

*Addis Ababa University  
School of Graduate Studies  
Regional and Local Development Studies*

*An Assessment of Revenue Generation Capacity in  
Gambella Region:  
Achievements and Constraints*

*By:  
Peter Gatkuoth Gey*

**A Thesis Submitted to the School of Graduate Studies, Addis Ababa  
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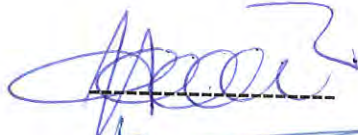

**Approved by broad of examiners:**

**Signature**

**1. Tegegne Gebre Egziabher (PhD), Chairman**

**2. Mehari Mekonnen (PhD), advisor**

**3. Beyene Tadesse (PhD), External examiner**

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## Declaration

I declare that this thesis is my original work and has not been presented for degree in any other university and that all sorts of my materials used for this thesis have been duly acknowledged.

Name: Peter Gatkuoth Gey

Signature: -----

Place: Addis Ababa

Date: February 2007

This thesis has been submitted for examination with my approval as a university advisor.



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Mehari Mekonnen (PhD), advisor

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## Abbreviations and Glossary

BOFED	=	Bureau of Finance and Economic Development
CSA	=	Central Statistical Authority
D.D	=	DireDawa
EPRDF	=	Ethiopian People Revolutionary Democratic Front
GDP	=	Gross Domestic Product
GNRS	=	Gambella National Regional State
Keble	=	Local administrative level, which make up district/woreda
MED ac	=	Ministry of economic development and cooperation
MOFED	=	Ministry of Finance and Economic Development
PAs	=	Peasant Associations
SNNP	=	South Nations and Nationalities People
Sefar coms	=	leaders of sub kebele administration
TGE	=	Transitional Government Ethiopia
UNDP	=	United Nation Development Programime
USD	=	United States Dollar
VAT	=	Value Added Tax
Woreda	=	local administrative level, which is equivalent district

## Abstract

Fiscal deficit is a common characteristic of developing countries. Particularly, Sub Saharan African countries have difficulty in generating revenue to cover their expenditures due to weak tax administration, tax evasion and corruption problem. Ethiopia also shares this feature of fiscal deficit, which is always financed through external assistance, and regions usually depend on federal grants for their expenditures.

For example, in the year 93/94-97/98 regions collected less than 20% of the national revenue, whereas regions accounted from 34 to 44% of the total expenditure in the country and they only covered 25 to 35% of their expenditures from their revenue. Among regions themselves, fiscal capacities vary. Some regions generate more than others do while some regions generate less. In 97/98-99/00, the federal grants coverage ranged from 94.36% in Gambella to 9.47% in Addis Ababa which implies that Gambella generate less revenue than its expenditure in the country.

Then the objective of this research is to examine the performance of revenue and revenue generation constraints in the Gambella region from 93/94-04/05. This study is a mixed of explanatory and descriptive researches where secondary and primary data were used. The primary data were collected through depth interview and focus group discussion from people that have experience in tax administration. Some community leaders who were involved in tax collection were also interviewed individually. The research findings showed that Gambella region in 00/01-04/05 covered only 7.6% of its expenditure while 92.4% of its expenditure is covered by federal grants. During 00/01-04/05 the federal grants coverage ranged from 92.36% in Gambella to 98% in Addis Ababa. Hence, Gambella depends highly on federal grants of all the regions due to low institutional capacity, low economic base and political instability.

In order for the region to reduce this dependency on federal grants, it should increase its revenue by alleviating political instabilities in the region; and weaknesses in institution such as weakness in audit, accounting and monitoring and evaluation systems of revenue department of the region. Incentives mechanisms for taxpayers to pay more tax are also needed to collect more tax in the region.

# Chapter One: Introduction

## 1.1 Over view

In any federal system, Fiscal decentralization attempts to respond to four fundamental questions. These are assignment of expenditure question; assignment of revenue question, vertical imbalance question, and horizontal imbalance question (Bird and Vaillancourt 1998:15).

The primary function of tax system is to generate revenue. This tax revenue is needed to fund public provision of goods and services. It is frequently argued that government revenue should exceed government expenditure so as to have a surplus for financing of government capital (Taylor 1969:124). However, the level of taxation differs from country to country because of economic, cultural and historical factors (World Bank 1991:2). For instance, the ratio of tax revenue to GDP in developing countries are typically in range of 15% to 20% compare to about 30% in industrial countries. The ratio of public expenditure to GDP is usually between 20% and 30% in developing countries, whereas in industrial countries the average ratio is above 30%. This implies that most developing countries are plagued by chronic fiscal deficit and by inadequate socio economic infrastructure. Hence, how to contain and rationalized an over expanded public sector has become one of principle challenges facing many developing countries in recent years. Therefore increasing tax revenue is the possible solution to these problems.

The limited ability to tax in Developing Countries is well recognized in several literatures of Public finance. In a sample of thirty-three Developing Countries, public sector deficits on average are 7 percent of GDP in 1986(World Bank1991:17). Sub Saharan Africa has difficulties in generating revenue that can cover their expenditure. Between 1962 and 1982 fiscal deficit in twenty five Sub-Saharan Africa Countries has increased from 4.2% of GDP to 9.7% (Shalizi and Squire 1989:3). It is argued that in most of developing countries, the administration of tax is weak and the problem of evasion and corruption are serious. The weakness in tax administration originates from several interacting factors including unduly complex tax law and procedures, poor information system, and political interference in tax administration (World Bank 1991:2).

Ethiopia one of Sub Saharan Africa countries has been in chronic fiscal deficiency; except in the early 1950s where there was surplus and in the mid 1960s where budget balance prevailed. There was over all deficits of 2 billion Birr in 1991/92, 3.23 billion Birr in 1995/96 and 3.06 billion Birr in 1997/98 (MEDac 1999:73). Recent evidence of fiscal deficiency in Ethiopia showed that fiscal deficit including grants and emergency assistance is estimated to have declined from 9.3% of GDP in 01/02 to 8.4% in 02/03 where compare to an average of 3.6% for Sub Saharan Africa and 4.8% for COMESA region (World Bank 2001:19).

In most developing countries, sub national governments have limited access to their own tax bases; while national have better access to their tax bases.

The disparity between revenue means and expenditure needs at various levels of government in federation is called Vertical fiscal imbalance; while the inconsistency between revenue raising ability and fiscal needs at the same levels of government in federation is called horizontal fiscal imbalance (Shah 1994:40). Then the question, which comes next to this, is the genesis and closing of this fiscal gap.

Vertical fiscal imbalance arise from poor tax administration in sub national governments (Kelly1999:7) and centralization of productive revenue sources (World Bank 2000b: 24).While Horizontal fiscal imbalance is due to differences in income due to various historical and institutional factors ; and variation in resource endowments(Bird and Vaillan court 1998:89).Fiscal imbalance can be closed in variety of ways.

In principle there are at least four ways in which any revenue –expenditure gap can be closed, namely (Bird and Vaillan court 1998:28):

1. Revenue could be increase at provincial level;
2. Expenditure could be reduced;
3. Expenditure function could be transferred up to the level with more revenue (or revenue raising power) or down to the level with expenditure; and
4. Some centrally collected revenues could be transferred to provincial governments.

Similar to the abovementioned means of solving fiscal imbalance, Bahl and Linn (1992:68) also forward four different ways to address fiscal gap for urban areas. These are: (a) increased local revenue effort with unchanged revenue authority, (b) increased revenue authority, (c) increased transfer from higher level governments and (d) reduced local expenditure can reduce fiscal deficit. Among the entire four alternatives in every country, it is the increased transfer from higher government level to lower one alternative that usually prevails. Nevertheless, World Bank (1988:79) notes that reducing fiscal deficit will require some combination of lower public spending and higher public revenue.

Intergovernmental transfers, which include revenue sharing and grants, are one source of revenue besides, taxes, user charges, administration fees and debt (Snyder 1977:122).

## **1.2 Statement of the Research Problem**

Since introduction of tax in 1942 and 1944, Ethiopia has almost been in chronic weak financial position. The central government as well as regional government exhibit fiscal deficit, but the regions suffer more from the shortage of revenue than central level. Some practical data showed that regional governments' revenue collection is less than 20% of the national revenue in the year 93/94-97/98. Whereas regions account from 34 to 44% of total expenditure in the country. They could finance only 25 to 35% of their expenditure from their revenue (Theo van der 2002:49-50).

The fiscal gap among regions is highly pronounced in some regions to degree of fiscal dependence. The same source also revealed that average level of regional government dependence on federal government transfer is highest in Gambella (94.36%), followed by Afar (93.92%), Benishengul-Gumuz (92.08%), and Somali (90.37%) in the year 97/98-99/2000. Among other regions, the average level of dependency is much lower like in Addis Ababa and Dire Dawa, it account for 9.47% and 45.11% respectively.

In short, since Transitional Government of Ethiopia, Gambella region is the highest in fiscal dependence even among all the emerging regions of the country.

### **1.3 Objective of the Research**

As fiscal decentralization in Ethiopia has assigned responsibilities of generating revenue and spending to the regions, for Gambella region to provide successful development intervention requires an effort to accelerate generation of own resources and clearly understand the trends of its revenue and expenditure. Besides these, the region needs to know the constraints and the determinants of revenue generation capacity. Hence, generally the objective of this study is to assess the performance of revenue in Gambella region. Specifically the objectives are:

1. To examine the structure and sources of revenue of the region;
2. To examine the growth of revenue and expenditure of the region;
3. To assess the revenue –expenditure ratio trend of the region;
4. To assess the factors those affect the revenue generation capacity of the region; and
5. To suggest solutions and remedies to the constraints of the revenue generation capacity.

### **1.4 Research Questions**

Base on the problem identified above, the general research question is why fiscal dependency is the highest in Gambella region among all the regions in the country? How fiscal dependency is growing?

Specifically, the research tries to provide answers to the following questions:

1. How is the growth of revenue of Gambella region?
2. How is the revenue-expenditure ratio trend in Gambella region? Or how is the fiscal deficit trend in the region?

3. What are the constraints of revenue generation in Gambella region?

### **1.5 Significance of the Research**

This research will contribute to promotion in efficiency of revenue department of the region. It will make the regional and local officials aware of the level of revenue that they can mobilize. The research also will show regional and local official the ability and the willingness of other states and local government to generate revenue. Further more, it will help in identification of the constraints of revenue collection and the new potential sources of revenue in the region. The practitioners, academicians, and policy makers too, will benefit from its findings.

### **1.6 Research Methodology**

This study is combination of descriptive and explanatory research that uses both primary and secondary data. In the study, two research methods were used to collect primary information in addition to secondary data.

First method is depth-interview method, which provides richer information than survey method .But its limitation is that the influence of the interviewer may be great and possibly affect the results. It is also difficult to compare the responses. Second method is focus group discussion, which is efficient; because it can reach more people within a given time compare to individual interviews; but has its own weakness. The disadvantage is that if the group is too small, one or two loud mouths can dominate it and if it is more than 12, it becomes tough to manage.

### **1.6.1 Sources of Data**

Data are collected from secondary sources as well as primary one. Secondary data were collected from published and unpublished sources such as annual reports of Gambella Bureau of finance and Economic Development, documents of Ministry of Finance and Economic Development and other relevant documents on revenue of Gambella region. Primary data such as information on the constraints of revenue generation were collected from tax collectors. Tax collectors were made up of revenue department head, inspection department head, housing expert, Gambella town tax team leader and tax team leaders of woredas.

### **1.6.2 Data Description**

Secondary data pertaining to revenue generation capacity of the region include revenue, and expenditure of 93/94-04/05, while federal subsidy to the region data covers 94/95-05/06. Similarly, secondary data on revenue generation constraints covers 93/94 up to 06/07. Primary data on revenue generation constraints were collected using two different methods (Depth-interview and focus group discussion) in January 2007.

#### **i) Depth- Interview:**

Semi structured interview is used to collect the data from individuals where the interviewee is allowed to talk free about various aspect of topic.

Data on revenue collecting constraints are collected from tax collecting organizations such as revenue and inspection departments of BOEFED and housing department of bureau of work and urban development. To be specific data are collected from acting revenue department head, inspection department head, housing expert, tax team leaders of woredas and community leaders were the key informants of study from which the data are collected.

## **(ii) Focus Group Discussion**

Focus group discussion was held on predetermined topics, with individuals who share characteristics. One focus group discussion on revenue generation constraints that was composed of Tax team leaders of 7 woredas, revenue department representative, Gambella town tax team leader regional economic advisor and moderator was conducted.

### **1.6.3 Data Analysis and Presentation**

Concerning the analysis of data, in secondary quantitative data, ratio, percentage, average growth rate and percapita were used, while the primary data was analyzed using qualitative description. Data were presented using tables, and chart.

### **1.7 Variables under Research**

The study considered the two sides of fiscal balance equation variables such as revenue and expenditure side plus the difference of the two i.e. fiscal balances in absolute term.

Fiscal balance shows the ability of revenue generation of sub national. Fiscal balance may be either positive or negative or zero depending on the volume of revenue means and expenditure needs. When ever, revenue means is greater than expenditure needs, fiscal balance is surplus whereas when the revenue means is lesser than expenditure needs fiscal balance is deficit.

Here the fourth variable may arise whenever fiscal balance is deficit and in order to close the gap between the revenue and expenditure, intergovernmental transfer to picture. There fore the fourth variable is intergovernmental transfer.

Otlter variables in the study are the decentralization of revenue, expenditure decentralization and financial autonomy ratios.

## 1.8 Definition of the Concepts

Financial decentralization can be expressed by ratio such as: expenditure decentralization, revenue decentralization, and financial autonomy ratios (Eshetu 1994:145).

1. Expenditure decentralization ratio is the percentage of total government expenditure spent by local government.
2. Revenue decentralization ratio is the of local government revenue in total government revenue .It assess the significance of local taxation.
3. Financial autonomy ratio is the percentage of locally raised revenue in total local expenditure. It gives an indication of the local government's independence from central government funding. It also termed as Horizontal fiscal imbalance, which is a share of region revenue to its total expenditure (World Bank 2000a:26).
4. Vertical fiscal imbalance: Vertical fiscal imbalance is measured by Coefficient Vertical imbalance or an index of sub national autonomy. It attempts to measure the degree of control exercised by federal government over lower levels of governments.

### **1.9 Limitation of the Study**

In the study, in addition to analysis of secondary data, primary data were collected only through depth-interview and focus group discussion. A sample survey method, which can supplement these data, was not included to generate primary information due to lack of financial resources. Not only this, but also adequate and complete time series data are not developed and organized in the region. There is no bank data system developed in the region special in the Gambella Bureau of finance and Economic Development. Furthermore, most the available data are fragmented and incomplete. Some regional government officials were reluctant to give information. Frequent turn over of revenue department staffs at all levels was also a serious problem that impeded the depth of the study.

### **1.10 Organization of the study**

This study is composed of five chapters. The first chapter of the study introduces the research problem, objectives of the research, significant of research, research methodology, and variables under research and their definitions.

The second chapter throws light on fiscal decentralization issues in general. It will discuss the advantages and disadvantages of centralized and localized provision of goods. It will also see the four elements of fiscal decentralization and constrains of revenue generation capacity as well the problem of revenue collection in developing countries.

Chapter three discusses fiscal decentralization practice and problem of government revenue collection in Ethiopia. Chapter four discusses revenue generation capacity of Gambella region .It includes expenditure and revenue performance, distribution of revenue and constraints of revenue generation in Gambella region. Then finally, chapter five through light on summary, conclusions and recommendations.

## **Chapter Two: Review of Literatures**

### **2.1 Decentralization: Definitions, Types and Objectives**

Decentralization in its broad sense refers to the division of political, economic and administrative power between the central and sub national governments. The degree of responsibility that is transferred by the central government to sub national government may vary. Decentralization can be in form of deconcentration, delegation, and devolution. It is intended for solving political and or economic problems and is meant to perform the following objectives (Rondnelli, et al; 1984:5-9):

- (a) To reduce over load and congestion in the channels of administration and communication .It is thought to improve government responsiveness to public and increase quality and quantity of service provided;
- (b) To achieve more effective or efficient management;
- (c) To mobilize local government support for national development and
- (d) To achieve self-reliance, self determination, democratic decision making, popular participation in government and accountability of public officials to citizens.

Besides this, Boko (2002:1) notes that decentralization can be political, administrative, fiscal or economic.

### **2.2 Fiscal Decentralization: Theoretical Concepts and Issues**

For decentralization to be successful there should be a clear definition and assignment of the fiscal functions among different levels of government. Then what are objectives of fiscal decentralization?

Fiscal Decentralization is carried out in order to achieve certain objectives. Even though they may vary from country to country, objectives of fiscal decentralization often include:

1. increased local resource mobilization;
2. reduced national expenditure;
3. improved efficiency of local government;
4. reduced number of national agencies operating at local level; and

5. Increased local funds directed towards investment rather than to public sector bureaucracies (Silverman 1992:29).

### **2.2.1 Assignment of Responsibilities**

The most important issue in a federal system is the allocation of expenditure and tax function to various levels of governments. It is argued that assigning responsibility for spending must precede assigning responsibility for taxation because tax assignment is generally guided by spending requirements at different levels and can not be determine in advanced (Shah 1994). The decentralization of the tax should be done together with decentralization of expenditure or the regions will depend completely on grants from federal level. If regional governments are not responsible for generating, at least some of their revenue they will have little interest to give local service in cost effective way. In the same way, if regional governments are assigned more revenue than their requirements of expenditure, they will have incentive to reduce taxes or increase public sector wage. For example, in 1990, some municipalities in Brazil increased public sector wages and lowered property taxes and other charges because of generous federal funding (Shah 1994:9).

In contrast, the timing of responsibilities assignment i.e. expenditure assignment is first and the revenue assignment come after is inclusive. For example, many Latin American countries assigned revenues to the sub national governments and put transfer in place before transferring the functional competencies from the central government to sub national government (Guigale and Web 2000:94). This approach resulted in weak sub national government and fiscally overburdened central government, which in many cases continued to take on most expenditure responsibilities with fewer resources.

### **(i) Centralized Against Localized Provision of Public Goods and Services**

Decentralization has both merits and demerits (Due and Fried laender 1981:486; Boko 2002:198; Wellisch 2000:14-16). One of the underlying arguments for fiscal federalism is that assigning expenditure responsibilities and decision making power to lower levels of government can improve a state's ability to efficiently identify and address its citizens' needs. Being closer to the beneficiary population, lower levels of governments have an informational advantage over the federal government as they can better see their constituencies' needs. They also know the local conditions that are important in internalizing benefits and costs of public service provision. More over, local governments have greater incentive to improve service delivery; the beneficiaries and citizen groups can easily monitor their actions and evaluate them through election. Realization of these benefits, however, is not guaranteed. Careful attention needs to be given to policy design particularly in quickly evolving, highly decentralized systems such as Ethiopia (World Bank 2000 a: 3).

In line with that argument, which localized provision of public goods contributes to several general goals of decentralized government (Helmsing 1991, Bennet 1980):

- (a) It stimulates local economic development;
- (b) It can promote local unity and sense of community;
- (c) Local provision enables a better adjustment to geographical variation of local needs and preferences;
- (d) it contributes to a diffusion of political power and as such may contribute to more responsible and relevant government; at the same time by absorbing pluri-formity over all political stability may be increased;
- (e) It decongests central government, relieving it of great many issues of only local importance enabling it to concentrate more fully on pressing national and international issues.
- (f) It may contribute to greater national unity as local issues are dealt with locally do not escalated in to national one, thus providing an additional level conflict resolution.

The same source further notice that local provision is not free from problems but may have several important drawbacks:

- (a) Most importantly it can result in great disparity in the provision of service due to considerable discrepancies in the fiscal local base of various districts;
- (b) It may result in rather insufficient organization; no economies of scale can be achieved, expensive equipment remaining idle and no professionally competent staff can be afforded;
- (c) Local democracy is automatically assured either. Much depends on the acts regulating terms of service, etc. the emergence of small local cliques and powerful "bosses" that dominate the councils is not conceivable nor is their manipulation of council behavior to their own interest and detriment of the population; and
- (d) Particularly in the absence of national checks and balances, great fiscal disparities can contribute to parochialism and excessive regionalism.

Similarly, centralized provision of local public goods has advantages and disadvantages (Helmsing 1997:14). The main advantages are:

- (1) Central government can limit and correct the disparities in local fiscal capacity. Only with a standard can be compensated and achieved. As such, it can also limit the dominant and explanation of unequal groups and areas.
- (2) Centralized provision can achieve increased efficiency and economy. Also, it enables a great specialization and development of knowledge about public provision; particularly when management and technical skills are scarce one is often forced to rely on a centralized provision and maintenance.
- (3) Centralized provision of a uniform package of standardized public service can enhance national unity and social justice.

However, centralized provision also has the following disadvantages:

- (1) Uniform delivery may not do justice to economic, geographic and cultural diversity of needs; land use rationalization and planning is needed in many areas, but widely varies in content depending on main land use type and agro ecological region.

- (2) Centralized provision can create severe bureaucratization and inefficiency resulting from long chain decision making; particularly when sub national local inputs are expected of the population, such delays can have serious demotivating effects.
- (3) It tends contribute to greater geographical concentration of government expenditures and of its multiple effects.

## **(ii) Principles of Expenditure Assignment**

One principle of assignment of expenditure is that assignment of expenditure responsibilities between the central and regional government base on “benefits area” principle. The three theoretical principles of assignment of expenditure are provided under lie (Wallich 1992:5).

- Public service whose benefits do not accrue beyond the boundary of a local community should be provided by the local government;
- Service whose benefits accrue jointly to individuals in several communities should be provided by oblast level government; and
- Benefits that affect the entire country should be provided by the federal government.

Other scholar in addition has mentioned some guide line of expenditure assignment. For example, Shah (1994:44) has recommended three principles of expenditure assignment. First, assignment of public services to local or regional governments can be based on economies of scale and economies of scope –the appropriate bundling of local public service for efficiency, coordination of information, and enhances accountability through voter participation and cost recovery. Second, is that assignment of expenditure should include cost-benefit spillovers, proximity to the beneficiaries, consumer preferences, and flexibility in budgetary choice on consumption of public spending. Third, Assignment of responsibilities to various local governments can be based on: population size, rural or urban classification, and fiscal capacity criteria.

All these principles of tax assignment among various levels of government almost reach to similar conclusion, though slight different exists. All the above-mentioned

broad expenditure assignment principles arrive at same conclusion and are summed up by Shah (1994) in table 1.

Table 1: Conceptual basis of expenditure assignment

Expenditure category	Service responsibility	Provision of service
Defense	F	F
Foreign affair	F	F
International trade	F	F
Environment	F	S,L
Currency , banking	F	F
Interstate commerce	F	F
Immigration	F	F
Unemployment insurance	F	F
Airline/rail way	F	F
Industry and agriculture	F,S,L	S,L
Education, health, social welfare	F,S,L	F,S,L
Police	S,L	S,L
Highways	F,S,L	S,L
Natural resource	F,S,L	S,L

Source: Shah (1991:7), Key: F= Federal, S=State, L=Local

This way of assignment may correspond with what is realized in many countries with federal structure, though some minor differences may exist due to specific factor of a country.

Expenditure assignment has some problems. The common problem with expenditure assignment is the lack of formal assignment.

The country's constitution often assigns expenditure responsibility among different levels of government, but the assignment is not specific. Expenditure responsibilities should be specified mostly in law, not the constitution, providing specificity as well as flexibility. The lack of clear formal assignment of responsibilities tends to destabilize intergovernmental relations (Guigale and Web 2000:94).

## **2.2.2 Tax Assignment Responsibility and its Principles**

### **(i) Tax Assignment Responsibility**

The second key responsibility assigned after assignment of expenditure is tax assignment. The division of revenue sources among federal and sub national government constitutes the tax assignment problems. Then what is the need of dividing the tax between sub national and central governments.

According to Guigale and Web (2000), the purpose of tax assignment is to provide sub national government with revenues that they control and thus to decentralize the control of public spending. For decentralization to be viable, sub national governments must have their revenues that are adequate to cover their recurrent expenditure. Own revenues are revenues that sub national government can affect by their own action , especially by changing tax rates ,but also by imposing new taxes or repealing old ones , by changing the tax base, and by varying tax administrative effort(Guigale and Web 2000:95). Access to marginal revenue is the key to fiscal decentralization because it gives sub national government control over the size of public spending with in their jurisdiction. Boex (2001:201) asserts also that decentralization may enhance revenue mobilization as local governments may be in better position to raise certain type of revenues.

On other hand, there is an argument for centralization of distribution revenue power in a number of advanced and developing countries. In other words, central government has extra ordinary large share of taxation revenue. There are a number of factors, which explain this enormous centralization of revenue power (Helmsing 1997:46).

a) Expanding geographical or spatial scale economy:

This makes it difficult for smaller Local Authority to tax such activity, which can manipulate in order to evade.

b) Administrative costs of older forms of taxation at local level (e.g. produce fees, city gate tax) and difficulty of handling large volumes.

c) Managerial and technical advancement facilitating improvement of administrative tax capabilities but at larger scales due to overheads.

- d) Equity considerations: same treatment of individuals across jurisdictions together with ability to pay principle for raising national revenues.
- e) The extraordinary expansion of central government especially in national merit goods (public welfare and education).

## **(ii) Principles of Tax Assignment**

Like expenditure, tax has its own assignment principles on which it bases. For example, Musgrave (1983) suggests that tax assignment should be done in line with equity (consistency of revenue means with expenditure needs) and efficiency criteria (minimizing resource cost). And it should follow these guidelines.

- Progressive redistributive taxes should be central ;
- Taxes suitable for economic stabilization should be central; lower level taxes should be cyclical stable ;
- Taxes on mobile factors of production are best administered at the center ;
- Residence based taxes such as sales on consumption goods to consumers or excise are suited for states;
- Taxes on completely immobile factors are best suited for local levels; and
- Benefit taxes and user charges might be appropriately used at all level (Agrawala 1992:24).

An alternate framework for tax assignment would use efficiency in tax administration and fiscal need criteria (Shah 1994:18).

- Efficiency in tax administration.

Here the level of governments, which likely to have the best information on a tax base would be the level responsible for levying tax on such a base.

For instance, corporate income tax would be assigned to central government, since it is likely to have more information on corporate income originating from different jurisdiction at home and abroad. On the other hand, property taxes would be assigned to local government, as a local government is better positioned to assess property values.

- Fiscal need

Base on this criterion, revenue means should be match as closely as possible to revenue needs. Therefore, tax instruments to further policy objectives should be assigned to the level of government having the responsibility for such service. Progressive, redistributive taxes are suitable for assignment to national government and tolls on inter municipal roads to state governments.

Above and beyond the mentioned tax assignment principles Shah (1994) presents in table 2 broad assignment of major tax instrument among various government levels.

Table 2: conceptual basis of tax assignment

Tax category	Determination of		Collection and administration	Comments
	Base	Rate		
Customs	F	F	F	International trade tax
Corporate income	F	F	F	Mobile factor, stabilization tool
Resource taxes	F	F	F	Highly unequally distributed tax bases
VAT	F	F	F	Border tax adjustment possible under federal assignment; potential stabilization tool
Property taxes	S	L	L	Completely immobile factor, benefit tax
Personal income	F	F,S,L	F	Redistributive, mobile factor, stabilization tool
Land taxes	S	L	L	Completely immobile factor, benefit tax
User charge	F,S,L	F,S,L	F,S,L	Payment for services
Excises taxes	S,L	S,L	S,L	Residence base taxes
Payroll taxes	F,S	F,S	F,S	Benefit charge e.g. social security
Business taxes	S	S	S	Business tax e.g. social security

Source: Shah (1994:19), Key: F= Federal, S=State, L= Local

This is type of assignment of taxes is not universal through out the world.

There are also other criteria besides the one discussed in the previous sections that should be taken in consideration whenever one assigns revenue sources to different levels of governments.

The revenue assignment typically may incorporate concepts such as: revenue adequacy, efficiency, equity and administrative feasibility (Bird et al 1998:205; Kelly 1999:5).

For instance , in assigning revenue to sub national governments, Bird and Vaillan court (1998 ) suggest two basic principles .First, own source revenue should ideally be

sufficient to enable at least the richest sub national governments to finance from their own resources all locally provided services primarily benefiting local residents. Second, to greatest extent possible sub national revenues should be collected from local resident only, preferably in relation to perceived benefits they received from local services.

They said, more specifically among criteria that might be sought in an “ideal” sub national taxes are the following:

- (1) the tax base should relatively be immobile, to allow local authorities some leeway in varying rate without losing most of their tax base;
- (2) the tax yield should be adequate to meet local needs and sufficiently buoyant overtime;
- (3) the tax yield should be relatively stable and predictable over time
- (4) The tax base should be visible to the ensure accountability (Bird and Vaillant court 1998:28).

On the other side, “good” local taxes are said to satisfy the following features:

(1)that are easy to administer locally; (2)that are imposed solely(or mainly) on local residents ;and(3)that do not raise problem of harmonization or competition among sub national governments or between sub national and national governments( Bird 2001:2).

Assignment of revenue to different levels of government is problematic. The “correct” revenue assignment in multi level government structure is by no mean clear in principle and is generally controversial in practice. The problems are two folds (Bird and Vaillant court 1998:11): First, the central government can inherently collect most taxes more efficiently than can local governments. Second, the potential tax bases that can be reached by the latter vary widely from region to region. The first of these problems give rise to vertical imbalance; the second produces horizontal imbalance.

In consensus with the Bird and Vaillant court (1998), Sphan (1991) discusses the weakness of the tax assignment .Decentralization of tax leads to existence in different tax bases and tax rates at the same layer of government. Different tax system is said to be inferior, to that uniform tax system, particularly on administrative and efficiency ground. Different tax system may also introduce inequity with in a federation. Applying different

tax rates on the same base across regions implies different tax burden and it considered to be unfair by those jurisdictions with high of tax burden may endanger the social and political unity of federation.

Sphan (1991:10) says:

*“ Regional taxation in a federation may entail ‘tax arbitrage tax’ in the sense that mobility of resources( capital ,labor, goods) will allow tax payers to ship taxed activities to those region where tax burden is the lowest. This would lead to ruinous tax competition among different regional governments in a federation and it would hence entail a sub optimal provision of public goods with in all regions”.*

### **2.2.3 Dimensions and Determinants of Revenue Generation Capacity**

Bird and Vaillan court (1998:81) and Meier (1995:66) stress that revenue collections are determined by income level and tax effort. An experience reveals that the failure of revenue to keep pace with both current and total expenditure reflects such a factor as inadequate tax effort on part of government (Taylor1969:124). Helmsing (1997) and Aronson (1985) measure the revenue (fiscal capacity) as the product of tax base and the standard tax rate. According to Helmsing (1997:50), the tax effort is the degree to which the local authority uses its fiscal base to full standard .It is the ratio of actual revenue obtained by the local authority to the revenues that could have been raised if the standard tax rate would have been applied. Furthermore, Aronson (1985:343) states that tax effort measure the willingness of government to tax their residents. It is a ratio of tax collection to the fiscal capacity of governmental unit. Calculating relative tax effort under the personal income approach is simple and to calculate tax effort one should divide the total tax revenue by total personal in come received in the state. Another way to measure the tax effort is Representative Tax System (RTS) or Tax Base Approach, which is developed by the Advisory commission on Intergovernmental Relation (Aronson 1985:343).

Mathematically Toye (1978:5) articulates tax effort of a country in the following formula.

$$\text{Tax effort} = \frac{\text{Actual ratio of taxation to GNP}}{\text{Predetermined ratio of taxation to GNP}}$$

This means tax effort equals to the ratio of actual tax to GNP divided by planned tax ratio to GNP.

Ladd (1999:39) has also used tax base and income of city residents approaches to measure the capacity of each to generate its revenue relative to other cities.

In addition, Scholars such as Taylor (1969:160), discovers that taxation potential of a country greatly dependent on:

- real income per head ;
- the degree of inequality in the distribution of income;
- the relative imbalance of different kinds of economic activity(such as the production of cash ,subsistence agriculture, mining , foreign trade);
- political leader ship; and
- administrative power of government

One should often perceive countries with higher real income per capita to have higher taxation potential than those having lower real income per capita since people pay tax from the surplus they get in the economy.

China practice shows that in 1992, the five wealthiest provinces account for 23% of GDP and 13% of the national population but about 1/4<sup>th</sup> of all revenue collections. In 1995 with local revenue collection, which primarily is income taxes, the revenue share rose to 30. The five poorest provinces accounted for about 13 percent of national income but 19 percent of the population. The provinces collected about 12 percent of total revenue and share fell between 1992 and 1995. The disparity in per capita revenue collection among provinces in 1995 ranged from 1551 Yuann in Shanghai to 139 Yuan in Anhui (Bird and Vaillant court 1998:66).

Political leader ship and administrative power of a country may affect the taxation potential. When political stability prevails in a country, its economic activities flourishes thus taxpayers can pay more income taxes because peace increases the honesty of citizens and their willingness to abide with rules of government. There may be more revenue if democracy and good governance as well as administrative competence of tax collectors are available in an area.

Another study on factors determining the revenue generating capacity by Bahl and Linn (1992:66) conclude that total revenue of a local authority is determined by:

- the size of economic base of the city which in turn may be conceptually divided in to per capita income and the size of the population ;
- the relation between economic base and various tax bases;
- statutory tax rate for each tax;
- The collection efficiency defined as the ratio of actual tax collection to statutory tax liability and
- Mix of tax selected.

In summary, the set of factors that determine the level of total tax revenue of urban government can be given in the following equation:

$$T = \sum_j \frac{T_j}{L_j} \frac{L_j}{B_j} \frac{B_j}{Y} \frac{Y}{P} P = \sum_j r_j t_j b_j y_p P$$

Where; T = total collection,

T<sub>j</sub> = revenue from tax j,

L<sub>j</sub> = legal tax liability of tax j for given tax statutes

B<sub>j</sub> = base of tax,

Y = total personal income,

r<sub>j</sub> = collection rate,

t<sub>j</sub> = legal tax rate

b<sub>j</sub> = base to income ratio

y<sub>p</sub> = per capita income

P = population

## **2.2.4 The Significance of Measuring Relative Revenue Raising Capacity in Different Levels of Government**

Relative fiscal capacity measurement is not crucial only to local and state governments but also to national governments. Aronson (1985:343) argues that the relative fiscal capacity measurement can promote efficiency in management of revenue sector in state and local governments. State and local officials need to know how much revenue they are able to raise from their own resources. In addition, it is essential for state and local authorities' officials to have an idea of ability and willingness of other states and local governments to raise revenue. Relative fiscal capacity besides these plays a role in designing grant in aid as well as in developing early warning system of financial stress.

Regarding relative fiscal capacity of nations, Bird (1992) and Toye (1978) conduct the international tax comparison. An inspection of these literatures suggests that there are at least seven reasons in support of usefulness of international tax comparison in developing countries (Toye 1978:34-39; Bird 1992:28). The reasons are simple arithmetic of growth, domestic appraisal of domestic policy, the macroeconomic effects of aid, the leverage effects of aid, allocation of aid, aid creditworthiness; and intellectual curiosity and academic bonus Points.

The first reason why so much attention was given to International tax comparison is that most economic formulations of development problem advocate that the adequate mobilization of domestic resources is the key to sustainable development. More briefly, the simple arithmetic of growth involves mainly an increase in tax revenue. For required level of growth to occur it require a certain rate of growth. And to attain this amount of growth, one should have amount of new capital formation but this level of investment cannot be achieved with out inflation pressure on economy. One rationale, which has been put forward in support of international tax comparison, is therefore to determine whether a given country could not if it wanted to raise more tax with out seriously 'burdening' the economy (Toye 1978:35). This is done in comparing the performance of one country with that of other developing country. The idea here is to see if a country can

if it wanted to reach the required stage of taxation required in order to attain the plan target.

A second, rationale forwarded in support of systematic international comparison is that whether they have a plan to satisfy or not. Officials and politicians are actually in habit of competition by comparing themselves with others. Such comparisons are some times an important part of the domestic appraisal of domestic policy. In a net shell, government decision makers often opt to use of comparisons with other countries to measure the performance of their fiscal capacities.

Third, the international tax comparison has crucial role to play at macroeconomic level. For example, foreign capital, specifically aid has been extended to substitute domestic saving in recipient country. This substitution of domestic saving by foreign aid has called for international tax comparison.

Fourth, over the last few years there has been increase in growth of program aid. The growth of this program aid has brought up an important reason for considerable attention that has been paid recently to measurement of fiscal performance.

Fifth, international tax comparison in relation to aid might be used as a basis for allocating both for recipients and donors. A country with lower tax effort receive larger portion of aid while the one having high tax effort receive smaller part. The relation ship between the collected taxes and allocation of a state aid to school is given by Snyder (1977) and said that a state aid may be inversely related to per capita property assessed value. Tax effort play an important role in designing grant in aid and measuring fiscal stress (Aronson1985:343).

Sixth, the use of international comparison in respect to aid is a one component of the assessment of creditworthiness. In other words, international comparisons show the ability of the recipient to pay back a loan with out undue internal or external financial tension. The tax capacity and the willingness of the borrower are relevant to a bank manager in order to sanction the loan.

Finally, it is clear that no poor country can improve its economy without improvement in resource mobilization through taxation. And, this tax performance is an intellectual concern for those who are interested in people welfare improvement.

### **2.2.5 Constraints of Revenue Raising Capacity in Developing Countries**

It is not an easy task to run any revenue generating scheme without facing some challenges that can hinder its successful full capacity operation. Revenue raising schemes usually encounter enormous amounts of problems that contribute to low achievements of revenue collection. Majority of these revenue generating capacity's bottlenecks are common all over the world, specifically in the developing countries, and in all government levels.

Several writers and scholars in the field of public finance recognize the impact of efficiency of tax administration, skill and number as well as integrity of staff of tax administration in revenue raising capacity. Such as Prof. Kaldor, claims that the low revenue yield taxation in underdeveloped countries can only be attributed to the fact that (Kaldor 1969:177):

*“Tax provisions are not properly enacted either on account of the incapability of tax administration or on account of straight forward corruption. No system of tax laws, however, carefully conceived, is proof against collusion between the tax administrators and the taxpayers; an efficient administration consisting of persons of high integrity is usually the most important requirement for maximum revenue, and exploiting fully the taxation potential of a country”.*

The ability of the government tax administration department should go hand in hand with the nature of the tax. Government should levy simple tax when the capacity of the tax administration is low in order to avoid overburdening. Hence, complicated taxes should be reserved until the government department dealing with tax administration is efficient

enough and capable to administer them. However, for tax administration to acquire high grade staff and personal of integrity, high salary is prerequisite which in turn require the level attention the government give to tax collection. Many under developed countries also suffer from twin problems of shortage of staff as well as comparatively low grading staff of the tax administration.

Moreover, United Nations (1991:48) discover constraints that prevent collection of more revenue in Less Developing Countries. This study has summarized the revenue collection problems of countries in to three groups that follow.

(i)First, are the universal problems like such as taxpayers' unwillingness to pay taxation and the problem of informing them of their responsibilities when the tax laws are complex and people lack education.

(ii) Second, are the systematic problems those threat tax administrations itself which includes the following.

1. Lack of information on taxpayers;
2. Inadequate use of what is available and the difficulty of manipulating and reporting data of relevance to the improvement of revenue raising;
3. Weak accounting system;
4. Absence of sufficiently probing tax audits;
5. Absence of systems of control ensuring that the various tax administration jobs are properly coordinated and carried out;
6. Lack of monitoring systems and follow up the revenue raising performance
7. Lack of anti- evasion policies and
8. Obsolete tax law

(iii)Third problem is the capacity of the people who administer taxes and revenues. In many countries, the tax administration staff lack skill at all levels and improved system of controlling as well as evaluation of tax administration staff. Lastly, lack of attention and resources tax given to revenue generating task. Revenue raising Departments are incapable of providing the necessary equipments and salaries for their employees.

Despite the fact that constraints of revenue generating capacity appear to be common in the different levels of government, the determinants of revenue raising capacity of local authority deserve discussion.

### **(a) Constraints of Revenue Raising Capacity of a Local Government**

As it discussed at country level, local governments as well have their revenue collection problems. Bahl e tal (1994:220-224) recognizes that resource mobilization of local government is constrained by: legal /political, administrative, economic, technical, cultural and institutional constraints along with role of incentives .Taylor (1969:177) and Sinha (1968:150) in addition; state that problems of tax administration affects the performance of revenue collection.

#### **(1)Legal and Political Constraints**

In a federal government, it is the law that assigns the responsibilities of tax and expenditure to each level of government. Some taxes are specially set aside for higher governmental units whereas others are at disposal of the local government financing. Those, which are assigned to higher levels of government, are more productive than those of lower levels government. Central governments try to preserve for themselves the most elastic and productive revenue instruments. Bird and Vaillan court (1998:81) remark that assignment made according to comparative advantage would result in revenue concentration and expenditure decentralization. This partly contributes to low revenue in most of the localities in developing countries. Even if, most of lower levels of governments face shortage of revenue, they cannot increase it on its own, as law does not allow them to do so. The central government frequently imposes strict rate limit on all local government taxes. Thus changing this assignment of revenue is not easy to alter unless the constitution or customs that supports this act is changed. In the statement of Bahl e tal (1984:220), such changes are less likely to be carried out than improvements in administration or in provision of existing revenue sources.

Having a look at the assignment responsibilities of revenue among different levels of government let us examine why more elastic and productive are assigned to higher levels

and the less productive ones to the lower levels. Primarily, central government may want to gain political favor of lower levels through transfer. The political system is another serious constraint of revenue raising capacity. Political and administration decentralization may improve the revenue generating capacity because decentralization increases the transparency and accountability of the local officials to the people. Decentralization will enhance relationship between taxpayers and tax authority. Moreover, existence of democracy and good governance boost participation of taxpayers in tax administration. Not only this but also it increase the honesty of taxpayers and tax collectors and accordingly may reduce tax evasion and corruption. In line with this argument, Taylor (1969:207) affirms that it is difficult and expensive to collect taxation if people of country fundamentally disagree with the system and the level of taxation, which is imposed, and this implies the need for dynamic and informed leadership as well as fair and enlightened public finance system.

Furthermore, bad tax law or bad tax administration or both are not only to be demonstrated by lack of knowledge of understanding of administrative competence. They are too the result of resistance from powerful group who block the way to effective reform. Political pressure has a lot to do in tax collection, as the political stability affects the number of taxpayers. Bird and Vaillancourt (1998) cites (Bukedi, 1958-1960; Toro, 1961-1963; Buganda, 1958-1969) that political disturbances have contributed to substantial falls in the number of taxpayers. Never the less, this instability did not reduce the taxpayers by more than 20 percent.

## **(2) Administrative Constraints**

Administrative structure plays an important role in resource mobilization. In developing countries, administrative structure is highly related to political system. As a result local revenue officials are directly connected to the higher levels government. Then if programs are initiated and accomplished at local level they would not met with success. This failure of the program may not be due to any weakness at local level, but, can attribute to the fact that program is not best long term interest of local revenue officer to conform to the proposed local reform. In the same manner, different departments with in

a local government must cooperate in order for a local revenue sources to be successfully administered. The success of local revenue source requires also joint inputs of higher officials. on the subject of the change in administrative structure, it is desirable to retain the existing administrative arrangement in order to increase the revenue instead of constructing complexly new organization.

### **(3) Economic Constraints**

Some most economic factors that may affect the revenue raising capacity of a nation are composition of economic activities, real per capita income, degree of inequality of income distribution and relative importance of economic sector that were seen above may also have role to play at local revenue collection performance..

Mostly the highest income group offers the highest potential yield to the tax collectors. Thus in place where more rich live should have high tax potential while in place where there are predominantly poor should have low tax potential. In other words, the taxation potential of any country strongly depends on the existing inequality in distribution of national income. This in turn is linked to the share of income derived from the property.

Taking into consideration economic constraints of local authority, local government is not isolated economic entities but existed in the larger economy. Some of it taxes may be taken a way to higher government level and hence lowered its revenue. It is small own resource base constraint prevent them to give one solutions to the problem of resource mobilization. Since tax is always paid out of surplus, obtain from economic activities, an economic activity that are under local government produce inadequate surplus and thus should pay little tax.

At macroeconomic level, many developing countries now are facing problems of foreign exchange and inflation, which leads to budgetary deficit. If central government is in shortage of budget, it is very difficult for it to provide grants to local level with a shortage of revenue.

#### **(4) Technical, Cultural and Institutional Constraints**

The current environment where the local government operates is one aspect that must be considered in resource mobilization. For example, it is not advisable to apply computerized annual reassessment of property values in absence of computer facilities in environment. Equally significance, it is inappropriate to use money resource mobilization tools, if many transactions are done on barter or in kind basis. In formulation of new policies, one must think about the institutional arrangement and the level of their capacity. Cultural issues also matters in the determination of feasible policy alternatives. Religious Doctrine of an Islamic society, for example may limit some taxes and debt financing (Shemeh 1969, Karsten 1982:108-142).

The example of local government revenue collection constraints cited above are largely general to all countries, a typical example of Africa is provided below.

Inanga and Wusa (2004:88) in their research on revenue collection constraints of local governments in Ghana revealed five serious design problems of internally generated revenue.

First, tax base of local governments are static because of unreliable databases for determining revenue potentials so the only mean available for increasing revenue is to augment the tax rate, which further may increase the number of defaulters. Second, areas within the districts where revenue could be raised are not well identified and revenue collection level is not optimal. Third, extracts from the auditor general's report shows that about 112 revenue collectors misappropriate revenue generated.

Fourth, mechanisms for collecting internal revenue are ineffective. For instance, revenue collection from property rates is low as they are underestimated, there are an inadequate number of the tax collectors in the districts, and these are aggravated by the poor logistics for revenue collection. Finally, absence of appropriate sanction or punishment for tax defaulters.

In addition to design problems of internally raised revenue mentioned above, the two authors also state that the following factors affect the revenue generating performance:

- requisite knowledge and skill
- relationship, transparency and accountability

- rewards and punishment
- Monitoring and evaluation (Inanga and Wusu 2004:89).

Lack of skill in finance and revenue collection, and lack of transparency between the tax administrators and taxpayers may reduce the amount of revenue collection. When compliance taxpayers are given incentive, the revenue collection may increase while lack of punishing tax defaulters may also reduce revenue collection.

Absence of the monitoring and evaluation of revenue collection program is an obstacle since is difficult to know the performance of revenue collection with out follow up.

### **(b) Problems of Tax Administration in Developing Countries**

Poor tax administration is one major constraint of revenue raising in several countries. The main problems are tax avoidance and evasion, and a poor relationship between the tax staff and public. Evasion is illegal manipulation to reduce tax liability while avoidance is an individual manipulation of his affairs with in law so as to reduce tax liability.

Scholars like Gillis etal (1996) and Taylor (1969) have identified some problems of the tax administration that affect revenue generation.

Some of the problems of tax administration are: shortage of well trained tax administrators, complex tax laws, light penalties for tax evasion, corruption and outdated techniques of tax administration, combine to make tax evasion one of the most intractable problems of economic policy in developing countries. In India for example, during the fiscal year 1981 it was discovered that taxes were avoided on at least 40 and possibly 60 percent of potentially taxable income. In Jamaica, also more than a third of the potential tax bases escape taxation, compared to less 15 percent in the United States or Canada (Gillis etal 1996:338).

#### **(1) Poor Quality of Staff**

The efficiency in tax collection depends on a properly made administrative setup. But the administrative arrangement can function perfectly only when the people running the tax administration are well trained and have knowledge of work along with the willingness to do the job ;however in several countries the tax administration staffs lack skill at all levels and improved system of controlling as well as evaluation of tax administration operations. An experience shows that under developed countries all suffer from severe

shortage of trained personnel for administrative work of all kind include income tax audit (Taylor 1969:182). Nevertheless, for tax administration to acquire high grade staff and personal of integrity, high salary is prerequisite which in turn require special government attention to be given to revenue collection.

### **(2) Law Complexity**

Governments should not impose complex tax laws, other wise tax collection should suffer. Thus, the ability of the government tax administration department should go hand in hand with the nature of the tax. Government should levy simple tax when the capacity of the tax administration is low in order to avoid over burdening. Then complicated taxes should be reserved until the government department dealing with tax administration is efficient enough and capable to administer them.

### **(3) Logistics Problem**

Many government authorities provide merely very little attention and resources to revenue generating operations. For example, Revenue Raising Departments are incapable of providing the necessary equipments and salaries for their employees.

Particularly lack of transportation facilities, computers, and low scale pay hinder the tax collection. Low salary scale of tax collectors and assessors pave way for direct cheating and corruption.

### **(4) Corruption**

The relation ship between the tax administrators and taxpayers may produce positive or negative result in the tax collection. If there is transparency that enable them to share tax law information may result in improved revenue raising. In some cases the two actors of tax administration may agree up on issues i .e under assessment of property and tax evasion.

Inanga and Wusa (2004:88) confirmed from Auditor General Report that about 112 revenue collectors misappropriated revenue generated. Similarly, in India, almost 70 percent of taxpayers covered in survey carried out by Gillis etal (1996) openly accepted bribing and three quarters of tax auditors admitted accepting bribes to reduce tax payments. The cost of a bribe was universally known to be about 20 percent of avoided tax. In Bolivia during the same period of 120,000 registered taxpayers one –third paid no taxes at all while 20,000 taxpayers who did pay were not on the register.

## 2.3 Fiscal Imbalance

The above sections have addressed the fiscal inequality between government units. Fiscal imbalance is of two types that is Vertical and Horizontal fiscal imbalance.

The former is disparity between revenue means and expenditure needs at various level of government in a federation. While the later is inconsistency between revenue raising ability and fiscal needs of government at the same level in a federation (Shah 1994:40).

### 2.3.1 Vertical Fiscal and Horizontal Fiscal Imbalances

In responsibility assignment, constitution assigns major expenditure responsibilities to the provincial jurisdiction; but tax responsibility assignment appears to favor the federal government, consequently vertical fiscal imbalance results. Then how to measure the vertical balance?

Coefficient vertical fiscal imbalance attempts to measure the degree of control exercised by federal government over lower levels of government, which is mathematically given by the following formula (World Bank 2000a:24):

$$1 - \left[ \frac{(R^s/R)}{(E^s/E)} \right]$$

Where;  $R^s$  = State revenues

$R$  = Aggregate Revenue (federal plus states)

$E^s$  = State expenditure

$E$  = Total expenditures (federal plus states)

A coefficient of zero is low vertical imbalance indicating that state governments are much more autonomous in their decision making as their revenue needs and spending share are the same. A coefficient of one shows complete control of federal government over states since the states revenue share is very small in comparison to the expenditure share.

World Bank (2000 a: 24) has applied this vertical imbalance coefficient to measure vertical fiscal imbalance in a sample of 13 countries (table 3). Among these, Ethiopia has vertical imbalance coefficient (0.52) that was higher than the federal system of Mexico

(0.36) or Malaysia (0.37). Bolivia and South Africa has vertical imbalance coefficient of 0.66 and 0.88 respectively that exceeded Ethiopia. But, the share of regional government expenditure in the total spending is far higher in Ethiopia (41.2) than in Bolivia (19.8) or South Africa (30.9). -0.22 vertical fiscal imbalances for USA indicate greater national revenue to the expenditure and lead to revenue –expenditure ratio which is equivalent to 1.22. And when this revenue –expenditure ratio is deducted from one the result is -0.22.

Table 3: vertical fiscal imbalance in selected countries

Country	Year ending	Sub national revenue share (%)	Sub national expenditure share (%)	Vertical imbalance
Argentina	Dec,31,1995	40.3	41.5	0.03
Australia	June,30,1996	28.2	37.3	0.24
Bolivia	Dec ,31,1996	6.8	19.8	0.66
Brazil	Dec,31,1993	24.3	27.4	0.11
Canada	March,31,1995	45.3	49.4	0.08
China	Dec,31,1996	51.0	54.7	0.07
Ethiopia	July,7,1996	19.8	41.8	0.52
Germany	Dec,31,1996	24.5	28.9	0.15
India	March,31,1995	28.0	39.1	0.28
Malaysia	Dec, 31,1996	9.7	15.5	0.37
Mexico	Dec ,31,1994	12.4	19.5	0.36
S.A	Dec31,1995	3.8	30.7	0.88
USA	Sep 30,1995	39.9	32.8	-0.22

Source: government finance statistics year book 1997 IMF Washington DC.

In other words, vertical fiscal imbalance is equal to one minus the ratio of revenue decentralization to expenditure decentralization.

Another study shows that expenditure responsibilities at state (sub national) level usually exceed the states' revenue raising capacity, leading to both vertical and horizontal fiscal balances (Guigale and Webb 2000:105).

Empirically, Shah (1994) demonstrates both vertical and horizontal fiscal imbalances where he examined revenue and expenditure of 15 nations. Out of 15 countries for which the national and sub national data on revenue and expenditure at national and sub national level are examined, only Australia and China are successfully completely eliminated vertical imbalances. 7 of the remaining 13 countries report fiscal deficiency at national level and 6 at the sub national level. Fiscal deficiency at the national level does not show

any correlation with degree of central control our sub national government (Shah 1994:40).

Ahmad (1997:241) furthermore in 1987/88 illustrates the existence of vertical fiscal imbalance among 9 different federations drawn from both developed and developing nations (table 4). Indian state governments for example, in 1987-1988 collected just about 30 percent of the total revenue and their share in total expenditure was 56 percent. But, if only current account is considered the states share is 36 percent from the revenue sources assigned to them, they could finance only about 43 percent of their current and to depend on central funds or borrowings to meet the rest. In India, the states dependence on the center for financing their expenditures was the highest among all federations compared with the revenue from own sources contributing only 43 percent of their expenditures. Only Australia comes close to Indian situation, with states raising resources to cover 45 percent of their expenditures. In all other states, the fiscal dependence of the states was much lower. it also see in India that the difference between revenue and expenditure concentration was the highest , implying that the sates are used mainly as spending agencies , much of revenue collection was under taken by the center.

Table 4: decentralization in selected federations in1987

Country	Percentage of states current receipts in total revenues	Percentage of states expenditure in total expenditure	Percentage of revenues to states (current + capital)
Australia	20.9	36.4	44.6
Austria	14.2	17.3	75.0
Brazil	16.7	33.0	67.4
Canada	45.1	54.0	75.4
Germany	44.7	54.0	79.0
India	30.2	54.4	43.4
Malaysia	13.4	18.5	68.0
Switzerland	31.6	38.2	73.7
United States	29.3	30.9	88.1

Source: Government Finance Statistics 1990, International Monetary Fund, Washington, DC.

All other states could finance more than two-thirds of expenditures from own sources. Only in United States, the degree of states' dependence on federal transfer was the lowest.

The underlying causes of vertical fiscal imbalances have different origins. A number of authors pinpoint some factors that creates the fiscal imbalances (Guigale and Webb 2000, Synder1977).According to Guigale and Webb (2000:105,106) imbalances happen due to the following reasons.

The most obvious reason arises from allocation of taxing and expenditure responsibilities under constitution; or could result from "first-mover" advantage. That is according to the constitution; the state may not have adequate capacity to raise revenue but may have to share the major sources of revenue with federal government, which preemptively occupied these tax areas.

Second, unless the federal government is willing to transfer tax room to the states, there is no way, short of excessively high tax rate, that can exercise their taxing authority. Third, it may be more efficient for the federal or central to collect taxes on behalf of the states. This can also occur for variety of reasons i.e. inadequate state level collection capacity, economies of scale, and the presence of spillover. The last reason is becoming more important; with increasing economic integration the optimal jurisdiction for collecting taxes is spending. That is, the tax bases are becoming more "mobile" relative to optimal jurisdiction for spending. In order to "internalize" these potential spillovers or externalities, taxes are collected at the national level with understanding that some or all of the revenue will returned to the states under a set of transfer arrangements.

The other cause of vertical fiscal imbalance is a difference between the ability of taxpayers to pay tax and the ability of the government in the central level and the state and local government.

For the national government, the capacity of the people to pay taxes and the ability of the government to raise the taxes are one and the same. However, since significance part of our public sector activities is carried out by regional and local governments, determining the ability of state and local government to generate revenue is not exactly the same as

the measuring the fiscal capacity of their residents. This variation is due to a number of reasons. For instance, Aronson (1985:343) cites that the difference is true because:

(1) People may live and work and shop in different jurisdictions. This may often leads to escape of taxes. Some times this may result in their paying taxes to support the public service of jurisdiction to export its taxes to people of other than the one in which they live. (2) It is possible for one jurisdiction to export its taxes to people of other jurisdiction.(3) By placing a tax on the production of good and services that takes place with the in jurisdiction , it may be possible to shift some of the burden to those people who buy the product but live in other jurisdiction.

In closed state or local economy the revenue raising capacity is determined entirely by residents' income. The higher is the residents' income the greater is the revenue of state or local government could raise at standard tax burden. However, the situation where the capacity of the people to pay taxes and the ability of the government in the lower levels to be the same as it is the case in the national government rarely happen.

As far as the factors for horizontal fiscal imbalance are concerned, Ghebrehiwot (2002:6) suggests factor like economic base variation among regions. As regions delineation is not base on economic criteria, regions vary widely in natural resources endowment, population size and social and physical infrastructure. Besides, the available limited manufacturing is concentrated in few regions and urban areas.

## **2.4 Intergovernmental Transfer: Types, Rationale and Design**

For disparity between the revenue means and expenditure needs, either between different or the same levels of government, to close this gap, intergovernmental transfers are needed. Intergovernmental transfers are the dominant of revenue means for sub national government in most developing countries. According to Shah (1994:24), central transfers finance 85% of sub national expenditures in South Africa, 72% of provincial and 85% of local expenditure in Indonesia, 87 to 95% of state local expenditure in Nigeria; and 70 to 90% of expenditure in less prosperous states of Mexico.

## 2.4.1 Types of Intergovernmental Transfers

In a federal system, the intergovernmental transfers that consist of tax sharing and grants can correct fiscal imbalances that result from the expenditure and tax responsibilities assignment.

### (a) Revenue Sharing

Revenue sharing normally means tax sharing, which is aimed mainly for reducing vertical imbalance. It can be achieved through : ( i) tax base sharing; (ii) tax revenue sharing.

Tax base sharing means taxation of common base by two or more levels of government, which is common in industrialized countries. On the other hand ,tax sharing refers to a system in which one government (usually the central government) collects revenue from a tax and shares it with sub national governments usually basis on geographic origin of revenues(Shah 1994:23). Tax sharing system is quite common in developing countries and use to address a variety of objectives including promotion of regional development and fiscal equalization. In tax sharing central government, direct given fraction of revenues from selected taxes to the various states where the revenue originates. States have essentially no control over the choice of taxes, tax base, tax rates or tax administration; they are fiscally weak.

Revenue sharing has similarity and difference to tax sharing. Like tax sharing it provide no sub national autonomy over the choice of taxes, the definition of tax bases, setting of tax rates and tax administration the use of formula does however offer possibility of reducing horizontal disparity among jurisdictions. Unlike tax sharing, revenue sharing returns fund to sub national government on the basis of formulas instead of the jurisdiction of origin.

Tax sharing unlike grants; the amount is usually determine unilaterally by grantors government. Tax sharing differs from grants in two aspects. The first aspect is the automatic nature of intergovernmental transfer is involved. It frees local government from dependency and allows some sense of independence and equal partner ship. The second aspect is the assurance of a predictable amount of revenue on a regular basis.

The distribution of tax shares among local government is usually made either on the basis of derivation or formula (Bahl and Linn1992).A derivation basis implies that the tax share is returned to the jurisdiction where it is collected. A formula basis implies that the total tax share is pooled and distributed among local jurisdictions. The purpose of such a formula usually aims at achieving fiscal equalization. Intergovernmental grants are universally used in federal countries, These can be of different types with different objectives.

### **(b) Grants**

Broadly, grants can be divided in to (1) non-matching and (2) matching grants.

Non matching grants are classified into two. These are unconditional and conditional non matching grants.

(a) Unconditional/block grants: are lump sum grants from one (usually higher) level of government to another with out any conditions. This happens when there is simply additional resources transfer to the recipient government to compensate for lack of adequate revenue (World Bank 2000 b: 25). This type of grant is not advice able as they give rise to disincentive on tax effort at lower levels. However they are preferable if the objective is to enhance the welfare of local residents

(b) Conditional grants: are usually intended to encourage greater sub national expenditure increase that may not be according to the same priority by recipient. They are viable to address spillover.

On the other hand, matching grants can be divided in to open ended and closed ended.

(a) Open ended grants: if matching grants are open ended, no constraint is put on grants through matching provisions. Such types of grants correct inefficiency from spillover and are suitable vehicle in inducing expenditure.

(b) Close ended grants:

If matching grants are close ended, fund are provided to a certain limits. Close ended grants are superior to open ended as the former stimulates expenditure on subsidy area more than latter (Shah1991, 1997).

## **2.4.2 Rationales for Transfers**

The design of intergovernmental transfers depends upon the purpose for which the transfers are given. Hence, it is necessary to understand the objectives of various types of transfers to evaluate their efficacy. In literature of fiscal federalism, federal transfers are recommended for: (i) Closing the fiscal gap, (ii) equalization, and (iii) spillover, and 'merit' good reasons (Ahmad 1997:235). In the same way Fisher (1987:345) as well identifies three roles for intergovernmental grants. Grants can be used to correct externalities, redistribution, and stabilization. Similar to the above conclusion, intergovernmental transfers' purpose in a federation specific purpose transfer support important policy objectives such as: benefit spill over compensation; bridging fiscal gap; ensuring the minimum standards of public services across the nations; fulfilling the redistributive function of the federal government; creating common internal markets; reducing net fiscal benefits across jurisdictions; and achieving economic stabilization objectives (Shah 1994:36).

Grants also have disadvantages. It encourage recipient to be less efficient. Like grant system in Indonesia and Sri lanka have paid the salaries and allowances of virtually all local government employees, including primary school teachers (World Bank 1988:165).

### **(i) Closing the Fiscal Gap**

One of the important reasons for giving transfers comes from inadequacy in assigned revenue to satisfactorily under take functions of sub national government, which is the vertical fiscal imbalance.

Some writers argue that imbalance should also exists even when the assignments of responsibilities is done on economic considerations. Because of the comparative advantage of central government in carrying out the redistributive and stabilization functions, the more productive tax and debt instruments get assigned to it. At the same time, sub national governments are better placed to provide public service corresponding to the preferences of the people (Ahmad 1997:235; Bird and Vaillan court 1998:105).

Their role in the allocation function and therefore expenditure is predominant. Consequently, revenue sources do not match expenditure needs, even in the richest units of sub national government (Bird 1993).

### **(ii) Equalization**

Fiscal imbalance varies from one sub national units to another .Some sub national levels have higher revenue raising capacity whereas; some have lower revenue raising capacity. Because of their higher revenue raising capacity, the richer state can provide better standards of public service than their poor counterpart. And, to correct these fiscal disadvantages, equalizing transfers are call for. Hence, economic literature has recognized that equalization is justified on grounds on horizontal equity.

### **(iii) Transfer to Correct Spillover**

In the absence of perfect mapping, the provision of public services by sub central government may spillover the jurisdictions. Such externalities result in non optimal provision of public services. Pigovain subsidies is require to get prices right .To be cost effective, specific purpose transfers made to sub national units to ensure optimal provision of public services require their matching consideration.

### **(iv) Distribution**

Attaining redistribution objective is another justification for intergovernmental transfers. Base on efficiency of resources allocation, local government have competitive advantage in reducing welfare cost of public service provision such as education, health, etc. Such services have redistributive nature, therefore, transfer from upper level to lower one play significant role in maximizing social welfare and achieving common minimum standard public service provision.

### **(v) Stabilization**

Macroeconomic stabilization too, is a reason for transfer. Capital grants have impact on attaining economic stability through injecting sub national government with adequate funds when they have economy constrains. Similarly, the central government diminishes the amount of grant when economy expends.

### **2.4.3 The Design of Intergovernmental Transfers**

In designing optimal transfer, two issues arise: how the divisible pool is determined and allocation divisible pool among sub national government is distributed? (Bird and Smart 2001:8) identify three ways of determining the size of total divisible pool. These are: fixed proportion of central / regional government revenue or tax sharing basis, ad-hoc basis and cost reimbursement method.

(a) Fixed proportion of central/ regional government revenue basis

Here central / regional governments decide what type of tax to be shared and what percentage of collection to be shared among different government levels. However to give answers to these two issues vary from one country to another.

(b) ad-hoc basis

This method implies that decision on volume of grants pool is made on discretionary by parliament or as a government directive each year. It gives flexibility advantage to the grantor. But , this method is not transparent, not predictable and does not promote accountability. Meaning they are subjected to political manipulation and is unknown that how much they will receive each year.

(c) Cost reimbursement method

This method is used to determine how much should be the size of divisible (grant) pool. To adopt this type the grantor needs to define all types of services that are guaranteed to cover the cost incurred in delivering a certain service by grantee. It is connected to matching grant type.

### **2.4.4 Sub national Government Borrowing**

In cases where revenue and intergovernmental transfers are not enough to cover expenditure needs of sub national governments, borrowing mechanism is suggested an ideal option .Long term projects/programs that would result in significant socio economic benefits necessitate for external and internal loans(Guigale and Web 2000:257).

However this issue is not free from paradox. Such as in most federal arrangements, borrowing power from external source is reserved for central governments, although some countries allow some countries allow sub national governments to borrow externally (Bird and Wallich 1993).

While some oppose sub national government from accessing external debt but accept internal loan, other argue against at least access of any form of loan. The rules applicable to all borrowing is that “a debt is use full only when it is invested to yield a rate of return that is at least enough to repay the principal along with interest due”(World Bank ,2000a:33). Nevertheless, in case of government borrowing, the rate of return is in form of social benefit.

The argument against borrowing by sub national governments is associated with possible adverse effect on macro economic stability, tax reduction risk rating and bail out.

Regional governments in Ethiopia are granted the right to borrow from domestic sources; but this borrowing is conditional, very stringent and above all problematic ( Befekadu, 1994:73) challenging the practice.

## **Chapter Three: Fiscal Decentralization Practice in Ethiopia**

### **3.1 Constitutional Background**

The history of raising government revenue in Ethiopia dated back to March 1942, and to the promulgation No 8 of 1942, which stated that “concerning tax the saying goes *“in order to accomplish the establishment of our government, the prosperity of country and the well being of our people land taxes shall be levied”* (Negarit gazeta, 1st year No.1:17).

About administrative system of the country, the imperial regime was highly centralized one. Moreover, the fiscal autonomy of regions was insignificant. The only fiscal attempt made was education and health taxes; earmarked for financing primary and health in the region. Under the unitary state of Ethiopia (1974-1991), both revenue and spending were highly centralized; meaning local and regional governments submit all their fiscal income directly to the central government treasury. There after central government would make allocation in order to finance the expenditure of the lower levels and closely monitored and guided their implementation.

Nevertheless; Transitional Government of Ethiopia (TGE), that assumed power in May 1991, has introduced fiscal decentralization. The aim is to enable central government and regional government to carry out their respective duties and develop their own initiatives and narrowing the gap in the level of development among regions.

Decentralization in Ethiopia post 1991 has three major steps. The first step is adoption of a charter of Transitional Government of Ethiopia, which affirmed the rights of Nations and Nationalities and People of Ethiopia. Here political groups held national Peace conference and adopt the charter. The charter of Transitional Government of Ethiopia (TGE) has affirmed the right of nations, nationalities and peoples to self administration, independence and to determine their own affairs by themselves (TGE1991:2).

The second step for decentralization practice in Ethiopia is proclamation, which affirmed the establishment of regional or national self governments. As result, 14 state governments (including Addis Ababa as a region) were established (Pro.No7/1992: 7-8).

How ever, the decision of people has define only nine ethnic based members states and Addis Ababa administration where by its residents shall have full measure of self government and shall be responsible to the federal government(Pro.No1/1995:103-104).

The third step is proclamation 33/1993 that defined the legal frame work for revenue sharing between the central government and national/regional self governments and arrangement for subsidies to the regions and borrowing by regions.

The objectives of this proclamation are: (a)to enable the central and regional government efficiently carryout their respective duties and responsibilities; (b)assist the regional self government their region on their own initiatives; (c)narrow the existing gap in development and economic growth between regions ; and (d) encourage activities that have common interest to the regions.

Moreover, this proclamation categorizes revenues in to three. These are revenues for central government, revenue for region; and joints revenues of central government and regional governments (Pro.No 33/1993:25).On the top of this article 35 of proclamation 7 of 1992 identifies grants to be given by central government and domestic borrowing; and other sources of income as sources of income in Ethiopia.

The revenue sharing proclamation has also defined the possibility for grants (subsidies) from the central government to the regions in order to: (a) Promote social services and economic development of the regions ; (b)accelerate the development of previously neglected and forgotten areas; (c) narrow down the gap in per capita income between regions ; (d) support projects that will help control negative economic externalities that may reflect from to region ; and (e) encourage foreign currencies earning project(Pro.No 33/1993:27).

In addition, article 7 sub article 5 of this proclamation placed precondition stating that as the amount of subsidy to be granted shall be proportional to the contribution made from revenue collected by the regions. However, the inherently weak economic base of some region may be a challenge to proportionate contribution of revenue collection.

## **3.2 Fiscal Decentralization: The Four pillars Issues**

### **3.2.1 Expenditure Assignment**

The first pillar of fiscal decentralization is assignment of expenditure. It is the extent of power division between levels of governments, i.e. how much power to retain at the center and how much to give to the regions. There is no universal formula in assigning responsibilities between various levels of government. The practice varies across countries; however, there seem to be wide degree of agreement on proper jurisdictions of certain functions (Eshetu 1994:171).

The functions assigned to the center and a region in Ethiopia is based on the proclamation No.7 /1992. Article 5 confers supreme political power on the council of representatives of the central transitional government, while article 9, sub article 1 specifies activities assigned to central government. They include: defense , foreign affairs , economic policy , conferring of citizen ship , declaration of state emergency , deployment of army , where situation beyond the capacity of national/regional transitional self government arises, printing currency , establishing and administering major development , establishments , building and administering major communication networks and etc.

On the other side , regions are assigned the power to prepare, approve and implement their own budget ; establish, direct and supervise social and economic development establishments or enterprises ; administer , develop and protect natural resources ; establish and direct regional security and police forces; own and transfer property and perform all other matters not reserved for the central government (Proc. No 7/1992:11). In addition, state government is given responsibilities to formulate and execute economic, social and development policies, strategies and plan of state... (Proc.No.1/1995:108).

### **3.2.2 Federal Expenditures versus Regional Expenditures**

A series of proclamations and constitutions and 1994 constitution established the responsibilities and power of the regional governments. Base on these proclamations, expenditures have been divided between central and regional governments.

However, weighing regional expenditure against federal expenditures, the former spends more than the latter.

In the last 12 years i.e. from 93/94-2004/2005, the amount of regional expenditures on average accounted for 5113.26 millions birr and ranged from 2439.75 million birr in 93/94 to 8838.91 million birr in 04/05. While federal government expenditure on average accounted for 6463.70 millions birr and ranged from 4762.91 millions birr in 93/94 to 145592.87 million birr in 2004/2005. In terms of percent, regional expenditures on average accounted for 33.42% of national expenditure, however federal expenditures on average accounted for 66.57% of the national expenditure (see table 5). This verifies more expenditure decentralization to the regions. In contrast to this Ethiopian scenario, Bennett (1990:47) and UNDP (1993:69) show that sub national governments in developing countries account for an average of 15 percent of total government spending.

In the table 5, shares of both federal and regional government have shown an increasing trend, which is the reflection of increase in investment on socioeconomic infrastructures in the country. All regions of the country expenditures increased from 2439.75 million birr in 93/94 to 8834.7 million birr in 04/05, while federal expenditures rose from 4762.91 millions birr in 93/94 to 14592 millions birr in 04/05.

Table 5: expenditure by level of government (million birr) from 93/94-04/05

region	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05
Tigray	237.37	297.89	298.48	401.09	374.66	316.57	300.27	365.64	374.59	475.46	438.15	626.77
Afar	80.9	73.49	114.33	86.88	141.94	242.81	259.81	219.88	221.57	235.11	205.94	255.86
Amhara	506.59	689.97	724.62	824.08	886.35	921.82	783.80	933.66	969.77	1071.88	3005.18	1459.49
Oromiyia	737.28	906.86	1118.45	1362.64	1269	1179.33	1133.11	1460.14	1447.53	1600.23	2283.11	2355.12
Somale	72.23	110.78	163.70	193.40	214.15	233.59	270.43	298.26	364.98	406.53	297.61	385.01
B.S.G	55.14	69.67	93.66	106.15	122.37	160.85	159.10	162.61	166.77	181.97	183.46	180.46
SNNP	375.52	560.63	666.80	704.61	682.96	753.26	600.57	651.96	555.98	859.39	1193.15	1369.55
Gambella	45.40	44.25	83.81	83.56	100.49	106.96	106.68	116.91	133.25	137.20	114.36	137.57
Harari	16.97	37.57	40.94	50.95	79.99	46.02	47.72	61.74	80.24	63.37	86.23	90.06
DireDawa	21.48	26.54	29.05	32.47	51.53	52.23	48.91	52.18	95.34	100.26	65.71	106.54
Regional	2439.75	3211.21	3797.04	4323.44	4633.87	4763.84	4399.99	5224.27	5438.41	6219.55	7516.25	8834.71
federal	4762.91	5656.9	5657.75	6105.99	6740.18	10479.72	13825.17	11251.15	11932.69	10069.95	12081.24	14592.83
national	7202.66	9274.29	10156.61	10429.43	11374.06	15243.65	18225.16	16476.42	17371.10	16294.47	19597.09	23431.7

Source: computation base on MOFED data

### 3.2.3 Revenue Assignment Principles

Unlike the expenditure assignment, the current tax assignment is inconsistent with a highly decentralized system. This is due to assignment of lucrative tax sources to the federal government and regions are left mainly to generate their revenue on inelastic direct taxes. Excise tax is assigned neither to the federal nor to the regional government. It has been levied, collected and used entirely by the federal.

In detail the revenues sources in Ethiopia are divided in to: revenues for central government, revenues for region; and joints revenues of central government and regional governments (Proc. No 33/1992:25). According to article 5 of proclamation 33 of 1992 the revenue sources assigned to central government include:

- (a) Duties, taxes and other charges on imports and exports;
- (b) Personal income tax collected from employees of the central government and international organization, including NGOs;
- (c) Personal income tax, profit tax and sales tax collected from enterprises owned by the central government;
- (d) Taxes collected from national lotteries and other charges winning prizes;
- (e) Taxes collected on income from air, train and marine transport activities;
- (f) Taxes collected from rent of houses and properties owned by central government

On other hand, according to article 97 of constitution state revenue sources include:

- (a) Income taxes on employees of state and private enterprises;
- (b) Land use tax;
- (c) Tax on income of private farmers and farmer incorporated in cooperative associations;
- (d) Tax on profit and sales on individual traders carrying business in their territory;
- (e) Tax on income from private houses and properties with in the state;
- (f) Taxes on profit, sales, excise and personal income of their own enterprises;
- (g) Fees and charges on licenses issue and services rendered by state organs.

Further more, article 98 of constitution shows that concurrent revenue sources of revenue include: (a) Tax profit sales and excise and personal income on enterprises jointly owned;

(b) Tax on profits of companies and dividends due to shareholders; and

(c) Tax on income of large scale mining and all petroleum and gas operation and royalties on such operations.

However, this tax assignment proclamation does not include revenue sources reserved to zones, woredas and municipality. Tax assignment is confined only to federal and regional government.

### **3.2.4 Revenue Distribution between Federal and Regional Governments**

Assignment of revenue sources between the regional and federal levels is always in favor of the latter. This is because assignment of revenue is base on comparative advantage. In other words, federal government is more efficient in tax administration than regions.

A study shows that the distribution of tax revenue in Ethiopia in 1997/98 is heavily tilted toward federal government. Federal collected 82 percent of Tax revenue and 83 percent of non tax revenue (World Bank 2000a:5).

The distribution of national revenue by level of governments in 93/94-04/05 is shown in the table 5. Out of 10545 million birr national revenue, regional revenue on average accounted for 1085 million birr whereas federal government revenue on average accounted for 8740.million birr. On the top of that the average revenue distribution among regions is also skewed .For example, base on the table 5 data the regional revenue on average is the highest in Addis Ababa (794.43) millions birr followed by Oromiyia (424.32) millions birr; however it is lower in Gambella (8.02) and Afar (14.52) millions birr.

To consider the revenue trend of both regional and federal level, there has been continuous increase in general. The exceptional is at federal level in the year 02/03 where revenue was only 21 million birr.

Table 6: Revenue by Level of Government from (93/94-04/05) In Million Birr

region	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05
Tigray	44.22	58.53	86.22	107.77	95.34	81.37	86.88	89.10	99.39	125.90	125.90	171.09
Afar	7.110	9.74	11.103	13.59	11.02	10.61	16.69	12.12	14.92	15.18	19.38	32.84
Amhara	95.03	120.42	135.22	174.52	178.29	212.46	208.34	212.96	218.95	244.44	319.16	412.34
Oromiyia	215.32	248.87	331.65	407.03	393.27	381.55	485.61	451.58	480.36	496.46	586.93	663.17
Somale	43.36	47.11	40.03	40.25	35.95	24.66	22.52	23.74	26.23	28.36	50.05	29.60
B.S.G	3.59	5.04	5.47	5.88	8.12	9.92	14.72	14.56	17.30	16.48	42.01	27.61
SNNP	72.32	104.86	143.43	165.65	159.08	154.70	171.83	164.69	192.04	207.00	245.93	277.05
Gambella	3.95	5.43	4.90	8.39	7.52	9.54	8.46	8.94	10.82	8.20	9.53	10.72
Harari	5.72	5.93	7.74	12.97	8.32	9.64	10.44	9.56	11.71	14.64	17.23	15.31
Addis. A	184.68	262.26	348.47	458.95	681.79	656.96	731.08	830.45	879.03	967.32	1635.12	189.48
DireDawa	20.19	18.32	14.77	18.55	14.79	17.33	27.29	19.42	23.22	21.50	36.90	33.36
Regional	695.50	886.50	1129.29	1413.54	1593.14	1568.73	1784.42	1845.20	1963.60	2118.76	3088.14	3569.56
federal	3243.30	886.50	5836.80	8924.99	8887.16	11888.24	10984.6	11923.66	15291.0	21	10839.79	12020.11
national	3939.80	5912.75	6966.09	10338.52	10480.57	13456.97	12769.03	13768.86	17254.60	2139.76	13918.33	15589.67

Source: MOFED data base

One observation in the table 6 is that the growth of revenue in the country has been showing an increasing trend from 93/94-04/05 except in 2002/2003 where federal revenue was extremely low. The continuous trend of revenue should attribute to high effort exerted in the revenue collection at all government levels.

As far as revenue decentralization is concerned, the federal government collects lion share of revenue since the introduction fiscal decentralization.

For instance, revenue collection data of twelve years (93/94-04/05) on average showed that out of 10545 millions birr about 18% belonged to regional governments. The remaining 82% belonged to federal government .This means federal government collected 64% more revenue on average than the regions. Table 7 below can provide the detail description of revenue and expenditure decentralization of in Ethiopia.

Table 7: Fiscal decentralization indicators of Ethiopia: revenue decentralization ratio and, expenditure decentralization ratio from (93/94-04/05).

Year	Region Revenue	Region expenditure	Total revenue	Total expenditure	R/E of region	Regional revenue share from total revenue	Regional expenditure share from total expenditure
93/93	695.50	2439.75	3938.80	7202.66	28.50	17.65	33.87
94/95	886.50	3211.21	5912.75	8865.11	27.60	15	36.21
95/96	1129.29	3797.04	6966.09	9312.1	29.74	16.21	40.77
96/97	1413.54	4317.54	7885.83	10166.98	32.73	17.92	42.46
97/98	1593.14	4633.87	8381.32	11006.22	34.38	19	42.0
98/99	1568.73	4763.93	9557.54	14261.68	32.92	16.41	33.40
99/00	1784.42	4853.44	9983.29	18225.16	36.76	17.87	26.63
00/01	1845.20	5224.27	10598.56	15497.22	34.00	17.40	33.71
01/02	1963.62	5438.41	10476.60	15251.51	36.10	18.74	35.65
02/03	2156.76	6224.55	2139.76	16294.47	34.64	19.01	38.20
03/04	3088.14	7516.25	13918.33	19597.49	41.08	22.18	38.35
04/05	3569.56	8838.91	15280.64	23431.78	40.38	23.36	37.72

Source: own computation base on tables 5& 6 MOFED data

Key: R= revenue, E=expenditure

When one compares the revenue decentralization ratio and expenditure decentralization ratio, regions usually have larger expenditure share than revenue share. This implies that less revenue sources are assigned to regions than expenditure responsibilities and this make them to rely on federal grants.

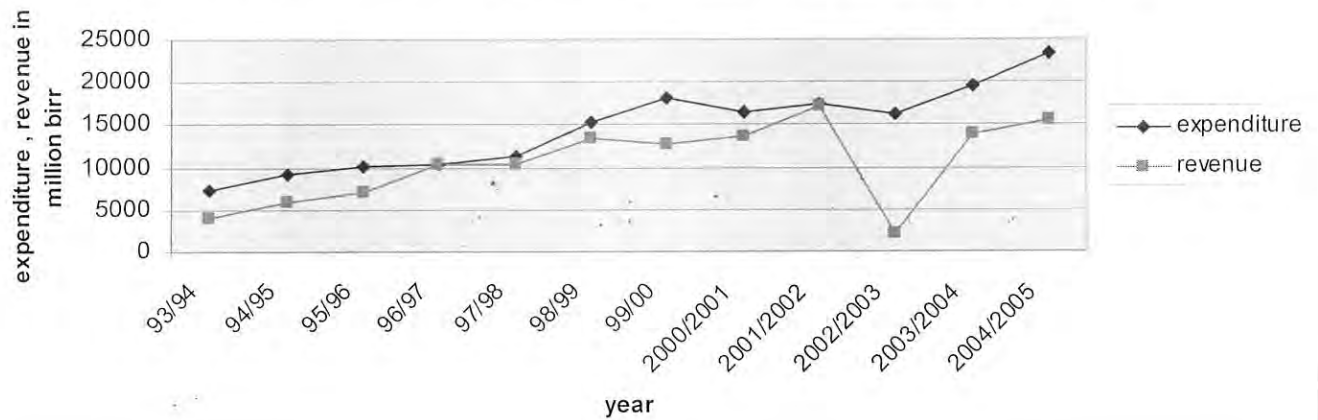
Empirically, table 7 shows that revenue decentralization ratio accounted for 18 % of total revenue while expenditure decentralization ratio was 37% of total expenditure from 93/94-04/05. To put it in other terms, regional revenue share was 18 % while 82 % share belonged to federal revenue of the national revenue. On the other hand, regional governments expenditure share was 37% and 63% share of the national expenditure belonged to federal government.

On the area of regional revenue –expenditure ratio, on average regional governments financed 34% of regional expenditures whereas federal government covered the rest of their expenditures. To support this argument, during Transitional Government of Ethiopia, grants from central government are projected to finance 47% of the regional recurrent expenditure and 100% of their capital expenditure (Eshetu 1994:81).

### **3.2.5 Fiscal Imbalance in Ethiopia**

Ethiopia is characterized by fiscal discrepancy. It has been hard to avoid some degree of inequality between the revenue means and expenditure needs at various governmental units. As certain revenue requires central government administration, this give rise to centralization of revenue sources and contributes to the vertical fiscal imbalance problem. The prevalence of fiscal deficit in Ethiopia too is not a new thing. It has existed for so many years. Recently there has been fiscal deficit since introduction of fiscal decentralization up to 2004/2005, meaning expenditure out weighted the national revenue. Chart 1 below explains the national expenditure trends versus revenue trends from 93/94-04/05 in Ethiopia.

**national expenditure and revenue trends from 93/94-04/05 in Ethiopia**



Source: own illustration base on table 5 and table 6

The chart 1 above contains two curves. The line at upper side of the chart depicts the national expenditure trends while the lower one represents the national revenue trends. Chart 1 illustrates that the fiscal gap is widen in 93/94-95/96 and then is narrowed down in 97/98 and 98/99 and become wider once again there after ward. Then, fiscal gap for second time is narrowed in the 2001/2002. Finally, the gap is widen again and is the widest in 02/03.

### **(i) Vertical Fiscal Imbalance in Ethiopia**

As it is a case in many federal systems, Ethiopia fiscal decentralization is also characterized by vertical fiscal imbalance. Vertical fiscal imbalance can be measured by vertical fiscal imbalance coefficient. Using the formula of vertical fiscal imbalance provided by World Bank (2000 a: 24), vertical fiscal imbalance coefficient trends of Ethiopia in twelve years period can be illustrated in table 8 below.

Table 8: Vertical fiscal imbalance in Ethiopia from 93/94-04/05

Year	Vertical fiscal imbalance coefficient
93/94	0.478
94/95	0.585
95/96	0.602
96/97	0.610
97/98	0.431
98/99	0.396
99/00	0.469
00/01	0.510
01/02	0.511
02/03	0.510
03/04	0.504
04/05	0.411

Source: own computation base on table 6 MOFED data base

Vertical fiscal imbalance coefficient increased from 93/94-96/97 and dropped again in 97/98-98/99 and rose in 00/01. It ranged from 0.396 in 98/99 to 0.610 in 96/97.

Vertical fiscal imbalance coefficient of Ethiopia was estimated to be 0.50 on average in 93/94-04/05 that is very high. This high vertical fiscal imbalance shows that regions depend highly on federal grants for their expenditures. The root cause for high vertical fiscal imbalance originates primarily from tax assignment between the federal and regional government. That means federal government controls indirect tax, the lucrative sources of revenue. Ghebrehiwet (2002:51) indicates that indirect tax on average constitutes 35% of domestic revenue, and of which only 10% is left to the regions. Among the indirect tax revenue; foreign trade, excise tax on locally manufactured and sales tax on goods are reserved to the federal government. Secondly, the poor tax administration also contributes to the existing high coefficient of vertical fiscal

imbalance. Thirdly, the federal government is still gigantic investor in the socio economic infrastructure development.

High coefficient of Vertical fiscal imbalance in Ethiopia results in the following:

(1) It may threaten the bold political decentralization dimension.

(2) It weakens the capacity of regions/woredas to provide relatively quality and adequate public services to their constituencies, one manifestation of good governance. (Ghebrhiwot 2002:54). A high level of vertical imbalance could bring inefficiency as the cost of public spending are not completely covered by regions but are supported by transfer from other parts of country. As a result, this reduces the incentive for provision of public services in an efficient manner. In addition, tax burden of public services is lower than private services, which distort the mix of public- private services.

A high level of vertical imbalance also involves some loss of regional autonomy since expenditures are dependent on transferred resources.

Though, privatization, development of private sector, ongoing reform in general and introduction of VAT have been used as means to reduce vertical fiscal imbalance by increasing the revenue base of regions; vertical fiscal imbalance seem constant. However some activities such privatization may widen the prevailing horizontal fiscal imbalances and the federal own enterprises are concentrated in few regions

## **(ii) Horizontal Fiscal Imbalance in Ethiopia**

Revenue collected by regions in Ethiopia as well as elsewhere varies.

For instance, from 93/94-04/05, regional revenue in table 8 shows the variation in the fiscal position of regions. About 52% of regional revenue is collected from Addis Ababa alone and 27 % is collected from Oromiyia. Addis Ababa has the lion share of revenue due to it highest socioeconomic development level in the country .In absolute terms the highest average revenue was collected by Addis Ababa(794.43)million birr followed by Oromiyia (424.32)and the lowest is collected by Gambella (8.09)millions birr followed by Harari (10.76), Afar(14.21)and Benishengul Gumuz (14.52). The main reason for this revenue variation among regions is due to differences in socio economic development of regions; and population, institutional and administrative capacity. Regions with larger

population and higher level of socio economic development, their average revenue should be higher and the reverse is true. The variation in revenue collection among Ethiopian regions shown in table 9 justifies the highest degree of financial dependent of Gambella region out of all other regions in the country in general and emerging regions in particular.

Table 9: Average revenue and the share of regions in the regional average revenue (93/94-04/05)

Region	Average Revenue (93/94-04/05) in million birr	Revenue share of a region from average regional revenue in % (93/94-04/05)
Tigray	87.16	6
Afar	14.52	0.94
Amhara	210.96	13.72
Oromiyia	424.32	27.60
Somale	34.32	2.23
B.S.G	14.21	0.92
SNNP	171.46	11.2
Gambella	8.02	0.52
Harari	10.76	0.70
Addis. A	794.43	51.6
DireDawa	20.86	1.4
Regional	1536.90	100

Source: Own computation from table 6 MOFED data

Though average revenue may replicate the revenue generating capacity of a region it is not a good sign alone with out considering the expenditure side.

A good indicator of regional raising capacity is horizontal fiscal imbalance. How is the extent of regional fiscal imbalance of Ethiopia? Recent trend of horizontal fiscal imbalance of Ethiopia can be depicted via table 10.

From the table 10 below the average horizontal fiscal imbalances in five years (00/01-04/05) computation is made. The average horizontal fiscal imbalance was 98% for Addis Ababa, 30% for Oromiyia, 29% for Dire Dawa, about 26 % for Tigray, 25% for SNNP, 21.5% for Amhara, 8.22 % for Afar, 18% for Harari, 13% for Benishengul Gumuz, 9.4% for Somale and 7.6% for Gambella. Average horizontal fiscal imbalance ranged from 7.6% in Gambella and 98% in Addis Ababa.

Out of all the regions, Addis Ababa, which finance almost all its expenditure is exceptional. But, the other regions can be classified into three groups based on their horizontal fiscal imbalances. First group encompasses Oromiyia, Dire Dawa, Tigray and SNNP, which covered on average 27% of their expenditure. Second group is made of Amhara and Harari, which cover about 20% of their expenditure. And, third group include emerging regions such as Gambella, Afar, Benishengul Gumuz and Somale region. These regions on average covered about 10% of their expenditure. They are the most dependent of all regions on federal transfer and to be precise, Gambella is the most reliant on federal grant. The overall summary reveals that federal government covered 73%, 30% and 90% of the expenditure of the first, second and the third group respectively.

The disparity in the degree of horizontal fiscal imbalance among regions of Ethiopia shown above is due to some reasons. Three reasons can be forwarded for significant variation in horizontal fiscal imbalances among regions (Ghebrihiwot 2002:56). Notably: (1) Sizeable economic base variation among regions exists. Manufacturing establishments, which are the main source of revenue, are concentrated in few industrial belt areas.

Besides, currently socio economic infrastructures are skewed to the four “big” regions, albeit federal government has taken corrective measures. Region such as Tigray, Amhara, Oromia and SNNP largely practice mixed farming and are also relatively urbanized, while in the four emerging regions pastoral economy is dominant.(2) Degree of variation in natural resources and human resources utilization capacity. In spite of the fact that under utilization of available resources is a common problems to all regions; emerging region have relatively weak administrative and institutions. They suffer severely from shortage of professional and experienced manpower than the other regions. (Meheret 1998:17). (3) Variation in tax effort of regions, which will be explained by regions’ per capita revenue.

Table 10: Horizontal fiscal imbalance trend in Ethiopia from 01/02-04/05

region	00/01			01/02			02/03			03/04			04/05		
	R	E	R/E	R	E	R/E	R	E	R/E	R	E	R/E	R	E	R/E
Tigray	97.19	365.64	26.6	89.10	374.59	24	99.39	475.46	21	125.90	438.15	29	171.09	626	27
Afar	12.1	219.88	5.51	14.92	221.57	6.73	15.18	235.11	6.45	19.38	205.94	9.41	32.84	255.86	13
Amhara	212.96	933.66	23	218.95	969.77	22.56	244.44	1071.88	23	319.16	3005.18	11	412.34	1459.4	28
Oromo	451.58	1460.14	31	480.36	1447.5	33.18	496.46	1600.23	31	586.93	2283.11	26	663.17	2355.1	28
Somali	23.74	298.26	8	26.23	364.98	7.18	28.36	406.53	7	50.05	297.61	17	29.60	385.01	8
BSG	14.56	162.61	9	17.30	166.77	10.37	16.48	181.97	9	42.01	183.46	23	27.61	180.46	15
SNNP	164.69	651.96	25.26	192.04	555.98	34.54	207.00	859.39	24	245.93	1193.15	21	277.05	1369.5	20
Gambella	8.94	116.91	7.65	10.82	133.25	8.12	8.20	137.20	6	9.53	114.36	8.3	10.72	134.57	8
Harari	9.56	61.74	15.5	11.71	80.24	14.60	14.64	63.37	23	17.23	86.23	20	15.31	90.06	17
A/A	830.45	896.27	93	918.57	879.03	96	967.32	1092.91	89	1635.12	1455	112	1896.3	1876.3	101
D.D	19.42	52.18	37	23.22	95.34	24.35	21.50	100.26	21.44	36.90	65.71	56	33.36	106.54	31

Source: own computation base on table 6 MOFED data

Key: R= revenue, E= expenditure

### 3.2.6 Intergovernmental Transfers System

In the previous sections, one can observe that there is fiscal disparity between the center and the regions among the regions themselves. During 1993/94-97/98 for instance, regional governments were able to finance their services on an average 30% from their own resources and the remaining 70% was financed by the federal government in form of a transfer or budget subsidy (World Bank 2000 a). The purpose of intergovernmental transfer is to correct the fiscal imbalance that come after the assignment of expenditure and tax responsibilities. Transfer can be used to bridge need-capacity gap, ensure minimum standard of public service across the nation, and make common internal market and stabilization of economy.

The aggregated budget trend from treasury, loan and assistance transferred from federal government to regions in Ethiopia can be described in the following table 11.

According to the table 11 budget trend transferred to region has been increasing continuously in the first four years (94/95 to 97/98). However, it drop in 98/99 and 99/00 and rise again in 00/01. This increase continues for other subsequent two periods (01/02 to 02/03) until it decline again in 03/04. Finally, it increases from 6364.2 million birr in 04/05 to 7832.9 million birr in 05/06. In absolute, figures the table reveals that 3407.6 million birr were allocated to regions in 94/95, 3561 million birr in 95/96, 4167.1 million birr in 96/97 and 4182.9 million birr in 97/98. Over the twelve years the budget allocated to regions reach minimum in 99/00 that is 3148.2 million birr and maximum in 05/06 i.e. 7632.9 million birr.

Table 11: Budget Allocated From Federal Government to Regions from 94/95-05/06 In Million Birr

Region	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05	05/06
Tigray	327.8	329	384.3	379.8	311.1	241.9	360.20	371.2	485	458.2	486	561.4
Afar	141.8	142	166.4	249.6	255.2	199.6	237.5	244.8	320	225	240.7	311.1
Amhara	741.4	814	956	951.6	849.9	689.5	929.80	958.3	1252	1335.1	1449.7	1750.8
Oromo	1039.6	1079	1267.7	1253.6	991.8	773.1	1215.10	1252.3	1636	1846.6	1990.2	2514.0
Somale	165.3	166	194.6	375.3	361.2	285.2	353.00	363.8	475	372	417.0	501.1
BSG	106.6	107	121.5	180.2	184.9	135.1	179.10	184.5	241	177.5	185.3	221.9
SNNP	608	651	764.8	788.4	703.2	572.5	780.80	804.5	1052	1138.9	1184.8	1444.2
Gambella	90.2	90.2	101.7	138.9	163.2	109.1	137.30	141.6	185	130.6	126.1	150.9
Harari	40.7	40.7	46.7	88.4	86.7	65.4	67.10	69.2	90.3	77.5	81.6	102.4
D.D	36.5	36.6	42.8	53.5	39.1	21	40.30	88	115	85.9	94.1	123.5
Sub total	3297.9	354	4046.5	4459.3	3946.3	3092.4	4300.20	4478.2	5852	5847.3	6257.4	7681.3
A.A	109.7	107	120.6	55.0	236.6	55.8	117.80	175	191	122.5	106.8	151.6
Grand total	3407.6	3561	4167.1	4514.3	4182.9	3148.2	4418	4653.2	6043	5969.8	6364.2	7832.9

Source: MOFED database

The increases in budget subsidy trend to regions imply increase in vertical fiscal imbalance in the country. Reflecting increase in discrepancy between revenue and expenditure needs of the country.

### 3.2.7 The origin of Grants System in Ethiopia

The grants are intended not only to shift resources from the federal to regions but also redress imbalances across the region, in way that do not under mine their incentive to draw their revenue sources (World Bank 2001:43).

Grants provision in Ethiopia is given in the federal constitution. According to articles 36 of proclamation of 1992 grants are provided to finance basic social services and economic development programs that can not be accommodate from the regions

resources due to the relative under development. Article 7 sub article 2 of proclamation 33 of 1992 specifies regional activities that are legible for grants.

Historically, as it cited above, federal transfer to region in Ethiopia begun in 1992/93, when grants were ad-hoc in nature, based on approved project of the regions and assessment of required assistances for individual project. Formula determined grants dated back to 94/95, were formula was applied to distribute grants among regions. The reason to go from ad-hoc nature grant to formula based grant was to determine the federal grant on objective ground.

In 94/95, two separate grant formula were used, one formula for capital budget and the other for recurrent one. For capital budget formula, five variables were included in calculation. These are: population (30%); I-distance (20%); regional tax raising effort (20%); capital expenditure (15% in 92/93) and the size of a region (10%). In case of recurrent budget, the variable considered were: number of zones, structure of bureaus and offices; number of civil servants, length of rural roads to be maintained, previous year budget, number of agricultural demonstration centers.

In 95/96 a different grant formula which differs in nature to 94/95 formula was introduced. First; it used a consolidated budget that covered both recurrent and capital expenditures instead of using a separate formula for each. Second, a number of variables included in the grant formula were reduced from five to three notably: population, I-distance factor and state revenues to budget ratio with 33.3% weight each.

In the 96/97 all other variables remained the same; but I- distance factors were reduced from eight to six elements. In the 97/98-00/01 a new grant formula were designed and variables have increased from three to four as weights assigned to the variables were completely different from the previous one. Here I-distance was renamed as "development level index"; and weight of population increased by 80% at cost of development level index and the ratio of revenue to budget. At that moment the weight of development level index and ratio of revenue to budget have reduced by 30%, and 45% respectively. To put it differently, the corresponding weight for population, development level index and revenue ratio to budget were 60%, 25% and 15% respectively.

Another formula was designed in 00/01-02/03 which is composed of four indicators with weight in brackets: population (55%), development level index (20%), revenue raising effort (15%) and poverty level index (10%) (MEDac 2001). The 03/04 grant formula has only three variables: population weighing 65%, development level index weighing 20%, and revenue effort weighing 15%. Grant formula of the 04/05-05/06 assigns a weight of 60% to population, 25% to level of development and 15% to revenue mobilization/sectoral output performance. Currently(06/07) the grant formula provide 65%weight to population, 25% to level of development, and 10% to revenue mobilization/sectoral performance.

After examining different grants formulae, it is essential to view the factors that determine the choice among grant formulae. To choose from grant formulae, these factors are paramount important: economic, social philosophy of a ruling regime development policy, objective of grant system, development level index of a Country or inter regional, and availability of reliable data are determinants(Ghebrhiwot 2002:60).

### **3.2.8 Limitations of Grant System of Ethiopia**

Grant system of Ethiopia has been used though is not free from some shortcomings.

The procedure the region follows in the request for subsidy and decision making processes are as follows. The region, through its Bureau of Planning and economic development( currently known as Bureau of Finance and economic development) submits to Federal Ministry of Finance and Economic development request, total expenditure and revenue forecast before the approval of budget by the council.

This Ministry reviews the application from the region and evaluates the request in view of the needs of the regional government and the capacity of the federal government to give subsidy. Then, this review is submitted together with the review of the Ministry to the Prime Minister's Office and council of ministers. Finally, the Council of Representatives approves the amount of grant and subsidy to be provided to the region. Moreover, annually the region is obliged to report the regional implementation to Ministry of Finance and Economic Development and Office of Prime Minister.

According to Eshetu (1994:69), the major problem raised with procedure of grants is that the organ of state deciding on grants is not identified and it is unknown whether there is a room for appeal or not when the request is denied.

The grant system is predominantly a block grant type and aims at redressing interregional inequalities and poor social infrastructure still lack full responsibility. Other forms of grants such as that assistances channel to Local Community Associations should also be considered and made transparent. The system should also emphasize and encourage the region's effort to expand its tax base with a view to finance its own development program fully.

Furthermore, federal grants system can be used with the following limitations.

(a) Grant formula is pro equity.

The prime objective of regional development is to use resources efficiently and equitable among region. However, to balance equity and efficiency is not always achievable and mostly the resources distribution is in favor of equity.

For example, efficiency in grant system has never attained more than 20% except in the years 95/96 and 96/97 were weight was 33.3%.

(b) Grant formula discourages revenue effort of regions.

The purpose of including revenue effort in allocation of grant is to initiate regions to increase their revenue. But, in net transfer calculation, revenue of a region is deducted from gross subsidy. World Bank (2000a:30) claims that the revenue incentive factor built in to budget subsidy formula is largely cosmetic and does not create a direct incentive for region to generate revenue.

(c) Grant formula lack community's participation. Though regions have democratic representation in the House of Federation, technical department, and top management of MEDac design grant formula at the center. Hence, regional role in design of grant formula is so minimal.

(d) Frequent change of grant formula

The practice shows that grant formula has changed five times since it beginning in 94/95. Though the regions agree to change of grant formula, frequent change of grant formula violates the general principle of revenue stability as Bird and Vaillan court (1998) states revenue should be stable. Hence, frequent change of grant formula affects planning and budgeting of the region, which causes a sudden change in funding to regions.

(e) The grant formula excluded poverty index except in 00/01.

Since poor regions are expected to have greater expenditure needs than the rich ones, poverty index should be considered in grant formulation in order to attain equality among regions.

### **3.2.9 Revenue sharing**

Joint revenue is another source of transfer besides grants. The sharing of joint revenue between the federal and region is to be developed by a committee established by Prime Minister Office, which is accountable to Council of Ministers. According to article 6, sub article 2 and sub article 3 of the proclamation 33 of 1992, the committee is to be composed of representatives from center and regional governments, which would submit recommendation to Council of Ministers. The recommendation includes information on the percentages in which the joint revenue is to be shared between the central government and the regions. According to House of Federation, joint revenue sharing formula between federal and regional government in Ethiopia is as follows (House of Federation 1997).

(1) From enterprise jointly established:

- Business profit tax is divided on per capita base
- Personal income tax 50% each
- Sales and excise tax 70% for federal and 30% for regional government

(2) From private company:

- Business profit tax 50% each
- Sales and excise tax 70% for federal and 30% for regional government
- Tax on dividends 50% each

(3) From large scale mining all petroleum and gas operation:

- Business profit tax 50% each
- Royalties 60% for federal and 40% for regional government.

The percentage share of joint revenue formula assigned larger share to federal government, which enable it to correct the fiscal imbalances.

### **3.2.10 Domestic Borrowing in Ethiopia**

Proclamation 7 of 1992 article 35 recognizes the rights of national/regional governments to borrow from domestic sources. In addition, proclamation 33 of 1992, article 10 gives the details conditions and procedures that the national /regional governments exercise borrowing.

Borrowing requires regions to submit to the MOFED, the amount they would want to borrow together with statement showing: (a) the relation of the requested amount to their revenue forecast, (b) economic indicators of their region including ability to repay debt. (c) Their consolidated budget and (d) feasibility study of the project for which the loan is required. Such conditions discourage regions from borrowing.

The current practice in Ethiopia is to discourage sub national borrowing because of its macro economy implication (World Bank 1999). Nevertheless, some of regions apply their borrowing power indirectly. In this case, regional governments guarantee farmers to borrow from commercial and the development bank of Ethiopia by using their annual budgets as collateral. This may make serious problems for regions when farmers fail to pay their obligations.

Another issue is the opportunity of credit markets. This does not seem to be available for woreda governments. Woreda governments on their own can not take loan. Similarly, in terms of receiving grants, the regional governments enter in to multilateral and bilateral agreements in order to receive grants. This right is not accorded to woreda governments

### **3.3 Government Revenue Collection Problems in Ethiopia**

There are three important tax collection entities in the country these are the Ethiopian custom Authority, the federal Inland Revenue authority and state tax or revenue Bureau. These different revenues collection and administration entities face varieties of problems while doing their work.

#### **3.3.1 Federal Government Revenue Collection Problems**

Base on the Federal General Auditor Bureau 1992 E.C(99/00) report in the year 1990-1991 E.C showed that out of all tax revenue collected for central government, the Inland Revenue Authority collected on average 34%. On other hand in these two years, Inland Revenue Authority covered on average 23% of the central government expenditure. During the process of assessment, collection and handling of tax, Inland Revenue Authority faced some challenges:

These included delay in tax declaration, delay in declaration of assessed tax, lack of penalty enforcement on the defaulters and delay in decision on the cases forwarded to court. Beside these, the basic problems of government revenue collection faced by Ethiopian Inland Revenue Authority are given in the following sections (Federal General Auditor Bureau1992:3-9).

##### **(a)Tax Assessment Problems**

Assessment of tax can be self or official assessment. When assessment is conduct by officials or assessor, who are employees of tax authority is called official assessment. While when the taxpayers do assessment is called self assessment. In other words when tax liability is declared by assessors is official assessment whereas when is declared by taxpayers them selves is self assessment. Taxpayers have right and duties to pay tax, as tax liability is timely declared. In land Revenue Authority also has right to assess, collect and have list of taxpayers names. However, looking in to tax assessment, both the main inland authority and its branches do not declare the tax liability on time. Table 12 can provide the empirical support to this argument.

Table 12: number of tax payers' files selected for audit and number of taxpayers files whose tax is assessed but undeclared in 1989 - 1990 E.C (96/97-97/98)

No	Fiscal years(E.C)	Number of taxpayers files selected for audit	Selected number of taxpayers files Assessed but undeclared	Percentage
	1989			
1	Business profit tax	200	71	35.5%
2	Employment tax	150	56	37.5%
	1990			
3	Business profit tax	597	523	88%
4	Employment tax	211	159	75%

Source: Federal General Auditor Bureau (1992E.C)

From the table 12 in 1989 from business profit tax , 200 taxpayers' files were selected for audit where 71 of them found to be assessed but undeclared . On the other hand, out of 150 employment tax sample, 56 of them were found assessed and undeclared. In 1990, out of 579 business profit taxpayers selected, 523 of them were assessed but undeclared. Whereas out of selected 211 salary taxpayers, 159 were assessed but undeclared.

This delay in declaration of assessed tax has negative impact on revenue collection.

#### **(b) Tax Collection Problems**

It has been expected the Ethiopian Inland Revenue Authority and its branches to collect the taxes on time, however sample data of business profit taxpayers files inspected by Federal General Auditor Bureau (1992) shows that some of them have unpaid amount accumulated .The number of tax payers files with arrears in five consecutive years time is shown in table 13 .

Table 13: number of taxpayers with arrears and the amount of arrears from 1986-1990 E.C(93/94-99/00)

No	Fiscal year	Audited files	Files with arrears	Amount of arrears(in birr)
1	1986	341	19	27,240,184.64
2	1987	120	26	30,486,708.87
3	1988	220	17	242,593,085.23
4	1989	350	116	349,753,331.35
5	1990	800	434	2,432,505,974.23

Source: Federal General Auditor Bureau Report (1992 E.C:3)

In the 1990 the tax payers with arrears came from different organizations such as government development organization, private business organization and employment tax. Out of total 2,432,505,974.23 arrears, the government organizations accounted for 2,260, 609,766.04 birr, private business organizations for 153, 030, 662.02 birr and employment tax for 18,865,557.17 birr. In the same manner Abdisemed (1998:33) argues that until 1987 E.C about 2.1 million birr of tax arrears had been identified in Somali region in Jijiga zone alone.

Income tax in Ethiopia has also enormous problems such that Ethiopians working for international organizations are unwilling to declare their salary for tax purpose. Both the international organization and embassies lack cooperation to declare the salaries of their employees.

### (c) Tax Reassessment Appeals Problems

As tax assessors find tax liability it should declares to the taxpayers as soon as possible. After declaration, unsatisfied taxpayers will appeal to Federal Inland Revenue reassessment commission for tax reassessment with in 30 days. However if tax payers did not apply for reassessment he/she should pay the tax on time ,other wise law section of in land revenue authority will accuse him/her for default. In 1988, 1989 and 1990, internal audit of Inland Revenue authority came across taxpayers with appeals for reassessment and some with court cases (table14). These two problems lead to evasion of tax and consequently to loss of government revenue in the specified period.

Table 14: the number of taxpayers files with appeals and their amount for 1988-1990 E.C(95/96-97/98)

No	Place of appeal	Number of files	Year(E.C)	Amounts(in birr)
1	Tax appeal commission	42	1988	26,832,880.87
	Instance court	81	1988	64,187,051.26
2	Tax appeal commission	84	1989	51,813,127.89
	Instance court	151	1989	279,599,304.23
3	Tax appeal commission	29	1990	40,312,555.67
	Instance court	319	1990	437,478,153.32

Source: Inland Revenue Authority Internal Audit Report (1992E.C:5)

The table 14 shows that the amount of tax that was not collected due to appeal and default is increasing from year to year. Due to transfer of lawyers from one place to another and lack of separation of tax cases from other court cases result in delay in decision making and consequently leading to delay in government revenue collection.

Another source, Walta Information Center (1992E.C) reported that including 1950 s transfers to Hamale 1 /1987 and Hamale 1/1987 up to Hidar 30 /1992 there were 702 taxpayers files directed having 1,412,091,889.07 birr arrears. On the one hand, starting from Hamale 1/1987 up to Hidar 30/1992, there were 383 taxpayers files that did not received court decision having 1,069,413,804.93 birr arrears. On other hand starting from Hamale 1/1987 up to Hidar 30/1992, there were 319 taxpayers' files who received court decision with amount of 302,678,084.14 birr arrears.

**(d) Weaknesses of Internal Control**

Inland Revenue Authority is responsible for joint revenue collection it seems to be capacitated more than state revenue department or bureaus. But, looking in to internal control situation of inland revenue authority, it has the following problems.

- Taxpayers' tax liability is not declared on time.
- Declared tax liability is not collected on time.
- Inadequate, unskilled and inexperienced human resources.
- Lack of records of taxpayers that can assist in knowing the taxpayers with arrears.
- Inadequate capacity of lawyers to follow up the court cases, etc.

**(e) Corruption Problems in Community**

According to Inland Revenue employees and heads, some taxpayers in community lack honesty are involved in illegal activities for their personal benefits. For example, they may not pay tax from the profit or salary they get. On the other hand, taxpayers who are honest and willing to pay taxes may come across delay from tax collectors when they want to pay their tax. The reason for unnecessary delay is that some tax collectors need to get benefits from taxpayers in form of bribe. This long bureaucratic process may force taxpayers to give bribe to them in order to save their time and energy.

Further, Ethiopian Custom Authority, which is responsible for collection of export and import taxes, faced also some constraints in revenue collection. According to Ethiopian custom Tax Authority (1992) the problems that are not resolved in revenue collection are:

- Change in community behavior. The habit against bribery has changed and giving and accepting bribe become habit and culture of the day.
- Lack of full control of contraband trade. This is due to:
  - lack of logistics supplies
  - inadequate community participation
  - low custom activities coverage
  - illegal trade is economic base in some communities
- Human resource problems. Such as, low scale pay and lack of incentives.
- lack of security and protection
- lack organizational culture
- Structural problems (Ethiopian Custom Authority 1992:17-18).

**3.3.2 Revenue Collection constraints in Some Regions of Ethiopia**

At regional levels, similar impediments to government revenue collection at federal were recognized in varieties of studies in various regions and municipalities of Ethiopia.

For example 1986-1992 E.C report of Oromiyia regional government revenue collection and budget performance, Bechak (1997), Digisie (1997), and Yasin (1998) discussed some problems of tax collection in Oromiyia, Gambella, North Omo Zone of South Ethiopia and Afar region respectively.

According to 1986-1992 E.C (93/94-99/00) budget report of revenue collection performance of Oromiyia regional state, the subsequent problems were encountered in the revenue collection.

- Taxes from chat are evaded by putting it in heavy load, taxi and public transport.
- nature of chat make taxes to be collect at check points which open way for corruption
- The discrepancy between original and copy receipts showing misuse of government taxes
- Difficulty in assessing of income of people such as work contractor, house renters, commission agencies, etc.
- inadequate knowledge and work experience of staffs due to low pay scale
- Expansion of illegal trade that affect the legal traders' interest to keep government rules.
- Poor accounting practices that leads to tax evasion.
- As the assessment committee under estimate the income of farmers, this lead to reassessment of the income which delay the collection of government revenue (Oromiyia Finance Bureau 1993:18-19).

Problems such as non existence of law for rural land use fees, urban land tax and agricultural income tax; lack of information, lack of access and inadequacy in number and skill of tax collectors were found in Gambella tax collection (Bechak 1997:23-24). Yasin (1997) has also reached analogous findings in Afar region taxation collection.

In addition across the regions in Ethiopia World Bank (2000a) as well discovered some problems of revenue departments. These problems of revenue department include lack of infrastructure, high turn over of staffs, and absence of operation guideline given to staffs, weak skill and lack of taxpayers' education. Although there was no study that has addressed each and every regions revenue collection problems, Meheret (2001) addressed the problems at five some local levels of Ethiopia in the section to come.

### **3.3.3 Revenue Generation constraints of Five Selected Municipalities**

The in efficiency of revenue collection in all the municipalities was observed and this happen for a number of reasons which are mostly common to all of them.

These revenue generation problems include:

- In efficient collection
- Old tariffs regulation
- Weak enforcement mechanism
- Loss of revenue sources
- Poor financial management
- Unwilling from tax payers part
- Low competence and poorly trained financial and revenue staffs
- Absence of up to date data base
- Absence of government subsidies
- Other problems such as absence of adequate information on tax assessment limited economic base were observed in Bahir Dar, Assosa and Gambella town.
- Authorization of unplanned expenditure by municipality authority and local politicians which was a particular problems for Assosa town
- Inadequate number and poor quality of staffs of revenue collection and finance. Staffs quality problem was not only specific to Assosa but also existed in all municipalities (Meheret 2001).

To windup this chapter, one of the aims of decentralization is to give autonomous or self administration status to regions. The degree of fiscal independence the regions enjoy is a true measure of autonomy. Befekadu (1994:66) asserted that the more resources the region controls the more autonomous it is and vice versa.

However, now almost all regions of Ethiopia even the richest regions do not fully finance their expenditures from their revenue, which imply that regions are not autonomous. This is because sub national governments have low technical capacity, low financial resource mobilization and low human resource capacity. Moreover, this degree of fiscal independence is the lowest in emerging regions among the regions in the country. Among these emerging regions, Gambella region fiscal independence status that will be addressed in fourth chapter to come can be cited as a case in point.

## Chapter Four: Empirical Analysis

### 4.1 General Background of the Region

#### 4.1.1 Administrative Structure

The Gambella regional state is one of nine regions that are provided with power of autonomy under federal government of Ethiopia. The region was administratively subdivided in to two zones and nine woredas. The Akobo, Jikawo, Itang and Gambella woredas were under zone one administration while the rest of woredas like Abobo, Gog, Jor, Godere, and Dimma were under the administration of zone two. The 9 woredas were further divided in to 162 (PAs) Peasant Associations (excluding Dimma woreda).

Starting from 1996 E.C (03/04) the region has been administratively divided for the second time in to three ethnic zones, namely Nuer, Anyua and Mejenger zones. Nuer zone encompasses Jikawo and Akobo woredas whereas Anyua zone include Alero Openo (Abobo, and some kebeles of Itang and Gambella), Dimma, and Gillo (Jor and Gog) woredas. Menjenger zone include only Godere woreda. Gambella and it surrounding areas was special woreda accountable to the region. Itang woreda's kebeles were segregated in to Nuer and Anyua zones. Lately, three other woredas were added. Two to Nuer zones such as new Jikawo (Nyinenyang) and Wanthoa woreda; and one special woreda (Itang).

There are five indigenous nationalities, namely Nuer, Anyua, Mejenger, Oppo, and Kommo in the region. In addition to these there are also significant number of settlers in Gambella and other towns came from different regions of the country belonging to diversified ethnic groups mainly Oromo, Amhara, Tigray and Gurage. There are also refugees resettled in the region. The census result of population of Gambella region as of October 1994 indicates that major ethnic groups of population are found to be 39.7% Nuer, 25% Anyua, 7.7% Amhara and 6.5% Oromo. In addition, the total number of refugees then was 16455 in Bonga, 34418 people in Pugnidu and 10547 people in

Dimma. The influx of refugees is certainly accounted for part of the population growth in the region (Tams-Ulg 1997).

#### **4.1.2 Geographical Location, Topography and Climate**

##### **(i) Location**

The Gambella regional state is located in the southwestern part of Ethiopia some 777km away from Addis Ababa. It located at an approximate geographic coordinates of  $6^{\circ} 20' N$ - $8^{\circ} 30' N$  latitude and  $33^{\circ} 10'$ - $35^{\circ} 50' E$  longitude.

The region is bounded by the Sudan Republic on the west and the south west by the South Nationalities and People region on the south and east, by the Benishengul-Gumuz and Oromiya regional states on the north. It covers a total area of some  $34,063\text{km}^2$ .

##### **(ii) Topography**

The study area is situated between altitude ranges of 300- 2300 meter above sea level and characterized by different topographic feature the eastern part is characterized by high mountainous rugged terrain (about 10% of the area lies in the high lands at altitude of over 1500m). The upper reaches have Peak Mountains and steep slopes the elevation of which is over 2000. Most of flashing rivers and streams originates from these areas and are directed to western direction. These areas include the high land of Godere and Dimma woredas (eastern part), east and northern parts of the Gambella woreda.

The central part of the region, which is estimated to cover about 44% of the total area is characterized by an undulating plain, lies between elevations of 500-1000m. It includes most part of Gambella, Abobo, Itang, southeastern parts of Godere, eastern part of Jikawo and some part of Gog and Jor woredas. Low -lying flat plain land is found on the western part and is estimated to occupy some 48% of the total area. Here the elevation varies between 300-500m. It is characterized by its seasonal or perennial swamps and flat to very flat. These different topographical features influence the climatic, vegetation cover, and soil characteristics, etc of the area.

### **(iii) Climate**

The Gambella People's National State is characterized by different climatic features. Accordingly, the Gambella People Regional State is divided into three agro-climatic zones namely, woina-dega, kolla and Bereha. In woina-dega zones falls Godere and part of Dimma woreda in the kolla zone falls Gambella, Abobo, Itang and Gog woreda and Jor, Jikawo and Akobo woredas are in the Bereha climatic zones.

Regional mean temperature and rain fall decreases from east to west (mountainous to plain areas) depending on the agro ecology of the area. Hence, the mean temperature is 17.5<sup>o</sup>c-27.5<sup>o</sup>c and the average annual rainfall is 2000mm to <1000mm (from Dimma towards Akobo and Jikawo woredas).

#### **4.1.3 Population Size, Structure and Characteristics**

According to 1994 census, the projected population size of Gambella region in 2003 was 228,435 in medium variant, of which 34,276 (15%) lived in urban areas and the remaining 85% are rural residents. As of 1994 census results, sex composition of population in the region was, 51.1% males and 48.9% females. From the age structure perspective, people under 15 years of age were about 41.8%, 15-64 of age were 56.9%, and 65 and above of age were 1.3%. Similarly, out of 92674 persons of 15-65 ages, 72% were economically active and 27% were economically inactive. As far as distribution of population by place of residence is concerned, in 1994 the urban and rural residents were 27,863 and 165,118 respectively.

#### **4.1.4 The Livelihood of the Region**

In Gambella region, all the rural communities practice very small-scale rain-fed agriculture. The community also practices livestock rearing. Hence, it would be very appropriate to consider the community as leading agro-pastoral mode of production. Very small number of people in community practice fishery business and almost all portion of the community members who have suitable conditions are also traditionally engage in beekeeping. Petty trade is also practice in urban community.

Agriculture is the main stay of the economy in Gambella region. The region has great potential either of agricultural development on rain fed or on irrigation. It also has fertile land and water resources, which were suitable for crop production and animal husbandry. Therefore it is possible to produce exportable agricultural outputs that could bring

economic development in the region as well as to the country as whole. However, the use of low agriculture inputs, erratic and unreliable rainfall pattern and lack of adequate and efficient extension service contribute to the frequent drought and famine in most parts of the region. As a result, the productivity is low.

## **4.2 An Assessment of Revenue Generation Capacity of Gambella Region**

### **4.2.1 Powers and Functions Assignments**

For a region to improve the welfare of its citizens; it must provide certain services assigned to it by constitution of a country. In the same way, it must finance these services by levying tax on its citizens. The Ethiopian legislative provision of powers and responsibilities to regions is given in article 52 of 1995 federal constitution.

#### **(i) Legal Frame Work of the Region**

The modification of article 52 of 1995 of federal constitution by Gambella National Regional State (GNRS) delineated the powers and responsibilities of the region. The sub article 1 of article 49 of Gambella Negarit gazeta 2003 states that the powers and functions of state government as “all powers and functions not provided to the federal government alone or joint to the federal government and the state government are reserved to the state” (article 49, 2003:8). Furthermore, sub article 2 of the article 49 of Gambella Negarit gazeta 2003 grants these responsibilities and functions to a state:

1. To formulate and execute socioeconomic development plans and strategies.
2. To enact and execute the state constitution and other laws.
3. To administer land and other natural resources in accordance with federal laws.
4. To establish a state administration that best advances self government, democratic order base on the rule of law, to protect and defend regional and federal constitutions.
5. To enact and enforce laws on state civil servants and their conditions of work and ensure that educational, training and experience requirements for any job title or position should be taken in consideration.
6. To establish and administer a state police force, and to maintain public order and peace within a state.

7. To levy and collect taxes and duties on revenue resources reserved to the state and draw up and administer the state budget.

The state's powers of taxation:-

- Levy and collect income taxes on employees of the state and private enterprises
- Determine and collect fees for land usufructory right.
- Levy and collect income agricultural income tax.
- Levy and collect taxes on income derive from private houses and other properties.
- Collect rent on houses and other properties it owns.
- Jointly levy and collect taxes (share) profits, sales, and excise and personal income taxes on enterprises they jointly establish.
- Jointly levy and collect taxes on the profits of companies and dividends due to stakeholders.
- Determine and collect fees and charges relating to licenses issued and services rendered by state organs.
- Fix and collect royalty and for use of forest resources.

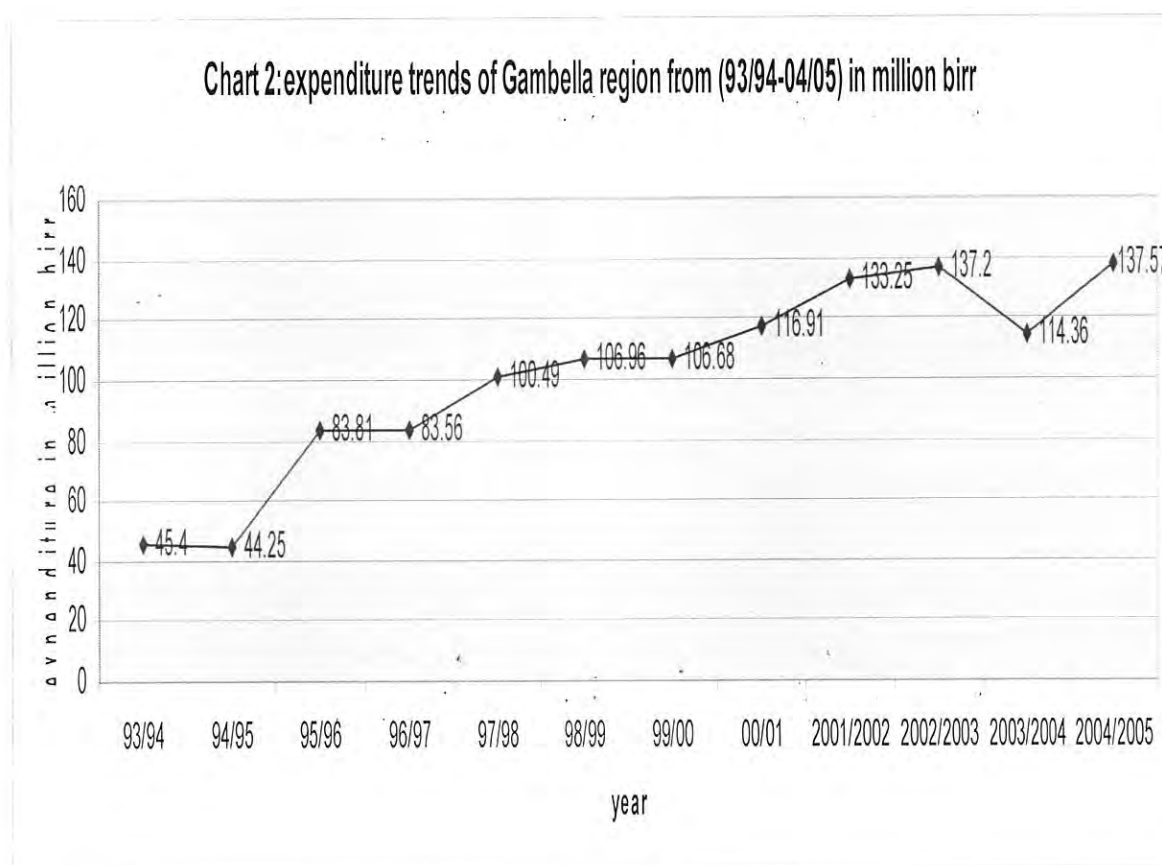
#### **(ii) Legal Frame Work of Woreda**

Gambella Negarit gazeta 2003, of article 83 assigns the following powers and functions to woreda government. These are:

1. To approve the socioeconomic and administrative operation plan and program proposals of the woreda;
2. To supervise the timely agricultural development, natural resource development and environmental protection;
3. To create conducive environment for local participatory development;
4. To produce internal operation principles and guideline;
5. To check the timely collection of land use rent and agricultural income tax; and
6. To enact detailed directives on woreda peace and security (Gambella Negarit Gazeta No 4 June, 2003:14-15).

## 4.2.2 Expenditure Performance

The responsibilities and functions granted to a region in article 52 of 1995 federal constitution and article 49 of Gambella Negarit gazeta of 2003 enable the region to carry out services for its citizens. For Gambella region to undertake these services some funds to spend is required. To examine the spending trend of Gambella region let us have a look at chart 2. The expenditure growth has been showing an unbroken trend except in the second year (94/95) where expenditure dropped slightly from 45.40 million birr in 93/94 to 44.25 million birr and again in the eleventh year (2003/2004) where it declined from 137.20 million birr to 114.36 million birr.



Source: own illustration base on table 5

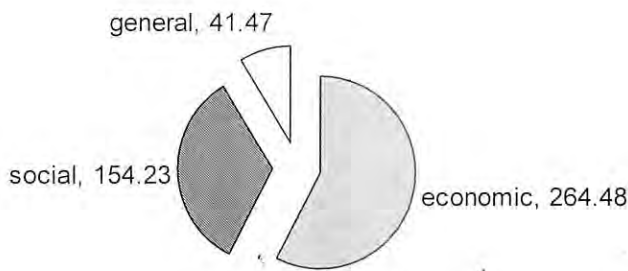
The increasing trend of expenditure justifies rise in the number of socio economic infrastructures. For example, a number of primary schools, health posts for both animals

and humans; and health centers to mention only few of them have been increasing during the period.

The regional expenditure differences show that it vary from 44.25 million birr in 94/95 to 137.57 million birr in 04/05. During 93/94-04/05 period Gambella region spent 104.5 million birr on average and 1256.16 million birr on actual figure. The expenditure growth has been showing positive trend except in 93/94 to 94/95 were it dropped by 2.6% and in 01/02-02/03 where it dropped by 20%. Generally, Gambella region on average expenditure growth changed by 7.4% in 93/94-04/05.

And when ever the actual expenditure is categorized in to capital and recurrent; the former accounted for 519.28 (41%) million birr while the latter accounted for 736.88 million birr (59%). The capital expenditure has three functional classifications such as economic development, social development and general development. All the three sectors have variety of expenditure share; for instance, economic development accounted for 264.48, social development for 154.23 and general development for 41.47 million birr of the total capital expenditure (chart 3)

**chart 3: capital expenditure of Gambella region by sector from (93/94-04/05) in million birr**

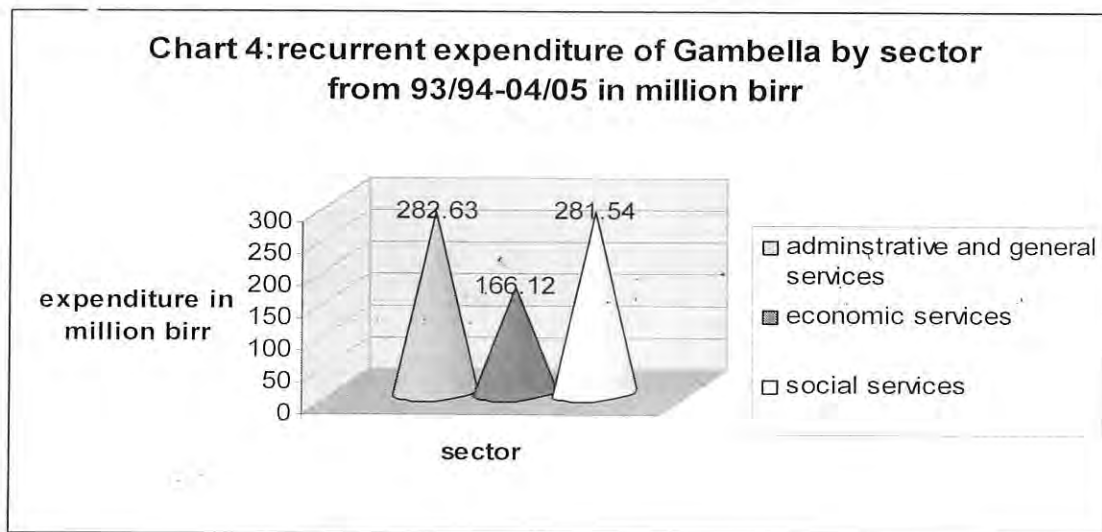


Source: own computation base on MOFED data

Chart 3 indicates that economic development sector had the largest capital expenditure share, followed by Social development and general development sectors in that order

from 93/94-04/05. This illustrates that agriculture development, natural resource, mining and energy, industry, road construction and transport and communication spent the largest capital expenditure. Next, in spending of capital expenditure were education, health and urban development and housing; as public administration building expenditure appear to be the last of all.

The second category of expenditure is recurrent expenditure. The functional classification of recurrent expenditure of Gambella region with their proportion in twelve years can be observed in chart 4. out of 736.88 million birr recurrent expenditure in (93/94-04/05), administrative and general services accounted for 282.63 million birr ((38.4%), economic services accounted for 166.12 million birr(23%), social services accounted for 281.54 million birr (38.2%) and the various expenditures accounted for 2.95 million birr (0.4%).



Source: own illustration base on MOFED data base

The above chart 4 is composed of three pyramids. The one at the left and right sides represent the administrative and general services and social services, which were almost equivalent in expenditure; whilst the middle pyramid represents economic services, which almost expended half of the two sectors.

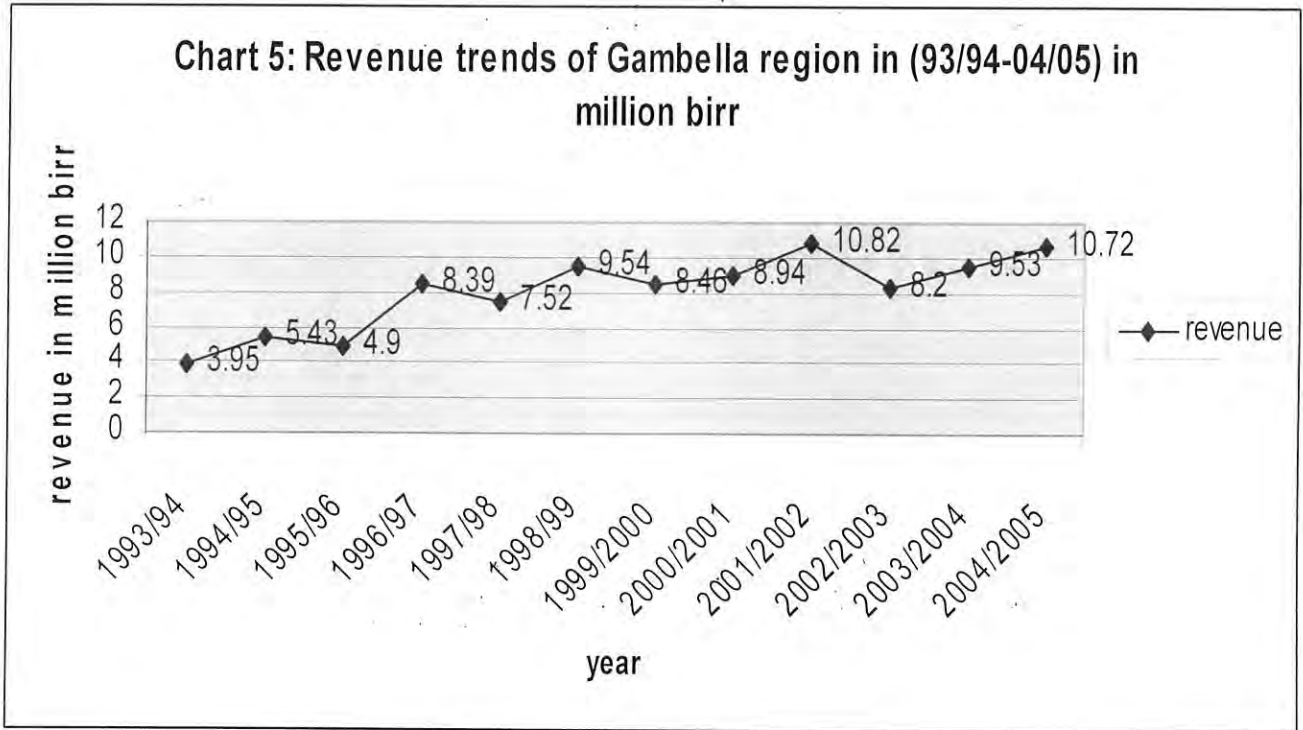
### 4.2.3 Revenue Performance

Proclamation No 33/1993, with minor additions in the articles 96, 97 and 98 of 1995 constitution of Ethiopia provided the power of sharing of revenue between the central government and regional self-government. As a result, regions began to levy and collect it revenue and accordingly; Gambella gazeta Negarit 2003, article 49 sub-articles 8 provided powers to Gambella National Regional State to generate it revenue. Chart 5 below can give description of the trend of revenue of Gambella region in twelve years.

Chart 5 depicts that revenue of the region fluctuates annually. To put it in other words there was a continuous rise and fall from year to year, except in 02/03 to 04/05 where the increase was in positive trend. The detailed picture of revenue growth of Gambella region is offered underneath.

First, revenue rose by 27% that is from 3.95 to 5.43 million birr in 93/94 to 94/95. Second, in 94/95 to 95/96 it declined by 11% that is from 5.43 to 4.9 million birr. Third, in 95/96 to 96/97 it rose by 42 that is from 4.9 to 8.39 million birr. Fourthly, it declined by 10.36 % that is from 8.39 to 7.52 million birr in 96/97 to 97/98. Fifth, it rose by 21% that is from 7.52 to 9.54 million birr in 97/98 to 98/99. Sixth; it declined by 7% that is from 9.54 to 8.94 million birr in 98/99 to 99/00.

Seventh, it rose by 17% that is from 8,94 to 10.82 million birr in 99/00 to 00/01. Eighth, dropped by 31% that is from 10.82 to 8.2 million birr. Ninth, it rose by 13% that is from 8.2 to 9.53 million birr. Finally, revenue rose again by 11% that is from 9.53 to 10.72 million birr. On average Gambella region, revenue growth change by 6%.



Source: illustration from MOFED database

Another remarkable feature of the graph is that it rose 6 and dropped 4 times. Nevertheless, the dropping is not to the value lower than the previous years' performances. At some point in this twelve years (93/94 - 04/05) revenue remained below 10 million birr except 01/02 and 04/05 when it achieved to some extent above 10 million birr which is far remote even from its recurrent expenditure. The amount generated by the region on average and total from 93/94 to 04/05 was 6.92 and 83.04 million birr respectively.

Once the trend of revenue is argued, one should also bear in mind the importance of differences between the planned and actual revenue in the revenue performance assessment. Though there may be slight variation in magnitude between the data of revenue of MOFED and that of Gambella Bureau of Finance and Economic Development, data of revenue of Gambella BOFED can provide a clue on actual and planned revenue of the region difference that may serve as a mean of revenue capacity assessment (table 15)

Table 15: Planned revenue versus actual revenue of Gambella region from (00/01-04/05)  
in million birr

2000/2001			2001/2002			2002/2003			2003/2004			2004/2005		
planned	actual	%	planned	actual	%	Planned	actual	%	planned	actual	%	Planned	actual	%
9.01	8.06	89	8.41	10.10	120	9.36	8.18	87	9.99	8.36	83	10.28	10.66	103

Source: Gambella Bureau of Finance and economic development database

From the table 15 in all five years there is variation between the planned and actual revenue. In some years, the planned exceed the actual and in other years , the latter go beyond the former. The performance of revenue of Gambella region for instance; from 00/01-04/05 was 89%, 120%, 87%, 83%, and 103% respectively. On average, the revenue performance was 96.4% from 00/01 to 04/05, which is, seem as a sign of good performance.

Besides this kind of revenue performance assessment, considering the revenue performance by type of revenue resources is of great value.

#### 4.2.4 Structure of Revenue

Revenue is broadly categorized in to tax and non-tax revenue. Further more; tax revenue is classified as direct and indirect tax. Levying and collection of revenue is often a legal issue. In Ethiopia, article 5 of proclamation of revenue No 33/1992 assign tax revenue and non tax revenue to regional and federal governments. The article states a region should levy and collect personal income tax, rental income tax, business profit tax, and agricultural income tax, tax income from inland water transportation, sale tax and rural land use fess. In addition to these, tax royalties and license fees includes regional mandate.

This revenue assignment provided in proclamation No /33/1992 to regions can be replicated in structure of revenue of a regional government. For example, table 16 shows the structure of Gambella regional revenue composition.

The revenue computation base on the table 16 reveals that out of 96.82 million birr total revenue, non-tax revenue was 27.47 million birr and tax revenue was 69.35 million birr. The composition and level of tax revenue shows that direct tax was 59.8 million birr and indirect tax was 9.55 million birr.

On the direct tax side , personal income tax was 51.83 million birr(87%) , rental income tax was 1.615 million birr ,business profit tax was 4.628 million birr(8%), agriculture income tax was 0.772 million birr(1.3%) , and rural land use fees was 0.955 million birr(1.6%). On another side, indirect tax out of 9.55 million birr, 8.73 million birr (90%) came from sales tax on goods and 0.82 million birr (9%) came from service tax and the rest (1%) are collected from stamp sales and duty tax. Of total revenue, personal income tax constituted 54% during the twelve years.

From the revenue composition, one cannot observe the share of voluntary contribution in the region. Voluntary contribution from other regions of the country comes from community associations. In fact, there were community associations established in the region based on ethnic group, but due to ethnics conflicts where one community play a role , all community associations were banned three years ago and still not operating until now though they are allowed to operate.

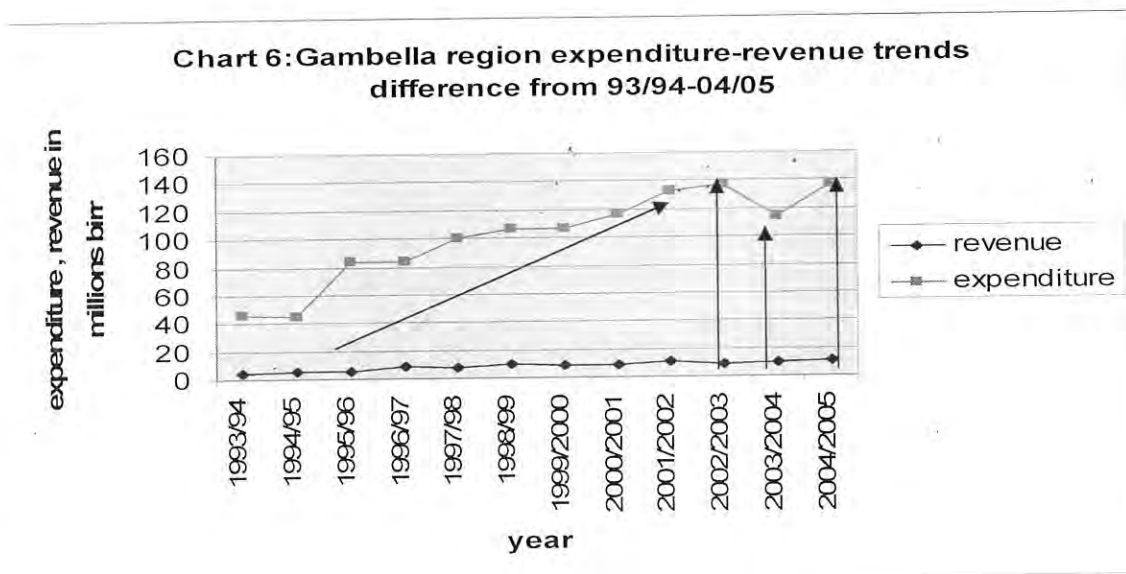
Table 16: revenue of Gambella region by source from 93/94-04/05 in (million birr)

Source of revenue	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05
1.direct tax	1.77	2.57	2.00	3.61	4.13	5.11	5.36	6.22	7.77	6.25	6.62	8.39
1.1personal income tax	1.62	2.34	1.92	3.35	3.63	4.39	4.60	5.34	6.67	5.33	5.59	7.05
1.2 rental income tax	----	-----	-----	-----	0.001	0.001	0.12	0.257	0.242	0.255	0.361	0.378
1.3 Business profit tax	0.09	0.10	0.01	0.16	0.370	0.587	0.50	0.466	0.635	0.544	0.475	0.691
1.4 agriculture income tax	0.01	0.07	0.03	0.05	0.058	0.065	0.07	0.075	0.117	0.047	0.086	0.112
1.5 rural land use fees	0.04	0.07	0.04	0.05	0.065	0.065	0.07	0.089	0.102	0.00	0.00	0.156
2. indirect tax	0.17	0.24	0.15	0.48	0.48	1.15	1.44	1.08	1.43	0.60	1.14	1.26
2.1 sale tax on goods	0.13	0.21	0.15	0.43	0.42	1.07	1.34	1.01	1.21	0.54	1.05	1.17
2.2 service tax	0.02	0.09	0.0	0.03	0.03	0.06	0.08	0.05	0.12	0.06	0.07	0.08
2.3 stamp sale and duty tax	0.01	0.02	0.00	0.02	0.02	0.02	0.01	0.02	0.11	0.001	0.03	0.00
Tax revenue	1.94	2.81	2.15	4.09	4.61	6.26	6.8	7.3	9.13	6.85	7.76	9.65
Non tax revenue	2.02	2.62	2.76	4.30	2.92	3.29	2.17	1.63	1.60	1.32	1.77	1.07
Total revenue	3.95	5.43	4.90	8.39	7.52	9.54	8.94	8.96	10.82	8.20	9.53	10.72

Source: MOEFD database

### 4.2.5 Expenditure Needs versus Revenue Generation Capacity

As it seen in chapter two, resembling other regions of the country, Gambella region generate fewer financial resources than its expenditure needs. However, the extent of the disparity between the revenue raising capacity and expenditure needs differs. There are some regions, which cover only very insignificance amount of their expenditure. Among these, emerging regions in general and Gambella region in particular can be cited as good case in point in Ethiopia. Chart 6 below provides the extent of fiscal gap of Gambella region.



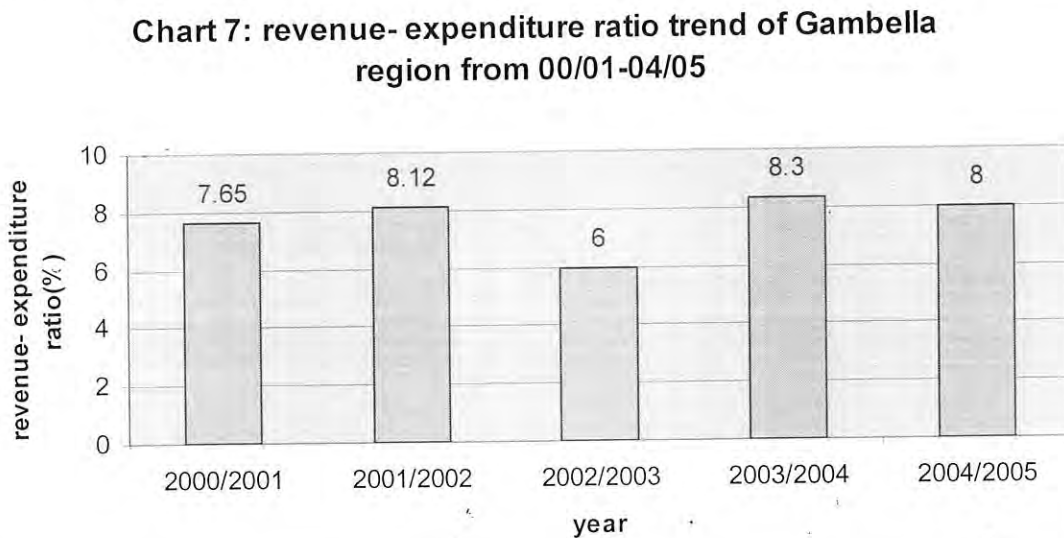
Source: illustration base on MOFED database

An important version of chart 6 is the widening gap between the revenue raising capacity and expenditure needs of the region. The gap between the expenditure and revenue can be illustrated in the above four arrows starting from left side of the chart to the right.(a) the gap is widening from 95/96 to 01/02 , (b) the gap reach maximum at 02/03 ,(c)however, the gap declined in 03/04 ; and (d) increased once again 04/05.

The widening gap show that fiscal deficit has been rising from year to year as the expenditure has been increasing beyond the revenue. Then revenue and expenditure growth on average changed by 6% and 7.4% respectively.

The possible reasons for revenue-expenditure gap are the following. First reason that one can mention for widening of the gap are increase in investment in socioeconomic development activities in the region as time goes, and weak revenue collection capacity at the beginning of regional administration. Second, revenue –expenditure gap declined in 03/04 attributed to political in stability in the region where several new and on going projects out side Gambella town were not funded .Third, in accessible woredas that did not get socioeconomic investment previously become accessible in 04/05 during dry season . Through oil exploration road, construction of projects in those woredas becomes possible.

Before concluding the expenditure versus revenue performance of Gambella region, another factor that is used to assess fiscal gap is revenue -expenditure ratio. This is often termed as horizontal fiscal imbalance. Revenue –expenditure ratio of Gambella region is illustrated in chart 7.



Source: illustration base on MOFED data

Revenue- expenditure ratio of Gambella region did not reach 9%. That is revenue of the region did not cover 9% of it expenditure. During 00/01, 01/02, 02/03, 03/04 and 04/05 regional revenue correspondingly covered only 7.67%, 8.12%, 6%, 8.3%, and 8% of it

expenditure which implies federal government finances , 92.33% , 91.88% , 94%, and 92% of regional expenditure. The value of revenue –expenditure ratio varied in 00/0-04/05 from 6% % to 8.38% where federal government covered 94% and 91.6% of regional expenditure. In the five years period the mean value of regional revenue – expenditure ratio was only 7.63%, which means 92.37% of the regional expenditure is covered by federal grants.

#### 4.2.6 Distribution of Revenue in the Region

Administratively Gambella region up to 1995 E.C was divided in to two administrative zones and nine woredas. Base on this, there were nine woredas finance offices, two zonal finance departments and regional revenue department that were responsible for collection of revenue in the region. These two zones were zone one and zone two. At that period zone one is composed of Jikawo, Akobo ,Gambella ,and Itang woredas; while zone two is made of Abobo , Gog , Jor , Godere and Dimma woredas. Depending on that administrative division, table 17 can depict the achievements of zonal revenue and regional revenue department of Gambella region.

Table17: Revenue by Level of Government in Gambella Region in 94-95E.C (01/02-02/03) in birr

Name of zone	1994E.C(01/02)	1995E.C(02/03)
Zone 1	1,761,046.98	1,517,127.84
Zone 2	2,633,757.82	1,609,047.76
Revenue department	5,705,276.76	5061,169.40
Total revenue	10,100,081.56	8,187,344.70

Source: Gambella Bureau of Finance and Economic Development

Evaluating the two zones with regional revenue department in table 17, the sum of two zones revenue is merely smaller than that of regional revenue department. For instance in 1994E.C and 1995 E.C, the total zonal revenue constituted 44% and 38% of the total revenue. On the contrary, the revenue department constituted 56% and 72% in 94 E.C

and 95 E.C respectively. This is a symbol of revenue centralization in the region (vertical fiscal imbalance) and horizontal fiscal imbalance between zones and the region and between zones themselves. As far as two zones revenue performance in 94-95 E.C (01/02-02/03) are concerned, table 17 shows that zone two collected more than zone one. This is because zone two includes the most urbanized centers such as Metti town.

Once the disparity between the regional revenue department and zones and among zones, let us switch to the disparity of revenue raising capacity among various woredas of the region. As there is variation of revenue collection performance between the two zones, there is also inequity of revenue among woredas with in zone (table18).

Table 18: Zone Two Revenue Performance by Woredas in 92-95 E.C (99/00-02/03) In Birr

Name of woreda	92 E.C(99/00)	93E.C(00/01)	94 E.C(01/02)	95 E.C(02/03)
Abobo	337,654	323,086.24	509,565.93	484,467.40
Dimma	40,579.57	118,335.96	255,878.57	236,476.28
Jor	NA	NA	NA	104,474.40
Godere	1,272,558.77	959,100.24	1,150,476.75	847,472.23
Gog	351,019.91	389,461.58	105,830.22	355,22822

Source: Gambella, Zone two Finance and Economic development department

Key: NA = Not available

In every year, table 18 shows that Godere and Gog woredas were the first two in revenue collection among the woredas of zone two. Moreover, Abobo, Dimma and Jor woredas followed them.

The current division of Gambella region, which changed the number of zones from two to three ethnic zones that started in 1996 E.C (03/04), also exhibits similar conclusions to the above. The three ethnic zones are Anyua, Nuer and Menjenger zones. All these zones are made up of more than one woreda apart from Menjenger zone which has only one woreda i.e. Godere woreda. Anyua zone comprises Gambella, Alero-Openo, Gillo and Dimma; whereas Nuer zone comprises of Akobo and Jikawo woredas. These levels of

regional government levy and collect taxes. The position of revenue collection base on current administrative division of the région is demonstrated in table 19.

Table 19: Gambella Region Revenue Collection Performance by Level of Government in 1996 E.C (03/04)

Name of woreda/zone	Amount collected in birr
Akobo	283,163.19
Alero –Openo	401,195.76
Gillo	400,792.81
Dimma	361,551.93
Jikawo	475,102.99
Godere	831,046.26
Gambella and it surrounding	436,794.34
Nuer Zone revenue department	102,039.43
Anyua zone revenue department	190,352.14
Menjenger zone revenue department	NA
Regional revenue department	5,075,452.86
Total revenue	8,367,139.57

Source: Gambella Bureau of Finance and Economic Development

Key: NA = not available

To compare the two zonal revenue departments, table 19 shows that Anyua zone revenue department collected more revenue than Nuer zone. However in 1998 E.C(05/06) Gambella regional revenue collection report where there were data on the three zonal revenue departments; Anyua zone, Menjenger zone and Nuer zone collected 206,849.44 birr, 151,563.00 birr and 121,874.40 respectively.

With in zones, for example, in Nuer zone, Jikawo woreda collected the lion share of revenue than its Akobo woreda counter part. The difference is partly due to external conflict with Lou that displaced many kebeles of Akobo woreda to big towns of the region such as Itang, Kuergeng and Gambella. Further more; in Anyua zone, Gambella

woreda and its surrounding is situated at top in revenue collection. Then Alero-Openo, Gillo and Dimma woredas come after it.

However, putting together all the woredas of the region in their effort of revenue collection, Godere woreda is the most leading. In that case, Jikawo, Gambella, Alero-Openo, and Gillo woredas rank second, third, fourth and fifth. This effort of revenue collection is in absolute term, but one cannot completely decide which woreda generated more unless they are compared in the terms of their per capita revenue raising or revenue-expenditure ratio. However, data on expenditure of zones and woredas are none existence and as the data on population of the woredas exists, their per capita revenue comparison is possible. The per capita revenue of the seven woredas of Gambella region is given in table 20.

Table 20: Percapita Revenue of Woredas of Gambella Region in 1996 E.C (03/04)

Name of woreda	Population	Amount collected in birr	Per capita revenue in birr
Gambella	34973	436,794.34	12.49
Gillo	31784	400,792.81	12.61
Dimma	26374	361,551.93	13.70
Alero-Openo	35449	401,195.76	11.32
Godere	41136	831,046.26	20.20
Jikawo	63019	475,102.99	7.53
Akobo	28016	283,163.19	10.10
Total	260751	3,189,647.28	12.23

Source: illustration base on Gambella BOFED data

Table 20 again proves that Godere woreda is the prime in revenue collection, having 20.20birr per capita revenue and is followed by Dimma, Gillo and Gambella, Alero - Openo, Akobo and Jikawo woreda. This per capita revenue comparison place woredas in different ranks from that of absolute revenue collection in table 20.

As of the above discussions from tables 18, 19 and 20 one thing that can be under lined is that Godere woreda generated more revenue than any other woreda in Gambella region.

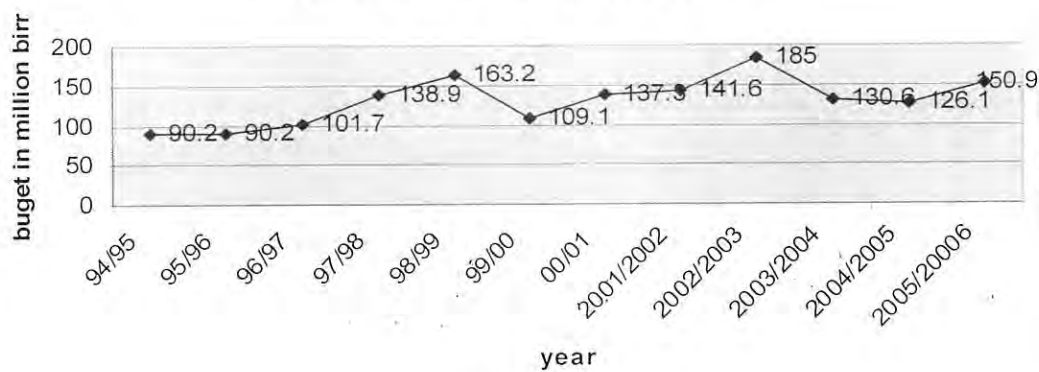
This attributes to its high urbanization level, which makes it to be in possession of more manufacturing and agro-industry in the region, as urban centers are known for their economic, administrative and commercial function. In Metti town the capital of Godere woreda for example, there are four large coffee processing plants, two coffee pulpier and two coffee hulling (Yeshi-Ber Consult 2003:19). Availability of infrastructure, fertile land, investment activity and peace and stability prevalence as well play a key role in revenue collection of the woreda. Efficiency in revenue collection can also be cited as factor that contributed to the high per capita revenue in the woreda.

#### 4.2.7 Federal subsidy to the Region

One of the rationales that make federal governments to reserve the most lucrative revenue sources for themselves is to keep equity among regions, as regions are not equal in their effort of revenue raising.

Chapter three has confirmed the reliance of regions of Ethiopia on federal grants for most proportion of their expenditures. In the above section of this chapter, it is also clarified that Gambella region revenue is by far less than its expenditure needs i.e. it covers only 7.63% of its expenditure. Then on average, the 92.37% of its expenditure will be financed from federal government, which means that the key source of Gambella regional revenue is federal grant. Chart 8 below presents the budget trend allotted from federal government to Gambella region in 94/95 to 05/06.

**Chart 8: budget allocated from federal government to Gambella region in (94/95-05/06)**



Source: own illustration base on table 11 from MOFED data base

A critical analysis of the budget allocated from federal government to Gambella region and its expenditures given in page 80 seems to disclose a surplus of budget over the regional expenditure. Since Gambella region is famous for its weak capacity in utilization of budget among others, this under utilization of financial resources allows some of the budget to remain unexploited. According to Gambella Bureau of finance and economic development budget utilization report in 93-97 E.C (00/01-04/05) the allocated budget were not fully spent. For instance, out of 76,737,801.00 birr recurrent budget and 545,000,000.00 birr capital budget allocated to the region only 63,083,538.57 birr and 54,259,296.95 birr were spent respectively.

Regarding the sources of budget allocated to regions, usually budget allocated from federal government to regions is drawn from treasury, loan and assistance. Treasury is domestic revenue source while loan and assistance are external finance sources. The amount of budget from treasury, loan and assistance out of the budget allocated from federal to Gambella region in 94/95-05/06 is denoted in the following table 21.

Of the total budget, principal share of the budget allocated from federal government to the regions originates from the treasury and loan and assistance followed in decreasing order. In Gambella region for example, treasury accounted for 89%, 78%, 86%, 78%, 89%, 94%, and 95% of total budget allocated from federal government in 99/00 to 05/06 respectively. On the other hand loan budget accounted for 9.7%, 15%, 9.3%, 12.3%, 6.4%, 3.29% and 1% in 99/00-05/06 (table 21).

Table 21: Budget Allocated From Federal Government to Gambella Region by Source in (99/00-05/06)-in million birr

Type of budget	99/00	00/01	01/02	02/03	03/04	04/05	05/06
Treasury	97	107.6	121.7	144.6	116.62	121.10	143.75
Loan	10.6	20.8	13.3	22.8	8.39	4.22	1.51
Assistance	0.9	8.9	6.6	18.10	5.66	2.72	5.66
Total budget	109.1	137.30	141.6	185	130.6	128.10	150.9

Source: MOFED database

Table 21 shows that in (99/00-05/06) the budget from treasury and loan on average account for 87%, and 8.14 % of budget allocated from federal government to Gambella region; whereas assistance accounted for the rest of total budget.

Whenever comparing the federal subsidy trend to the Gambella region and the regional revenue capacity trend, the federal subsidy seems to encourage the revenue generation capacity even though the region will realize the benefits of many projects not now but in the future. As federal subsidy increases Gambella, revenue raising capacity increases and vice versa but with weak correlation coefficient of 0.499 (Ghebrehiwot 2002:120). This implies that when federal subsidy increase with one million birr regional revenue increases with 0.499 million birr. This relation between federal subsidy and regional revenue necessitates the federal grant provision to the region.

Regional grant given by federal government includes the grants that are given to the zones and woredas of the region. It may take the form of either block grant, which the woredas might allocate in a manner they see fit, or it may take the form of specific grant, which the region gives to woreda for specific purpose. Grants given to the zones and woredas are allocated using grant formula.

The grant formula used by Gambella BOFED constitutes variables such as population, level of development, and revenue raising effort each having corresponding weight of 60%, 25% and 15%. The grant given to region is further allocated among the region, zones and woredas. Accordingly, Budget allocation of Gambella region 1998 E:C (05/06) report showed that a total budget of 63,917,927.70 birr was allocated to zones and woredas.

From this amount, Alero-Openo got the greatest part of the budget of all woredas. Gambella, Godere, Jikawo, Gillo, Akobo and Dimma woreda, followed it. Similarly, Anyua zones obtained the biggest share, followed by Nuer zone and Menjenger zone.

#### **4.2.8 Revenue Generation Capacity Constraints**

In the previous sections, one can observe the weak financial position of the Gambella region and the factors, which contribute to poor revenue collection, will be dealt with under this section.

##### **(i) Economic Factors**

From economic point of view, Gambella region has weak economic base. First, the level of urbanization of region of region is extraordinarily low. According to the Ministry of Works and Urban Development criteria, only four towns qualify to be town i.e. with population more than 2000. Among them only two towns such as Gambella and Metti which have legal status from municipality. The town ship status is not given to Itang and Pugnidu even if they satisfy the requirements. These urban centers are known for their economic, administrative, and commercial function. The major economic activities in the urban area of region are trade and service, manufacturing and other forms of occupation. For instance, in Gambella town, trade tax contributed to 39% in 1996 and in Meti town, the economic activities depend on coffee producing and trading.

As far as status of trade and service activities are concerned, it was found to be very small and insignificant in urban economy of the region. Base on information obtained from the data on business establishment from Trade, Transport and Tourism Bureau reveals that out of the 1,259 establishments of different towns and establishments of the region; wholesale, retail and service providing business accounted for 22%, 62%and 17% respectively. Besides, CSA (1999) discloses that 13% of urban population depending on wholesale repair of vehicles and personal house hold goods.

The second next to trade and service sector of urban economy in the region is manufacturing and agro industry. Then how big or small is the position of manufacturing in the urban regional economy?

The role of manufacturing to the economic base of the region is very irrelevant. The only manufacturing that exists is lumbering of Meti town of Goderè. According to CSA

(1999), the urban population that is engaged in manufacturing is only 2.5%. Nevertheless there are brick factory, hollow block manufacture, bakeries and grain mills.

Regarding agro industry, the ginnery plant in Gambella town is the only large –scale industry that exists but producing under it capacity. There are also four large coffee processing plants, two coffees pulpier and two coffee hulling. In region, the role of private sector is also at its child hood stage and the majorities are rural based investment. Agriculture from this private investment is the largest in both capital investment and employment. On other hand of total investment, industry and hotel constitute 10.8% and 3.1 % ( Yeschi-Ber Consult 2003:19).

Income and poverty level is another economic aspect that contributes to revenue collection in the region. An important proxy for revenue performance is per capita. Income Food poverty line that provides the minimum food requirement per adult per annum is 647.81 birr (99.66USD) per annum per adult in Gambella. The basic food requirement is also estimated at 427.22 birr (67.7 USD) and the basic food and non-food requirement in combination make up absolute poverty at 1075.03 birr (165.4USD) per annum per adult (MEDac 1999). The income and poverty level of Gambella region is full of paradox. Most of the municipalities covered by Meheret (2001) in rapid appraisal report have less per capita relative to African standard where Gambella and Assosa stood in the bottom. (See table 22).

Table 22: Average per Capita Revenue of Five Selected Municipalities versus African Standard in USD

No	Municipality	Average per capita revenue in USD
1	Gambella	1.52
2	Dire Dawa	5.5
3	Bahirdar	10.50
4	Awassa	5.0
5	Assosa	1.40
6	Africa	15.20

Source: Five municipalities 2001, Urban Indicators survey HABITAT, April 1994

In reality, per capita income of the region seems to be very low compare to other regions, as the majority of people could not satisfy the bare minimum food requirement. A survey by Yeshi-Ber consult (2003:22) asserts that on average food deficit prevails in most woredas of the region from three to six months. In this circumstance, it is impossible for some one starving and in need of food assistance to pay tax, particularly in remote rural woredas that are in accessible during the harvest, which is the time of agriculture income tax land use fees collection.

Yeshi-Ber consult(2003) further, cited that Kebede and Temesgen (2000) argued that Gambella region have per capita income of 1223.5 birr (188.2USD) which is greater than the national average. It is surprising to see the regional per capita income of Gambella region to exceed the national percapita average, having a per capita of 1.52 USD in Gambella town and revenue-expenditure ratio of 7.6% of the region.

## **(ii) Political Factors**

Political stability of a region play big role in its economic development. From information found through group discussion, one main factor that affects revenue collection is political instability. Gambella region is internally well known for its frequent ethnic clashes since the beginning of Transitional Government of Ethiopia. Some of these conflicts are Anyua –Mejenger conflict, Nuer-Anyua conflicts and inter clan conflicts of the Nuer. In addition, external conflict between Lou Nuer of South Sudan and Nuer people (Jikany) of Akobo is case in point that had hampered development of the region particularly the revenue collection. Yeshi-Ber Consult (2003:67) identified such types of conflicts where they acknowledged that fights and conflicts due to tribal grazing rights are not known among Ethiopian Nuers but occasionally conflict between Ethiopian Nuer and Sudanese Nuer flare up when the former tries to rear cattle crossing the Ethio- Sudanese border.

These conflicts cited above have created political instability in the Gambella region and made people not to move freely from one woreda to another other wise rivalry ethnic group or clan may kill them. Generally, this has created problems for government employees to carry out their fieldwork including tax collection.

Conflict between Lou Nuer and Nuer people of Akobo woreda led to displacement of 18 kebeles of Akobo to other parts of Gambella region and raid of thousand of cattle. Expansion of Lou conflict to Makuay Zuria of Jikawo woreda has also resulted in to lose of lives, displacement of all Makuay kebeles and raid of livestock. The accumulative consequent of these conflicts imply lose of agriculture income tax and land use fees source of revenue for Akobo and Jikawo woredas in particular and for the region in general. Further, insecurity prevalence in Anyua zone prevents tax collection in remote areas of Anyua zones. A result of interview with tax team expert of Dimma woreda, revealed that no collection of revenue done in Bereha kebeles of Dimma woreda since sene 30, 1996 up to 1998 due to in security reasons. Once again, Nuer -Anyua ethnic conflict of 1995 E.C has led to dismantle of Itang woreda, which had been zone one capital town and one of four towns of the region. In an interview with housing department expert, he said customers abandoned all 30 low cost houses in Itang town for three years and no revenue collected from them since then. Not merely this but also businesspersons who have been trading in Itang town left as their customers departed because zone one and Itang woreda administration evacuated the area.

Nuer inter-clans conflicts affected tax collection in Jikawo woreda. According to Jikawo Woreda Tax Team leader, a tax collector who belongs to one clan cannot collect tax from another rival clan. This makes employees such teachers and guards to involve in tax collection, who do not follow rules and procedures of tax collection. For example, they may use ordinary paper to collect tax from farmers. In Nyikowa, kebele of Gambella woreda in 1985-1986 E .C(92/93-93/94) this practice is witnessed where tax collector used ordinary paper for recording the name of the farmers and the amount collected (Zone two revenue collection 1986 E.C report)

### **(iii) Infrastructure Factors**

Infrastructure development is the key to development. Physical infrastructures such as roads and markets are deficient in the region. According to revenue department representative, several woredas of the region are in accessible that make collection and supervision of tax collection hard. Besides this, tax payers in remote area where there is

no financial institution and financial markets may pay tax in form of either grain or livestock.

Paying tax in kind which may involve barter activities may open way for corruption and embezzlement of government revenue. As one Jikawo woreda finance and economic development worker said, some tax collectors sell cattle on their way back to towns on pretext that it is inconvenience and tire some to drive cattle from a distant kebeles to town. To put it in another words they may keep well-fed cattle behind for them selves and pay a little to government instead. Even if they drive the cattle to town where committee from woreda finance office can sell them, on auction most cattle are below their estimated value. Hence, it mitigates regional government revenue.

#### **(iv) Institutional Factors**

One of major constraints on Ethiopian fiscal decentralization is weak administrative capacity. This weak administrative capacity is extremely pronounced in emerging regions such as Gambella. Notwithstanding, revenue institution is an independent bureau in other regions of the country, it is still operating at department level in Gambella region and hence it shares all resources with other departments of BOFED. The reason forwarded by revenue department expert for revenue institution to remain at department level is the low revenue generation of the region compare to other regions in the country.

Gambella region revenue department has got shortage of human resources at all levels and lack financial resources. Not simply shortage of human resources but also the quality of the staff is poor. Though Gambella regional revenue department teams have increased from two to four teams now, inadequacy of personnel still exists. The existing four teams include tax assessment, tax collection, data base administration and revenue intelligence teams (Gambella BOFED Human Resources Budget Allocation 1999 E.C or 06/07).

The same source argued that, there are two daily tax collectors earning 381.00 birr each per month in the revenue department. Two daily tax collectors are insufficient to cover the whole town and the checkpoints even though Gambella town administration has it

own two daily tax collectors. On the top of this, monthly earning of 381.00 birr is not enough and can invite the daily tax collectors in to accepting bribe.

Inadequate human resources in tax teams also exist in woredas. Example, in 1994 E.C (01/02), all zone two woredas have no daily tax collectors. Currently in Jikawo woreda, there is one tax team leader, one tax expert, one tax auditor and one daily tax collector. Not only this but also the quality of these staffs is poor one. For instance, according to 1998 E.C(05/06) audit report of Gambella BOFED, Ato Getachew the tax team leader of Jikawo woreda is not tax professional and lack experience of tax collection .Hence, he can not control tax collection cards as a result.

In Jikawo woreda there has been in and out, follow of goods since beginning of peace agreement in the Sudan. The control of these trade activities are mandates of custom authority, however as it is not yet established in the region, woredas are provided with responsibility to do the job. The prescribed duty of woreda tax team plus collection of custom duties has swollen the workload of the tax team. According to Jikawo Tax Team leader, Tax team some time uses typists and other junior staffs to collect the daily taxes in the town. As these personnel are not tax collectors in their assignment, they do not bother to respect the rules of tax collection. When they are blamed because they do not respect the rules of tax collection, they may not help in tax collection another time. Therefore, either the tax team should accept the mistake made by delegated daily tax collectors or the tax should remain uncollected. These delegated daily tax collectors are expecting some payment in return which is always not offered. In my presence in office of tax team leaders, a staff came in with compliant for payment of daily tax collection task at weekends.

According to results of interview and focus group discussion, frequent structural change of revenue institution and high turn over of staffs, as well as logistics problems affected the activities of revenue collection in the region. Placement of new people with little experience in revenue assessment and collection can lessen the amount of tax that can be collected if experienced people were in office.

Revenue department and woredas tax teams lack some logistic facilities such vehicles and budget, which hinder many activities of the department such as monitoring and evaluation. For illustration, Dimma woreda in 1995E.C (02/03) taxes were not collected due to lack of budget and personnel.

#### **(v) Legal Factors**

Most of the tariffs rates currently use in the region are out dated, as they are no new proclamations produced to change the old proclamations. Land and building tax are still unchanged since the issuance of proclamation No 64 of 1979 (Meheret 2001). The agriculture income tax and land use fees are also unchanged i.e. 20 birr tax per household from Transitional Government period still is the tax per household. Low cost houses rate also remain constant from Ethiopian Transitional Government up to now. The only revised one is business tax. As prices, increase tariffs should also correspondingly increase unless inadequate revenue should be collected. Absence of separate day for tax non-compliance cases in the court and in effective decision on tax defaulters and on those who use to embezzle regional government funds also affects revenue collection of region.

Another imperative issue in tax collection is lack of taxing the migrants or displaced people in Jikawo, Itang and Akobo woreda. In conversation with one migrant who came from Akobo to Itang for medical treatment but remained there for schooling of his children said they are neither taxed by Akobo nor Itang woreda. The reason is that Itang woreda people fear taxing these displaced people as tax payment responsibility might provide the displaced people a right to remain in the land forever. Later on, these people may claim a seat in woreda administration and other administrative position.

Similar experience exists in Jikawo woreda. According to one community leader of Kuergeng kebele a migrant is not directly taxed they just share the tax of his friend or relative who is indigenous of the kebele.

## **(vi) Other Revenue Collection Constraining Factors**

### **(a) Poor Tax Compliance**

According to Godere woreda revenue collection report of 1994 E.C(01/02) , poor tax compliance behavior was observed among Mejenger people where they refused to pay agriculture income tax and land use fees.

Another example, law service of Gambella Bureau of finance and economic development document reveal that up to 1996 E.C (03/04) there was a total of 461 debt allegation cases of some businessmen and organizations. These debt cases were cancelled in 1996 E.C (03/04) as a mean of exit strategy. Furthermore, government offices collect taxes but some times, they keep it for office use. According to Ato Nyigawo Abella head department of inspection, many offices do not report the collected tax on time and they mostly use taxes for their own. This used tax will be difficult for the office to refund. Third, a dialogue with Telecommunication office manager of Gambella reveals that some very important officials involves in illegal use of internet in which they expense a lot of money.

Housing expert also emphasized that in more than 390 customers and the indigenous official of the region constituted the majority of defaulters.

### **(b) Lack of Awareness of Taxpayers and Lack of information on Taxpayers**

Even though, revenue department representative said that taxpayers are aware of their responsibilities, focus group discussion result further shows that lack of tax education is highly prevailing in woredas. Above all rural kebeles where majority of taxpayers are illiterate and do not know why they pay tax.

Lack of awareness is not just only for taxpayers but also government officials are non-tax oriented and are ignorance of inclusion of tax in regional government budget.

As far as lack of information on taxpayers is concerned, representative of revenue department in interview said, every taxpayer in Gambella town has a file in revenue department.

However, from information gathered in focus group discussion, in Jikawo and Akobo woredas, the number of household in all kebeles is unknown and often agriculture in come taxes and land use fees are allocated on kebele base, which is further divided among sub clans and households with in sub clans. For instance, if tax team assigns 500 birr to a certain kebele, this 500 birr will be divided among sub clans in a kebele and then sub clan will divide it in to house holds. Consequently, kebeles with small population may have high tax to pay per household whereas those with larger population will have small tax to pay. Because of inappropriate distribution of tax, Ato Koang an employee of Akobo woreda told me that he was once requested to help his family in paying taxes since they cannot afford.

There are also unrecognized tax bases available in some woredas including Gambella town. Charges from kebeles local court, cattle sell, and fish sell are good illustration.

The Nuer Kebeles Local Court of Gambella town that charges 60 birr per case and penalizes wrong doers with 200 birr collects much money. This fund is not reported to kebele administration but it is used by Sefar choms. Fish sell can also bring some money to government if the market is organized very well in woredas such Gambella, Abobo and Itang. Moreover, cattle tax that are not implemented in some woredas need consideration.

### **(c)Accounting and Audit System Problems**

Both interview and focus group discussion results show prevalence of weak accounting and audit systems in the region. According to revenue department representative, among all the businessmen in Gambella town, only 7 of them use double entry system. Consequently, this lack of improper accounting practice of majority of businessmen make calculation of profit business difficult. The inadequate information on business profit may lead either to under or over estimation of profit. Both the over and under estimation of profit should either produce defaulting or appealing for reassessment of tax which finally result in lose of government revenue.

Audit system that deals with the monitoring and evaluating of financial resources procedures is very weak in the region. As far as tax audit work division of Gambella region is concerned, inspection department of BOFED should perform monthly tax pre audit, and general auditor should perform post audit every two years. However, base on information from head of inspection department of BOEFED, bureaus who collect taxes seldom do not audit their tax before sending it to inspection department of BOFED. As a result, the workload of inspection department increases leading to under estimation of taxes. About tax post audit, it has never been done in the region except in 1992 E.C (99/00) but the document is not available. Besides that drugs inventory at all levels has never been carried out in Gambella region.

#### **(d) Weak Information Management Systems**

Regional revenue department and tax teams in woredas have weak information management. Data management and reporting system in all level is weak. The weak reporting system of woredas and zones may under estimate revenue of the region by creating problem in planning of woredas revenue during budget allocation.

#### **(e) Lack of Regular Monitoring and Evaluation**

For every scheme or project to be flourishing, monitoring and evaluation is the key to success. The results of interview and focus group discussion show that follow up of revenue collection in Gambella region is neglected. According to representative of revenue department of BOFED every year, there is a follow up of tax assessment. The assessment that is done once a year gives a misleading tax liability as businessmen may hide their goods in the days of assessment. Base on focus group discussions, lack of monitoring and evaluation of tax collection in most woredas is due to inaccessibility and political instability. Despite the ease of access, some organizations do not follow the collection of revenue. For example, low cost houses whose rate range from 50 to 205 birr have many defaulters due lack of follow up.

#### **(f) Tax Evasion**

Habitually a number of taxpayers try to run away from paying taxes. Taxpayers of Gambella region via various approaches they attempt to avoid taxes.

During the absence of checks points in the region, businessmen use to evade tax by traveling at night. Since no daily tax collectors working at night, they unload their goods without paying taxes. This problem was tackled by establishing checkpoints. Base on speech of one Gambella municipality daily tax collector, even though there are daily tax collectors at check points now, business men put the heavy taxed items such as local Areki and chat together with heavy load that make inspection of goods difficult. Moreover, Chat is some times placed under vehicles where it is not easy to find. Domestic animals such as donkeys are also use to transport these heavy taxed items using different routes from the main roads and they escape the checkpoints.

From information gathered through focus group discussion, in woredas such as Jikawo, Gambella, Godere and Dimma the situation of tax evasion exists. A cattle tax is susceptible to evasion in Jikawo woreda because there is no specific market place and day for cattle sell. In Gambella woreda, also though cattle are sold in one market in specific day; the number of cattle businessmen brings to market is usually unknown to tax collectors. Tax collectors do not have the list of cattle sellers who use to come to market and the number of cattle they sell. While in Dimma woreda, gold businessmen in Berha kebeles are mobile and travel between Dimma woreda of Gambella and South Ethiopia. Taxes on wood and wood products are another area of tax evasion. In Gambella town, there are enormous amount of illegal traders of wood and charcoal. These people sell their wood or charcoal by moving from door to door in the town and it is burdensome to tax.

Therefore, due to the lack of strong enforcement of policies, government revenue is lost.

### **(g) Corruption Problems**

Even though the results of survey and focus group discussion did not clearly specify any type of corruption, Gambella region has several ways of miss using government revenue. For example, according to Gambella BOEFD inspection department audit report of 1998 E.C(05/06), 1929 birr were found not included in model 64 in Jikawo woreda. Further, an inspection of Store of Godere woreda finance office from Nehase 27/1997-Tikmete 2/1998, 3 quintals of tax collection cards were found missing. Alike an analysis of tax collection cards issued to Hambtamu Mekonen and Bekelesh Gebre, 52302.96 birr and 631.90 birr were misappropriated.

Similarly, Zone two revenue collection report 1986 E.C(93/94), showed that in Nyikowa kebele of Gambella woredas in 1985-86 E.C(92/93-93/94) out of 115 taxpayers, taxes of 15 people was found missing and among 100 taxpayers payment receipts were not issued to some farmers. Of total 3835 birr, receipts were issued only for 1960 birr whereas they were not issued for 1875 birr. This shows that the balance was used for private use of tax collectors.

Another case of miss using of regional revenue found through interview is that of Gambella Hospital. Gambella Hospital is service providing organization that generates revenue to the region. According to Ato Gebrial who is in charge of hospital dispensary, half of the daily prescriptions of the hospital are free from charges on ground that they are poor and cannot afford to pay for medical treatment. Never the less; many of the so called free patients are families of wage earners and even some times the wage earners themselves are treated freely.

## **Chapter Five: Summary, Conclusion and Recommendation**

### **5.1 Summary and Conclusion**

The primary objective of Fiscal system is to generate revenue, which is needed to fund public provision of goods and services. This revenue should exceed expenditure in order to have a surplus that can finance government capital; however, revenue generation ability differs from nation to nation. The variation in the level of taxation from one nation to another is because of economic, cultural and historical reasons.

For example, Developing countries are characterized by limited ability to tax since they have low economic performance, weak tax administration, and evasion and corruption problems. Between 1962 and 1982, fiscal deficit in twenty five Sub Saharan Africa Countries has increased from 4.2% of GDP to 9.7%. This implies that most developing countries are plagued by chronic fiscal deficit and by inadequate socioeconomic infrastructure. Ethiopia, one of Sub-Saharan African countries has been in chronic deficiency, except in the early 1950s and in the mid 1960s. During fiscal decentralization, there was over all fiscal deficits of 2 billion birr in 1991/92, 3.23 billion birr in 1995/96 and 3.03 billion birr in 1997/98. Recently, fiscal deficit including grants and emergency assistance is estimated to have declined from 9.3% of GDP in 01/02 to 8.4% in 02/03. Hence, increasing tax revenue is the possible solution to these problems.

Regarding the distribution of responsibilities between the central and regional governments, more responsibility is assigned to the former. For instance, in assignment of revenue in most developing countries, sub national governments have limited access to their own tax bases; while national have better access to their tax bases. In Ethiopia since introduction of tax in 1942 and 1944, central as well as regional government exhibit fiscal deficit, but regional governments suffer more from shortage of revenue than central level. In the year 93/94-97/98, regional governments collected less than 20% of national revenue, whereas regional governments accounted from 34 to 44% of total expenditure in the country.

In the last twelve years i.e. from 93/94 to 04/05, regional government accounted for 33% of national expenditure, which is greater than sub-national governments revenue (18%) of the national government revenue. This indicates that Ethiopia provides more expenditure to regional governments than that of developing countries. On other hand, federal expenditure accounted for 67% of the national expenditure.

As far as revenue decentralization in Ethiopia is concerned, more revenue is collected by federal government .Federal government collected 82% of tax revenue and 83% of non-tax revenue in 1997/98. From 93/94-04/05, regional government collected 18%, while federal government collected 82% of national revenue. If one compares and contrasts expenditure and revenue decentralization in Ethiopia during 93/94-04/05, more expenditure is decentralized than revenue to the regions as regional governments spent 33% but collected only 18% of national revenue. This has led to fiscal deficit between the revenue capacity and expenditure needs of regional governments.

The vertical fiscal imbalance is another feature of fiscal decentralization in Ethiopia. Vertical fiscal imbalance is measured in vertical fiscal imbalance coefficient. During 93/94-04/05, it was estimated to be 0.50 on average, which seem constant and fairly high. Primarily, the reason behind this high vertical fiscal imbalance coefficient is the assignment of most lucrative sources of revenue i.e. indirect tax to federal government. In 2002, indirect tax constituted 35% of domestic revenue and of which only 10% left to the regions. Secondly, the poor tax administration in the regions also contributes to this high coefficient vertical fiscal imbalance. Thirdly, the federal government is gigantic investor in the socioeconomic infrastructure development.

High vertical fiscal imbalance coefficient in Ethiopia leads to the following. it threaten political decentralization , it weaken the capacity of regions or woredas to provide relatively quality and adequate public services to their constituencies , it increase inefficiency and it result in loss of regional autonomy .

The variation between revenue raising capacity and expenditure needs among regions also prevail in Ethiopia. It can be measured by regional revenue share and horizontal

fiscal imbalance. From 93/94 to 04/05, Addis Ababa on average collected 52% of regional revenue, followed by Oromia (27.6%), Amhara (13.7%), SNNP (11.2%) and Tigray (6%). Among emerging regions such as Somale, Benishengul Gumuz, Afar and Gambella collected 2.23%, 0.94%, 0.92 % and 0.52% respectively. Average regional revenue share ranges from 52% in Addis Ababa and 0.52% in Gambella.

In terms of regional horizontal fiscal imbalances during 93/94-04/05 on average, Addis Ababa covered 98% of their expenditure. Horizontal fiscal imbalance was 30% for Oromia, 29% for DireDawa, about 26% for Tigray, 25% for SNNP, 21.5% for Amhara, 18 for Harar, 13% for BSG, 9.4% for Somale 8.22% for Afar, and 7.6% for Gambella. This disparity in horizontal fiscal imbalance of regions attributes to difference in socioeconomic infrastructures, institutional and administrative capacity, and variation in natural resources and tax efforts. Of all regions, both in terms of regional revenue share and average horizontal fiscal imbalance, Addis Ababa stood the first. It collected 52% of regional revenue and covered 98% of its expenditure. Similarly, Gambella stood the last such that it collected 0.52% of regional revenue and covered 7.6% of its expenditure.

The needs and capacity gap of the country due to vertical and horizontal fiscal imbalance pinpointed above, can be bridged through provision of federal transfer that begun in 1992/93. However, these federal transfers have its limitations. Grant request procedures are cumbersome and discouraging; and grant formula is pro equity, excluded poverty index, frequently changing, lack regional participation and discourage tax effort.

The magnitude of Gambella total expenditure exceeded total revenue by 92% in 93/94-04/05 and the former change more than the latter by 1.4%. During 93/94-04/05, the total expenditure was 1256.16 million, whereas total revenue was 96.82 million birr respectively. Moreover, the corresponding change in growth for expenditure and revenue were 7.4% and 6%.

With reference to the revenue composition of the region as of 93/94 to 04/05, out of 96.82 million birr total revenue, tax revenue constituted the lion share. Tax revenue was 72% while non tax revenue 28% respectively. Out of 69.35 million birr tax revenue, direct tax made the larger share. Direct tax was 86%, while indirect tax was 24%. Out of direct tax, personal income tax is the leading followed by rental income, business profit tax, agriculture income tax and rural land use fees. Personal income tax constituted the half of the total revenue collected. If personal income tax is deducted from 93/94-04/05 total regional revenue as it originates from federal transfer, regional revenue should be 48.41 million birr and on average, it should be 4 million birr only. Then revenue-expenditure ratio should be 4% in twelve years, meaning regional revenue will cover only 4% of its expenditure. This is an indication of regional fiscal dependence on federal grants. About voluntary contribution, no information obtained in the region except community associations' contribution whose size is not documented.

There also exist vertical and horizontal fiscal imbalances in Gambella region. There is variation in revenue collected in the region by regional revenue department and the zonal revenue departments. There is disparity in revenue collected among zones and woredas with in zones. For example, in 1994 E.C and 1995 E.C the total zonal revenue constituted 44% and 38% of total revenue, while the revenue department constituted 56% and 72%. Among zones, in 1994 -1995 E.C (01/02-02/03), zone two collected more revenue than zone one in absolute term. In zone two in 1992-1995 E.C (99/00-02/03), Godere woreda collected the highest revenue. In terms of percapita revenue collection of woredas in 1996E.C (03/04), Godere collected the highest percapita revenue (20.20 birr), while Jikawo collected the lowest percapita revenue. Godere collected more revenue because of its high urbanization level, availability of infrastructure, fertile land investment activity and peace and stability.

Low revenue capacity of Gambella region in which it covered only 7.6% of its expenditure and possessed only 0.52% of the total regional revenue in 93/94-04/05 is due to economic, political, legal, infrastructural and institutional factors. There are also other revenue collection constraining factors in the region such as poor tax compliance, lack of

taxpayers awareness, accounting system problems, weak information management, tax audit problems, lack of monitoring and evaluation , lack of information on tax payers, tax evasion and corruption.

## **5.2 Recommendation**

### **5.2.1 Vertical and Horizontal Fiscal Imbalances**

In Ethiopia, despite introduction of privatization, development of private sector, on going reform in general and introduction of VAT in order to reduce vertical fiscal imbalance by increasing the revenue base of regions seem constant and fairly high. Therefore, federal government should continue to carry out those activities that can alleviate revenue base of regions. Moreover, federal grant provision is provided to reduce vertical and horizontal fiscal imbalance; however, Ethiopian federal grant lack transparency as other regions get other forms of financial assistance to community associations that are not deducted from the subsidy. Ethiopian federal grant should be fair only if all these financial resources are taken in to account when calculating subsidy. Never the less, federal transfer to the region should continue and own revenue generation should be encouraged.

### **5.2.2 Revenue –Expenditure Gap of the Region**

In 93/94 -04/05, the total expenditure exceeded the total revenue by 92%; moreover, expenditure growth change by 7.4%, whereas revenue growth change by 6%. Hence, expenditure grew by 1.4% faster than revenue and consequently, the region covered only 7.6% of its expenditure. This weak revenue generation will bring about inefficiency in provision of services and lack of services provision in cost effective way in the region, as they do not finance the services from their own revenue. Consequently, region will have infrastructures of poor quality that will not last long and will not provide the intended benefits. In addition, in order to reduce these side effects of high revenue –expenditure gap in the region , revenue must grow at rate greater than or equal to that of expenditure. Therefore, for the regional revenue, to grow at that rate annually, it should try to alleviate the regional revenue collection constraining factors.

### 5.2.3 Revenue Generation Capacity Constraints

(i) The key revenue collection constraining factor in the region is political factor. It influences other revenue generation constraining factors in one way or another. It is also the root cause to many factors that directly affect revenue collection performance

For example, a political factor such as political instability reduces the investment opportunities in the region and there are few infrastructures as result that further lessens revenue generation. Similarly, political instability partly affects institutional and legal capacity. Conflicts in Gambella region have contributed to attrition of revenue workers that make revenue department structural change to be so frequent.

They prevented revision of old revenue proclamation as well as timely, effective tax court case decision, tax auditing, and information management since some of personnel has turned over. Political instability prevented revenue collection monitoring and evaluation, though is not regularly done in politically stable woredas. Conflicts have eroded revenue base of the region. Losses of Live of people, cattle raid, displacement of people, which come about because of conflicts, are the base of revenue. Hence, federal government, regional government as well as peace loving bodies should join hand to maintain peace in the region.

(ii)The structure of revenue institution has affected revenue collection in the region. Gambella region has neglected revenue generation activity and it is still now operating at level of department on argument that it generates very little revenue. For regional revenue generation to improve Gambella regional state should make revenue department an independent bureau with full capacity and this can improve tax administrative capacity that may enhance revenue collection. It can improve tax literacy, tax compliance, information on taxpayers, etc.

(iii) From economic point of view, there are revenue economic constraining factors. The low revenue base of the region besides other factors cited above is also due to low agriculture productivity. For example, in 93/94-04/05, agriculture income tax was only 1.3%. Therefore, for revenue to increase, agriculture productivity where majority of population rely on, must be improved in the region. Again, population in an area

determines the revenue base, and then woredas in the region should have the exact number of household so that tax administration can levy and collect the fair amount of tax.

(iv) Tax evasion is one of other factors affecting the amount of revenue to be collected.

To avoid tax evasion, traders who lack licenses; and cattle and fish sellers should be licensed. Cattle and fish sell charges should be considered in areas where they were not under taken. Region should also consider, collect and report the charges of Kebele local court of Nuer to kebele administration. Number of cattle each seller brings in to the market should be registered at the eve of market day in order to put off tax evasion. Charcoal sellers should be organized into associations; as well, they should be given license in order to reduce tax evasion.

(v) Legal factors such ignoring migrants tax who are benefiting from area in fear to involve them in political administration is one of critical issues in revenue collection. Nevertheless, any person who settles in an area and who cultivates the land should be obliged to pay agriculture income tax and land use fees. As people in the region are struggling for political posts as source of power and wealth, they often prefer not to tax migrants but share with them other services because they do not want to share political administration with them. Then the region should tax migrants if they are cultivating the land and using other services in an area by either the woreda of origin or the woreda of destination. The second legal factor is existence of old tariffs that require legal decision. All these old proclamations with their old tariffs should be revised as soon as possible.

(vi) Auditing system in the region is very weak, particularly, it lacks tax post audit and drug inventory of health facilities that under estimate the amount of revenue. Therefore, region should give more emphasis to tax auditing and drug inventory so that revenue collection can be enhanced. Patients free of charge in Gambella Hospital as well as in other health facilities should be limited as much as possible and free medical service should be given only to the real needy people. The use of inappropriate procedures of tax

collection should be reduced, for example agriculture income tax and land use fees tax collectors and health personnel should use tax collection cards to collect taxes.

(vii) For voluntary contribution to materialize in the region, NGOs, Federal and regional government should support the Community Associations to restore their development activities.

(viii) Region should provide incentive mechanisms to tax collectors and tax payers in order to increase revenue collection.

(ix) Region should reduce some recurrent expenditure in order to narrow the revenue expenditure gap of the region.

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## Summary of the study questionnaires

1. How is the tax compliance of taxpayers, tax evasion and corruption?
2. What is the level of taxpayers' literacy and tax awareness?
3. How is an accounting, information management and audit system?
4. How is the status of tax assessment, collection, and monitoring, and evaluation and low cost houses rent collection?
5. How is the institutional capacity of the regional revenue department and tax teams institutional capacity?
6. What ways used to reduce tax noncompliance and incentive mechanisms you used in order to increase revenue collection?
7. What are the factors that affect revenue generation capacity?
8. Are there any unexploited areas of tax base in the region?
9. Why revenue institution is still run by department in Gambella while it is at bureau level in other regions?
10. What is an experience of other organizations in user charge collection in the region?
11. What is an experience of voluntary contribution in the region?

## Profile of Respondents

s/no	Organization	Position
1	Regional bureau of finance and economic development	Acting revenue department head
2	Regional bureau of finance and economic development	Accounts and budget department head
3	Regional bureau of finance and economic development	Inspection department head
4	Bureau of Work and Urban development	Housing department expert
5	Gambella Hospital	Hospital dispenser
6	Telecommunication district manager	District manager
7	Dimma woreda finance and economic development office	Tax team expert
8	Jikawo woreda finance and economic development office	Tax team leader
9	Itang woreda finance and economic development office	Tax team leader
10	Gambella town administration	Tax team leader
9	General Auditor Bureau	Bureau head
10	Supreme court Bureau	Bureau head
11	Regional Council	Economic advisor