient allocation of resources. Further, the erratic trend in the share of woredas' expenditure over the regional total while the regional total had been increasing indicates there is no clearly defined expenditure responsibilities given to woreda level administration in the region.

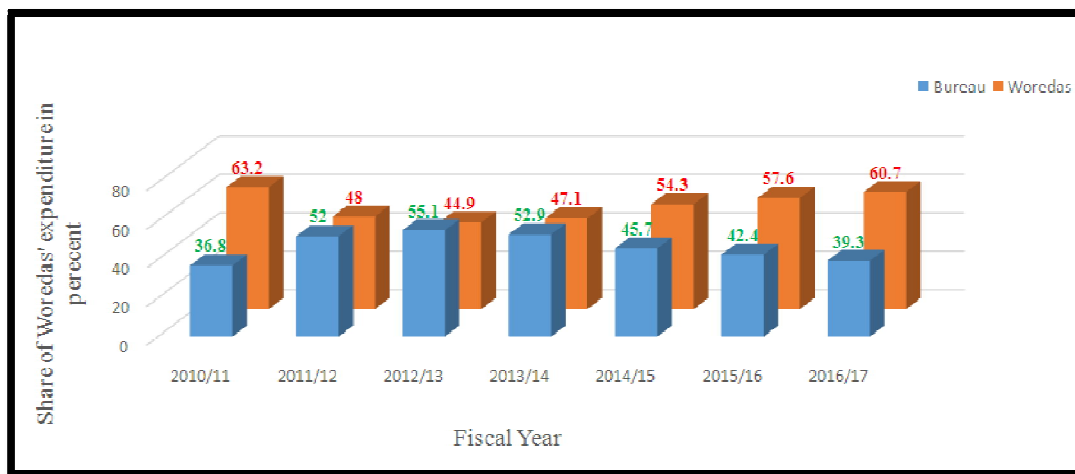


Figure 3: Share of Woredas' Expenditure from the Total Regional Expenditure of Oromia
Source: BOFED

Furthermore, when the total woredas' expenditure was segregated as capital and recurrent expenditure, the average share of capital expenditure from 2010/11 up to 2016/17 was 9.6% whereas the recurrent share was 90.4%. Thus, this share shows that capital expenditure decentralization to woreda level of administration in the region is by far so infant than recurrent expenditure decentralization.

4.2.3. Pillar -3: Revenue Ratio Measurement of Fiscal Decentralization in Oromia Region

The other dimension of fiscal decentralization is the assignment of tax sources to Woredas. Like the federal and regional governments of Ethiopia, tax sources are assigned to regional bureaus and Woreda level administration in Oromia (The revised constitution of Oromia regional state Article 47 (2) h - q).

When we see the revenue trend of the region, the total own revenue of Oromia regional state increased from 2.34 billion in 2010/11 to 10.59 billion in 2016/17. From the total regional revenue, in the fiscal years from 2010/11 up to 2016/17, the average contributions of direct tax, indirect tax and non-tax revenues were 61.84%, 26.19% and 11.97% respectively (Table 2).

Fiscal Year	Aggregate Revenue	Direct Tax	Indirect Tax	Non-Tax	Capital	Ratio in %		
						Direct Tax	Indirect Tax	Non-Tax
2010/11	2,341,901,570.04	1,442,506,260.32	551,579,439.1	344,851,498.2	2964372.44	65.5	23.6	10.9
2011/12	3,593,928,942.25	2,212,539,739.79	926,792,806.85	451,933,345.37	2663050.24	61.6	25.8	12.6
2012/13	4,964,846,105.72	2,898,201,952.68	1,410,474,266.11	653,289,916.12	2879970.80	58.5	28.4	13.1
2013/14	7,135,424,380.44	4,185,384,465.26	2,073,607,905.76	873,131,196.16	3300813.26	58.9	28.4	12.7
2014/15	9,167,122,635.87	5,527,256,613.20	2,573,492,989.30	1,063,437,609.66	2935423.72	60.3	27.6	12.1
2015/16	9,832,768,720.73	6,263,211,096.11	2,508,409,152.73	1,058,303,339.34	2845132.55	63.7	25.5	10.8
2016/17	10,596,259,308.62	6,832,425,100.14	2,536,092,150.49	1,227,055,699.33	686358.66	64.4	24.0	11.6

Table 2: Oromia Regional State Revenue by Source
(Source: Oromia Revenue Bureau)

According to Motuma (2011), the share of direct and indirect taxes of the Oromia region own revenue was 67% & 6% in 2003/04, and 59% & 23% in 2009/10 respectively. He associated the increase in the contribution of indirect tax from 6% to 23% with the introduction of VAT since 2005/06. From 2009/10 onwards, the contribution of indirect tax gradually increases and reached to 28.4% in 2013/14.

With regard to the contribution of Woredas and Bureaus to the total regional revenue, averagely, Woredas contributed 75.2% of the regional revenue and the remaining 24.8% was contributed by the regional Bureaus during 2010/11 to 2016/17 fiscal years (Table 3.6). The contribution of Woredas was 66% in 2003/04 and 72% in 2009/10 (Motuma, 2011). This implies the largest share of the regional revenue are collected by the lower level governments of the region.

Fiscal Year	Bureaus' Revenue (1)	Woredas' Revenue (2)	Regional Revenue (3= 1+2)	Ratio in %	
				Bureaus (4= 1/3)	Woredas (5= 2/3)
2010/11	501869335.81	1,840,032,234.23	2,341,901,570.04	21.4	78.6
2011/12	819864522.26	2,774,064,419.99	3,593,928,942.25	22.8	77.2
2012/13	1,206,445,146.96	3,758,400,958.76	4,964,846,105.72	24.2	75.8
2013/14	2,291,810,514.52	4,843,613,865.92	7,135,424,380.44	32.2	67.8
2014/15	2,377,121,700.65	6,790,000,935.22	9,167,122,635.87	26.0	74.0
2015/16	2,309,789,183.54	7,522,979,537.19	9,832,768,720.73	23.5	76.5
2016/17	2,396,042,169.40	8,200,217,139.22	10,596,259,308.62	22.6	77.4

Table 3: Woredas, Bureaus and Regional Revenue & Percentage Share
Source: ORB

4.2.4. Pillar -4: Measurement of Fiscal Imbalance

Woreda level governments in the region have been challenged by inadequacy of own revenue sources to discharge legally assigned expenditure responsibilities. As it is presented in the Table 4 below, averagely, Woredas covered 26.9% of their expenditure by own revenue in 2010/11 and 28.8% in 2016/17. Woredas' average fiscal autonomy was found to be 34.5% in the fiscal years between 2010/11 and 2016/17. This trend implies that Woredas in the region are heavily dependent upon subsidies from the regional government to cover their expenditure requirements. This may have an impact on the budgeting and planning process of capital expenditure to provide economic and social services to citizens according to their needs and preferences which is actually the primary intension of decentralization.

Fiscal Year	Woredas			Bureaus			Oromia		
	Revenue (1)	Expenditure (2)	Fiscal Autonomy (3=1/2)	Revenue (4)	Expenditure (5)	Fiscal Autonomy (6=4/5)	Revenue (7)	Expenditure (8)	Fiscal Autonomy (9=7/8)
2010/11	1.8	6.7	26.9	0.5	3.9	12.8	2.34	10.54	22.2
2011/12	2.8	8.0	35	0.8	8.7	9.2	3.60	16.16	21.8
2012/13	3.8	9.7	39.2	1.2	11.9	10.1	4.96	21.70	22.8
2013/14	4.8	12.0	40	2.3	13.5	17.0	7.14	25.46	28
2014/15	6.8	17.7	38.4	2.4	14.9	16.1	9.17	32.56	28.2
2015/16	7.5	22.3	33.6	2.3	16.4	14.0	9.87	38.74	25.5
2016/17	8.2	28.5	28.8	2.4	18.5	13.0	10.60	52.26	20.3

Table 4: Revenue & Expenditure (in Billion Birr), and Fiscal Autonomy (in Percent) Trend of Woredas in Oromia (Source: Obor, Obofed)

5. Conclusions and Recommendations

5.1. Conclusions

The paper had the task of analyzing the nature and degree of fiscal decentralization in Ethiopia with particular focus on Oromia regional state in the fiscal years 2010/11 to 2016/17.

The main findings of the study are summarized based on the major dimensions of fiscal decentralization which include the extent of enabling environment, expenditure ratio and revenue ratio of sub-national governments & local governments, and intergovernmental relations.

With regard to enabling environment, Ethiopia's constitution promotes fiscal decentralization and it has provisions about expenditure assignment implicitly and revenue assignment explicitly between the central government and the states. There are also institutional arrangements to coordinate, execute and control its implementation. However, the constitution is not strengthened by specific laws that accommodate clear, specific and detail aspects of expenditure and revenue assignments among levels of government in the country. Likewise, in Oromia regional state, the regional constitution stipulates the expenditure powers and responsibilities of the regional and district level governments and tax sources. However, the expenditure power of districts is limited and it is covered by grants from the regional government.

To analyze the trends of fiscal decentralization at sub national and district level of governments in Oromia regional state, expenditure and revenue ratio measurement models were used. In this regard, expenditure ratio shows a gradual improvement from 43.5% in 2010/11 to 52.1% in 2015/2016 at sub national level. In reference to the expenditure share of Oromia of the total national revenue, the share increases from 11.2% in 2010/11 to 13.8% in 2015/16 (though it had been erratic per year). This increase in expenditure share of sub national governments shows the increase in the size of the governments. However, their share of capital expenditure relative to the recurrent expenditure is small. This shows that fiscal decentralization to sub national governments in terms of capital expenditure is so infant in the country.

With respect to expenditure share of districts/woredas in Oromia regional state, the expenditure share of districts is found to be erratic every year. However, the average expenditure share of woredas of the regional total is 50%. Which means 50% of the total regional expenditure is controlled by bureaus of the region and the average capital expenditure share of woredas is found to be 10%.

With respect to revenue ratio, The average share of sub national governments' revenue from 2010/11 up to 2015/16 was 28.3% which is higher than 16.3% average revenue share of regions during 2003/04 to 2009/10 fiscal years (Diriba, 2015). This fact showed that regions in the country are heavily dependent on transfers from the federal government because of their limited share of the total government revenues. Thus, from revenue ratio dimension, fiscal decentralization in Ethiopia to the sub national government level is at an infant stage and it challenges the fiscal autonomy of the regions.

In terms of vertical fiscal imbalance, large proportion of sub national governments' expenditure (on average 68.3%) had been financed by federal transfers during the fiscal years 2010/11 to 2015/16. This implies that sub national governments are heavily dependent on the transfer from the federal government which means that the fiscal capacity and autonomy of regions are minimal. When we see the average revenue share of Oromia from the total domestic national revenue it is found to be 4.15% during the fiscal years 2010/11 to 2015/16. However, averagely the regional revenue covers only 40% of its total expenditure requirements and the remaining 60% is covered by grants transferred from the federal government.

At district level in oromia regional state, with regard to revenue collection, of the total regional revenue averagely 75.2% is collected by districts. However, districts have no autonomy over revenues and the collected revenues are returned to districts as grants.

5.2. Recommendations

Based on the findings of the study, the following recommendations are suggested so as to further realize sound and effective fiscal decentralization in Ethiopia in general and in Oromia regional state in particular:

- Regarding expenditure responsibility assignments, in addition to the constitutional provisions, there should be a detailed and clearly defined legal framework that can govern it explicitly. Especially, concurrent expenditure responsibilities need to be clearly defined at all levels so as to avoid duplication of efforts and confusion on spending plans. Therefore, the distribution of expenditure responsibilities among levels of government should be largely in accordance with the economic principles of fiscal federalism and common practices of other decentralized countries in the world (Nigerian expenditure assignments). As to key informants, States and Woredas in Ethiopia have been created to behave more of as agents of the center, and perhaps for the primary purpose of political distribution of national resources, and not for effective delivery of public services. Thus, the exclusive responsibilities of the Federal Government of Ethiopia should be in accordance with standard international practices, including matters of national concern such as defense, foreign affairs, regulation, and monetary policy.
- Besides, the role of the federal government should be defining minimum standards of service delivery, providing equalization transfers for those states which short fall to cover their expenditure responsibilities.
- Since spending and service-delivery assignments among levels of government are usually decided by the basic criteria of fiscal performance, namely, efficiency, income redistribution, and macroeconomic stability, taking the first criterion which refers to the extent to which the public service delivery satisfies the needs and preferences of taxpayers at the lowest possible cost for both service providers and users, without compromising the other two criteria, capital expenditure assignment should be more decentralized to sub national and woreda level governments. Particularly, in Oromia regional state, capital expenditure responsibilities should be more decentralized to Woreda governments like the recurrent expenditure responsibilities so as address efficiency argument of decentralization. The regional government should decentralize more capital expenditure responsibilities to districts so as to ensure grassroots participation in development issues.
- For better expenditure efficiency, there should be performance standards accompanied by reward and punishment at sub national and local level governments.
- The existing tax source assignments between the federal and regional governments that favors the central government should be revised without compromising macroeconomic stabilization and income distribution role of the central government so as to improve the fiscal autonomy of sub national governments. For instance, unlike other federal states, all property taxes are not given to local governments, thus, these taxes should be assigned to local governments.
- The existing shared revenue ratio of 50:50 for direct taxes and 70:30 for indirect taxes between the federal government and regional states need to be revised and large proportion should be given to regions to realize further progress in fiscal decentralization. On this count, the language of the constitution is not transparent and there is still considerable debate as to its implication for revenue sharing. However, the fact is that a move towards federalism based on the derivation principle is gaining ground. This is potentially a highly explosive issue making fiscal federalism in Ethiopia more of a political bargaining game than an economic exercise of establishing equitable and minimum standards of basic services throughout the country.
- Borrowing by regional governments seems to be more of a smoke screen rather than a genuine financing mechanism. The articles governing and defining the procedures involved and the sources of credit are muddled and vague. The most generous interpretation of the sentiment (and definitely not the appropriate legal provisions) leans towards a working arrangement whereby the central government borrows on behalf of the regional governments from the National Bank of Ethiopia. Thus, since borrowing serves as an adequate source to investment capital, there should be a genuine legal framework that could allow sub national governments to raise funds from domestic sources. Thus, borrowing by sub national governments from domestic sources should be practiced considering the paying ability of the states from their own revenue sources so as to not to go to soft budget constraints.
- The Federal government should try to reduce money transfers while increasing local revenue sources, such as taxes, in an effort to create more self-sufficient sub national governments.
- As a result of extreme dependence on the federal transfer, lower level governments always blame lack of resources as the problem behind lack of performance without having the right incentives to deliver with any given level of resources. Therefore, the general purpose of subsidy in the country should be to encourage certain types of spending by the lower tiers of a government that are considered to be either national priorities or to have positive spillovers to other jurisdictions.
- The federal government should honestly work hard to capacitate regional governments for enhanced implementation of fiscal decentralization. Besides, the regional government should have continuous woredas' capacity building programs so as to enable them to attract and retain competent professionals in the area with the required infrastructural facilities.

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