

Federal-State Fiscal Relation: The Ethiopian Experience (A Descriptive Study of the Southern Nation, Nationalities, and People's Regional State)

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Abstract

This study focuses on the central-state relation on public expenditures from the view points of public preferences at subnational governments' level and financing responsibilities incurred at the state and federal levels to accomplish the overall economic directions of the country. The study touches on how traditional views of public expenditures work in central-local relations and how they work in overall public revenue and expenditure responsibilities. It presents the revenue productivity and the degree of dependence of the regional governments on the central/federal government grants and what impacts this dependence would have on local revenue and expenditure, as well as the overall public responsibilities. Moreover, it shows how and why public sectors should minimize the degree of dependence on federal grants, and the relevance of revenue sources from constitutional point of view.

Key words: Fiscal decentralization, federal grant, revenue from own sources, public expenditure, total revenue, subnational governments dependence

1. Introduction

Decisions on public expenditures¹ and revenues are the main concern in fiscal decentralization in federal countries. Governments spend a large amount of resources making various decisions in performing various public responsibilities, and allow subnational governments to spend on public goods and services that may not necessarily conform with the federal government's ultimate objectives.

Compared to private expenditures, government spending is considerably large. It is also characterized by inefficiencies and lack of accountability, transparency, and responsibility in general. It most probably happens in many countries due to weak administrative and technical measures. Governments' operations and responsibilities are very complex and their targets in a particular expenditure are diverse, and achieving all these targets complex administrative and managerial structures and skills. In a centralized² government structure all the commands are located at the center and subnational governments are expected to accomplish the policy directions of the center. On the other hand, in a federal country the devolvement of responsibilities and accountabilities to the subnational governments eases the central burden of specific decisions. Furthermore, the degree of control over public operation in centralized and decentralized governments³ differ in that in a centralized system the accomplishment of policy can be evaluated from the viewpoint of the accomplishment of the centrally designed and approved policy directions. In the circumstance of decentralized structure, lower tiers are entitled to accomplish both the central government's policy and their local preferences together and strike the balance between them, that is, subnational governments are striking the balance between their local preferences and the central government's social, economic and political directions.

¹ Public expenditures require very comprehensive administrative, political, and economic decisions. For example, example, subnational spending accounts for 6 percent to 50 percent in twenty-one developing countries. In ten developing countries the local spending ranges between 12 percent and 53 percent with an average spending of 26 percent (Bird and Vaillancourt, 1998). Thus, decisions on public spending should be thoroughly scrutinized as they have impact on economic resources of government.

² A centralized system of governance makes the politician accountable for multiple subnational governments (Hindriks and Lockwood, 2004). Centralized system is most probably inconvenient to produce a diverse level of output across jurisdictions. It is aimed at maintaining a certain degree of uniformity across governments due to important informational and political constraints that would prevent the central government from achieving its objectives (Oates, 1999).

³ Findings of Hindriks and Lockwood (2004) show that decentralization matters in competency and honesty. They argue that decentralization dominates when politicians differ in competences, and the honesty difference of politicians would result in conflicting accountability effects of both subnational and central governments.

In this article, therefore, the interrelated questions such as “Has fiscal decentralization allowed subnational governments to make decisions on expenditures that would address their community’s interest? Are local governments raising revenues sufficiently from their revenue sources to finance their expenditures? Has public expenditure been harmoniously spent in local government levels to ensure public sector efficiency?” The above all questions are asked to answer the main question “Has fiscally decentralized structure empowered subnational governments in exercising their power on revenue and expenditure decisions?” This article heavily relies on the financial data and responses collected from regional and local governments.

2. Theories of Federalism

2.1. Theory of Fiscal Federalism

Public finance is related to the responsibilities of a government in the economy as a whole. It deals with the roles of government on revenue and expenditure decisions in the economy and to take needed actions in favorable and unfavorable economic situations. Musgrave states the basic economic objectives of public finance as:

1. To ensure efficiency in allocation of resources;
2. To distribute income and wealth as desired; and
3. To maintain sustainability in output and the level of employment (cited in Oates, 1968).

The goal of public finance is to understand the government’s roles in the economy (Gruber, 2011, p.2). These above three objectives indicate the government’s responsibilities (functions) in the economy in allocating, distributing and stabilizing the economy using scarce resources available. Public finance is an essential requirement regardless of the type of government – either centralized or decentralized form.

The centralized government structure is characterized by concentration of decision-making powers at a particular location holding off the states or subnational governments from decision-making (Hindriks and Lockwood, 2005 p. 28). On the contrary, a decentralized government structure is characterized by devolution of powers and responsibilities of subnational governments to exercise their decision-making power in their territories. This is commonly known as fiscal federalism.

In discussion of federalism, we are compelled to go back to sixty years to refer to Tiebout’s work. He basically states the rationality of consumers of public services in that consumers are the best judges¹ and the *consumer-voter relation* is based on rational connection between them. According to his explanation, citizens can choose places that better satisfy their desires, which would create competition among governments (Tiebout, 1956).

Basely and Smart (2007, cited in Porcelli, 2009) also state the effect of election on accountability from two perspectives – selection effect and an incentive discipline effect. The selection effect is that the principals will not be voted by their people because of their inefficient services. And the incentive discipline effect is related with government officials’ motivation to improve their government quality aiming to increase their re-election probability.

However, can the voters (citizens in a given territory) be the true judges of their government? In which type of community can they be true judges? Are there any other factors that make the voters either to vote for or not to vote for their government? The Tiebout’s “*Voter-Government*” relationship may work within communities who are aware of their government’s responsibility to the expected level and have sufficient information regarding their government’s accountability and performance. Moreover, they have to have sufficient information about their government to compare their government’s performance with other governments’ performances. It has to be also underscored that governments are not in power because their citizens voted for them and any under-achievement of their promise does not necessarily penalize them. Thus, the Tiebout’s government has to be very benevolent and judged against its achievement by its citizens. Moreover, the vote doesn’t depend only on the existing achievement but also the promises and policy directions that the government has in the future. Of course, it is not deniable that public obligations have an impact on citizen-government relation.

As said earlier, Tiebout’s theory argues that searching for efficient provision of public goods would solve the inefficiency problems of lower tiers of government. His model of mobility would be determined by the information available to the public regarding what responsibilities and accountabilities do local governments have in their jurisdictions and choices available to consumers of public services to select the best service providers around them.

Porcelli (2009) states that second generation theory of fiscal federalism relates the effects of fiscal decentralization from the view point of political process and the possibility of information asymmetry² across the

¹ Consumers are free to choose efficient subnational governments and their connection is determined by what the subnational governments are providing to satisfy their need(s). Tiebout considers voters as free to vote or refuse to vote based on what they actually know and understand about the performance of their government so that their vote is based on what they actually observe on the ground.

² Rodden (2003) states that officials would abuse information asymmetry and ignore preferences of citizens and wrongly define public choices.

agents and the principals resulting in inefficiency in the government performance.

In general, sustainable decentralization would smoothly perform when state and local governments are accountable for their taxpayers in raising revenue and aggregation of their expenditure needs (Zhou, 2009, p. 16). This would happen when the benefits from public services are tailored with the revenues that the subnational governments raise from tax and non-tax sources. This relation would also create accountability for inefficiencies in public services and policy failures at lower jurisdictions. This general concept is practically challenged in many ways if revenue sources are not sufficiently tailored¹ with public operations.

2.2. Tax Competition

Revenue sources assigned to the subnational governments play greater role in allocation of resources and effectiveness of policy goals and objectives because adequate funding to the subnational governments has a paramount contribution for the successful decentralization (Escobar-Lemmon, 2001, p. 25).

In a federal system, tiers of government have their own revenue sources and autonomy² on tax rates and tax bases. This would result in tax competition at local governments' level. Tax competition is related to tax rate reduction for some political and/or economic purposes. This would result in unfair competition of subnational governments in an economy and their fiscal needs (i.e., a yardstick competition). Do these arguments truly have influence on public revenue and expenditure decisions? This question actually needs a country-specific answer as it is very difficult to plainly accept the cases in the applications from the fact that different countries have different political, economic and administrative structures in even federal structures. In their empirical analyses, however, Hindricks and Lockwood (2005) state the existence of limited accountability when the tax rate is centrally set and observed by the voters in all regions. They argue that centrally set taxes are always uniform.

In a decentralized structure, the expenditure assignment has to be attached with local taxing powers to create the competition and to strengthen the relationship between citizens and their closer governments (Rodden, 2002). The efficient allocation of resources can be seen from the view point of local governments' proximity to their community as a result the decisions would be on public expenditures that the beneficiaries would prefer and control over resources would be strengthened and ensured as the residents are direct contributors of economic inputs to public goods and services. However, government's operation cannot be seen only from provision of public goods and services. There are political and other related factors that would determine its operation. Fischel (2006) argues on Tiebout's model that it omits politics, a supply side and a budget determination process. Closer governments can also be better evaluated and judged by their jurisdictions making their government accountable for what they have planned, actually performed, and the results they produced (either tangible or intangible outputs). This would hold veracity if first, voters have sufficient information about their government's operations and its specific tasks for which they are accountable. Residents' judgment may be compromised by other factors such as the tax rate that their government levies on their income or wealth. On the other hand, local governments may conceal (or become opportunist in) their power of decisions and tend to make their higher government accountable for the decisions they have made themselves.

Second, voters' judgment can be determined by their ability to compare the resources that have been spent for public services with their government's level of operation and outcomes they produced, among other things. One of the challenges of the residents is the information accessibility of their government and they also vote for other reasons such as family relation, family members, dominant clans' leaders; or they may punish because of other factors such as cast groups.

2.3. Which Government to Bear Stabilization Function

The basic issue that can be seen from the view point of stabilization³ in a federal system is whether a multi-tiered government can achieve its economic stability objectives doing its share of responsibility as a central government and allowing subnational governments to take part in economic decisions. With distinguished tasks, the central government's responsibilities are associated with themes of national scope and local governments with obligations of meeting local needs. Can the authority and assignment of responsibility make governments of various tiers to achieve a stabilization function (Oates, 1968)?

¹ In some governments, spending decisions are more decentralized than revenue sources, which would lead to high demand of transfer. On the other hand, revenue sources without decision-making power would also impair subnational discretions and doesn't allow local officials to consider the preferences of their communities.

² Autonomy enables subnational governments to decide on their affairs without the central dictates. It avoids the central government's interference on local matters. In addition to decisions on expenditures, it allows local governments to increase their revenues from their own sources (Martinez-Vasquez and Searle, 2007). Autonomy thus has an impact on local decisions and resources available to be spent for their preferences.

³ Stabilization function is fundamentally related to the macroeconomic policy controlling the prices in an economy. A stabilization function is not the responsibility at subnational levels because of the fact that they use fiscal rather than monetary tools in an economy. Central government is thus in the best position to accomplish the stabilization responsibility in an economy (Auerbach & Feldstein, 2002).

Due to various economic reasons, stabilization function is not at the hands of the subnational governments, although the aggregate amount of expenditure at the subnational levels is considerable. In USA, for example, public finance is the major responsibility of both central and state governments in that the central government takes the larger share of expenditure, which accounts for 63.5 percent of the total expenditure (21 percent of the GDP). The state governments also account for 36.5 percent of the total expenditure (12.10 percent of the GDP) of the country (Gruber, 2011). Soothing

Stabilization function is influenced by the government spending as a whole since the local decisions on public spending is part of the total expenditure of the country. The normative theory of fiscal federalism states that stabilization function has to be the central government's responsibility. Some of the factors influencing stabilization are the availability of the amount of currency in the market (money surplus), the currency printing and injecting it into the economy, and borrowing money from internal and external sources for public spending (particularly capital expenditures as a deficit financing approach suggests that governments have to invest in important expenditures and share the burdens among the generations in its settlement).

The stabilization function has to be managed by the central government due to the fact that management at regional level would most probably be economically expensive and challenging. The severity of the challenge would be very considerable if the preferences are highly diverse and the economic inequalities across the local governments are significant.

2.4. Fiscal Autonomy and Harmonization

Harmonization of local autonomy is indispensable in minimizing the uncoordinated decisions of states and local governments. These uncoordinated decisions of taxation cause problems such as insufficient provision of public goods, inefficient capital allocation of states, and manipulation of capital tax rates to increase their revenues (Wellisch, 2004, p.59). As Poddar and Mathur (cited in Bizoili and Sacchetto, 2011) state the Indian case that fiscal autonomy of the central government and the states has to be harmonized in order to ensure a simplified compliance level and enforcement in managing the tax rates, tax bases and the administrative structure. They mention that any difference in interstate fiscal autonomy leads to economic distortion. However, the harmonization of fiscal autonomy would take the decision-making powers of states in that it would force the regions to stick on policies set by the center but rarely suitable for their internal administration and cause for conflicts and non-compliance.

Although harmonization is needed for some tax structures such as VAT, it needs to consider the subnational tiers' conditions in which the economic situations and the value of the tax bases are specified. For example, the difference in state of VAT or sales tax would create the economic distortions by forcing the taxpayers to move from the area where the high tax rate is levied to the area where the low tax rate is levied. On the contrary, minor difference in the taxation of immovable properties located at some regions or states would not cause economic distortion through shifting economic resources from the area where the tax rate is high to the area where the tax rate is low. Thus, the economic distortion depends on the tax bases and their characteristics.

As Daniel P. Rentzsch discusses the structure of government in expenditure decisions of the Swiss cantons (see Bizoili and Sacchetto, 2011), the system of federalism believes that if the level of government has competence to legislate on certain areas, it has to finance its expenditures while executing them. This argument shows that the level of government to which tasks are assigned should also bear the costs of executing the tasks.

The practice of the federal council of the Swiss government shows that it prepares a financial plan, the draft budget and the expenditure of the confederation, and the budget is adopted (ibid). When special circumstances are considered, expenditures are decided by qualified quorums (for example, when debts exceed the maximum limit, or the new non-recurrent or recurrent expenditures are to be approved).

3. Subnational Government and Their Autonomy in Ethiopia

The aim of decentralization is to allow subnational governments to decide on the basic needs of their citizens. Local needs are very diverse and meeting them at the same time is impossible. It needs a consistent and strong commitment and financial, human, and material resources. In principle, subnational governments know their community's choice better than the central government. Government's ability to accomplish citizens' needs is determined by the human and financial resources, among other things, and the power given to take action on public responsibilities.

The division of subnational governments in Ethiopia is characterized by heterogeneous classification of sub-units. This classification has a unique feature in its economic and/or political environment. Firstly, economic and/or political decisions are based on the limit of their jurisdiction as a result spillover effects are not getting much attention in the savings of aggregate national economic resources. Secondly, resources allocated to some political boundaries have to be consumed either within the specific period (budget year) or even after the budget year (no refund whether or not the budget is partially or totally consumed in a given year), which poses difficulties in budget control. In other words, control over resources at a given level is weakened and the allocation of resources for policy priorities or local preferences can be unwisely consumed at lower levels of

government. If local governments have this incentive, they would not be able to accomplish their plan as variances of accomplishment against their plans do not have any consequence.

The structure of subnational governments differs from region to region. In Southern Nation, Nationalities and People's Regional State, for example, the zonal administrations are very active and function as an arm of the regional government; whereas in Afar Regional State, woredas have the direct linkage with their regional administration and there is no strong bond between zonal and woreda administrations. In Southern Nation, Nationalities, and People's Regional State, therefore, the administration is hierarchically extended and needs more administrative tasks in public responsibilities than Afar Regional State.

3.1. Components of Subnational Expenditures at Subnational Level

At subnational governments' level, particularly at woreda level, local governments are entitled to perform social, economic, and administrative responsibilities. The responsibilities of social sectors are basically associated with duties such as education, health, women and children sectors, civil service, sport, rural roads and transportation, and culture and tourism related activities. Responsibilities of economic sectors are also associated with agricultural, revenue and finance, municipalities, and cooperatives and marketing sectors. The above tasks are basic responsibilities that have to be managed by the lowest level of government (woreda). These tasks are uniformly applied in all woredas of the region to maintain uniformity in the region and to control the overall public services and political directions of the region as well as the country. However, this lacks the specific needs of citizens of particular woredas and community since their taste of public service in various localities differs in accordance with their social and economic needs.

The need for expenditure responsibilities is attached with the available resources allocated to the governments at the local level, the commitment of the governments to accomplish the required level of services and technical and educational capacity to make decisions on these responsibilities. At local levels, governments' expenditures are not coordinated and synchronized among adjacent local governments to ensure resource efficiency through spillover effects of public expenditures, especially capital investments. Woredas incur costs for similar investments that could have been coordinated by two adjacent local governments resulting in weak coordination of public expenditures and inefficiencies in public resource utilization.

At regional level, the strategic direction of the government takes a considerable share in local governments' plan and budget execution, and sectors need to strictly follow these strategic directions in their expenditure responsibilities. Although various tasks of the government are accomplished by local governments, most expenditure priorities are in the hands of the region. This restricts their decisions on their specific needs and limits the flexibility of altering their priorities within their territory. This can be seen from two perspectives. On the one hand, leaving these areas to the local governments has some adverse impacts such as inefficiencies and wrong prioritization of needs as a result of knowledge gap and technical and professional requirements. Uncontrolled expenditures would result in inefficiencies and the policy directions may be ignored. On the other hand, restricted categories of expenditures limit the discretion of local governments and affect their allocative responsibilities in achieving local needs and preferences.

Woredas are mostly focusing on expenditures that have little value for economic growth and development. In other words, expenditures at local levels have little impact on economic growth and development. Most capital projects are implemented and managed by the regional government. This happens to make control over unnecessary spending and mitigate wrong decisions in acquisition of long-term investment. However, restricting decisions at lower levels hampers the real local preferences that the citizens at local level demand.

3.2. Local Revenue and Their Productivity

Regional governments in Ethiopia, highly depend on the central government's transfer (i.e., the share of federal grant is about 80%- 95% of the total budget), which means their revenue from their internal sources covers only 20% to 5% of their total expenditures. The large portion of their revenue is from the block grant of the federal government. Although the central government is the main source of the local governments' revenue, expenditure decisions are made at regional government levels with little control over the expenditures from the center. Practice shows that local spending has less control and at the center it is very common to be as a report reader.

Revenues at local levels of government are not productive as trends of local shares on total budget of the region indicate. The table and figure shown below indicate that the total revenue of the region and the block grant of the federal government increase with very slight increase of revenues from own sources. On the other hand, non-tax revenues and revenues from other sources are almost nil and have the lowest contribution in the aggregate subnational government revenue of the region.

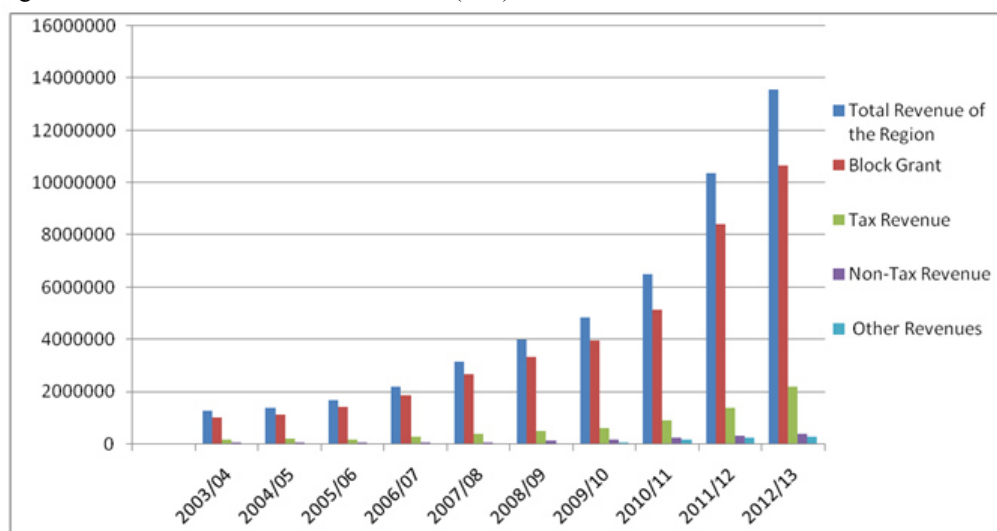
Table 3.1: Share of Revenue from Total Budget of SNNPRS (000)

Year	Total Revenue of the Region	Block Grant	Tax Revenue from Own sources	Non-Tax Revenue	Other Revenues	Block Grant %	Tax Revenue Share %	Non-Tax Revenue share %	Rev. from Other Sources %	Total %
2003/04	1,283,714.44	1,042,818.000	175,540.3007	65,348.0035	8.13	81.23	13.67	5.09	0.00	100
2004/05	1,414,419.25	1,129,008.229	206,521.9824	78,445.0873	443.95	79.82	14.6	5.54	0.031	100
2005/06	1,707,694.56	1,438,060.000	200,289.7202	68,760.9364	583.90	84.21	11.72	4.02	0.03	100
2006/07	2,222,339.38	1,875,021.07	278,212.5131	60,515.8418	8,589.96	84.37	12.51	2.72	0.4	100
2007/08	3,170,979.05	2,672,454.359	406,223.8126	91,940.4421	360.44	84.27	12.81	2.89	0.01	100
2008/09	3,997,736.21	3,341,735.188	523,650.6828	131,676.7592	673.58	83.59	13.09	3.29	0.02	100
2009/10	4,872,331.10	3,989,448.488	627,107.4211	169,666.2122	86,108.12	81.88	12.87	3.48	1.77	100
2010/11	6,521,923.92	5,166,313.004	924,034.9774	245,218.0513	186,357.89	79.21	14.16	3.75	2.86	100
2011/12	10,390,476.33	8,412,958.663	1,407,386.063	326,710.4691	243,421.13	80.96	13.54	3.14	2.34	100
2012/13	13,566,054.98	10,677,192.78	2,196,402.121	406,497.0622	285,963.02	78.70	16.19	2.99	2.11	100

Source: Compiled from ten years financial reports of the Region, 2014

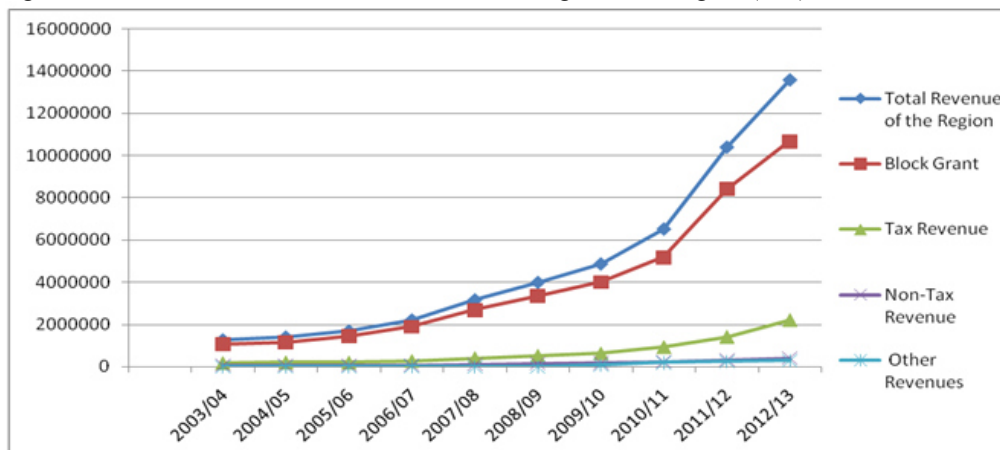
The trend of shares of revenues in the past ten years of the region can be shown in the following way.

Figure 3.1: Share of Revenue of SNNPRS (000)



Source: Financial Data of the SNNPRS, 2014

Figure 3.2: Federal Government Share on Total Budget of the Region (000)



Source: Compiled from ten years financial reports of the Region, 2014

The constitution of the government clearly distinguishes the revenue sources of the federal government and the

regional governments. The central government's revenue sources are major revenue sources characterized by contributing a large share on aggregate government budget of the country. Article 96 of the Constitution of the Federal Democratic Republic of Ethiopia explains the power of the federal government to levy and collect taxes on imports and exports, employees of the federal government and international organizations, profits, income, sales and excise taxes on enterprises owned by the federal government, national lotteries, transportation services such as air, rail, and sea transportation, income on properties and houses owned by the federal government, licenses issued and services rendered by the federal government, monopolies, and federal stamp duties.

The above revenue sources are the major revenue sources and have the largest contribution in the government budget of the country. For example, more than twenty-nine (29) percent of the total national tax revenue is raised from customs duty, which is owned by the federal government. Moreover, the federal government's share of revenue on VAT is about three-quarters (70%) of the total VAT collected at the regional level.

On the other hand, the Constitution allows regional governments to levy and collect taxes on employees of the state and private enterprises, land usufructuary rights, farmers incorporated in cooperative associations, incomes of individual businesses within their territory, water transportation on their territory, private houses and other properties, income, profit, sales, personal and excise taxes of enterprises owned by the states, small-scale mining and royalties, licenses issued and services rendered by the states, and royalties on use of forests.

Despite these revenue sources which are assigned to the local governments, the amount of revenue being raised from these sources is very insignificant and forces the central government to bear a large share of the regional government's expenditures. The above table and figure indicate that local governments are highly dependent on the federal government's transfer as a result of either (both) the non-productivity of their own revenue sources or (and) the commitment problem of lower level governments due to the convenience of federal block grant in avoiding costs and energy of collection from own sources.

Furthermore, the trend of the regional government indicates that the actual collection exceeds the planned one in many instances. The following table indicates the budgeted revenue and actual collection from domestic sources of the region.

Table 3.2: Actual vs Budgeted Revenue of SNNPRS (000)

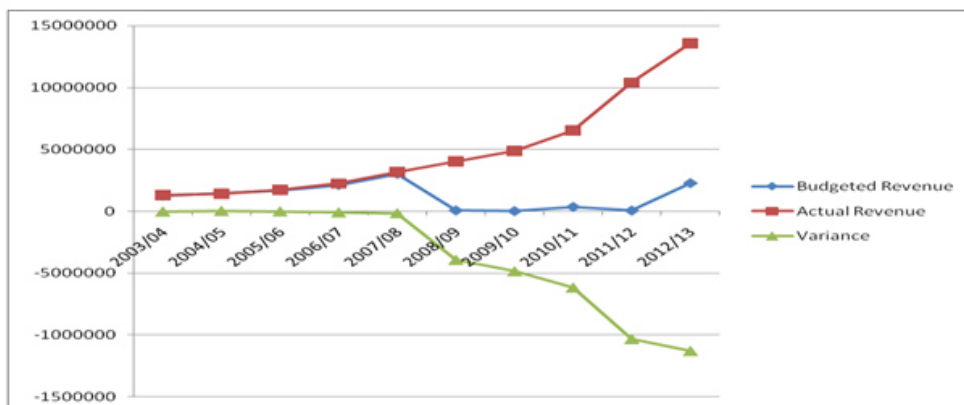
Budgeted vs Actual Revenue of SNNPRS (000)			
Budget Year	Budgeted Revenue	Actual Revenue	Variance
2003/04	1,258,968.024	1,283,714.435	-24,746.411
2004/05	1,445,204.332	1,414,419.251	30,785.081
2005/06	1,696,150.000	1,707,694.559	-11,544.559
2006/07	2,125,058.329	2,222,339.382	-97,281.053
2007/08	3,012,664.359	3,170,979.050	-158,314.691
2008/09	74,540.689	3,997,736.212	-3,923,195.523
2009/10	22,300.00	4,872,331.104	-4,850,031.104
2010/11	355,663.0837	6,521,923.919	-6,166,260.835
2011/12	64,605.5907	10,390,476.330	-10,325,870.740
2012/13	2,272,370.912	13,566,054.980	-11,293,684.070

Source: Computed from Financial (IBEX) Report of SNNPRS, 2014

The revenue trend shows that the regional government (state) underestimates the amount of revenue that could be raised from its own tax bases. This may be the indication of the level of local governments' commitment in raising revenues as close as the potential allows. This presses for a large amount of block grant from the federal government. In principle, the estimate of revenue takes place on the basis of past achievement and the change in economic conditions such as increase in trade licenses and registered businesses within their territory. However, the actual trend shows that regions rarely focus on the past trends to plan for future collections and a large variance indicates that the local government's plan is not exhaustive and based on economic changes. On the other hand, the incentive effect of the federal grant might have created a compromise on local revenue sources. As it has been underscored many times previously, local governments are highly dependent on the federal grant and their share on economic resources is five to twenty percent according to the financial report of the regional states. The following two figures indicate how the actual collection deviates from the budgeted amount revenues in the region.

The above bar diagram can be shown graphically in the following way.

Figure 3.3: Graphical Representation of Variance between Actual and Budgeted Revenue



Source: Compiled from Financial Report of SNNPRS, 2014

In the structure where insufficient revenue sources are assigned, the major source of revenue comes from the center and it alters local governments' ability to raise revenues from their own sources and impairs accountability by loosening the connection between revenue sources and public services. As said earlier, at regional level the dependence of revenue on the central government is very significant (i.e., 80-95%), which indicates almost all the local government's expenditures are covered by the federal grant and the role of local governments on raising revenue from their own sources is very minimal. This in turn, creates difficulty of tailoring revenue sources with public services, impairs the enthusiasm of local governments to raise revenues as their revenue potential allows, and reduces the efficiency, accountability, and responsibility in local jurisdictions. The constitution of Ethiopia states the revenue sources that are shared between the federal government and the regional governments. The shared revenue sources or tax bases are stated in Article 98 of the Constitution of the country. The federal government and the region jointly levy and collect tax revenues from these sources in principle. The indicated concurrent tax bases are tax revenues from profit, sales, excise and personal income taxes on enterprises the federal government and the regional government jointly establish; profits of companies and dividends due to shareholders from these companies; and large-scale mining and petroleum and gas operations, and royalties on these operations.

The above concurrent tax bases are constitutionally designated as jointly owned revenue sources of the region. However, the implementation and administration of these revenue sources have become the main challenges as a whole. Firstly, the government has been privatizing many publicly owned enterprises and holding its hands back from investing in public enterprises. The trend shows that there are not jointly owned public enterprises established in regional governments. The government also doesn't have any plan to invest in profit making public enterprises, because in a market-led economy it is not a priority of a government. Thus, the credibility and importance of this article is not clear. Furthermore, the revenue collected from jointly owned tax bases is almost zero. Currently the government is working on how to manage these bases and revising the policy directions to create a clear accountability and responsibility of administration and management.

Moreover, jointly owned companies are avoiding payment of tax obligations due to a loophole created as a result of unclear and vague reporting responsibility either to the state/region or the federal government. At woreda or zonal level, there are no constitutionally assigned revenue sources although they are entitled and collect the revenues from their citizens in their constituency.

4. Conclusion and Policy Implications

Developing countries face difficulty in implementation of decentralized structure when compared to industrialized countries. Factors such as macroeconomic structure and policy flexibility, tax structures and administration, and capabilities of local decision-making autonomy coupled with devolution challenges of tasks and responsibility are the main challenges in developing countries.

Decentralization requires striking the balance between the central control policy direction and local needs. Public responsibilities have to be coordinated to efficiently allocate scarce resources and to ensure effective distribution of public services allowing adjacent governments to work together in achieving public policy directions avoiding policy disintegration among governments at subnational level.

Governments at subnational level need to exercise the autonomy in revenue and expenditure decisions and minimize unnecessary dependence on federal grants. The central government has to take responsibility in enforcing and supporting subnational governments to strengthen their effort in planning and collecting revenues as their economy allows them to generate. Moreover, the federal government needs to make a decisive analysis of the structure of revenue sources considering the distortive effects of these revenue sources.

Clearly distinguished responsibility on concurrent revenues would improve government's revenue and avoid loopholes and tradeoffs in administration of these revenue sources.

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