



**Addis Ababa University**  
**School of Graduate Studies**  
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**Center for Federal Studies**

The Impact of Fiscal Decentralization on Urban Public Service  
Delivery in Oromia: *Comparative Study on Chiro and Sebeta Towns*

A Thesis Submitted in Partial Fulfillment of the  
Requirement for Masters Degree in Federal Studies

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This is to certify that the thesis entitled “**The Impact of Fiscal Decentralization on Urban Public Service Delivery in Oromia: Comparative Study on Chiro and Sebeta Towns**” is prepared by **Samuel Kebede Aboye** and complies with the regulations of the university and meets accepted standards with respect to originality and quality.

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## **Declaration**

I, the undersigned, declare that this thesis is my original work and has not been submitted for any degree or examination in any other university or academic institution. All sources and materials used are duly acknowledged and are properly referenced.

A handwritten signature in blue ink, appearing to be 'SKA', is written over a horizontal line. The signature is stylized and somewhat abstract.

Samuel Kebede Aboye

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## *Acronyms*

BoFED	Bureau of Finance and Economic Development
EPRDF	Ethiopian People Revolutionary Democratic Front
FDRE	Federal Democratic Republic of Ethiopia
ORS	Oromia Regional State
SNNPR	Sothern Nations Nationalities and Peoples Region
TVET	Technical and Vocational Education and Training
ULG	Urban Local Government
UNDP	United Nations Development Program
VAT	Value Added Tax
WB	World Bank
WBG	Woreda Block Grant

## ***Abstracts***

*The main objective of the study is to investigate the capability of Chiro and Sebeta urban administrations to provide their respective residents with preference based services, to identify the possible problems constraining their efforts with this regard and to propose appropriate solutions to the problems.*

*The study employed more of qualitative method. Accordingly, the fiscal powers and functions as well as the fiscal autonomy of the ULGs in ORS in general and that of the study areas in particular are looked into thoroughly. The investigation started with the scrutiny made on legal frameworks in place for local governments including ULGs both at the federal and regional level.*

*Primary and secondary data are collected and analyzed accordingly. Structured and unstructured interviews are carried out with pertinent officials and experts from the municipalities and sector offices of the study areas as well as from the federal and regional government offices. Group discussions of stakeholders and field observations that focused on selected services are also part of the study process.*

*The introduction of legal frameworks that weakened the autonomy of the urban administrations, inappropriate interferences from the regional government, the mismatch between the taxation powers and expenditure responsibilities of the urban administrations and lack of capacity to administer taxes and to carry out expenditure responsibilities are among the findings of the study.*

*As a result, it is concluded that the urban administrations under consideration are not in a position to render appropriate level and mix of local public goods and services.*

*In light of the findings, it is recommended that there is a need to enhance the autonomy of the urban administrations in a manner it tackles the multi faceted interference from the regional government. Boosting the taxation power of the ULGs and allowing them to access additional financial sources so as to help them match their financial capacity with their expenditure responsibilities is found to be equally important. Redesigning the grant transfer arrangement in a manner it takes the economic disparities along jurisdictions into consideration is also part of the recommendation.*

# Chapter One

## 1.1. Introduction

Fiscal decentralization gives lower levels of government the opportunity to provide their residents with local public goods and services efficiently. It brings government closer to the people where decisions can be made based on local preferences. That means it allows local governments to decide on the level and mix of taxes and expenditures and hence enables them to provide preference based local public goods and services (Bahl, 1999:60 and Abu 2013:6).

The argument is that when government is brought nearer to the people, it will be in a better position to understand the real interests of local residents and to make decisions well matched with the local preferences. That is why Shah (2007:9) is of the opinion that “*A decentralized system ideally ensures an order and combination of public services consistent with voters’ preferences, while providing incentives for efficient provision of such services.*”

However, one cannot conclude that the existent of some kind of fiscal decentralization alone guarantees the provision of efficient and preference based local public goods and services. Among the factors believed to affect the outcomes of local public goods and service provision efforts are: -

- i. The level and scope of taxation powers,
- ii. Expenditure responsibilities assigned to local governments,
- iii. The degree of comparability between revenue capacities and expenditure responsibilities of local governments,
- iv. The level and scope of autonomy (fiscal, political and administrative autonomy) local governments are endowed with and,
- v. Mechanisms in place to ensure accountability and fiscal arrangements to tackle fiscal related challenges,

If local goods and services are to be provided based on local preferences, there is a need to endow local governments with appropriate level of fiscal powers and functions and to allow them act autonomously within their boundaries of powers and functions. In other words, as far as levels of

government are endowed with appropriate level and scope of fiscal powers and autonomous enough to exercise the powers and functions they are endowed with, they will be accountable to their residents for every decision they make, which in turn enhance efficiency of service delivery.

In the same manner Bahl and Bird (2008:12) argue that in principle multi-tiered governments can be effective and efficient when tax payments from and services rendered to residents are closely related as much as possible. That is why Norregaard (in Ter-Minassian 1997:50) argued that the nexus between taxes collected and services provided is very important for levels of government to enhance efficiency of local public service provision.

Norregaard (in Ter-Minassian 1997:53) explained further that the level of autonomy sub-national governments are endowed with to set their tax rates and hence to determine the size of revenue they generate affects their capability to determine the level and mix of public goods and services they provide to their respective residents. Thus, if sub-national governments have meaningful fiscal autonomy, especially to set their tax rates, they will be in a better position to determine the size of their revenue, where to spend it and to adjust the level and mix of public goods and services they provide with the real preferences of their respective residents and local specific circumstances.

Bahl (1999:61) also explained further that, people are more willing to pay taxes if the services they are provided conform to their preferences and if they are guaranteed to question and hold their local governments accountable. According to Dillinger (1994:2), a clear linkage between a unit of government and a specific service seems to be essential to enable constituents to hold their respective local governments accountable for specific functions. In other words, putting a clear demarcation between the responsibilities of levels of government is also equally important.

As opposed to such positive outcomes of fiscal decentralization, unwanted fiscal consequences such as inefficient resource allocation and economic instability are also possible to happen if loopholes that can lead to such distortions are not taken into consideration when designing intergovernmental fiscal arrangements.

According to Shah (2007:10) because of the difference in fiscal capacities richer jurisdictions provide their residents with higher level of services at lower tax rates than the poorer jurisdiction can do. This unequal treatment of citizens with identical income based on their place of residence

encourages people to relocate to richer jurisdictions seeking better net fiscal benefits, which in turn results in fiscal inefficiency (Ibid). Therefore, the economic inefficiency that can emanate from distorted allocation of resources across jurisdictions at the same level is among the possible unwanted consequences of inappropriate fiscal decentralization.

## **1.2. Historical Background of Decentralization in Ethiopia**

Despite the fact that there are many advantages that can be secured from decentralization, Ethiopia was not in a position to practice meaningful decentralization in all aspects until the fall of the *Derg* regime two decades ago. Before the fall of the military regime, the highly centralized political system in Ethiopia had been the basis for the then centrally controlled socio-economic activities. Meheret (Bahiru & Pausewang, 2002:134) states that Haile Selassie regime and its successor the *Derg*, did not take decentralization seriously and the country has been mostly centralized.

Asmelash (Gebrehiwot, 2013) revealed that the reorganization of the Ethiopian empire into thirty two administrative divisions in the early 1930s enabled the emperor Hile Sillassie to appoint governors from the centre, which clearly showed that the motive behind the reorganization of the empire has nothing to do with genuine decentralization.

Kassahun (2004) and Meheret (2007) (Dickovick and Tegenge, 2010:2-3) mentioned the establishment of *Taqalay Gizat and Woreda* administrations in 1942 by the emperor as a futile move towards decentralization. According to Gebrehiwot (2013), assimilation policy was at the heart of the emperors' decision to establish *Teklay-Gizats, Awrajas* and *Weredas*.

Meheret (Bahiru & Pausewang, 2002:134) also claimed that the decree of *Awraja* Self-Administrations in 1966 was a move towards institutional decentralization in Ethiopia. Mentioning the fact that the central government appointed the chief administrators for the *Awrajas* and the power given to the *Awrajas* to generate revenue and utilize it for development was limited, he claimed that the motive behind the decentralization has never been to put government nearer to the people and to realize effective self-government.

Meheret argued also that the intensification of the civil war forced the military regime to establish Tigray, Ogaden, and Afar as autonomous regions and to award Eritrea a special

autonomous status in 1987. However, he claimed, all these actions did not work, as they did not devolve genuine power to the local level (Ibid).

The World Bank report (2007:155) also claims, “*Over long course of history, until the early 1990s, successive regimes treated Ethiopians more like subjects than citizens- this was the case under the quasi-feudal monarchy and the totalitarian Marxist-Leninist state.*” That means, during the past regimes, it was unthinkable for citizens to influence government decisions that affect their life.

An assessment report prepared by a team lead by Gulyani in 2001 explained that most of the major legislations regarding municipalities have been formulated during Emperor Haile Selassie’s era. According to the team report (2001:7), the 1932 and 1942 decrees assigned a number of basic services to Addis Ababa and created municipalities with appointed councils under the auspices of the then Ministry of Interior Affairs respectively. The team report mentioned that the 1942 decree defined some basic municipal functions and revenue sources as well (Ibid).

Despite the fact that the municipalities used to be involved in decisions related to revenue generation and public service provision activities, they were more of agents of the center with no significant power to shape their decisions based on the real preferences of their residents and the circumstances on the ground. Thus, revenue generation and public expenditure responsibilities were highly centralized in the same manner as the then political system used to be. As a result, both the revenue generating and expenditure activities including those related to basic public service delivery had been subjected to the centralized command chain controlled at the center to the extent that urban local administrative units were not in a position to serve their residents based on the need on the ground accountably.

Consequently, Ethiopians were not entitled to get preference based public goods and services until recently. The destination of revenues used to be collected from the urban centers and the expenditure targets were not to the knowledge of the taxpayers to the extent that transparency and accountability were almost nonexistent. Service satisfaction of citizens had also been at its lowest level, as urban development was hampered and poverty reached beyond its limit.

That is why fiscal decentralization got attention in Ethiopia and started to be implemented as part of the newly introduced federal political system, after the fall of the military regime in 1991. To put government nearer to the people in a manner it enables citizens to participate directly in their affairs and to make local officials compliant with their real preferences are among the main objectives and goals of the new decentralized fiscal approach in the country.

As a first step, the 1992 transitional charter and other statutory laws, which were introduced by the EPRDF lead coalition government, established 14 decentralized autonomous administrative units, including the capital city Addis Ababa, as sub-national units constituting the nation and mandated them with some political, administrative and fiscal powers so as to achieve the above objectives among others.

The 1995 FDRE constitution also reorganized the federation once again merging some of the constituent units in the south and established the nine national regional states as the constituent units of the Ethiopian federation (Article 47/1). Article 50/4 of the constitution also endowed the constituent units with political, administrative, and fiscal powers, leaving the decision to establish further devolved government units nearer to the people to these constitutionally recognized state governments.

Even though the regional states did not give that much attention to establish autonomous lower levels of government with their respective pre-amendment constitutions, the 2001 amendments of the state constitutions, including that of the Oromia Regional State (ORS), allowed the state governments to devolve more power to the *woreda* and *kebele* levels. Dickovick and Tegegne (2010:5) argued that the intention of the devolution power to the grassroots level was to improve service delivery as well as to promote democracy (participatory governance) and economic development.

### **1.3. Profile of the Study Areas**

#### **1.3.1. Profile of Chiro Town**

Chiro town is located in west Hararghe Zone of the ORS, 325 km away from the capital Addis Ababa to the east. The town is approximately 58 sq km wide and currently inhabited by 68,676 people. It shares borders in the north with *Chiro Qala*, in the south with *Madhicho*, in the west with *Najabas* and in the east with *Qilliso* rural *kebeles*. The town is serving as the seat of both the

Chiro *Woreda* and West Hararghe zone administrations. Most of its residents involved in small scale trading. There are many government employees and there are also residents who are involved in farming. However, there is no compiled data on the overall economic activity of the town.

Fitawrari Takla Hawariat Takla Mariam, who was the first governor of the former *Charchar awraja* administration, established Chiro town in 1923.

Tekla Hawariat claimed in his autobiography (2004:360) that he has been thinking to maintain the original name of the place "*Chiro*" for the newly established town or to name it after the nearby hill called *Moti*. However, he could not do that as Prince Teferi (later emperor Haile Sillassie I) ordered him to name it *Asebe Teferi*, which remained the name of the town until the fall of the *Derg* regime in 1991.

According to Local elders, the fact that officials, proprietors, and nobles made their center at the town, attracted many people to migrate to and settle there and made the town expand further. As the town links the roads to Dire Dawa, Galamso and Addis Ababa among others, foreigners like Greeks and Arabs did not waste time to make the town their home and continued to dominate especially businesses at least until the late 1960s E.C.

Tekla Hawariat (2004:364) claimed also that after he established the town, construction of a school, internal roads, health, and water projects were among his plans. Ensuring security and putting in place effective justice system were also among his priorities. Accordingly, he managed to get the construction of the first ever school at the town completed, even though he failed to make the school operational and to start the actual construction of the rest of the projects before he left his position as governor, which happened in 1930. He claimed also that his effort to ensure security and to put in place effective justice system in the town was also successful (Ibid).

A document at the town's municipality states that the appointment of another western educated scholar, as the governor of *Charchar Awraja* also contributed a lot to the development of the town. The document stated that a number of social services are introduced in the town during this period. The construction of the internal road system of the town and the construction and opening of the only hospital in the town were among the major services that had been introduced during that period. Hakim Worqneh Eshete has also been credited for making operational the first ever

school which Fitawrari Takla Hawariat has constructed. As of now, the town has two secondary and 10 elementary schools. Among the ten elementary schools and only three of them are privately owned.

According to elders at the town, the construction of the Chiro-Mi'esso road in 1928, which connects the town to the Ethio-Djibouti railway and the establishment of the military camp at the town in 1960s among others, contributed a lot to the expansion of the town and its business activities.

Now, the town has 7.2 km asphalt road constructed by the federal government as part of the Addis Ababa Dire Dawa highway. 1.5 km cobblestone and 42 km gravel road is also part of the internal road system of the town.

However, the town could not manage to boost the coverage and quality of the services it started early when compared to other towns. Residents who participated in the group discussion on the issue argued that, especially during the Derg regime, there was no coordinated effort to improve the services at all. The development of the town stayed rather stagnant until the fall of the regime.

As a result, Chiro town, which was part of the Chiro woreda administration until 2003, has been recognized as 2<sup>nd</sup> grade autonomous urban local government by proclamation 65/2003 of the ORS in March 2003. Now Chiro town is 2<sup>nd</sup> grade urban administration as the amendment proclamation (Proc. 116/2006) annulled the **ULG** status of urban areas in the regional state and reestablished them as **urban administrations**.

### **1.3.2. Profile of Sebeta Town**

Sebeta Town is located 25 km away from Addis Ababa along the Jimma road in the southwest direction. The town shares border in northeast direction with Addis Ababa and it shares the rest of its borders with the Hawas Sebeta *Woreda* of the Finfinne hinterland special zone of Oromia.

The official document of the Sebeta urban administration indicated that even though the exact date in which the town was established is unknown, it is believed that the town is founded during emperor Minilk's reign. According to this document, it might be a settlement of garrison that marked the foundation of the town. According to the official document mentioned above, currently, its population reached more than 110,000. Sebeta is being a center of huge investments

these days. Because of the factories, being expanded at the town and its surroundings the number of residents who work in the factories is increasing. Small-scale trade, government employment and farming are also among the sectors part of the residents involved in.

The town started to be administered under a municipality system in 1936 Ethiopian calendar and got its first master plan from ministry of Housing and Urban Development in 1972 Ethiopian calendar. The town had got its first school when an elementary school established in the town back in 1948 Ethiopian calendar. As of now Sebeta town has 37 elementary and seven secondary schools (1-10<sup>th</sup> grade) among which most of them are privately owned. It has also more than 54 health service providing institutions. Almost all of them are privately owned.

Despite the fact that Sebeta town is located at a short distance away from Addis, its development was not as it was supposed to be until the fall of the *Derg* regime. The town started to show dramatic change after it is recognized as a grade 3 urban local government by proclamation 65/2003 of Oromia regional state along with 20 other urban areas in the regional state.

However, the town did not stay long when it was upgraded into a grade 2A urban local government in 2005. Its *kebeles* are also increased from five to eight as additional three rural *kebeles* incorporated into it in 2004 Ethiopian calendar. Because of the extraordinary growth of its population size and economic activities in the town, the regional state upgraded it in to grade 1A urban administration at the end of 2012.

#### **1.4. Statement of the problem**

Despite the fact that, Ethiopia has made a major shift from the highly centralized form of government to multi tiered decentralized government system, the objectives and the goals that are supposed to be achieved through decentralization are not fully achieved yet. Though commendable achievements secured in the areas of local service provision in general, urban residents are still facing serious problems with regard to some basic services like education, clean water and sanitation. Repeated interruptions of services, service inadequacy, and lack of service quality are among the problems urban residents are suffering from. That is why the World Bank report (2007:155) claims, “*While the formal Ethiopian state structure has been transformed from highly centralized system to an increasingly decentralized one, challenges remain.*”

Thus, the constitutional aspirations associated with comparable basic public service entitlements of citizens is far from reach yet, as public service provision in urban areas appears to be still short of the needs of residents and far below the standard. That means, preference based public service provision has not fully realized hitherto to the extent that there are situations in which residents may not be provided with some basic services while they are willing to pay for. The disparity with regard to service provision along jurisdictions is also huge.

Heymans and Mussa (2004) quoted in World Bank report (2007:158) for highlighting a variety of challenges constraining the effort to realize viable decentralization in Ethiopia. Lack of clarity in expenditure and revenue assignments to different levels of government, lack of capital expenditure budgeting capacity at local level and absence of auditing systems that are adapted to decentralized systems are mentioned among the shortcomings that have negatively affected the outcomes of decentralization in Ethiopia.

The following factors are among the possible problems affecting the local public service provision activities of local governments:

- The huge gap possibly existing between the revenue generation capacities and expenditure responsibilities of the respective jurisdictions
- Absence of meaningful autonomy to set tax rates and hence to determine one's own revenue size
- Failure to earmark the tax collected to the service it meant to be allocated
- Disparities in economic activities and revenue-generating capacities across jurisdictions at the same level
- Ineffectiveness of the grant transfer arrangements to tackle the fiscal related challenges
- Absence well-qualified employees and lack of competent tax and expenditure administration and planning capacities
- Absence of well functioning mechanisms that ensures accountability and transparency and,
- Absence of incentives for revenue maximizing efforts are also worthy to mention here as part of the problem.

## 1.5. Research Questions

- Are the urban administrations under consideration providing their respective electorates with preference based public goods and services?
- Do the towns have appropriate level of fiscal powers and functions?
- Are the urban local governments exploiting all their revenue sources exhaustively?
- Do the urban administrations under consideration have the appropriate level of fiscal, political, and administrative autonomy?
- Are there appropriate intergovernmental grant transfer arrangements that can address both horizontal and vertical fiscal gaps effectively?

## 1.6. Objectives of the Study

### 1.6.1. General objective

Providing local governments with appropriate level of expenditure responsibilities and taxation powers as well as endowing them with the appropriate level and scope of autonomy so as to enable them provide their residents with preference based public goods and services is among the major objectives of decentralization. Therefore, the general objective of the study encompasses, to scrutinize the capability of the urban administrations of the study areas to provide their respective electorates with preference based local public goods and services, to identify the major constraints possibly affecting the services adversely and to come up with possible solutions to the problems undermines their capability with this regard.

### 1.6.2. Specific Objectives

- To assess the level and quality of services the urban administrations are providing and to check the level of satisfaction of residents in the two towns so as to identify the magnitude and seriousness of the problems the residents of the respective towns are facing with regard to urban public service provision,
- To assess expenditure and taxation powers assigned to the two towns under consideration so as to identify the level of their fiscal powers and autonomy as well as their capability to provide their residents with comparable and efficient local public goods and services,

- To evaluate the towns' revenue generation and expenditure trend and their overall fiscal performance with the aim to judge their fiscal administration, planning and implementation capacity
- To assess the accountability mechanisms in place and their impact on the provision of local public goods and services
- To find out the scope of the economic disparity between the two towns, the fiscal gaps the towns are facing and to scrutinize the mechanisms in place to tackle such fiscal challenges so as to identify their deficiencies
- To recommend some solutions to address the challenges the towns are facing in their effort to provide their residents with preference based local goods and services.

### **1.7. Research Methodology**

The study has been conducted using mainly qualitative research method. Quantitative method has also been used to some extent. The researcher employed comparative approach involving Chiro and Sebeta urban administrations fiscal powers and functions and their urban public service provision activities. Case studies that are conducted on clean water, education, and sanitation service provision activities in the two study areas are taken as the core of study process so as to answer the research questions adequately. The researcher chose these three local public services based on their financial sources in a manner it enables him to include the services that are being funded through each type of revenue sources available to the urban administrations. Descriptive method is used to present the findings and to deal with the research questions.

When it comes to data collection, the researcher used both primary and secondary data that are directly relevant to the study subject matter. Literature review from books, journals, and articles written on the issue is part of the study process with the aim to establish the basic principles and findings that are used as standard tools to analyze the relevant data and facts on the ground. The researcher assessed legal frameworks of fiscal decentralization at both the regional state and the Federal government level to show the foundation of the fiscal decentralization practices in urban administrations in Oromia Regional State in general in Chiro and Sebeta urban administrations in particular.

The researcher consulted also annual revenue and expenditure performance reports of the respective towns in a manner it shows the trends for some limited period with this regard. Field observations on selected local public good and service provision activities have also been conducted as part of the investigation to identify the factors affecting the service provision activities and the problems behind the failure to provide residents with preference based local public goods and services.

The researcher also conducted structured and unstructured interviews with 40 informants including officials and experts from finance and economic development, revenue, education and health offices of the two towns as well as from the respective municipalities. Experts from the education and finance and economic development bureau were also among the interviewees. Elders from the two towns are also interviewed as informants.

The researcher selected his informants based on the roles the institutions they represent are playing in the overall service provision activities of the towns. The researcher interviewed experts from different offices on anonymity basis to access information that are difficult to get from officials. The researcher held focus group discussions with residents and stakeholders that the local public services under consideration concern them as part of the study process. Members of the focus groups for each service under consideration are selected among the direct and indirect beneficiaries of the respective services and from those who have role in the service provision activities.

As mentioned before, the data and facts gathered throughout the process are analyzed descriptively based on the basic principles and findings compiled in the literature review in a manner it enabled the researcher to identify the factors and constraints affecting the provision of urban public goods and services in the two urban administrations. Comparative analysis also made on the revenue capacity difference between the two jurisdictions and its impact on their service provision capabilities.

### **1.8. Significance of the Study**

The researcher selected Chiro and Sebeta towns as the study areas because their difference in economic activities depending on their geographical location creates an opportunity to look into the fiscal decentralization impacts on local public service delivery under different circumstances.

In addition to that, since urban areas are not given that much attention in the effort to realize genuine decentralization to the grassroots level the findings of the study will be helpful to both solve relevant problems and conduct further researches.

The study has come up with conclusions and recommendations that can enable concerned bodies to be aware of the constraints that are capable of undermining the efficacy of fiscal decentralization with regard to local public service delivery in urban areas and possible remedies that can tackle the problems that are affecting the public service provision activities adversely.

### **1.9. Scope and Limitations of the Study**

The study focused mainly on the level and scope of fiscal powers and functions assigned to the urban administrations in Oromia Regional State in general and Chiro and Sebeta towns in particular as well as the autonomy (both political and administrative autonomy) they are endowed with to exercise these powers and functions as well as the challenges they are facing.

The study aimed at specifically to evaluate the capability of the Chiro and Sebeta urban administrations to provide their respective residents with preference based local public goods and services.

Among the major local urban public services, the study concentrated on education, potable water, and sanitation services so as to identify the main problems that are constraining the effort being made to provide efficient, adequate and quality services.

Scarcity of materials and financial resources; absence of willingness among selected informants to give the necessary information as well as absence of well-organized documentation of relevant data as well as planning and performance reports are the major limitations of the study.

### **1.10. Organization of the Study Report**

The study report is organized in five chapters. Concepts of the nexus between fiscal decentralization and efficient public service delivery, historical background of fiscal decentralization in Ethiopia, statement of the problem, objectives of the study, research questions and research methodology as well as scope and limitations of the study are parts of the first chapter of the study report.

Chapter two of the study report focused generally on the review of the related literatures while chapter three of the study report is devoted to the legal frameworks for fiscal decentralization in Ethiopia and the discussion on the legal frameworks.

The fourth chapter comprises the practice of fiscal decentralization in the study areas and the analysis on the detail practices of expenditures, taxation, intergovernmental transfers, and borrowing. The last chapter of the study report, which is chapter five, is dedicated to the conclusion and recommendation parts of the study report.

## Chapter Two

### 2. Review of Related Literatures

#### 2.1. Decentralization

Rondinelli is quoted (in Paulos, 2007:52) for defining decentralization as the transfer of powers and functions from the center to subordinate or quasi-independent government organizations and the private sector. Dafflon & Madiés (2011:6-7) note that the process of decentralization can be either top-down or bottom-up. They argued that top-down decentralization involves transfer of powers and functions, previously assigned to the upper level of government, to the lower levels and gives the former the chance to retain ultimate arbitration power. The bottom-up decentralization on the other hand is a federal structure in which priority is given to the lower levels of government and local governments hold substantial autonomy (Ibid).

To examine the real impacts of decentralization on urban local public service provision activities, it is important to look into its three major aspects: - administrative, political and fiscal decentralization.

##### 2.1.1. Administrative Decentralization

According to Falleti (2004:3), administrative decentralization has to do with transferring the authority to administer and deliver social services to lower levels of government. The World Bank on its part defines administrative decentralization as redistribution of authority, responsibility, and financial resources for providing public services among levels of government. According to the World Bank, the transfer of power and function through administrative decentralization include responsibility for planning, financing, and management of certain public functions. In this case, the central government and its agencies redistribute their authority to field units of government agencies, levels of government and semi-autonomous public authorities among others ([www1.worldbank.org](http://www1.worldbank.org)).

Among other things, the authority local governments have on human resource management is also part of administrative decentralization. According to Dillinger (1994:18) if local governments are to provide their services efficiently, they should have the authority to recruit,

retain, and motivate their staff. That is why Bahl and Bird (2008:2) also emphasized the need to endow local governments with the power to control their employees.

However, the practice on the ground varies based on the level and scope of the decentralization itself. That is why administrative decentralization found to have three major forms. That are - deconcentration, delegation and devolution.

### ***Deconcentration***

Deconcentration refers to an act of making, some services of the center, available at different jurisdictions without any transfer of decision power to lower levels of government. In the case of deconcentration, powers over certain decisions would be given to agents that operate in a given boundary while remaining under the hierarchical authority of the center. The main goal it generally aims at is improving the operational efficiency of the center at a given jurisdiction (Dafflon & Madiés, 2011:8).

The argument is that, in the case of deconcentration, the dispersed operation centers across regions are considered simply branches of the center with responsibilities to make the outputs of the decisions of the center nearer to the people rather than bringing the decision power itself to the grassroots level in a manner it enhances public participation. That means, deconcentration refers to delivery of some services of the center through non-autonomous branches. Therefore, it is clear that deconcentration by no means involves transfer of powers to lower levels of government. In other words, deconcentration does not allow authority to be exercised without direct involvement of the center; it rather symbolizes the direct presence of the center across jurisdictions. That is why it is argued that deconcentration is criticized for its inability to devolve decision-making authority to the grassroots level (Solomon, 2008:43).

### ***Delegation***

Delegation on the other hand refers to the transfer of powers and functions from higher to lower levels of government temporarily. According to Solomon (2008:43), delegation involves powers and functions that do not fall in the power jurisdiction of the delegated level of government.

Since the delegating level of government retain the right to revoke the powers and functions it delegated to other levels of government any time, the discretion to exercise the powers and

functions the delegated levels of government are endowed with remains with them only until it is revoked back by the delegating level of government.

However, until the delegated powers and functions to be recalled back, the delegated levels of government will have the autonomy to exercise them without any consultation with the delegating level of government. As much as delegation gives, the delegated levels of government, the autonomy to exercise the delegated powers and functions, it also keeps them accountable to the delegating level of government for the decisions they made to exercise the powers and functions (Ibid).

### ***Devolution***

Devolution refers to complete transfer of functions and powers to lower levels of government without any possibility to revoke them back. Dafflon and Madiés (2011:8) portrayed devolution as the most advanced form of decentralization and argued that it transfers powers and functions to local entities elected by their constituencies. In the same manner, Paulos (2007:53) argued that devolution is all about transferring of power to sub-national political bodies, which are accountable to their electorate. That means devolution endows lower levels of government with powers and functions that are believed to belong to them and it gives them legal guarantees to retain the devolved powers and functions for good and to exercise them with full autonomy within the limit of legally recognized level and scope.

As devolution involves endowment of lower levels of government with powers and functions, they deserve to own, it makes them free from being accountable to the higher levels of government in their decisions to exercise the powers and functions they are mandated with. Lindaman and Thurmaier (2002:919) claim that, "*providing sub-national governments with some degree of financial in-dependence from the central government is one of the most critical elements.*" of a devolution policy. As a result, Dafflon and Madiés (2011:13) Claimed, devolution is capable of matching local public services to citizens' preferences. Administrative decentralization in its devolution sense underlies most political decentralization ([www1.worldbank.org](http://www1.worldbank.org)).

### **2.1.2. Political Decentralization**

Political decentralization is all about devolving political power to units of government that are accountable to their electorates. Falleti (2004:4) argued, “*Political decentralization is the set of constitutional amendments and electoral reforms designed to open new or activate existing but dormant or ineffective spaces for the representation of sub national polities.*”

It is argued in the joint working paper of UNDP & the Government of Germany (1999:10) that if decentralization is to be successful and sustainable there should be political decentralization that involves the transfer of administrative, fiscal, and political power to the lower levels of government. In addition to that in democratic settings political decentralization consolidates political accountability (UNDP & the Government of Germany, 1999:20).

That means endowing local residents with full political right to elect local officials and lawmakers and hence allowing them to participate in policy and law making processes through their representatives will enhance accountability. The existence of such downward accountability by itself forces local officials to respond to the preferences of local residents, which in turn enhances welfare. This is because electing one’s own representatives from local electoral jurisdictions allows residents to be well aware of the representatives they elect and allows elected officials to know better the preferences of their electorates ([www1.worldbank.org](http://www1.worldbank.org)). That is why Bahl and Bird (2008:2) emphasized the need to endow local residents with the authority to control their governments.

### **2.1.3. Fiscal Decentralization**

Fiscal decentralization is all about giving away fiscal powers and functions among others to lower levels of government to enable them provide their residents with preference based and improved public goods and services. In fact, the real impact of fiscal decentralization on local public service delivery is determined by the level and scope of the decentralization.

It is the fact that sub-national governments are proximate to their residents that raises the hope; they can be responsive to the interests of their constituencies (Oates 1999:1120) by tailoring the outputs of the services they provide to the specific preferences and circumstances of their constituencies. Economic development, revenue mobilization, innovation in public service

delivery, accountability of public officials, local capacity development, and participatory governance system at grassroots level are also among the possible advantages that can be achieved through such form of government (Bahl & Bird 2008:2, Shah, 1997:11).

The most important issue that should be understood clearly once again is that, the physical proximity of local governments to their residents alone is not enough to make them responsive to the preferences of their respective residents. The level of fiscal autonomy devolved to and exercised by democratically elected autonomous local governments determines the level and scope of fiscal decentralization (Abu, 2013:7 & [www1.worldbank.org](http://www1.worldbank.org)).

If sub-national governments are to be responsive to the specific preferences of local residents and circumstances of their respective jurisdictions, they need to have considerable level and scope of fiscal powers and functions.

However, since there are also strong arguments against devolving significant fiscal powers and functions to the lower levels of government, there is a need to look in to the cases for both centralization and decentralization of expenditure responsibilities and revenue powers as well as the fiscal autonomy lower levels of government deserve to have. This is because these three aspects of fiscal decentralization have different implications for the status, role, and responsiveness capabilities of levels of government.

Generally, endowing local governments with appropriate level and scope of expenditure responsibilities, taxation powers and adequate fiscal autonomy will enhance their fiscal importance and hence their role in the provision of local public goods and services. Furthermore, such government units believed to have the opportunity to provide their residents with more preference based public goods and services by tailoring the outputs of the goods and services they provide to the specific preferences and circumstances of their respective jurisdictions.

Bahl and Linn (1992:386) listed three general arguments that favor fiscal decentralization:

- As the authority to determine the tax rates and expenditure mixes is brought closer to the people, the quality of the public service will improve and the satisfaction of the consumers will be increased.
- As citizens identify themselves more closely to their localities, stronger local governments will contribute a lot to nation building efforts.

- Fiscal decentralization enhance local resource mobilization, as local governments are in a better position to tax their fast growing economic bases easily than the higher levels of government.

Even though such empowerment of local governments is acceptable from local governments' point of view, there are situations in which such level and scope of fiscal decentralization is not acceptable especially to higher levels of government on different grounds including economic efficiency. According to Boadway & Shah (2009:31), the involvement of lower levels of government in different expenditure, taxation, and regulation activities may distort economic efficiency in internal common market. That means it may affect the free flow of products (services and goods) and factors of production (labor and capital) across jurisdictions.

Boadway and Shah argued, lower levels government might use taxes, subsidies, and regulations deliberately to benefit one's own residents at the expense of others (2009:31-32). Shah (1997:11) is of the opinion that such form of government "*is open to a great deal of duplication and confusion and may not be able to secure national unity*" in addition to its capability to cause distortion of internal common market. Bahl (1999:3) on his part argues that Fiscal decentralization has the potential to counter equalization efforts and it is difficult to tackle disparities along jurisdictions under a fiscal decentralized system

To address such problems, one may consider compromising the advantages of decentralization as an option, which Boadway and Shah regard as inappropriate. They rather proposes the unobtrusive use of spending power as a mechanism to balance between benefits of decentralization and distortions to the internal common market that can arise from decentralization (2009:33).

According to Boadway and Shah (2009:65), political, economic, and institutional characteristics of the country under consideration as well as the actual role that its sub-national governments supposed to play determine the degree and form of its fiscal decentralization. According to Bahl and Linn (1994:6-7) stage of development of a country, size of geographical area and threat of social upheaval are also factors that are believed to determine the level and scope of fiscal decentralization in a given country.

Bahl and Linn (1992:388) further explained that the case for fiscal decentralization is stronger in industrial countries than in low-income economies. Their argument is that, since the less diversified economies of developing countries are vulnerable to external factors especially to international commodity price fluctuations, wars, worldwide recession and natural disasters, stabilization is more important for them. However, Bahl and Linn (1992:12) investigated fiscal experiences of different countries, both industrial and developing, and found out that sub-national governments are of substantial fiscal importance in developing countries as well, even though their role is not as great as that of local governments in industrial countries.

In the same manner, Bahl and Bird (2008:4) also claim that in most developing countries higher levels of government are not in favor of devolving taxing powers to local governments for fear of macroeconomic instability, and shift of financial resources from infrastructure projects to consumption goods and services. That means infrastructure development and minimizing risks of macroeconomic instability are priorities for higher levels of government in developing countries, which in turn favor centralization.

Therefore, according to Bahl & Linn (1994:6-7), the level and scope of fiscal decentralization depends, among others on-

- i. The objectives it is supposed to achieve
- ii. The willingness of higher levels of government and their officials to give up power for the sake of empowering lower levels of government

The need to keep the balance between cases for centralization and decentralization is also the other factor that affects the level and scope of decentralization (Bahl & Linn 1992:470). This in turn needs doing informed analysis on fiscal experiences of countries with different circumstances and at different levels of development.

Litvack, Ahmad & Bird (1998:10) argued that if it is to consolidate accountability, there is a need to create strong link between cost and benefit in the local public service provision activities.

According to Bahl & Linn (1992:393-402), regardless of the amount of revenue local governments generate and expenditure they expend, their status to determine on their budgets and to set their taxes determine the level and scope of their autonomy. They are also of the opinion

that, the way local councils and chief administrative officers are selected and the definition of the powers of the councils and administrative officers determine level and scope of local autonomy (Ibid). The argument is that, whatever fiscal powers local governments have, if budgets and tax rates for local governments are required to be approved by state governments or to be carried out by state appointed officials, the level of intervention from state governments is likely to be pervasive, and the local fiscal autonomy will also be compromised equally.

The share of grant transfers allocated to the lower levels of government is also mentioned as among the factors that determine their fiscal autonomy (Blochliger & King, 2006:179). That means as the share of the grant transfer in the budgets of lower levels of government increases, their fiscal autonomy shrinks, as the discretion they have to determine on the grant transfers is insignificant.

To understand the level and scope of fiscal powers and functions lower levels of government need to be endowed with, one should look thoroughly into the basic principles behind the three major components of fiscal decentralization: Assignment of Expenditure Responsibilities, Tax Assignment, and Intergovernmental Grant Transfers as well as their implications.

#### **2.1.3.1. Expenditure Responsibilities**

Different levels of government assume different responsibilities for different reasons. The traditional fiscal federalism literature is known for allocating stabilization and income redistribution functions to the center and allocation functions to sub-national (regional and local) governments generally. Accordingly, the literature restricts sub-national governments from being in charge of functions related to economic stabilization because of their open economies, risk of free riding and budget deficit, which believed to constrain their capabilities to contain both negative and positive consequences of their fiscal decisions (Oates 1999:1121).

The literature is in favor of preventing regional and local governments not to involve in functions aimed at income redistribution. It is argued in the literature that allowing local governments to involve in local programs designed to redistribute income to low income residents will attract poorer people to the locality, while it encourages rich people to change their place of residence with a motive to avoid cost burdens that possibly emanate from redistribution programs (Ibid). This in turn obviously distorts resource allocation across jurisdictions. However, Dafflon

(2006:278) claim that moderate local redistributive programs are possible if psychological and social attachments to one's own jurisdiction are high. The argument is that rich people do not prefer to run away from the jurisdiction that they have strong social and psychological attachment with, just to avoid redistributive taxes.

When it comes to allocation functions in general, the literature makes lower levels of government the favorite choices to be in charge of them. Ahmad, Hewitt and Ruggiero (Ter-Minassian, 1997:25) claim that based on the benefit principle the provision of local public goods and services are considered to be the right responsibilities of local government units such as municipalities on administrative and allocative efficiency ground, as far as these services benefit residents of that particular jurisdiction only. According to Oates (1999:1122) since local preferences and costs of service provision activities are likely to vary across jurisdictions, the need to adapt the outputs of services to the particular local preferences and circumstances so as to maximize the overall social welfare gains is the strong reason behind assigning the responsibility to provide such services to local governments. If local officials, who are accountable to the local electorates, are authorized to determine on the provision of local public services they will have the incentive to provide the services based on local preferences (Abu, 2013:9).

The main point here is that, assigning of such functions to the center is inappropriate because, the center is too far away from the localities to have enough information about local preferences and other local specific circumstances and to provide the services in a manner they can satisfy residents of each locality.

The other argument for assigning local services to the unit of government closest to the people is that, providing public services efficiently is possible if it is performed by the level of government having control over the minimum geographic area that would internalize both the benefits and costs of the provision.

Shah (2007:9) claims that generally the capability of local governments to understand the preferences of local residents and to respond accordingly, the real possibility to eliminate unnecessary layers of jurisdictions and to enhance competition and innovation are the arguments behind assigning local services to the unit of government closest to the people.

Devolution of political power to different levels of government is also one aspect of decentralization that affects the decision making power of levels of government significantly and hence the level and scope of their expenditure responsibilities. Ekpo (Shah 2007:210) argues that if political power is devolved to different levels of government, there is a need to endow the levels of government with appropriate functions that they can perform.

That is why Shah (2007:15-16) argued that the constitutional and legal status of local governments determines their role in the provision of goods and services. He mentioned the situation in Brazil, where local governments are equal partners with the federal and regional governments and authorized to play extensive role in local public service provision activities. He also mentioned communes in Switzerland as the main source of sovereignty claiming that they have greater constitutional significance than the federal government itself, which gave them the potential to play extensive role in local service provision.

On the other hand, Shah explained, in federations such as Australia local governments are more of extensions of higher levels of government and allowed to play insignificant role in local public service provision activities (Ibid).

Bardhan and Mookherjee (2006:102) also argue that in the absence of contestability in local elections local officials will not have incentives to strive for improvement of public services and accountability, efficiency, and equity might be weakened under decentralization. That means unless local officials face risk of losing their position, they will not be encouraged and devoted to be responsive to the local preferences.

As contexts on the ground determine the role of lower levels of government in general and urban local governments in particular in the provision of public goods and services, in order to come up with effective expenditure responsibilities assignment principles, there is a need to assess trends and patterns of expenditure responsibilities of different levels of government in different countries.

According to the findings of Bahl & Linn (1992:17), common functions of urban governments in developing countries would appear to be markets, abattoirs, fire protection, street cleaning lighting, garbage collection, cemeteries, and minor public disease prevention services, provision

of potable water, education, sewerage, and drainage services among others. While telephone and electricity services are typically responsibilities of agencies of higher levels of government (Ibid). Ekpo (Shah 2007:210-211) on his part mentioned geographic range of spillover effect and economies of scale, as factors that might influence the allocation of functions between different levels of government. With respect to spillover effect, he argued that each function should be performed by the level of government that coincides in size with the group of people that can be benefited from the function. He also explained that where there is a possibility to provide the service in a cost-effective manner, the function will be assigned to the level of government where it can be performed more efficiently cost wise.

Shah (2007:13) argued that the provision of some goods and services might also require the involvement of both the higher and lower levels of government to correct fiscal inefficiencies and inequities arising from differences in fiscal capacities across different jurisdictions. As decentralized political jurisdictions and economically optimal areas might not coincide most of the time, fiscal instruments designed to correct spillover effects so as to maximize benefits from economies of scale and related conditions attached to it are also other factors that initiate involvement of different levels of government in the provision of a particular service simultaneously. The need to realize minimum standard at national or regional level is also requires involvement of levels of government in a particular service provision activity.

Bahl and Linn argued further, overlapping responsibility also occurs when one level of government takes the responsibility to oversee what the other level does. They claim also that arrangement in which national or state-appointed civil servants carry out local government functions is also another scenario that leads to overlapping responsibility of different levels of government (Bahl and Linn, 1992:17-23).

Accordingly, Bahl and Linn (1992:17) also found out in their analysis that cities in almost all developing countries are facing overlap of expenditure responsibilities of local, state and national governments. That means the three levels of government often involve in the provision of a particular service within an urban area. Shah (2007:13) is also of the opinion that many major services are suitable to be assigned as concurrent responsibilities of different orders of government. Nevertheless, they claim, there is a need to specify the role of each level of

government in a specific expenditure responsibility as clearly as possible so as to avoid duplication and confusion as well as to ensure accountability to the electorate, and he emphasized the necessity of such precise specification for infrastructure and social service provision in developing countries (Ibid).

According to Bahl and Linn (1992:17-23), the role of different levels of government in a particular service provision activity in an urban areas depends based on the intergovernmental arrangements in place to coordinate the involvements of each level of government. That means, they explained further, in some cities agencies of the different levels of government provide the services together, whereas in others different levels of government themselves appears to share the responsibilities of providing the services.

### 2.1.3.2. **Revenue Assignments**

Taxes, user charges and fees as well as intergovernmental transfers and access to capital markets are possible sources of revenue available for lower levels of government including urban local governments to finance their expenditure decisions. However, since tax assignments have other consequences beyond their function as revenue sources, it is difficult to allow levels of government to access different revenue sources freely. That is why putting in place fiscal arrangements that favor proper assignment of tax powers to different levels of government appears to be necessary.

Before discussing the principles and rationales behind tax assignment arrangements, it is important to find out what sub-national (regional and local) tax means. According to Bird (2011:6), sub-national taxes give the level of government they are assigned to the following discretions: The freedom to levy the tax or not, the authority to determine the tax base, to set the rate and to administer the tax as well as the right to own and to expend the revenue it generated.

However, Bird (2011:8) claims also that in relation to the need to realize accountability, the most important point for regional and local governments is to have the discretion to set tax rates and hence to determine the size of the revenue they raise and to be responsible to their residents for doing so.

To come back to the assignment problem, in some countries, high level of decentralization of taxation power appears to be suitable while centralization is preferable in others depending on the

contexts on the ground including the role lower levels of government supposed to play in the sub-national expenditure activities and objectives intended to be achieved through the fiscal arrangements.

Since the traditional literature allocates redistribution and stabilization functions to the center, it is understood that the related taxes are meant to follow these functions and assigned to the center. That is why the traditional public finance literature takes efficiency, equity, and stabilization functions, into consideration to allocate taxation powers among different levels of government.

Norregaard (Ter-Minassian 1997:53-54) referred to the literature on fiscal federalism and local government finance for suggesting centralization of taxes aimed at income redistribution or economic stabilization as well as taxes on tax bases that are mobile and unevenly distributed across jurisdictions. The argument is that if mobile tax bases and taxes targeted at income redistribution or economic stabilization are to be devoted to lower levels of government, inefficient tax competition is likely to happen between jurisdictions and hence rich people and other economic factors will have the incentives to move from high to low tax rate areas. It is also obvious that migration of rich people and other economic factors has the potential to cause inefficient resource allocation across jurisdictions.

Furthermore, if lower levels of government are allowed to own and exploit most of, if not all, elastic sources of revenues and tax bases that are unevenly distributed across jurisdictions, fiscal inequities between jurisdictions at the same level will be aggravated and, residents of poor jurisdictions will be vulnerable to under-provision of services. In addition to that, economic development policies, that focuses on infrastructures with national benefits, also favors centralization of potent tax bases, as it is believed that the taxation of potent tax bases at lower levels of government may also result in scarcity of capital for infrastructure investments of national benefits.

In the same manner, Bird (2011:3) also mentioned what he called the three standard sub-national tax assignment principles summarized by Oates:

1. Sub-national taxes on mobile economic units should be related to benefits received by the economic units to be taxed

2. Redistributive taxes on mobile economic units should be imposed only by higher levels of government
3. Sub-national non-benefit taxes should be limited to immobile economic units.

What one can understand from this argument is that, the room left to sub-national (regional and local) governments to access taxes on mobile economic factors and to exploit taxes targeted at income redistribution is very limited.

On the other hand Bird (2011:4) criticizes the public finance literature emanating from Musgrave (1959) and Oates (1972) for endowing lower levels of government with taxation powers that do not match their expenditure responsibilities even if they control sub-national expenditures because, it considers them almost as decentralized service providers with their role limited only to allocation functions. Therefore, one can argue that the traditional tax assignment model leaves lower levels of government without any significant taxation powers and forces them to be viewed almost as agents that implement decisions of the higher levels of government.

In addition to the importance of endowing local governments with appropriate level of fiscal powers and functions, fiscal autonomy and accountability mechanisms are also other factors that can affect responsiveness of local governments to their residents because fiscal autonomy and accountability determine the level and scope of fiscal decentralization itself. That is why Lindaman & Thurmaier (2002:919) as well as Bahl and Linn (1992:386) claim that providing lower levels of government with some degree of fiscal autonomy is one of the most vital elements of a devolution policy and an integral part of genuine decentralization.

In fact, there are arguments that emphasize the acceptability of limited fiscal powers assigned to local governments. Norregaard (Ter-Minassian 1997:53) claims that limiting the role of lower levels of government in local fiscal policy would not appear to be serious as far as they are responsible to implement policies of other levels of government. Their inability to set their tax rates and hence to determine the size of their revenue appears to be a serious problem only if they are meant to implement their own local policies (Ibid).

But, as far as local governments have significant role in expenditure activities, the need to associate the level and scope of their taxation power with the level and scope of their expenditure responsibilities and hence to endow them with the appropriate level of fiscal autonomy is among

the major fiscal arrangement arguments that need to be given the due attention. This is because; the absence of meaningful taxation powers has also its own impact on the fiscal autonomy of local governments, which in turn possibly undermines their capability to respond to local preferences and circumstances.

Bahl and Linn (1992:32) argue that the greater power local authorities have to raise revenues from local sources, the more autonomous they will be to determine their expenditure areas. Unless lower levels of government are mandated with meaningful taxation powers that enable them to set at least tax rates, their autonomy and hence their accountability to their respective constituencies will be compromised in one way or another. The main point intended to make here is that, unless lower levels of government are allowed to set their tax rates and to determine the level of the revenue they generate, they will never be in a position to adjust their service provision with the real preferences of their respective residents and the circumstances on the ground. Local residents also cannot question and make local authorities accountable for unsatisfactory service provision, if local authorities do not have the power to set tax rates and to collect taxes directly from them. Bahl and Cyan (2010:29) are also of the opinion that lower levels of government are not passionate about accountability that accompanies taxation powers.

Thus, the strong cases for both centralization and decentralization signify the need to come up with compromised assignment of fiscal powers that balances between the cases of centralization and decentralization. That means there is a need to endow different levels of government with taxation powers that enable them generate the revenue they need to finance their expenditure decisions from local sources without causing any significant distortions to resource allocation and economic stabilization. With this regard, Bird (2011:8) argued that the traditional model failed to pay attention to the political and fiscal conditions within which politicians and authorities operate. That is why the second-generation assignment model is emerged.

According to the second generation assignment model, Bird insists, the appropriate way to assign taxation powers depends on the assignment of expenditure responsibilities and hence the more expenditure responsibilities allocated to a given level of government the greater autonomy it need to has over its revenue sources (Ibid). He claims also that if governments at any level are to respond to the preferences of their respective residents responsibly, they should be able to increase or decrease their revenue and hence their expenditure (Bird 2011:9). That means, they

should be autonomous enough to determine the level and mixture of goods and services they provide so as to respond to the preferences of their residents and to the specific circumstances of their respective localities and hence to ensure accountability.

Accordingly, Shah (2007:20) mentioned four general principles (two of them are from the first generation), which he claims require consideration in assigning taxation powers to different levels of government: 1. Economic efficiency, 2. National equity, 3. Administrative feasibility, and 4. revenue adequacy or fiscal need. He explained that economic efficiency and national equity objectives require assignment of taxes on mobile economic factors and taxes targeted at income redistribution to national governments so as to prevent distortions related to resource allocation across jurisdictions. Among the above principles, weak administrative capability of lower levels of government gives a leeway to block tax decentralization (Bahl and Cyan, 2010:30).

Shah (2007:20) claims also that own revenue of levels of government should be matched to their expenditure responsibilities as closely as possible so as to realize revenue adequacy. He is also of the opinion that long-lasting assets should be financed through borrowing so as to distribute the burden of the cost across generations. According to Shah, the case for administrative feasibility also requires the assignment of taxes to the levels of government where they incur minimal compliance and administration costs (Ibid).

Furthermore, Shah tried to sort out detailed considerations that should be made to identify tax bases that are suitable to be assigned to local government units. With this regard, Shah (2007:24) argued that local governments should not finance their redistributive programs using self-revenue sources. He also emphasized the need to associate different local revenue types with benefits received and to devote them to the relevant services. That is, services with public goods characteristics such as street lighting and road services should be financed through local taxes. User charges should also be associated with and devoted to services with private goods characteristics such as water, sewerage and solid waste removal services among others (Ibid).

To summarize what second-generation tax assignment model emphasizes on, Bird (2011:13) insists that if local governments are not assigned with significant expenditure responsibilities they do not need to be mandated with taxation powers more than that prescribed by the traditional

model. If otherwise, he argues, they need to be assigned with adequate revenue sources comparable to their expenditure responsibilities and it is also important to give sub-national governments discretions to determine their own revenue at the margin in a manner it is meaningful both politically and economically. He explained further that if it is to realize efficient, effective, accountable, and sustainable decentralization, lower levels of government should be endowed with the authority at least to set their tax rates.

When applying these principles, other factors such as the level of development of the country, the tax assignment arrangement is designed for, is also need to be looked into thoroughly, as such contexts affect the real consequences of assignment of different taxation powers to different levels of government. That is why Bahl and Linn (1992:210) argued that local governments in developing countries can impose productive set of non-property taxes such as excises and narrowly based income and sales taxes. Bahl and cyan (2010:28) also consider residence based personal income tax, payroll tax, and property tax as the best choices to be assigned as local taxes. However, according to Bahl and Linn (1992:210), there is a need to structure and combine these taxes in consistent tax system that meets economic efficiency, fairness, revenue performance, and low administrative cost objectives.

However, evidences show that most of the time the practice on the ground does not comply with the principles discussed above. According to Bird (2011:10-11), in most emerging economies, tax assignment to lower levels of government is determined by the discretion of higher levels of government. Hence, the lower levels of government are mandated to levy taxes or user charges, which are too small to bother with and taxes which are difficult to levy at higher levels of government such as property taxes among others.

Bahl and Linn (1992:209) argued that in most cities, the structure of non-property tax is also obsolete to the extent that it is not fit to the purpose anymore, as the context in which it was designed is changed and they mentioned absence of comprehensive tax reform as one of the reasons that allowed the problem to persist. They argued also that local governments lack good alternatives when they carry out reforms, as higher levels of government have preempted the use of most, if not all, of the more productive taxes such as broadly based income and sales taxes.

To come up with more efficient tax assignment arrangement and to solve the existing problems, first it is important to scrutinize the nature and impact of each type of taxes based on the basic principles of tax assignment and experiences of different countries discussed above.

### *User Charges*

User charges are payments individual residents entitled to pay for services they receive from the level of government authorized to provide them. User charges are favorable revenue sources to finance local urban services as far as the services are confined to individual consumers and no related distortions in income distribution (Dillinger 1994:26). It is also believed that user charges can be structured in a manner they can help to meet revenue adequacy, efficiency, and equity objectives (Bahl & Linn 1992:470).

That is why Dillinger (1994:26) claims that besides its function as a means to finance local services, user charges can also be used as a means of rationing consumption among consumers according to willingness to pay and to extract information about the consumer preferences from the consumer itself. However, it should be clear that, user charges could be used to achieve the objective mentioned above through well-designed pricing mechanisms. Therefore, pricing of user charges and its implications for service provision are among the issues that should be discussed here.

Price for a given public service is said to be efficient if it is set to be equal to the marginal cost of producing the service. Because, welfare is maximized when the benefit the consumer gets from additional unit of service is equal to the cost incurred to produce the additional unit of the service (Bahl & Linn 1992:241). Bahl and Linn (1992:242) argued that, when the price is above the marginal cost, reduction in price appears to be the appropriate measure to realize an increase in net benefits by encouraging additional consumption because it will increase total benefits by more than total costs. They are also of the opinion that, when the price falls short of the marginal cost, the net benefits can be increased by raising the price and hence reducing consumption, as increase in price forces consumers to reduce their consumption so as to maximize their net benefit.

Short and long run marginal cost concepts and their role in maximizing the net benefits of consumers are also important issues need to be discussed here. Short run marginal cost is

incurred when additional unit of service is produced while the production capacity is kept constant. Whenever there is excess capacity the charge for consuming additional unit of service should be low because the marginal use of excess capacity imposes virtually no opportunity cost (Ibid).

According to Bahl and Linn (Ibid), when the existing capacity is fully utilized the price should be set in a manner it can adjust the demand for the service to equal the production capacity. Such price rationing appears to be preferable to other types of rationing because it saves administrative costs and avoids losses related to overcrowded public facilities.

The role of marginal cost pricing in guiding investment in expansion of production capacity is also another issue worth to discuss here. When extension of capacity is feasible only in lumpy stages, investment in new capacity will be appropriate if consumers are willing to pay the long run marginal cost of capacity expansion (Bahl & Linn 1992:243).

In the same manner, Bahl and Linn (1992:476) also claim, "*the recovery of urban service costs from beneficiaries, can contribute to an improvement to resource allocation within and between urban areas.*" They are also of the opinion that, this mechanism can promote equitable urban growth and it helps to minimize especially windfall benefits resulting from public investments. According to Bahl and Linn, as windfall benefits are likely to be appropriated by high-income people in the form of increased property values through general revenue financing, it is possible to recover the cost in the form of benefit charges on property owners that are benefiting from increased property values.

However, according to William Dillinger (1994:27), in developing countries the level of charges consumers required to pay for the services they receive is far below the cost incurred to provide the services. He also mentioned, making the services dependent on subsidies and restriction on the level of charges by higher levels of government on distributional grounds as part of the constraint. In his opinion, one cannot realize poverty reduction effectively through subsidizing services like water supply and such subsidies are inefficient as they benefit non-poor consumers unfairly and encourage over consumption of services.

Bahl and Linn (1992:310) argued that self-financing urban water services have many advantages. Sense of fairness that can emanate from paying for the service received and avoidance of possible

distortions in resource allocation that can arise from generating additional revenue from other sources to finance water services are among the advantages of self-financing of water services. They claim also that strengthening budget certainty and planning efficiency by avoiding the need to rely on transfers from higher levels of government and strengthening fiscal autonomy and encouraging appropriate service standards are among the reasons that make self-financing of water services important in urban areas.

### *Property Taxes*

Property tax is a tax that property holders supposed to pay based on different arrangements. According to Bahl and Cyan (2010:15), property tax fulfills many of the formalities to qualify as good local tax and the broadness of its base. They argue also, its productivity, its stability over business cycles and the correspondence between the tax and the benefits received from services financed by the tax except for some situations, are among the factors that make property tax a good local tax.

Shah (2007:20) also claim that property, land and betterment taxes are suitable to be assigned to local governments as local governments are in good position to assess the market value of such assets. That means, the better knowledge base local governments likely to have to asses property values and the better motivation they have to collect the tax compared to higher levels of government make local governments the right level of government to own property taxes (Bahl & Linn 1992:473). Property tax is believed also to be among the few sources of local revenue that can finance significant share of urban expenditures (Bahl & Linn 1992:474). Norregaard (in Ter-Minassian 1997:55) also claims that revenue from property taxes can also be predicted more accurately than that of income tax and hence it is advantageous for local governments to plan their expenditures on time.

Bahl & Linn (1992:81) argued that in a situation where the fiscal system is highly centralized or local expenditure responsibilities are financed mostly through locally raised non tax revenues or through grants and shared taxes as well as when property taxes are collected at the center and shared to local governments, property tax will be less important local tax. However, where local taxes are the major sources of revenue to finance local services, property tax will be important revenue source.

There are also factors that undermine the suitability of property taxes for local governments. Its high administrative cost and its unpopularity with voters are among the factors that undermine its suitability (Bahl & Cyan 2010:15). However, Norregaard (in Ter-Minassian 1997:55) believes that as far as there is consistent and frequent registration of properties with updated values, administration costs of property taxes are generally lower than that of income taxes.

Regarding utilization of property tax bases in developing countries, Bahl and Cyan (2010:15) argue that the revenue potential of property tax is well above the amounts now being collected in most developing economies. They mentioned delays in revaluation, which lowers income elasticity of the tax and its unpopularity among elected officials as the major reasons for unproductive pattern of the tax in developing countries.

Bahl and Linn (1992:472-473) are also of the opinion that, even though property tax is the most common and the most important of the taxes collected by local urban governments, its productivity is not showing improvement with the growth of urban incomes and property values. Lack of adequate assessment practices and professional expertise for valuing properties, absence of organized database to support assessment and enforcement as well as taxpayers' resistance are mentioned as among the problems that are believed to constrain the improvement of productivity of the property taxes (Bahl & Linn 1992:474).

These constraints are also believed to have their own sources. Limited technical and administrative capacity, uncertain land ownership and tenure conditions as well as interferences from higher levels of government to limit the use of or the rate of property taxes are among the sources of the constraints mentioned above (Ibid).

According to Norregaard (Ter-Minassian 1997:60), the unpopularity of property taxes may also be associated with infrequent updates of values because it may result in abrupt and large increase of tax liabilities when updating actually takes place. Therefore, to exploit the potential of property taxes effectively it is argued that there is a need to put in place reliable urban property registration and property tax valuation lists so as to update them regularly and to bill and collect the tax effectively (Bahl & Linn 1992:474). They are of the opinion that also, it is advisable to introduce value and tax improvements gradually and fairly in order to make the tax politically

acceptable and it should be complemented with an effort to educate the people so as to create awareness on the nexus between the tax and the provision of essential urban services (Ibid).

As it is mentioned in the discussion about user charges above, some consider property taxes to be guided by benefit principles, as local expenditures appear to increase the value of local properties (Norregaard; in Ter-Minassian 1997:55). This argument makes sense when one looks into the impacts of the provision of infrastructures such as roads in urban areas on the values of residential and other buildings. According to Norregaard, some of the property taxes can be levied on businesses and it can be considered as a benefit tax as far as the businesses are benefited from local services such as roads (Ibid). However, as it is mentioned above, it needs awareness creation among business owners about the link between the taxes they are entitled to pay and the benefits they are getting from services financed through such taxes if such taxes are to be acceptable.

#### *Local Income Taxes*

To begin with, personal income taxes are known for their potential to generate substantial amount of revenue. However Norregaard (Ter-Minassian 1997:61) argued that the main disadvantage of local income taxes as the main local revenue sources is that, high tax threshold excludes many local services consumers from being eligible to the taxes which possibly creates free rider problem. However, he mentioned that in some cases scheduler income taxes could be used by local jurisdictions without difficulties particularly if the taxes on such bases are going to be withheld at source.

Norregaard is of the opinion that the more the country is developed, the greater the possibility that individuals can receive revenues from different sources in different jurisdictions and hence the more difficult it will be for local governments to get the information that enables them to collect the taxes effectively. As a result, he argues, under such circumstances, countries may prefer to use a global income tax system in which the revenues received by an individual from different sources added together and the tax liability is adjusted accordingly. He believes also that to avoid the risk of tax evasion resulting from possible absence of adequate information on the revenue received from different jurisdictions, it is better to leave a global income tax base at the center (Ibid).

However, in the case of poor countries, the possibility for residents in a given locality to generate revenue from different jurisdictions is minimal and hence one can have a good reason to recommend local income taxes to be included in own revenue sources of local government units.

Regarding effects of local income taxes on efficiency, Bahl and Linn (1992:212) argued that there are possibilities in which local income taxes may affect the allocation of resources in urban areas. They are also of the opinion that if the tax is to be levied only on wages in the formal sector, employment in that sector will be discouraged, pretax wages will tend to rise, and a more highly capital-intensive development will be favored. Nevertheless, they argued that the level of the tax rate, the possibility for capital-labor substitution in the modern sector, and factor mobility between the modern and traditional sectors are the factors that determine the effects. Taking the possible low tax rate and low elasticity of factor substitution in the formal sector in developing countries into consideration, they concluded that effects of local income tax increases are likely to be quite marginal in such countries.

Mobility of individuals and firms from high to low tax areas is the other concern raised by Bahl and Linn. But, Wasylenko and McGuire (1985) are quoted in Bahl and Linn (1992:213) for arguing that as the less variation in the tax rate among local governments in low economy countries limits occupational and jurisdictional mobility of the labor force, mobility of individuals and firms is not likely to be of as much concern in developing countries.

Hammer and Linn (1987) (in Bahl & Linn 1992) also claim that in the case of developing countries, local taxes are not influencing the choice of location of businesses either. Based on the above arguments Bahl and Linn (1992:13) concluded that the insignificant variation in tax rates across jurisdictions and the limited factor substitution trends in developing countries compel the magnitude of any distortions of resource allocation likely to be inconsequential.

Administrative cost can also be another concern that can hamper the productivity of local income taxes, as local governments lack the necessary skilled workforce to assess and collect the tax properly (Bahl & Linn 1992:217). However, this is also not a challenge without a solution as well. Bahl & Linn argued that an arrangement that coordinates local income taxes with the higher levels of government taxes could be used as effective solution to overcome the administrative challenges. They suggested also, defining the local income tax as surtax on the higher levels of

government tax and leaving the administration to the higher levels of government as the easiest procedure to consider (Ibid). In general, Bahl & Linn (1992:474) argued, local income tax can be integrated in to local revenue structure if tax competition between higher and local authorities is avoided and viable coordination is established.

### **2.1.3.3. Intergovernmental Transfers**

Horizontal fiscal imbalances and vertical fiscal gaps are among the deficiencies that can emanate from different levels of fiscal decentralization and lead to different inefficiencies across jurisdictions. As horizontal fiscal imbalances and vertical fiscal gaps are likely to affect the level and scope of fiscal decentralization and fiscal autonomy of levels of government, they are among the issues that should be given the due attention and discussed here.

#### *Vertical Fiscal Gap*

Vertical fiscal gap is considered as the revenue deficiency originating from a mismatch between expenditure needs and revenue means of sub-national governments (Shah 2007:28). Abu (2013:10) explained that vertical fiscal imbalance arises from allocation of functions with the cost of provision exceeding the own revenue of local governments while Shah (2007:28) mentioned inefficient tax competition between sub-national governments and lack of tax room for sub-national governments arising from heavier tax burdens imposed by the center as additional source of vertical fiscal gaps.

Bahl and Linn (1992:471) believes that urban governments' insignificant taxation power, which is usually restricted to income inelastic revenue sources such as property taxes, specific excises, fees, fines and intergovernmental transfers is the primary source of the vertical fiscal gaps related to misallocation of expenditure responsibilities and revenue means. That means highly decentralized expenditure responsibilities and centralized taxation power assignments are likely to create huge vertical fiscal gap. They recommended also more attention to be given to efforts to deal with vertical fiscal gaps that have their origins in misallocation of revenue and expenditure responsibilities as well as to address those fiscal gaps arising from inefficient tax competition and lack of tax rooms for sub-national governments (Ibid).

To deal with such vertical fiscal gaps, Shah (2007:28,29) recommends reassignment of responsibilities, tax decentralization or tax abatement by the center and tax base sharing as a first

option and revenue sharing or formula based unconditional transfers as a last resort as the latter options undermine accountability to local taxpayers. Bahl and Linn (1992:473) on their part argue that levying user charges and financing major urban infrastructures through borrowing are more promising avenues to deal with the problem and they claim that the chance to address the problem through increased tax authority and intergovernmental transfers is limited because of fiscal constraints at higher levels of government.

However, they did not deny that local tax capacity and effort could be strengthened through careful design and application of certain higher-level interventions. They are also of the opinion that the higher level of government should capacitate local governments to use their tax authority and minimize interventions that undermine local efforts (Bahl & Linn 1992:473).

Bahl & Linn (1992:471) mentioned also the demand for high standard services which are not compatible to an urban economy as additional factor in which fiscal gap may have its origin and recommended assessment of the resource constraints under which local economies operate more accurately as the best approach to provide public services that are accessible to more people.

#### *Horizontal Fiscal imbalances*

Horizontal fiscal imbalances refer to fiscal disparities along jurisdictions at the same level and have their origin in differential sub-national capacities. Horizontal fiscal imbalances are known to find their sources both in revenue and expenditure sides of the budget. Watts explained that if there are differences in tax capacities across jurisdictions there will be per capita tax revenue difference (Watts & Hobson, 2000:24). The difference in per capita revenue in turn will result in difference in net fiscal benefits.

According to Shah (2011:29), the difference in net fiscal benefits received by residents of different jurisdictions arising from devolved decision-making leads to fiscal inequity and inefficient resource allocation. Shah explained that fiscal inequity concerns with differential treatment of citizens with identical incomes depending on their place of residence, while inefficient resource allocation arises from relocation decision of people due to the difference in gross income.

Ahmad and Craig (Ter-Minassian 1997:76) claim that horizontal fiscal imbalance can be dealt with mostly by equalization transfers from the center and sometimes between regions and

income redistribution elements embedded in conditional grants are also used to achieve equity objectives in the absence of equalization framework. According to McMillan (Shah, 2008:276) transfers aimed at gap closing and equalization normally fall into the unconditional category of grants. Shah (2011:29) is also of the opinion that, “*the more decentralized the tax system is, the grater the need for equalizing transfers.*” However, he argued also, if equalizing grants are to eliminate the differences in net fiscal benefits, it should depend on relative tax capacities and relative needs for and cost of service provisions of the grant receiving jurisdictions. He claimed also, economic factors mobility across jurisdictions and distortions related to economic wellbeing of disadvantaged jurisdictions as well as transfer dependencies are among unwanted consequences that can be resulted from equalization programs especially if they are generous (Ibid).

Therefore, to address such unwanted consequences and to maximize the gains from fiscal decentralization there is a need to put in place appropriate intergovernmental transfer systems compatible to the respective fiscal circumstances on the ground.

Intergovernmental transfers are among the major mechanisms to finance expenditure decisions of lower levels of government in general, local urban governments in particular. They are also ideal tools for higher levels of government to retain the authority to control and tax the most potent revenue sources while keeping part of the revenue to reach lower levels of government through different intergovernmental arrangements. Shah (2007:28) argued that higher levels of government use fiscal transfers to achieve national and regional efficiency and equity objectives and he mentioned six broad objectives.

- Bridging vertical fiscal gaps, which requires revenue sharing or unconditional formula based transfers as a last resort;
- bridging horizontal fiscal imbalance, which designed to address fiscal equity concerns through equalization transfers;
- setting national minimum standards, which uses conditional non matching grants and imposes conditions on attainment of standards in quality, access and level of services
- compensating for benefit spillover, which uses matching conditional grants

- Influencing local priorities, which requires matching transfer with matching rate that varies inversely with the recipients fiscal capacity
- Dealing with infrastructure deficiencies and creating macroeconomic stability in depressed regions, which requires providing capital transfers

The arrangements that constitute the design for a given intergovernmental transfer system will be directly influenced by the different mix of objectives the higher levels of government intended to achieve through the transfer system itself (Shah 28-31). Therefore, it is obvious that, all intergovernmental transfers accommodate specific interests of the higher levels of government in one way or another. This is because situations on the ground and objectives that higher levels of government intend to achieve in relation to the situations on the ground are the major factors that determine the mix of arrangements of intergovernmental transfers.

The intergovernmental transfer designed for one purpose may also result in some other unwanted consequences. For instance Ahmad & Craig (Ter-Minassian 1997:74) claim that as vertical fiscal gaps may possibly be affected by individual policy choices, an intergovernmental transfer designed to correct only the vertical gap may not encourage recipient jurisdictions to manage their resources efficiently and to increase their revenue and hence it may result in some unwanted consequences such as macroeconomic instability. Therefore, to put in place effective intergovernmental fiscal transfer system that can live up to its objectives, there is a need to take, such unwanted consequences, into consideration as part of the effort.

Intergovernmental transfers can be categorized into two broad categories: conditional and unconditional grants (Litvack, Ahmad & Bird, 1998:12). As their name indicates, conditional (specific purpose) grants refer to grants attached with some kind of preconditions the grantor wants to achieve or they may require attainment of certain results in service delivery, whereas unconditional (lump sum) grants refer to grants without any preconditions attached to them (Shah 2007:25). With regard to their implications, Shah argue that if conditional grants are output based (if they require attainment of certain results in service delivery) they can achieve the grantor's objectives while preserving autonomy of the recipient. However, if it is input based, it undermines autonomy and likely to be unproductive. He claims also that unconditional grants preserves local autonomy as it gives discretions to the recipient levels of government to decide where to spend the grant without any influence from the granter (Ibid).

Intergovernmental transfers should consider some important issues so as to ensure equity and efficiency of local public service provisions and to avoid distortions with regard to fiscal situations of recipient levels of government. Clarity in grant objectives, autonomy, revenue adequacy, predictability, equity, transparency and simplicity are among the issues that need to be given the necessary attention in the effort to design viable intergovernmental transfer arrangement that can live up to its objectives (Shah 2007:26-27). That is why there is a need to have more detailed categories of intergovernmental transfer arrangements as much as possible.

To have the proper intergovernmental transfer mechanism in place, two issues need to be decided first. The method of determining the size of the divisible pool and the method of determining the distribution among the lower levels of government are the two issues that need to be decided in advance (Bahl & Linn 1994:6).

Bahl and Linn argue that the current practice in developing countries with regard to the options to determine the size of the divisible pool suggests, there are three basic approaches. They explained that a specified share of national government tax revenues, an ad hoc decision, and reimbursement of approved expenditures are the options available to decide the size of the divisible pool (Ibid).

There are also four different options to share the divisible pool among the local governments. Returning shares to the jurisdictions from which the taxes are collected, sharing the pool using formula, ad hoc decision, or reimbursement of approved expenditures are the four options that can be used as alternative mechanisms to determine the system of allocation among the local governments (Ibid).

#### *The Pure Shared Tax*

The pure shared tax is an intergovernmental transfer arrangement in which, both the divisible pool and its allocation among jurisdictions are determined based on derivation based shared tax principle (Ibid). It means, a specified portion of the revenue generated from shared tax bases will be returned to the jurisdiction from which it is collected. It is also possible for lower levels of government to collect the revenue from the shared tax bases and transfer the share of the higher levels of government as far as they have the necessary capacity to do so.

Bahl (2000:9) claims that, the derivation based tax sharing is practiced widely among developing and transition countries, and there is much diversity in the taxes shared and the rating of the share. In many countries where derivation based sharing mechanism is in place, local governments are allowed to access the more productive tax bases through derivation based shared tax arrangements (Ibid).

However, denying local governments an access to such potent revenue sources is also possible with the same system. Excluding the most productive and income elastic tax bases from the shared tax domain and lowering the size of the share, the lower levels of government entitled to receive are the only measures that should be taken to do so. This indicates, pure shared tax arrangement can be used as a tool for both decentralization and centralization.

The more the shared tax domain comprises productive and income elastic tax bases, the larger the size of the revenue the recipient jurisdictions will be entitled to receive and hence the more decentralized the system will be as well. The system will be more centralized otherwise. The political power of different levels of government will also determines the extent of the inclusion of productive and income elastic tax bases in the derivation based shared tax domain, and hence the extent of decentralization is also to be influenced in the same manner.

Bahl claims that, in many countries derivation based tax sharing arrangement considered to be an effective tool for local governments to access productive tax bases such as VATs, company and individual income taxes. Some of the productive excises have also been included in the sharing base, which does not seem to work everywhere for reasons to be discussed after a while (Ibid).

According to Bahl, many countries share revenues from potent taxes, such as consumption and income taxes, between levels of government to strengthen fiscal position of their local governments. However, he argued that, some taxes are more suitable for derivation based tax share arrangement than others are, and mentioned VAT as one of unsuitable choices to be included in the shared tax domain in most developing and transition countries (Ibid).

According to Bahl (2000:10), company income tax also mentioned as unsuitable to be included in the derivation based sharing because it is cyclically unstable and susceptible to national industrial policy, ablation of company profits across all over jurisdictions, where companies do businesses,

is also the major reason that makes company income tax unsuitable for the derivation based tax sharing domain.

As opposed to VAT and company income tax, individual income tax is more suitable for derivation-based tax sharing arrangement, because its burden is more or less borne by local residents, and it is relatively easy to administer (Ibid). The fact that individual income tax is considered to be essentially a payroll tax, keeping taxes on capital incomes and self-employment earnings outside the base in most developing countries makes personal income tax suitable for derivation based shared tax (Ibid).

However, Bahl (2000:6) argued, allowing the lower levels of government to share elastic tax bases will have negative consequences because, unless there is a room to manipulate the distribution during budget tightness, it can constrain fiscal flexibility of the higher levels of government for good. He explained also that loss of flexibility in turn possibly undermines efforts to cope up with difficulties related to revenue fluctuation and budget shortages.

In addition to that, pure shared tax believed to aggravate horizontal imbalances as it has a tendency to make the rich localities richer and the poor localities poorer. Even though it gives larger cities the opportunity to access the resources they badly need, it has the potential to abort efforts aimed at tackling horizontal fiscal disparities (Bahl & Linn 1994:11).

However, pure shared tax or derivation-based transfer is not without advantages. Bahl and Linn claimed that it probably makes the tax more productive than would be the case if it were an independent local tax (Ibid). Since lower levels of government are often have weaker tax assessment and collection capacities than any higher levels of government, it is reasonable to believe that the pure shared tax arrangements might be helpful to assess and collect taxes efficiently and to increase tax productivity.

Derivation based (pure shared tax) transfer have also predictability advantages over other transfer mechanisms. Compared to the ad hoc and formula based transfers, the amount of shared tax transfer is more predictable. Thus, it has a positive impact on fiscal planning of local governments and it may also improve the revenue capacity of local governments giving them access to income and inflation elastic tax bases (Bahl & Linn 1994:10), given that the upper level government willing to strength the lower level governments' fiscal capacity.

It is also argued that, shared tax transfer might increase local autonomy given that conditions are not attached to the use of the funds (Ibid). The other advantage is, as local authorities do not have that much control over shared taxes, they will be free from consequences of unpopular decisions related to increasing tax rates and enforcements of tax collections (Bahl & Linn 1994:11).

### *Formula Grant*

Formula grant is a grant transfer mechanism that allocates resources among eligible jurisdictions using a formula equipped with a set of arrangements aimed at the realization of a combination of objectives. Addressing jurisdictional differences in expenditure needs, fiscal capacity equalization, encouraging tax efforts, tackling the imbalance between revenue raising capacity and expenditure needs and finding the data which can be used as inputs for the formula are the major approaches to design formula grant arrangements for allocating the divisible pool among local governments (Bahl 2000:12-13).

Bahl and Linn (1994:12) are also of the opinion that formula grant arrangements varies widely but, balancing jurisdictional inequalities in the ability to finance public services or in the level of public services as well as encouraging resource mobilization efforts of local governments are some combinations of desires seems to be reflected in formula grants.

Formula grant can be categorized in to two, based on the mechanism its divisible pool is determined. The divisible pool for formula grant can be determined based on shared tax principle or on an ad hoc basis (Bahl & Linn 1994:11). The choice between these two formula grant taxonomies depends on the extent of control the higher level of government wants to have on the allocation of the resource between the eligible jurisdictions and on its confidence on the recipient jurisdictions in their ability to utilize increased revenues efficiently (Ibid).

If the higher level of government wants to have strong control over the allocation of the resource or if it does not have confidence on the recipient jurisdictions in their ability to utilize the resource productively, it might consider deciding the divisible pool on an ad hoc basis. If otherwise, the divisible pool could be decided based on the shared tax principle.

Even in the case of shared tax formula grant, the type of taxes to be included in the shared tax domain and the percentage of the revenue to be allocated among the eligible units of government depends on the intention of the higher-level government. If the higher level of government is

willing to retain control over the fiscal resources, it will exclude productive and income elastic tax bases from the shared tax domain. If it is to strengthen the fiscal capacity of the recipient units of government, the opposite will happen. That means, more centralizing objective the higher level of government has, the lesser the chance the productive and income elastic tax bases to be included in the shared tax domain and the smaller percentage of the revenue the divisible pool will be.

To achieve combinations of objectives attached to formula grant arrangements the formula should take into consideration some indicators relevant to the situations on the ground. For instance identifying expenditure needs of a given jurisdiction requires getting information on population size, population density, percent of households with access to adequate water supply and percent of families living below the poverty line among others (Bahl 2000:13). However, most of the time the formula is likely to be constrained by lack of availability of data about needs and conditions in jurisdictions under consideration (Bahl & Linn 1994:12). It goes without saying that such problems are more pervasive in developing countries to constrain the designing efforts of grant formulas that can live up to the objectives they are supposed to achieve.

According to Bahl (2000:16), the interregional fiscal capacity equalization potential of the formula grant arrangement depends on the resource allocation factors included in the formula and it appears to be equalizing whenever it includes the proper indicators. Even though there is a real desire to provide poor jurisdictions with equalizing funds so as to achieve the above objectives, the practice is not as simple as such, as measures of personal income, which are helpful to design equalizing allocation formula, are rarely available at sub-national level in developing countries (Bahl & Linn 1994:12).

Unavailability of personal income data is also constraining efforts of boosting tax productivity. Bahl (2000:16) claimed that, the success of “tax effort provision” approach of formula grant arrangement is not encouraging because, only few countries have adequate measures of local personal income, which is an input to calculate the ratio of taxes to personal income, the common measure of tax effort. Regarding local autonomy, he argued that, the unconditional nature of formula grant generally gives local governments some kind of flexibility to decide the purpose of expenditures and it encourages local autonomy particularly if based on a shared tax pool (Ibid).

This shared tax formula grant is favored especially by small municipalities for its openness to reasonable amount of local control (Bahl & Linn 1994:17).

### *Cost Reimbursement Grants*

Cost reimbursement grant is a conditional type of grant arrangement designed to cover costs of specified local activities. Under such schemes, the higher level of government covers the full or part of the cost of certain eligible local activities based on the design of the grant. If it is matching grant, the higher level of government will channel a specified share of the cost of certain activities to the eligible jurisdictions, leaving part of the cost to be covered by the recipient jurisdictions (Bahl & Linn 1994:13).

According to Bahl and Linn, the higher levels of government have the discretion to determine what is eligible for reimbursement, which makes the reimbursement grant always closed-ended (Ibid). Thus the recipient jurisdictions will have no the autonomy to decide where to spend the grant. They will rather find themselves striving to realize the end goals of the grant providing levels of government.

According to Bahl & Linn, the size of the divisible pool for cost reimbursement grants can be determined based on either shared tax method or on an ad hoc basis and current services, eligible to grants are often funded through closed-ended shared tax grants, whereas an ad hoc determination is more frequently used for capital projects (Ibid). This has its own reasons. As ad hoc based grants are not predictable, current services such as salaries for employees cannot be funded through such funds. However, in the case of capital investment a given project can be postponed until enough financial resources are available. In fact, such grants do not give incentives to recipient jurisdictions to plan their expenditures beforehand.

Despite the fact that full reimbursement grant may promote equalization of services in different jurisdictions through the provision of certain services by lowering the marginal cost to zero and by mandating a certain level of services, it reduces the autonomy of recipient jurisdictions and it doesn't encourage local governments to mobilize additional resources (Ibid).

According to Bahl & Linn (1994:3), the matching reimbursement grant on the other hand encourages local jurisdictions to mobilize additional resources by forcing them to secure the specified share of the costs they are required to cover. However, it will distort local budgets by

shifting the expenditure attention of local authorities towards aided services leaving aside the real preferences of the local residents.

They are also of the opinion that, it may be counter equalizing because, it is often the rich jurisdictions, which will be in a position to contribute the matching share they are required and benefit from the grant more. When it comes to the poor jurisdictions, they may not afford to contribute the required share of the cost and to exploit the opportunity. In such conditions, the solution will be to entitle the poor jurisdictions to receive non-matching full reimbursement grants, even though it weakens their autonomy and does not initiate them to mobilize additional resources.

Oates (2005:352) explained that where a local public goods provision have the capacity to benefit residents of adjacent jurisdictions appropriate level of subsidies would encourage local officials to extend outputs to the efficient level. Ahmad and Craig (in Ter-Minassian 1997:88) explained that matching conditional grants are favorable to encourage local officials to maximize their service production to the efficient level and to benefit people in adjacent areas through the spillover effect.

#### **2.1.3.4. Access to Financial Markets (Borrowing)**

According to Bahl and Linn (1992:451-452), local governments in developing countries, including large cities do not use credit financing extensively. Limited ability to carry debt, central government constraints on borrowing such as lengthy review and approval process, high local capital matching contributions and short loan maturities are among the reasons behind the weak interest for sub national borrowing in developing countries.

However, the reality on the ground seems to be changing these days. Now there are different reasons that necessitate sub national borrowing in developing countries. The local revenue being secured from local taxation and intergovernmental transfers is very small when relative to the large infrastructure demands created by the rapid expansion of urbanization which in turn necessitates sub national borrowing (Liu & Waibel; in Shah, 2008:215).

According to Liu & Waibel, giving lower levels government access to financial markets expands financial space for infrastructure financing. In addition to that, it is the best way to finance

infrastructure projects more efficiently and equitably. That means as infrastructure investments benefit future generations, the cost of the project should also be shared across generations fairly. They argued also “*allowing sub national governments to access the financial market exposes them to market disciplines and reporting requirements, hence strengthening fiscal transparency, sound budget and financial management, and good governance*” (Liu and Waibel; in Shah, 2008:217).

Margassi (2000:4) on his part argued that local officials should be careful not to finance projects that do not benefit future generations with long-term borrowing. According to Margassi financing such projects through long-term borrowing undermines intergenerational equity by shifting the costs of services enjoyed by today’s taxpayers to future generations. However, it is possible for sub national governments to use sub national borrowing to smooth out revenue inflow and outflow within a single fiscal period as far as it is to be repaid at the end of the fiscal year.

### ***Summary***

Fiscal decentralization allows local governments to provide preference based public goods and services (Bahl, 1999:60 and Abu, 2013:6). The fact that governments nearer to the people have better information about local preferences enables them to shape their decisions according to the need on the ground.

The greater power local authorities have to raise revenues from local sources, the more autonomous they will be to determine their expenditure areas (Bahl and Linn, 1992:32). For levels of governments to match their decisions with the preferences on the ground, they should be provided with adequate means of revenue. That means, revenue means of levels of government should be matched to their expenditure responsibilities as closely as possible (Shah, 2007:20).

Fiscal decentralization creates an opportunity for local governments to decide on the level and mix of taxes and expenditures in a manner it enables them realize revenue adequacy and respond to the preferences of their respective residents. The authority levels of government have to determine their tax rates and hence the size of their revenue is the decisive factor with this

regard. In the same manner, Blochliger & King (2006:179) argued that the share of grants in the budgets of local governments determines their fiscal autonomy. As the share of the grant in their budget increases, their autonomy will also be compromised equally as grants are attached with some kinds of preconditions most of the time.

The constitutional and legal status of local governments determines their role in the provision of local public goods and services (Shah, 2007:15-16). If local governments are established based on ordinary legal frameworks, their sustainability might not be guaranteed as ordinary laws are easy to amend when compared to constitutions.

Political decentralization is also the other factor that determines the status of local governments. The way local councils and chief administrative officers are selected as well as the authority local governments have to set tax rates and to decide on budgets determines the level and scope of their fiscal autonomy (Bahl & Linn, 1992:393-402). Local officials, which are not accountable to local residents through elections, will have no incentives to improve public services (Bardhan and Mookherjee, 2006:102).

Service provision capability is also dependent on economic activities in a given jurisdictions. Economic disparity along jurisdictions at the same level is one of the causes of the difference in tax capacities. The difference in tax capacities between jurisdictions in turn results in difference in per-capita tax revenue (Watts & Hobson, 2000:24). As the gap between per-capita revenue of jurisdictions widens, their capability to provide their respective electorates with preference based services differs equally. Therefore, there is a need to have viable equalizing arrangements if there are differences in economic activities across jurisdictions at the same level.

The nexus between services rendered and tax paid is also the other factor that possibly affect local service provision activities. According to Litvack, Ahmad & Bird (1998:10) there is a need to create a strong link b/n cost and benefit so as to consolidate accountability which in turn motivates local governments to shape their decisions in favor of local preferences. Dillinger (1994:27) also argued that Subsidizing services like water supply cannot realize poverty reduction effectively as it benefits non-poor consumers unfairly and encourages over consumption of services.

Financing mechanisms of expenditures are also worth to mention here as factors that affect service provision activities. Long term projects should be financed through borrowing (Shah, 2007:20) so as to distribute burdens of costs along generations that supposed to be benefited such projects.

## **Chapter Three**

### **3. Legal and Institutional Frameworks for Decentralization in Ethiopia**

Despite the fact that different regimes in the past had introduced different types of administrative structures at different times in Ethiopia, it is the federal arrangement, which is established back in 1991 introduced meaningful decentralization all over the country. As part of the federation, the ORS also practicing decentralization based on the legal frameworks from both the federal and the regional state itself. This chapter discusses the federal and the regional state legal frameworks for fiscal decentralization and their implications.

#### **3.1. The Legal Frameworks at the Federal Government Level**

The current decentralization in Ethiopia finds its origin in the federal structure, introduced two decades ago. Article 47 of the 1995 constitution of the Federal Democratic Republic of Ethiopia (FDRE) clearly states that, the Ethiopian federation comprises nine regional states including the State of Oromia. The constitution made it clear that constituent units of the federation shall have equal rights and powers.

The FDRE constitution did not establish local governments below regional states. It rather gave the mandate to establish levels of government nearer to the people to the regional states (Article 50/4, FDRE constitution). If it were to create most autonomous government units at the grassroots level, it would have been appropriate for the FDRE constitution to establish further devolved levels of government. However, the fact that the Ethiopian federation has been established through bottom-up process makes it unlikely for the constituent units of the federation to agree with such decisions from the center as it might impede their autonomy.

Article 50/2 of the FDRE constitution endows both the federal and state governments with legislative executive and judicial powers. The House of People's Representatives and the state councils are placed as the highest authorities of the federal and the state governments respectively (Article 50/3, FDRE Constitution). Both the House of People's Representatives and state councils are responsible to their respective electorates.

Article 50/8 of the FDRE constitution required both the federal and state governments to respect each other's powers, which shows that each of them are autonomous in their decisions to

discharge their functions and to exercise the powers they are endowed with. That means, the federal government is not allowed to interfere in regional states' matters and the regional states are also obliged to stay away from the powers and functions allocated to the central government.

The FDRE constitution listed functions and powers of both the federal and state governments and endowed the state governments with all powers that are not given to the federal government or concurrently to the federal and state governments (Article 52/1). That means the constitution reserved residual powers to the regional states.

### **3.1.1. Assignment of Expenditure Responsibilities Between the Federal and State Governments**

#### ***Expenditure Responsibilities of the Federal Government***

Article 51/2 of the FDRE constitution clearly showed that, among the responsibilities the federal government is endowed with, the authority to formulate and implement the country's economic and social development policies, strategies, and plans is worth to mention here. Article 51/3 of the constitution mandated the federal government to establish and implement standards and basic policy criteria for public health and education among others. Article 51/7 of the federal constitution awarded the federal government also the authority to determine the conditions and terms under which state governments can borrow money from internal sources.

The authority to formulate and execute the countries financial, monetary and investment policies and strategies (Article 51/3, FDRE constitution) as well as to regulate interstate commerce (Article 51/12, FDRE constitution) and to administer and expand all federally funded institutions that provide services is also given to the federal government (Article 51/13, FDRE constitution) .

According to article 51/9 of the FDRE constitution, the power to develop, regulate and administer air, rail, water ways and sea transport and major roads connecting two or more regional states as well as postal and telecommunication services are also assigned to the federal government. Article 51/6 also mandated the federal government to establish and administer national defense and national security forces as well as the federal police force. According to article 50/9 of the FDRE constitution, the federal government is allowed to delegate its powers and functions listed in Article 51 of the constitution to the regional states.

### *Expenditure Responsibilities of the Regional States*

The state governments are authorized by Article 52/2/c of the FDRE constitution to involve in formulation and implementation of economic and social development policies and strategies as well as plans of their own. As it can be understood clearly from this article, the FDRE constitution does not put clear boundaries between the expenditure responsibilities of the two levels of government.

The FDRE constitution authorized state governments to establish state administrations that enhance self-government and democratic order based on the rule of law and to protect and defend the federal constitution (Article 52/2/a, FDRE constitution). It mandated them also to enact and enforce laws on state civil service and their condition of work and required them to ensure the observance of approximate national standards with this regard (Article 52/2/f).

Article 52/2/g of the FDRE constitution also required regional states to establish and administer state police force and to maintain public order and peace within their respective jurisdictions.

Enacting state constitution and other laws as well as administering land and other natural resources in accordance with the federal laws are also competences of state governments (Article 52/2/d & e, FDRE constitution).

All residual powers are also awarded to state governments based on the lists of expenditure responsibilities of the federal government (Article 52/1).

#### **3.1.2. Revenue Assignment between the Federal and State Governments**

Article 94/1 of the constitution made it clear that both levels of government are required to bear all financial expenditures necessary to carry out their respective responsibilities and functions assigned to them by law. The financial resources needed to carry out delegated functions by states shall be covered by the delegating level of government. That is why their respective taxation powers and other possible revenue sources are provided for in the FDRE constitution.

Accordingly, article 51/10 and Article 52/2/e of the FDRE constitution authorized both the federal and regional governments to levy taxes and collect duties on revenue sources reserved to them.

### ***Revenue Sources of the Federal Government***

Accordingly, the following are lists of revenue sources that the federal government is authorized to levy and collect them (Article 96/1-9, FDRE constitution).

- Custom duties, taxes and other charges on imports and exports,
- Income tax on employees of the Federal Government and international organizations,
- Income, profit, sales and excise taxes on enterprises owned by the Federal Government.
- The income and winnings of national lotteries and other games of chance,
- Taxes on the income of air, rail, and sea transport services,
- Taxes on income of houses and properties owned by the Federal Government; it shall fix rents,
- Fees and charges relating to licenses issued and services rendered by organs of the Federal Government,
- Taxes on monopolies and duties on federal stamp

### ***Revenue Sources of the Regional States***

Article 97 of the constitution also authorized state governments to levy and collect the following taxes, charges, and fees.

- Income taxes on employees of the State and of private enterprises in the regional state,
- Land use fees,
- Taxes on the incomes of both private farmers and farmers incorporated in cooperative associations.
- Profit and sales taxes<sup>1</sup> on individual traders carrying out a business within their territory,
- Taxes on income from transport services rendered on waters within their territory
- Taxes on income derived from private houses and other properties within the State.
- Rent on houses and other properties of the regional states themselves.
- Profit, sales, excise, and personal income taxes on income of enterprises owned by the States,
- Fees and charges relating to licenses issued and services rendered by State organs and royalty for use of forest resources,

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<sup>1</sup> Note that Value Added Tax (VAT) replaced sales tax as of 2003.

The regional states are also authorized to levy and collect taxes on income derived from mining operations and royalties in a manner consistent with the concurrent powers they are endowed with together with the federal government in article 98/3 of the federal constitution (Article 97/8, FDRE constitution).

### ***Concurrent Taxation Powers***

According to Article 98 of FDRE constitution, the federal and regional governments are endowed with concurrent powers to jointly levy and collect:

- Profit, sales, excise and personal income taxes on enterprises they jointly establish,
- Taxes on the profits of companies and on dividends of shareholders,
- Taxes on incomes derived from large-scale mining and all petroleum and gas operations, and royalties on such operations.

Gebirehiwot (2013) argued that the FDRE constitution allocated taxation powers among the federal and the regional governments based on types of business organizations, administrative convenience, as well as domiciliation, mobility, and ownership principles.

### **3.2. Legal Frameworks at the Oromia Regional State Level**

State of Oromia is the largest state of the federation in its both geographic area and population size. Even though Article 50/4 of the FDRE constitution recognized only two levels of government (the federal and state governments), it awarded the regional states including State of Oromia the right to establish regional state government and other devolved administrative levels that they find necessary. The same article of the constitution emphasized the need to bestow the lower levels of government with adequate powers and functions so as to enable the people to participate directly in the administration and decision making processes of their respective local governments. Yonatan & Zemelak (2012:94) argue that article 50/4 of the FDRE constitution strongly requires the regional states to establish democratic and autonomous local governments.

Accordingly, the Oromia National Regional State (ORS) is established based on Article 45 of the federal constitution. It is a four-tiered government; regional, zonal, *Woreda* and *kebele* levels (Article 45, ORS Constitution). Among these four levels of government, the regional, the *woreda* and *kebele* levels of government are designed to have legislative and executive councils as well

as judicial bodies (Article 46, 76, ORS Constitution). The zonal administration however, is the only level of government of the ORS without legislative powers.

Powers and Functions of the Regional State emanate from Article 52 of the FDRE constitution. Accordingly, Article 47/1 of the State constitution clearly stated that all powers and functions, unless assigned to the federal government or to the federal and regional governments as concurrent powers by the FDRE constitution are considered powers and functions of the regional governments. As all the powers and functions for regional states are listed in page 49-52, there is no need to list them here again. Therefore, the next sections will focus only on legal frameworks for the lower levels of government of the region.

### **3.2.1. Legal Frameworks for Zonal Administrations**

Zonal administration is described as executive body organized below the regional administration (Article 71/1, Oromia Constitution). It is also directly accountable to the president of the regional state and for the regional council (Article 71/2, ORS Constitution).

As opposed to the case for the other regional states like Sothern Nations Nationalities and Peoples Region (SNNPR) The decision not to endow the zonal administrations in the ORS with legislative powers and not to recognize them as autonomous level of government is justifiable, as the state of Oromia does not have geographically concentrated diversity. Risk of redundancy is also the other factor that justifies the decision not to award zonal administrations a government unit status as *woredas* are in place as local governments nearer to the people.

The risk of breaching the autonomy of local governments is another factor that makes the necessity of the very existent of zonal administrations questionable in the case of Oromia. The fact that the ORS is using zonal structures to grip over local governments makes its existent disadvantageous for well functioning of decentralization in general and fiscal decentralization in particular in the regional state. Therefore, there is a need to put in place a mechanism that can prevent such scenarios from happening.

According to Article 71/3 (a-i), the zonal administrations in the regional state are endowed with the authority to:

- Coordinate the activities in the *woredas* within their respective boundaries; they follow up, support, coordinate and supervise the activities of their sector offices and other institutions;
- They support, supervise and coordinate institutions that serve more than a *woreda*;
- They assess social service and economic development needs of the zone, present it to the president of the regional state and execute after they are ratified;
- They ensure the protection of heritages in their boundaries and they are also responsible for environmental protection;
- They follow up the overall activities in their boundaries and report to the president of the regional state through their respective chief administrators;
- They are also authorized to ensure respect of law and orders as well as to realize peace and security in their respective boundaries;
- They ensure the implementation of policies, proclamations, orders, directions, and decisions from the regional legislative and executive councils;
- They perform other activities to be given to them by the president and executive council of the regional government.

The above list of responsibilities indicates that the zonal administrations in the ORS are simply extensions of the regional state. That means they have no expenditure responsibilities and taxation powers that are exclusively assigned to them.

### **3.2.2. Legal Frameworks for Woreda Level Governments**

Even though it is obvious that *woreda* level of government used to stand for both rural and urban local governments previously, as the regional state came up with separate proclamation for urban local governments, one can consider the powers and functions listed for *woreda* levels of government in the ORS constitution as legal frameworks for rural *woredas* only.

According to Article 77 of the ORS constitution, the *woreda* administrations are government units organized below the regional government, which clearly indicates that *woredas* are not intended to be subordinates of zonal administrations. The fact that Article 78/2 of the regional constitution made the members of the *woreda* councils accountable to their respective electorates is also concrete evidence that indicates *woredas* have local government status.

When it comes to powers and functions of *woreda* level of government, the ORS constitution listed powers and functions of the *woreda* legislative and executive councils separately. Therefore, the researcher also considered the powers and functions of both the legislative and executive councils of the *woredas* as the powers and functions of the *woredas* themselves.

### **3.2.2.1. Powers and Functions of *Woreda* Legislative Council**

According to Article 79 of ORS constitution, a *woreda* legislative council is mandated to:

- Formulate and implement respective social and economic development plans and programs of the *Woreda*;
- follow up and ensure basic agricultural activities are taking place timely and environmental rehabilitation and protection activities are being conducted with the due attention in the *Woreda*;
- create conducive environment for the mobilization of the electorates for development activities;
- ensure the collection of land use fee, agricultural income tax and other service charges;
- They are also mandated to utilize the revenue sources that are not assigned to the regional state and to determine and implement their respective annual budgets.
- It is mandated to elect its speaker, deputy speaker, as well as chief administrator of the *Woreda* among the political party/parties holding the majority seat in the council.
- It endorses the appointment of *woreda* officials including that of the deputy chief administrator presented to it by the chief administrator.

### **3.2.2.2. Powers and Functions of *Woreda* Executive Council**

According to Article 85 of the state constitution, a *woreda* executive council is mandated to perform the following responsibilities:

- It implements government policies, laws, directions, plans and programs in the *woreda*.
- It coordinates executive bodies in the *woreda* and follows their activities.
- It prepares draft budget of the *woreda* and present to the legislative council. It is also expected to implement the budget after approved by the legislative council.
- It prepares social, economic, and administrative plans and presents to the legislative council for approval.

- It protects and develops natural resources. It is also expected to mobilize the public massively for development.
- It ensures the protection of heritages in the *woreda*.

### **3.2.3. Legal Frameworks for *Kebele* Level Government**

As it is mentioned before, *kebele* level of government is the last level of government nearer to the people in the case of ORS. Article 90 of the ORS constitution gives the *kebele* level of government legislative, executive, and judiciary powers, where the social courts acting as the judiciary.

According to Article 91 of the ORS constitution, the legislative council holds the highest authority of the *kebele* government. The same article made the *kebele* legislative council accountable to both the electorate and to the legislative council of the *woreda*.

The powers and functions of the *kebele* level of government are also listed as powers and functions of its legislative and executive councils separately.

#### **3.2.3.1. Powers and Functions of *Kebele* Legislative Council**

Article 92 of ORS constitution states that, the *kebele* legislative council expected to perform the following responsibilities:

- It ensures the implementation of plans and directions prepared by the *woreda* legislative and executive councils.
- It formulate and implement directions
- It appoints the administrator of the *kebele* among the residents and it endorses the appointment of the deputy administrator and the judges of the social court to be presented by the administrator
- It draws timetables for execution of socio-economic and administrative plans and follows their implementations
- It formulates and implements additional plans that are useful to the residents
- It mobilizes residents for development works and it follows the natural resource protection activities
- It ensures the respect of law and order in the *kebele*

### 3.2.3.2. Powers and Functions of *Kebele* Executive Council

Article 96 of the ORS states that the administrative (executive council of the *kebele* level of government is authorized to perform the following responsibilities:

- It formulates development plans and programs and implements them after approved by the legislative council
- It facilitates natural resource protection and development activities. It mobilizes and coordinates the people for development works
- It protects heritages in the area and it notifies to the pertinent body about their utilization
- It reports its performance to the legislative council

The above lists of powers and functions of the *woreda* and *kebele* levels of government provided for in the ORS constitution clearly shows that, the state constitution did not assign meaningful powers and functions to the lower levels of government. It rather considers them subordinate bodies established to ensure the implementation of policies and programs of the regional government. The fact that the *woreda* and *kebele* legislative councils are accountable both to the electorate and to the next higher level of council gives a leeway for the higher levels of government to dictate the local government below them. Their accountability to higher levels of councils should have been defined clearly based on the powers and functions they exercise on behalf of the respective higher levels of government.

In fact, the authority given to the *woreda* legislative councils to appoint chief administrators and other officials of their respective *woreda* is one of the positive aspects of the constitution at least at legal framework level.

The failure of the constitution to draw boundaries between the revenue sources of the regional state and local governments and to endow local governments with the authority to define their tax bases and to set their own rates is another problem that undermines the autonomy of the local governments.

Above all the fact that the constitution did not try to treat the issues of urban local governments separately based on the special circumstances specific to urban areas is also the other problem.

### 3.2.4. Legal Frameworks for Urban Local Governments (ULG)

Even though the devolution of powers to the *woreda* level gave some of the urban areas in Oromia region the chance to secure the local government status, most of the urban areas in the region had not been recognized as urban local governments until the declaration of the Urban Local Government (ULG) proclamation in 2003. As opposed to the provision in the FDRE constitution that required regional states to devolve power to the grassroots levels by establishing local governments closer to the people, the amended constitution of the ORS did not recognize most of the urban areas in the region, except some of the bigger ones, as autonomous government units.

Thus, most of the urban areas in the regional state had rather been extensions of the respective *woreda* administrations they were part of, until the year 2003. The fact that, administrations at urban areas are not recognized directly at least by the regional state's constitution as autonomous local governments has undermined their status to the extent that they were not in a position to determine on the issues specific to their respective residents.

That is why the regional government came up with the idea of devolving more political, administrative and fiscal powers to the grassroots level by establishing urban local governments at the towns and cities in the region using a separate proclamation. Accordingly, the urban local government proclamation № 65/2003 of the ORS recognized towns and cities in the region with population size 2000 and more as urban local governments. Yonatan & Zemelak (2012:98) however argue that the fact that ULGs in Ethiopia are creations of ordinary regional statutes rather than constitutions has placed their existence as autonomous local government units in precarious position.

Article 7 of proclamation 65/2003 categorized the cities and towns in the region in to four categories (1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, and 4<sup>th</sup> grade cities) based on population size and organized them as autonomous legal bodies. The objectives of the recognition include, among others, to promote self-rule; to institute good governance in which effectiveness, transparency, and accountability to residents can be realized; to ensure the provision of efficient, equitable, and sustainable urban services to residents and to promote social and economic development at the grassroots level (Article 1-4, Proc. 65/2003).

Article 10-12 of the proclamation 65/2003 chose to employ Council-Mayor system, which comprises the city council, the mayor, the deputy mayor, and the mayor's committee among others. This 14/1 of the proclamation clearly stated that, all the city powers are vested in the city council. Article 13/1 of the proclamation also mandated residents of the respective cities to elect members of their city councils in free, direct, and secret election and article 16/1 of the same proclamation on its part made the city councils accountable to the electorate and the regional council.

In addition to the participation of the residents in the cities' affairs through elections, article 32 of proclamation 65/2003 put in place other mechanisms through which residents can participate in public affairs. Mass organizations, public forums, boards, and committees that require the direct involvement of the residents are among the mechanisms provided for in the proclamation to ensure active participation of the residents.

According to article 14/g and 19/1 of proclamation 65/2003, the city councils had been authorized to choose the mayors and deputy mayors of their respective cities among their members. Article 24/1 of the proclamation also required the relationship between cities and the regional government to be guided by the spirit of cooperation, partnership, support, and rule of law. Regarding human resource management, article 43/1 of proclamation 65/2003 endowed urban local governments with the authority to recruit, determine the salaries and benefits of its employees as well as to discipline and dismiss staff members in accordance with the law of the regional state.

Therefore, one can conclude that the establishment of ULGs by proclamation 65/2003 of the ORS had been a big leap towards realization of autonomous units of government at grassroots level.

However, their status as autonomous government units could not be sustainable. Possibly the fact that the ULGs are not recognized clearly at least in the regional state's constitution made them vulnerable to the arbitrary decisions of the ORS council. Accordingly, the amendment of proclamation 65/2003 repealed the "**Urban Local Government**" status of the urban areas and replaced it with "**Urban Administration**" (Article 2/1 proclamation 116/2006). As opposed to the argument by Bahl and Linn (1994:5) that requires local officials to be elected among the city

council members, article 2/1 and 2/6 of proclamation 116/2006 awarded the mandate to elect the mayor and deputy mayor of 1<sup>st</sup> and 2<sup>nd</sup> grade cities to the president of the regional state.

In addition to that, article 2/6 of the amend proclamation made city mayors accountable to the president of the regional state, which obviously created loopholes for pervasive interventions from the regional government. This by itself is a sign of the strong motive of the regional government to consolidate its grip over the urban administrations. This in turn is likely to undermine the overall autonomy of the urban administrations equally. That is because; the fate of the mayors to stay on power or not, will always depends on the whim of the president of the regional state. This in turn forces mayors to shape their decisions in favor of the interest of the president of the regional government at the cost of local preferences so as to secure their survival in office as long as possible.

This situation is creating different problems on the stability of the urban administrations. If we take the Chiro urban administration, it changed more than 13 mayors within a decade since 2003 with the decisions from the office of the president of the ORS.

According to the consulted document<sup>2</sup> from the office of Oromia regional council, if proclamation 65/2003 had remained practical as it was, the situation on the ground at urban areas in ORS would have given city councils the opportunity to claim chartered administration status in a manner it endangers the self rule right of the Oromo people. The first paragraph of the preamble of the amend proclamation 116/2006 also revealed that the amendment is required to revise provisions of proclamation 65/2003 that hinder the Oromo People not to adequately exercise the right to self-administration provided in the FDRE and ORS Constitutions in the cities. The researcher considered this concern emanated from the fact that non-Oromo residents dominate most of the cities in ORS. Therefore, the researcher is of the opinion that the amendment is required to avoid this danger by controlling city councils through mayors appointed by the regional government among other mechanisms.

This stance clearly shows that the regional government is willing to tighten its grip over the urban administrations in the name of avoiding the so called risk of endangering the self rule right of the Oromo people in general, at the cost of the right of the urban residents to act autonomously on

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<sup>2</sup> It is a document with a brief explanation about the necessity of the amendment of proclamation 65/2003 of ORS.

the issues specific to their respective jurisdictions. As a result, the form of decentralization at the urban administration level is characterized by deconcentration, not devolution of powers and functions. Therefore one can conclude that the status given to LGs in ORS does not fit to the emphasis the FDRE constitution gave to the need to bestow the lower levels of government with adequate powers and functions.

#### **3.2.4.1. Expenditure assignments to the Local Urban Governments**

Article 8 and 9 of proclamation 65/2003 of the ORS assigned the following responsibilities to the urban administrations.

- To initiate, adopt and execute its visions, goals, values and operation systems;
- To initiate, adopt and execute the economic and social development plan and budget of the city.
- To introduce, adjust and collect taxes and service charges under its jurisdiction in accordance with the law.
- To administer urban land and houses under the administration of the city government in accordance with law,
- To manage its human resource in accordance with the law,
- To enter into contract and cooperation agreement with the Regional Government bodies, private sector, mass organizations and other cities,
- To expropriate, without prejudice to Article 40 (8) of the Constitution, private property for Public purposes subject to paying equivalent compensation,
- To provide efficient, effective and equitable services to the residents: especially environmental services, construction and management of city roads, sewage and drainage lines, parks and recreation areas, waste disposal, prevention and control of pollution, etc
- To render social services including education, medical and ambulance services, housing, public notary and vital statistics services, abattoir, cemetery, and market services etc,
- To provide cultural services including the promotion of sports, theatres, establishment of public libraries and museums,
- To provide public utilities including water, electricity, telephone, public transport services;

- To provide protective services Including public security, judicial service, fire control, food and drugs inspection, etc,
- To promote and facilitate investment and income generating schemes as well as poverty reduction programmes that help the development of the city and the improvement of the living standards of the residents;
- To exercise regulatory functions including the enforcement of government laws and standards and licensing specific activities in accordance with the law;
- To prepare, revise, update and implement its city plan;
- To facilitate forums for the expression of local opinions;

According to Article 9 of proclamation 65/2003, the urban administrations are expected to be in charge of, among others, the provision of public utilities including water, electricity and telephone services and regulatory functions including the enforcement of government laws and standards. The same article of the proclamation allowed the urban administrations to facilitate the provision of services in partnership with public or private sectors. Article 14/2/C of the proclamation endowed city councils with powers to approve and follow up socio-economic plans and budgets of their respective urban administrations.

The fact that the urban administrations in ORS are endowed with major expenditure responsibilities such as education, health and water services, road construction and maintenance, sanitation, and beautification services shows that they are of a great importance in service provision activities. Especially the mandate given to them to provide education and health services to their residents is concrete evidence that shows how major the urban administrations' expenditure responsibilities are.

However, proclamation 65/2003 of the regional state did not define the expenditure assignments it provided for clearly. For instance, the responsibility given to the urban administration to provide education services by article 9/2 of the proclamation is not clear, as it did not list down the levels of education services the urban administrations supposed to provide clearly. Therefore, this situation by itself creates loopholes for the regional government to intervene in the affairs of the urban administrations and to manipulate decisions in a manner they favor its goals.

The assignment of the authority to provide utilities such as electric city and telephone services (Article 9/4, proclamation 65/2003 of ORS) contradicts with the principle of economies of scale.

As electric and telephone services have high economies of scale, it is not feasible to provide these services at local government level. The practice also shows that it is rather the federal government, which is providing these services all over the country. Let alone the local governments, the regional states themselves are involving in the provision of such services.

#### **3.2.4.2. Revenue Sources of the Urban Administrations**

Urban administrations secure the financial resources they need to finance their expenditure responsibilities from various sources. Their financial source comprises own revenue, community contributions, *woreda* block grant from the regional state, financial borrowing from the regional government and financial institutions as well as external loans and assistances.

##### **3.2.4.2.1. Own Revenue For Urban Administrations**

Proclamation 65/2003 of ORS listed also the financial sources urban administrations are entitled to exploit in their effort to discharge their expenditure responsibilities.

Article 14/2 and 37/1 of proclamation 65/2003 authorized the city councils and the urban administrations respectively to introduce, adjust, and collect taxes, rentals, and service charges in line with policies and laws of the upper levels of government. This clearly shows that the proclamation imposes some kinds of limitations on the exercise of these powers and functions.

Urban land fees and property taxes are also mentioned as exclusive income sources for the urban administrations (Article 37/2). Article 37/3 of proclamation 65/2003 allowed the urban local governments to generate funds from voluntary contributions and donations among others.

**Table 3.1 Revenue Sources of Urban Administrations**

Municipality Tax Revenue	Municipality Non-Tax Revenue	Municipality Service Charges	Municipality Sales of Goods and Services
1. City house tax 2. Assurance 3. Entertainment	1. Municipality Rent Revenue 2. City land rent 3. Residential houses rent 4. Trade houses rent 5. Verandah rent 6. Sales place/guilt rent 7. Funeral service vehicle rent 8. Municipal investment income 9. Municipal land lease income 10. Non-governmental transfers 11. Private contributions 12. Community contribution	1. Trade and professional registration and licensing 2. Housing and fencing construction license 3. Soil dumping space license 4. Vehicle license on prohibited land 5. Traffic fines 6. Fines on violation of rules and regulations 7. Bus terminal service charge	1. Sanitation Services 2. Engineering and asset estimation 3. Building construction supervision 4. Contract registration and confirmation 5. Road transport 6. Water Service 7. Sewerage service 8. Fire and emergency services

Source: - [www.obr.gov.et](http://www.obr.gov.et)

#### 3.2.4.2.2. Woreda Block Grant

Article 37/4 of the proclamation 65/2003 indicated that the regional government might adopt a mechanism of giving urban local governments subsidies so as to entitle them a defined portion of the revenue collected within their respective jurisdictions. The same article hoped such subsidies shall enhance competitive performance, to discourage mal practices, and left the details to be defined by law.

According to a budget expert from the finance and economic development office of Oromia, the new grant transfer arrangement is necessitated by the failure of the previous grant arrangement of the ORS, which has been in use from 1998 to 2004 E.C, to match the real circumstances on the ground. The informant argued that the fact that it did not take the specific circumstances in urban areas into account is one of the setbacks of the previous grant transfer arrangement. That is why the regional state designed the new grant transfer arrangement in 2004 Ethiopian calendar and made it operational at the beginning of the 2005 Ethiopian fiscal year.

The informant, who was the member of the grant design taskforce, claims that the new grant transfer arrangement is designed to apportion the available financial resource to the eligible

jurisdictions based on transparent and genuine conditions as well as in a manner it tackles inequities between jurisdictions.

However, as it can be understood from the consulted document, the preparation process of the grant transfer arrangement lacks participation from stakeholders and concerned bodies. The document revealed that even though representatives of the offices of the speaker of the Regional Council and the president of the regional state as well as experts from the finance and economic development bureau of the regional state had been required to participate in the preparation process, they did not participate fully in the process. The document further explained that the technical committee consulted only 10 urban administrations and 17 *woredas* randomly on the issue. Therefore, the failure of the technical committee to put in place a mechanism to participate the rest of the grant recipient *woredas* and urban administrations makes the process unfair and not trustworthy. However, the effort the technical committee made to consult *woredas* from both urban and rural areas is one positive step that can give a chance to take real circumstances in urban areas into consideration when allocating grants among jurisdictions. This has not been that much the case in the previous grant arrangement.

The document revealed that the expenditure needs of ULGs are estimated through:

1. Basic service recurrent budget based on unit costs including the number of schoolchildren;
2. Capital budget focused on infrastructure gaps and;
3. Expenditure needs difference that can emanate from geographical area.

These three components cover 88%, 7%, and 5% of the total grant transfer respectively (Grant arrangement 2004 E.C, Oromia BOFED). In fact, the 7% capital expenditure share is set as a minimum amount.

The informant from the finance and economic development office of the regional state explained that the grant transfer targeted to finance the services believed to contribute to poverty reduction efforts such as education, health, and job creation activities.

#### **3.2.4.2.3. Access to Financial Markets (Borrowing)**

Borrowing from federal and regional governments as well as from accredited financial institutions, city funds or similar institutions for capital expenditures, with the prior approval of the regional government, is also another source of revenue allowed to the urban administrations.

The details are left to be defined by regulations of the regional executive council (Article 37/6 of Proc. 65/2003).

The access to financial markets is not freely open to the urban administrations to use it as they want. The article rather mandated the executive branch of the regional state to oversee the activities of the urban administrations with this regard, which in turn gives the executive branch to influence the expenditure activities of the urban administrations as well.

## **Chapter Four**

### **4. Fiscal Practices in Chiro and Sebeta Urban Administrations**

As it is discussed in chapter three, urban administrations in the ORS including that of Chiro and Sebeta towns are endowed with varieties of expenditure responsibilities. The responsibilities awarded to the urban administrations include municipal services such as street lighting, waste removal and disposal, sewerage and drainage services, intra-town road construction and maintenance, as well as social services such as education, health, and supply and distribution of water.

The urban administrations are also assigned with some revenue powers so as to enable them generate some of, if not all, the financial resource they need to produce the services they are expected to provide to their residents. Grant transfers from the regional state and access to financial markets or loans are also revenue sources provided for urban administrations in Oromia including that of Chiro and Sebeta towns.

The researcher conducted case studies especially on education, sanitation, and water services the Chiro and Sebeta urban administrations are providing. The revenue generating powers and the level and scope of the urban administrations' autonomy to determine their revenue size and hence their expenditure as well as the discretion the urban administrations have to determine the way they use their financial resources are also scrutinized.

#### **4.1. Expenditure Practices of Chiro and Sebeta Urban Administrations**

According to the Heads of the finance and economic development offices of Chiro and Sebeta urban administrations, the urban administrations are providing education services up to first cycle secondary school level (1-10<sup>th</sup> Grade). According to these informants both of the urban administrations are providing health services up to health center level, while the Sebeta urban administration is planning to upgrade its health service to zonal referral hospital level. The informants explained that the urban administrations are providing municipality services such as street lighting, road construction and maintenance, sanitation and abattoir services among others with varying level.

When an urban local government plans to provide a number of services to its residents, it has to think equally about the size of its budget and the allotment of the budget among the sectors that are authorized to provide a specific service each. If an urban administration is to provide preference based local goods and services, it has to determine the size of its annual budget and it has to put in place the mechanism to generate adequate revenue that covers the budget it planned.

The Chiro and Sebeta urban administrations have two major categories of annual budget. The first category of the urban administrations' budget is known as ordinary budget (Grant transfer from the regional state or woreda block grant). This budget made its source the ordinary revenue from the regional state's tax bases in the respective towns and the direct annual grant transfer from the regional state. If the ordinary revenue generated in a given town is more than the ordinary budget the town is entitled to receive, the town does not receive direct grant transfer from the regional state. In such cases, the regional state allocates the ordinary budget from the ordinary revenue collected from the regional states' tax bases in the town. Generally, the ordinary budget the regional state is allocating to the urban administrations is considered as WBG from the regional government.

The second category of the budget is the municipality budget, which is generated from the revenue sources officially assigned to the urban administrations themselves.

#### **4.1.1. Expenditure Practices under the Ordinary Budgets (WBG)**

What makes the annual ordinary budget different from that of the municipality is that it is the regional government that decides its size and the share of the budget to be devoted to capital expenditure as it is generally a resource allocated from the regional state as woreda block grant (WBG). Its sources are also the ordinary revenue being generated from the regional state's tax bases at the respective towns and the direct state transfer from the regional state.

The annual ordinary budgets (WBG) to Chiro and Sebeta Urban Administrations are devoted to the urban administrations' non-municipality expenditure responsibilities such as, among others, education and health. In this case, the mandate of the urban administrations' councils is limited to apportioning this budget among the non-municipal sectors under the urban administrations.

One can simply realize from Tables 4.1 and 4.2 below that the yearly ordinary budgets (WBG), allocated to Chiro and Sebeta towns has never been in conformity with the need on the ground, as they focus mostly on recurrent expenditures and other running costs.

Even though McMillan (in Shah, 2008:276) argued that transfers aimed at gap closing and equalization normally fall into the unconditional category, it seems that the ORS did not give that much attention to the disparity in economic activities across jurisdictions. Almost all the transfer from the regional state is earmarked and hence the urban administrations do not have the discretion to determine where to expend it by their own.

**Table 4.1:** The annual Chiro Town ordinary budget and its relative composition

	2001(E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C) (pre Actual)	Average Growth Rate
<b>Total ordinary budget</b>	10,028,172.00	11,739,673.00	15,550,217.00	19,539,977.00	20,842,548.00	<b>20.46%</b>
<b>Recurrent Budget</b>	9,238,434.00	10,944,735.00	14,500,482.00	18,367,211.00	18,341,442.00	<b>19.37%</b>
<b>Capital Budget</b>	789,738.00	794,938.00	1,049,735.00	1,172,766.00	2,501,106.00	<b>39.42%</b>
<b>Share of the capital Budget to Total Ordinary Budget</b>	<b>7.86%</b>	<b>6.77%</b>	<b>6.75%</b>	<b>6%</b>	<b>12%</b>	

**Source:** *The Chiro Urban Administration Finance and Economic Development Office*

**Table 4.2:** The Sebeta Town Annual Ordinary Budget and its Relative Composition

	2000 (E.C) <sup>3</sup>	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	Average Growth Rate
<b>Total Ordinary Budget</b>	8,291,747.00	15,399,722.00	21,495,898.00	29,899,737.00	32,158,280.51	<b>42.99%</b>
<b>Recurrent Budget</b>	8,291,747.00	12,731,221.59	16,161,110.66	20,726,888.00	30,658,280.51	<b>39.16%</b>
<b>Capital Budget</b>	N.A	2,668,500.41	5,334,787.34	9,172,849.00	1,500,000.00	<b>29.94%</b>
<b>Share of Capital Budget to Total Ordinary Budget</b>	.....	<b>17.33%</b>	<b>24.82%</b>	<b>30.68%</b>	<b>4.66%</b>	

**Source:** *The Sebeta Urban Administration Finance and Economic Development Office and BOFED*

**N.A** - Data not available

As it can be seen from Table 4.1 above, the ordinary budget allocated to the Chiro urban administration focuses mainly on the recurrent expenditure side and the share of the capital budget had never been more than 12% of the total ordinary budget. There are also times when the share of the budget allocated to capital expenditure found to be less than the minimum 7% share. As a result, even though the average growth rate of the capital budget is more than that of the recurrent and the total ordinary budgets, its size remains very insignificant as its share remains low when compared to that of the recurrent budget.

Table 4.2 shows that, the share of the capital budget of the total ordinary budget of the Sebeta town also reached above 30% in 2003 Ethiopian calendar when compared to the practices in the

<sup>3</sup> Refers to Ethiopian Calendar.

last four years. The same table showed that this number declined to 4% in 2004 Ethiopian calendar. Even though the average growth rate of the capital budget allocated to Sebeta urban administration is less than that of both the total ordinary and recurrent budgets, the urban administration is managed to receive better amount of capital budget from the regional state when compared to that of the Chiro urban administration. The fact that the capital budget the Sebeta urban administration is receiving from the regional state is well above the minimum 7% share most of the time is also a concrete evidence for this.

However, as can be understood from Tables 4.1 and 4.2 in general, the shares of the ordinary budgets devoted to the capital budget are very insignificant to the extent that the sector offices of the Chiro and Sebeta urban administrations being financed through this budget cannot be in a position to be involved in major capital expenditure activities. In fact, Sebeta urban administration is still in a better position to spend more money on capital expenditure activities as it is mentioned before when compared to Chiro urban administration.

Thus, as service expansion works require considerable capital investments, absence of adequate capital budget is undermining the capability of the urban administrations to respond to the real preferences of the residents and to the circumstances specific to their respective jurisdictions. The problem is more serious in the case of Chiro town as it receives very insignificant amount as capital budget when compared to that of the Sebeta town.

As the ordinary budget is completely determined by the regional state, manipulating the budget so as to adjust with the preferences on the ground is also unthinkable. Therefore one cannot increase the capital expenditure share of the ordinary budget significantly in a manner it enables the urban administrations to boost their services.

The situation undermines also the accountability of the urban administrations to their respective residents because the urban administrations have limited room to determine their expenditure targets as it is allocated to mostly mandatory expenditures such as salaries and other running costs. As a result, it does not allow the local residents to question their respective urban administrations for their performance in the service provision activities being financed through these budgets.

To understand the impact of the ordinary budget allocation and other related issues on the service provision activities, one should look into the practice on the ground with this regard. Therefore, among the services being financed through the ordinary budget (WBG) the practical education service provision activities of the two towns are looked into as part of the study.

### ***Education Service***

The first school in Chiro town is Chiro number one elementary school, which is established in 1930 and became operational in 1931. The establishments of *Noh Markab* elementary and *Charchar* secondary schools in 1969 and in 1970 respectively were also the major events that boosted the education service in the town.

According to education office of Chiro urban administration, currently, one secondary, one preparatory and 10 elementary schools are in service in Chiro town, out of which three are non-governmental. The primary schools in the town all together are hosting 8107 students, of whom 3835 are females. These 10 first cycle and elementary schools all together have 265 teachers. The secondary school (9-10) in the town is also hosting 3,759 students with 72 teachers. The fact that the economic activity in Chiro town is very weak undermines the capability of the town to attract investments in general and education investment in particular to the town.

The data obtained from Sebeta education office revealed that, the town has 12 government schools out of which nine are elementary (1-8), two of them are secondary schools, and the remaining one is preparatory school. The nine government elementary schools are accommodating 10,394 children, out of which 5,508 are females. There are also 57 elementary, seven secondary and 2 preparatory non-government schools in Sebeta town. The fast growing economic activity in the town is attracting education investments to the town which obviously contributing a lot to the expansion of education service of the town as well. Especially the opening of seven private first cycle secondary schools (9-10) in the town starting from 2003 Ethiopian calendar boosted the coverage of the secondary school education service significantly.

Student-books, student-class and student-teachers ratios as well as teachers' qualification and the time devoted to the teaching learning process are among factors that affects quality of education services. If the teaching learning process is to be effective, the students should devote most of

their time for their education. That means, the students should stay at school the whole day and attend their classes accordingly.

However, both in Chiro and Sebeta towns, students are forced to attend their classes for half day only, so as to create an opportunity for all children in the town to access education on shift basis. According to education office of Chiro urban administration, had it not been for the shift system being practiced in the town, almost a third of the children from the town and its environs would have missed the opportunity to get access to education services because of shortage of classrooms and teachers.

Even though the shift system at the schools in both towns created the opportunity to accommodate all children in the towns, it did not solve the shortage of classrooms completely. One of the factors constraining the effort to provide quality education in the towns has to do with class-students ratio. Despite the fact that, the standard in place by the ministry of education for elementary schools requires class-students ratio to be 1:50, some of the classrooms in the elementary schools are accommodating 55 to 65 students at a time.

Experts from the education offices of the two towns claimed that this problem appears to be the worst at the towns' secondary schools. Officials from the education office of the Chiro urban administration admitted that class-students ratio at the town's secondary school is almost 1:85, as opposed to the 1:45 ratio standard put in place by the ministry of education.

Officials from Sebeta education office also claim that they are facing the same problem with this regard, and revealed that the class-students ratio reached 1:105 at one of the two secondary schools they have. The second school has also been suffering from the same problem until the additional classes built by the financial resource secured from the urban administration and community contribution became operational in September 2013. As a result, even though there are enough teachers at each level, absence of enough classes is constraining the effort to give quality education services in the towns.

The student class ratios that are well above the standards of the ministry of education are constraining the effort being made to realize quality education service provision in the town.

Regarding student-books ratio, head of Chiro education office revealed that even though there were problems with regard to access to textbooks earlier, now all students attending their classes

in Oromo language at all schools have at least a one to two ratio access to books for all the subjects they are attending. However, the informant explained, students who are attending their classes in Amharic language are not provided with textbooks at all.

Deputy Head of Sebeta urban administration education office also claimed that students at all levels of education in the town have a one to one ratio access to books for all subjects except those who attend their classes in Amharic language.

Therefore, even though the shortage of the textbooks in Chiro town is not as serious as that of the shortage of the classrooms in the secondary school, its impact on the education quality cannot be simple, as two students cannot access a single textbook simultaneously unless they are always together.

**Table 4.3: General Statistics for Primary Education (2003 E.C)**

	Primary Age Participation GER	Primary Age Participation GDI			Class-Student Ratio	Teachers-Student Ratio	Student-Text Ratio
		male	Female	Gap			
Chiro	100.4%	104.8%	96.6%	8.2%	1:52	1:30	Not Available
Sebeta	105.6%	103.2%	108%	-4.8%	1:38	1:28	Not Available
Oromia	92.7%	96.9%	88.5%	8.4%	1:57	1:57	Not Available
National	96.4%	94.2%	88.4%	5.8%	1:57	1:51	Not Available

**Source:** *Oromia Education Bureau & Ministry of Education*

The urban administrations are also facing difficulties to provide minorities with preference based education service. According to the two informants, the Oromia education bureau did not provide them with printed texts for schools using Amharic as their medium of instruction. The informants claim that they could manage to get only the soft copies of the Amharic version books for the teachers delivering the courses to use them. Curriculum development expert at Oromia education bureau explained that the bureau did not provide textbooks for the schools using Amharic as their medium of instruction because it could not get the Amharic version books printed as planned for all of the subjects. According to the informant, as the number of copies needed for the schools using Amharic as their medium of instruction is very small, potential printers are found to be less interested to do the job and the bid for the contract has been failed three times.

The other option to solve this problem was to coordinate the printing of the Amharic version textbooks with that of the other jurisdictions such as Addis Ababa city government or Amhara national regional state. However, the fact that the contents of the textbooks for the schools in

Oromia should take the social, cultural, and economic circumstances specific to the Oromia region into consideration makes it impossible to coordinate the printing of the textbooks with other jurisdictions.

The informant further explained that even though the contract is now awarded to printers finally, lack of capacity among the printers is still constraining the effort being made to get the books printed on time and to distribute them as soon as possible. Therefore, it will be difficult for the regional state to provide the non-Oromo language-speaking students with quality education, which disadvantages the students in every aspect. The situation might also create grievances among the non-Oromo residents.

Failure to equip the schools with the necessary materials is also among the problems that stakeholders in the two towns complaining about. According to the teachers, students and parents participated in the group discussions held in the two towns on the issue, lack of student desks, shortage of teaching materials such as duplicating papers, pens, pencils, and chinks, as well as absence of adequate laboratory materials and chemicals are constraining the effort to provide quality education services. Especially lack of desks is forcing students to share one desk for three, despite the fact that the chairs are designed to accommodate only two students at a time. Shortage of financial resources is mentioned as the major reason behind the problems mentioned above.

Even though education services up to 10<sup>th</sup> grade are supposed to be free from any payments, lack of materials is also forcing parents in the two towns to contribute financial resources to tackle such problems. However, officials from the education office of Sebeta town claim that the presence of big companies and factories in the town created opportunities to scaffold the contribution from residents with donations from these companies and to tackle the problem to some extent.

Heads of the finance and economic development offices of Chiro and Sebeta urban administrations argue that the ordinary budget (WBG) from the regional state to the urban administrations is not that much relaxing to conduct capital investments to expand the service. The successive annual ordinary budgets of the Chiro and Sebeta urban administrations in general and that of the education sector in particular is always inclined significantly to the recurrent

budget side. Thus, the chance to invest on capital projects is very slim as far as the ordinary budget is concerned.

**Table 4.4:** The Chiro Town Education Sector Budget

Budget Category	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)
<b>Total Budget</b>	5,602,387.00	6,324,657.00	7,255,444.00	9,740,347.00
<b>Recurrent Budget</b>	5,438,348.00	5,860,192.00	6,425,734.00	9,730,347.00
<b>Capital Budget</b>	164,039.00	464,465.00	829,710.00	10,000.00
<b>Capital Budget percentage</b>	<b>2.93%</b>	<b>7.34%</b>	<b>11.4%</b>	<b>0.1%</b>

**Source:** *The Chiro Urban Administration Finance and Economic Development Office*

As one can understand from Tables 4.4 and 4.5, the budget devoted to the education sector is increasing from year to year significantly. However, the budget allocation trend shows that almost all the ordinary budget being allocated to the education sector is devoted to recurrent expenditures.

Especially in the case of Chiro urban administration Table 4.4 shows that the share of the education budget allocated to capital expenditures is almost nil to the extent that the education office of the town could not rely on the annual budget to address specially shortage of classrooms. That is why the education office of Chiro urban administration is trying to tackle shortage of classrooms through community contributions.

**Table 4.5:** The Sebeta Town Education Sector Budget

Budget Category	2001(E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C) (Pre Actual)
<b>Total Budget</b>	5,259,848.18	7,751,824.00	13,557,539.90	9,304,683.50	17,861,516.00
<b>Recurrent Budget</b>	5,259,848.18	6,368,841.00	8,384,691.00	7804683.50	12,210,838.00
<b>Capital Budget</b>	-----	1,382,983.00	5,172,848.90	1,500,000.00	4,659,247.00
<b>Capital Budget percentage</b>	<b>0%</b>	<b>17.84%</b>	<b>38.15%</b>	<b>16.12%</b>	<b>26.09%</b>

**Source:** *Sebета Finance and Economic Development office*

However, as one can understand from Table 4.5 the Sebeta town is in a better position when it comes to capital expenditure activities in the education sector when compared to that of Chiro town because, it is allocating relatively better amount of money for capital expenditure activities. Even though ORS considers infrastructure gap when it estimates expenditure needs, the fact that this component covers only 7% of the total grant transfer makes it very difficult for the urban administrations to allocate substantial share of the grant transfer to capital expenditures. However, the fact that Sebeta town has better economic activities put its urban administration in a better position to devote additional money from municipality revenues for non-municipality service provision capital expenditure activities when compared to that of Chiro.

In addition to that, the fact that the urban administrations are fully dependent on WBG from the regional state for non-municipality expenditures such as education and health, is forcing them to focus on what the regional state wants them to do rather than to respond to the preferences of their respective residents and to the specific circumstances on the ground. Had they been entitled to generate financial resources that match their expenditure responsibilities, they could have been responsive to the preferences of their respective electorates.

Thus, one cannot expect the problems related to shortage of classrooms can be solved for good unless the share of the budget that will be devoted to capital expenditures is significantly increased. As most of the recurrent budget is devoted to salaries and other mandatory expenditures, there is no possibility to increase the capital budget without increasing the total ordinary budget in a manner there will be a room to devote significant amount of money to capital expenditure activities.

In addition to that, though the ordinary budget inclines to the recurrent budget significantly, it does not mean that the urban administrations have enough financial resources to cover their running costs. As discussed in the previous chapter, the inability to provide the schools under the urban administrations with the necessary teaching and supporting materials are also made their sources mainly the shortage of financial resources the urban administrations are facing every year.

Therefore, even though the absence of meaningful capital expenditures is the major problem undermining the urban administrations capability to expand their services to the level it matches the needs on the ground, the inadequacy of recurrent budgets is also forcing the schools to operate under serious financial constraints and undermining the quality of the education service in the two jurisdictions.

The partial solution is possibly to increase the total ordinary budget size in a manner it gives the urban administrations a leeway to devote significant amount of money for capital expenditures and to ease the burden related to running costs. However, as the urban administrations especially that of the Chiro town are not in a position to generate significant amount of money from own revenue sources, reassignment of taxation powers might be needed if the urban administrations are to provide their residents with adequate and preference based services.

The economic activity disparity between Chiro and Sebeta towns is also creating a big difference in urban public service provision capability between the two jurisdictions. While the big companies in Sebeta town are sharing the residents' burden with regard to contributions for school running costs and development works, the residents in Chiro town are carrying the burden of contributing for school running costs almost alone in addition to the effort they are making to construct new schools and additional classrooms. As the grant transfer requirements take the number of school age children into consideration, Sebeta urban administration receives more grant transfers in the name of the school age children while many of the children in the town are receiving education services from the private schools in the town, which is not the case in Chiro town.

As it is listed in Table 4.6, the private schools in Sebeta reached 57 while the number of private schools in Chiro is only nine. The number of private secondary schools in Sebeta is seven while there is no a single private secondary school in Chiro. The Sebeta urban administration has this advantage because of its better economic activities.

**Table 4.6:** Number of Elementary and First Cycle Secondary Schools in Sebeta Town

№	Year	Elementary Schools			Secondary Schools		
		Government	Private	Total	Government	Private	Total
4	2001(E.C)	8	33	41	1	-	1
5	2002 (E.C)	8	37	45	2	3	5
6	2003 (E.C)	8	46	54	2	5	7
7	2004 (E.C)	9	57	66	2	5	7
8	2005(E.C)	9	57	66	2	7	9

**Source:** *Sebeta Education Office*

Therefore, if it is to provide comparable basic public services along all the jurisdictions, the regional government has to take, not only the income generation capacities of jurisdictions at the same level but also the advantages the towns with better economic activities have, into consideration when it allocates grants to the urban administrations.

The better economic activity in Sebeta is enabling the urban administration's education office secure additional subsidy from the municipality at least in the form of capital expenditures for the construction of new schools and additional classrooms. The elementary school and the additional classes for one of the secondary schools constructed last year and the additional classes under construction for the other secondary school in the town are among the benefits the Sebeta town is securing because of its better economic activities. The financial contributions from business firms

in the town to solve the problems related to shortage of classrooms and school running costs are also additional advantages the Sebeta urban administration has.

However, that does not mean that the capital budget allocated from the urban administration is always secured. The trend of capital budget performance of the Sebeta education office indicates that there are times when the allocated capital budget is unavailable.

**Table 4.7:** Sebeta Town Education Sector Capital Budget Performance

	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Capital Budget</b>	1,382,983.00	5,172,848.90	1,500,000.00	4,659,247.00
<b>Performance</b>	1,374,014.00	1,171,198.50	1,500,000.00	2,369,974.69
<b>Performance percentage</b>	99.35%	22.64%	100%	50.87%

**Source:** *Sebata Finance and Economic Development office*

As can be seen from Table 4.7, the amount of capital budget secured from the municipality revenue in the fiscal years 2003 and 2005 is only 22.64% and 50.87% of the plan respectively.

#### 4.1.2. Expenditure Practices under the Municipality Budget

Municipality budgets are planned financial resources to fund municipal services such as, sanitation, intra-town road construction and maintenance, sewerage, and drainage services among others.

The Chiro and Sebata urban administrations' municipality budgets made their sources totally own tax bases of the urban administrations themselves. The urban councils of the two towns are also in charge of determining their budget and their expenditure areas among others. They have the mandate to scrutinize their respective municipality budget in detail, to seek reconsideration and to approve its implementation. The councils are also in charge of questioning the sector offices to ensure effective implementation of the plans on behalf of the electorates.

According to the Heads of the finance and economic development offices of the two urban administrations, their respective offices are responsible to assess the need on the ground in cooperation with the sector offices in their respective urban administrations and to prepare the budget in detail. These informants explained further that, they engage residents in the planning process through elected *kebele* and urban council members. What makes the Chiro and Sebata urban administrations' municipal budget different from their respective ordinary budget is that, its significant share goes to capital expenditures.

The trends described in Tables 4.8 and 4.9 indicate that both the Sebeta and Chiro urban administrations' municipalities' budgets gave better attention to capital expenditures. As one can see from Table 4.8 and Table 4.9, the shares of the capital budget are at least 40% in the case of Chiro town and even far more than that of the Chiro in the case of Sebeta for all the fiscal years under consideration. However, the real practice on the ground making it difficult for the Chiro urban administration to involve in expenditure activities as it is described in Table 4.8.

**Table 4.8:** The Chiro Urban Administration Municipality Budget and its Composition

	2001(E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005(E.C)
<b>Total Budget</b>	5,556,511.00	5,209,744.00	10,202,734.00	10,010,044.00	13,450,000.00
<b>Recurrent</b>	3,289,150.00	3,110,344.00	4,360,734.00	4,675,659.00	7,842,066.00
<b>Capital</b>	2,267,361.00	2,099,400.00	5,842,000.00	5,334,385.00	5,479,000.00
<b>Share of the Capital Budget</b>	40.8%	40.3%	57.26%	53.29%	40.74%

**Source:** *The Chiro Urban Administration Finance and Economic Development Office*

**Table 4.9:** The Sebeta Urban Administration Municipality Budget and its Composition

	2001(E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Total Budget</b>	67,803,336.00	112,121,962.00	133,726,753.00	128,415,899.00	121,126,255.00
<b>Recurrent</b>	18,603,176.00	38,641,582.00	44,354,463.00	51,855,899.00	42,600,000.00
<b>Capital</b>	49,200,160.00	73,480,380.00	89,372,290.00	76,560,000.00	78,526,255.00
<b>Share of the Capital Budget</b>	72.56%	65.54%	66.83%	59.62%	64.83%

**Source:** *Sebata Finance and Economic Development office*

**Table 4.10:** Performance Trend of the Sebeta Urban administration Municipality Budget

	2001(E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005(Pre Actual)
<b>Planned Budget</b>	67,803,336.00	112,121,962.00	133,726,753.00	128,415,899.00	121,126,255.00
<b>Actual Budget</b>	35,028,329.48	50,278,003.62	51,459,699.52	56,602,795.43	52,131,568.34
<b>Performance</b>	51.66%	44.84%	38.48%	44.08%	43.04%

**Source:** *Sebata Finance and Economic Development Office*

The municipality budgets of Chiro and Sebeta Urban Administrations are supposed to be devoted to the municipality expenditure responsibilities such as, among others, sanitation and street lighting, internal road construction and maintenance services. However, the Sebeta urban administration allocates some amount of money to other expenditure areas that are not supposed to be financed through the municipality revenue. According to the head of budget planning and performance review department of Sebeta finance and economic development office, the 4 million birr school construction budget allocated this fiscal year from the municipality own revenue are among the subsidies the urban administration is allocating even to the non-municipality services when necessary. The urban administration is also allocating up to one million birr a year to the water service office of the town despite the fact that the water service

office of the town is considered as an autonomous agency that should cover its annual running costs through its own revenue.

The amount the municipalities of the respective urban administrations are generating determines their expenditure nature. To implement their expenditure plan as it is, the municipalities have to secure the amount of money they allocated as the municipality budget of each fiscal year. Even though the urban administrations has better discretion to plan and approve the municipality budget as opposed to the case for the ordinary budget, the budget trends displayed in Tables 4.11 and 4.12 Clearly show that there are situations in which the municipalities may fail to secure the planned municipality revenue. The municipality budget trend of Chiro urban administration listed in Table 4.11 indicates that Chiro municipality has never been in a position to secure more than 50% of its annual budget from its own revenue sources. The failure of the Chiro urban administration municipality to secure at least half of the annual budget allocated to finance the municipality services shows that, the municipality has been operating under serious budget constraints to the extent that it could not even cover its recurrent budgets, let alone to have some extra money to devote for capital expenditure activities.

The figures displayed in Table 4.12 shows that, among the Chiro municipality budgets of the last five years, the first three had failed to cover even the recurrent budgets and showed 676,176, 908,180 and 736,244 ETB in 2001, 2002 and 2003 Ethiopian calendar respectively. Thus, one can conclude that the Chiro municipality has never been financially capable to provide its residents with preference based local public goods and services during this period.

**Table 4.11:** The Chiro Town planned Municipality Budget and the Amount Secured

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Allocated Budget</b>	5,556,511.00	5,209,744.00	10,202,734.00	10,010,044.00	13,450,000.00
<b>Secured Budget</b>	2,612,974.00	2,202,164.00	3,624,490.00	4,954,735.00	
<b>Share of Secured Budget</b>	<b>30.68%</b>	<b>42.27%</b>	<b>35.5%</b>	<b>49.5%</b>	

**Source:** *The Chiro Urban Administration Finance and Economic Development Office*

**Table 4.12:** The Recurrent Budget in Comparison with the Municipality Revenue of Chiro Town

	2001(E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Secured Revenue</b>	2,612,974	2,202,164	3,624,490	4,954,735	
<b>Recurrent Budget</b>	3,289,150	3,110,344	4,360,734	4,675,659	7,842,066
<b>Difference</b>	<b>-676,176</b>	<b>-908,180</b>	<b>-736,244</b>	<b>279,076</b>	

**Source:** *The Chiro Urban Administration Finance and Economic Development Office*

To understand the real impact of these budget trends, one should look into the practical provision of services being financed through the municipality budget *per se*. As sanitation service is among

the municipality services supposed to be financed through the municipality budget, the practical activities of the two towns with this regard are examined as follows.

### ***Sanitation Services***

Sanitation services include street cleaning, dry-waste removal and disposal services. The removal and disposal of sewages including that of toilets is also among the sanitation services the urban administrations are providing.

#### ***❖ Sanitation Services of Chiro Town***

Consulted official documents from finance and economic development office of Chiro urban administration indicate that, the population in Chiro and Sebeta towns exceeded 68,000 and hence the waste being produced in the town is increasing in the same manner.

Head of the sanitation and beautification department of Chiro municipality stated that the town produces at least 29,880 metric cubes of dry wastes and 15,000 metric cubes of sewages annually. The informant further added that the urban administration was expected to remove and dispose these wastes safely. It is also supposed to have three dry waste trucks, 1 vacuum truck, and at least 50 sanitation workers to conduct waste collection, separation, recycling and dumping activities. There should also be temporary and permanent dumping areas to dump and to process both dry wastes and sewages safely.

However, the practice on the ground in Chiro town with this regard is completely different from what is supposed to be. The town and its residents are suffering from absence of waste removal services. Even though the municipality has sanitation and beautification service department, the department is not organized in a manner it can give these services properly.

The informant explained that the Chiro urban administration municipality has no workers that are involved in street cleaning as well as in waste removal and disposal activities at all. According to the informant, absence of dry waste disposal trucks and other equipments, absence of temporary and permanent dumping areas and landfill systems to remove and dump dry wastes safely are among the main problems residents are complaining about.

Residents participated in the group discussion on the issue also revealed that coming across solid wastes dumped on streets and in drainage ditches are familiar scenes for anybody in the town or

visited the town occasionally. Community health expert at the Chiro health office also claims that family breadwinners who vend different products, including the local stimulant *chat* along the roadsides in the town are the most vulnerable group of people to different diseases emanating from rotten wastes dumped here and there in the town.

residents who are located near to and along with the seasonal river crossing Chiro town '*Chiro Qala*', are also dumping wastes in the river in a manner it can pollute their environment and the downstream areas. Inhabitants of the hinterland, especially that of the downstream areas along the *Chiro Qala* river are already complaining about the risk of pollution resulting from the inappropriate waste disposal activities in the town.

The fact that the physical structures that are mandatory for sewage removal and disposal services are not in place at all is also another factor aggravating the dire situation. The fact on the ground clearly shows that, the town does not have sewerage systems at all starting from the beginning and the problem is persisting to the extent that the residents have no any safe mechanisms to remove and dispose their sewages including that of toilets. Absence of vacuum truck that can be used to remove toilet wastes is the main obstacle aggravating the problem to the worst.

As a result, participants of the group discussion and the manager of Chiro municipality explained, there are times when even some government institutions like the prison facility in the town as well as hotels and other service providers usually release their toilet sewages and other liquid wastes during rainy seasons so that it can be washed away by floodwaters. These informants added that people dump liquid wastes during nighttime on the streets also. For owners of hotels and restaurants as well as for some residents, the best they can do to remove toilet sewages is to hire vacuum trucks from other urban areas like Adama and Dire Dawa, which residents say is costly for most of them.

According to the manager of Chiro municipality, the fact that the town lacks reliable drainage ditches along the existing 42 km long internal road system and dry wastes are blocking the existing drainage ditches most of the time are the other problems constraining the effort to make the town more comfortable to its residents.

As a result, the floodwaters are affecting internal roads of the town during rainy seasons and the residents are feeling the damage already. The residents blame absence of timely road

maintenance and drainage cleaning activities from the administration for aggravating the dire situation to the worst. As a result, they claim, floodwater inundation incidents are damaging private belongings and affecting their life in many aspects.

The manager of the municipality admitted that the drainage system coverage of the town is not more than 10% and it is common to see floodwaters inundating the roads in the town during rainy seasons because, the existing drainage ditches are filled and blocked with dry wastes most of the time.

A Community health officer at Chiro urban administration health office explained that the effort the health office of the town is making to create awareness among the residents and to realize healthy urban environment is being constrained by absence of coordinated sanitation service. The officer argued that if it was to make the awareness creation activities fruitful the people should have been provided with safe mechanisms to remove and dispose their wastes. However, the informant claims, because of the absence of such services the environment is losing its hospitability and some health cases being reported repeatedly at the health facilities in Chiro town are implicating the filthy environment as the cause.

The reason behind the absence of sanitation services in Chiro town is much complicated than that of the Sebeta urban administration. The failure of the municipality to implement the planned budgets effectively is affecting the municipality's service provision activities adversely. The fact that the municipality could not generate financial resources that matches its expenditure responsibilities is one of the major problems behind the failure to provide the residents with quality services with this regard.

Shah (2007:20) argued that if levels of government are to satisfy local preferences the revenue they generate from their own revenue sources should be matched to their expenditure responsibilities as closely as possible. However, as it is discussed in Tables 4.11 and 4.12, the Chiro urban administration planned municipality budget could not be matched to the actual revenue the municipality is generating, which in turn is undermining its capability to respond to the local preferences and to the circumstances specific to the town.

As it is discussed in the previous chapter, lack of financial resources is not the only reason behind the poor service quality and under provision of services in Chiro town. The findings from group

discussions and interviews with the municipality and finance office officials of the town revealed that financial mismanagement, including lack of budget discipline and wasteful utilization of public funds are among the factors adversely affecting the provision of municipality services of the Chiro urban administration.

That means absence of well-organized revenue generation and service provision plans, lack of commitment to devote all the revenue generated from the residents in the name of municipality services for the provision of the municipality services the residents need more is the major problem that undermined the effort to provide adequate services with this regard.

The fact that the Chiro urban administration was spending the revenue it was generating in the name of municipal services (including sanitation) to compensate farmers evicted from their lands, so as to provide individual residents with urban lands for residential house construction is one of the factors that had been affecting municipality services adversely.

The municipality manager and the head of the finance and economic development office of Chiro urban administration explained that especially the devotion of almost all the municipality revenues to expenditures related to land compensation payments is the major problem that affected the service provision activity adversely. These informants explained that almost for the last five years, the urban administration has been paying the revenue being collected from residents in the name of municipal services such as sanitation as compensations for urban land expansion purposes so as to provide residents with residential house construction plots.

According to these informants, the Chiro urban administration was paying at least 50,000 birr for a plot of land to be apportioned among at most three persons. However, they further explained, it used to collect 50 birr from each land recipient, 150 birr from the three land recipients. That means the urban administration had never tried even to recover the money it was paying for compensation from the land recipients at all. The informants explained further that, it is possible to say the urban administration had been distributing the land it secured through payments of high amount of money to residents free of payments.

As the financial resources devoted to land compensation payments was meant to be spent on municipal services, the expenditure diversion obviously forced the municipality to compromise the services it was expected to provide. Therefore, this expenditure decision clearly shows that,

the Chiro urban administration has been violating the principles that require to establish strong relation between revenue collected from and services rendered to its residents. This fiscal practice not only broke the strong nexus supposed to exist between the revenue collected and the service provided but also opened a loophole for residents with better financial capacities to receive unfair benefits by making urban lands accessible to them almost free of charge.

What made this expenditure practice more hurtful for the residents was that, the fee the Chiro urban administration was collecting from the land recipients has been very insignificant to cover the compensation the municipality was paying to the farmers. This situation did not only hamper the municipality not to provide the residents with the services they paid for, but also distorted the resource allocation by forcing the poor to subsidize residents with better financial status including the rich.

The manager of the Chiro municipality explained that especially the zonal administration was also forcing the urban administration to pay land compensations to the urban lands needed for its sector offices. The informant revealed also that the mayors, who were in office at different times, had been approving inappropriate payments from the municipality account for different purposes such as per dime payments for civil servants from sector offices of both the urban and the zonal administration.

#### ❖ *Sanitation Service of Sebeta Town*

The situation in Sebeta town is a little bit different in this regard. Head of the sanitation and beautification department of the Sebeta town municipality revealed that even though the amount of waste the town is producing is not to the knowledge of the municipality so far, the department is removing and disposing 25,550 metric cube dry wastes and 10,560,000 liters of sewage annually using one vacuum and two dry waste trucks. According to the informant, the sanitation and beautification department organized eight small-scale enterprises, which are giving door-to-door waste collection and removal services at some parts of the town by charging the residents a certain amount of payments. He added also, the department organized residents in 1 to 5 systems to mobilize them to clean their areas regularly.

The informant explained further that the department is using the dump trucks and loaders, the urban administration is employing for internal road construction and maintenance activities as

additional logistics to boost the capacity of the sanitation department so as to enable it to remove and dispose as much wastes as possible temporarily.

As opposed to Chiro town, Sebeta town has open waste dumping area and it is planning to construct a sanitary landfill with a cost of 45 million birr. The town's urban administration allocated 3 million birr budget already to ensure the commencement of the project before the end of the fiscal year.

Even though, the Sebeta urban administration is providing relatively better sanitation services when compared to that of the Chiro town, its failure to boost the service to the level that comply with the local preferences shows that it is not in a position to respond to the needs on the ground effectively so far. Residents participated in the group discussion revealed that the waste removal service the department is providing is not satisfying the need on the ground as significant amount of waste remain uncollected.

In fact, as it is the case for the ordinary budget expenditure activities, lack of financial resources is mentioned once again as one of the reasons behind the inefficient provision of municipal services including sanitation. According to the Head of the sanitation and beautification department of Sebeta Urban Administration absence of adequate equipments and workforces resulting from lack of financial resources, is found to be the main reason behind inadequate sanitation services in the town. However, residents participated in the group discussion on the issue argue that lack of financial resources is not the only problem. They claim that there are also other factors that should be looked into if it is to tackle the problems affecting the service provision activities effectively.

These residents are of the opinion that the fast growing economic activities in the town that lead to the overwhelming migration of people to the town and the uncontrolled expansion of the town itself are among the major factors that affected the sanitation service provision activities of Sebeta town adversely. According to these residents, the fact that the urban administration was giving land to almost all the people coming from other jurisdictions facilitated the fast growth of the population size in the town. As a result, the sanitation service the urban administration is providing could not catch up with the population growth and the gap is widening because the

administration was not striving to expand the service provision in parallel with the population growth.

As it is mentioned before, in fact the annual municipality budget of the Sebeta urban administration is far better than that of the Chiro town as Sebeta urban administration generates better revenue from its own sources than that of Chiro town. However, as opposed to the argument from Shah (2007:24) that prohibits local governments not to finance their redistributive programs using self-revenue sources, Sebeta urban administration is dedicating significant amount of its financial resources from the municipality revenue to the non-municipality services it is providing. This in turn obviously affects its municipality service provision activities including that of the sanitation service adversely. The fact that the Sebeta urban administration is allocating up to one million birr for its water service provision activities annually from the municipality revenue is one such a case.

### ***Clearwater Supply***

According to a communication officer at water, mining, and energy Bureau of ORS, with the effort made to boost the clean water service all over the region, the total clean water service coverage of the region reached 71.36 % as of the end of 2012/13 fiscal year. The informant explained further that the average clean water service coverage of the rural and urban areas of the regional state reached 68.57% and 89.7% respectively. The communication director of the ministry of water and energy of FDRE also revealed that the average national clean water coverage for rural and urban areas reached 66.54% and 81.31% respectively as of the end of 2012/13 fiscal year. Therefore, one can conclude that Oromia is doing well in its effort to boost access to clean water in the urban areas.

Even though urban water service is considered as one of the municipality services, its structural arrangement in the two study areas made it out of the municipality control. The water service offices are organized as autonomous bodies so as to enable them provide preference based services to their customers including the poor. Their financing mechanism is also designed in a manner it is detached from both the ordinary and municipality budgets, as they are authorized to collect their own revenue and determine their budget independently.

The water service offices in the towns are responsible to produce the water, to put in place the infrastructure and to distribute the water to their respective beneficiaries. The only support they expect from the upper level of government with this regard is limited to technical supports in the form of expertise, machineries, and related materials.

To understand the level of satisfaction of the residents there is a need to look into the water service provision activities in the two towns thoroughly.

#### ❖ *Clean Water Service Provision in Chiro Town*

The water service office of Chiro urban administration is responsible to provide nearly 69,000 residents with adequate clean water.

According to the Head of the water service office of Chiro urban administration, the water service of the town has its own board of administration with eight members. However, only two of the members are representing the residents. The rest of the board members are from different sector offices of the urban administration. Even though chairperson of the water service board of the town is used to be from the urban administration previously, currently the head of the zonal water service office is in charge of chairing the board.

The water service board of the town has the mandate to determine the total budget and expenditure targets of the budget in detail. However, the board is not authorized to hire or fire workers of the water service office. According to the head of the water service office, such decisions have to be approved by the regional water resource bureau before implementation. Thus, one can conclude that the town's water service provision activities are not free from interventions from the higher level of government.

Consulted documents from the water service office of Chiro urban administration indicate that, the water service of the town is an extension of the old services of the previous regimes. According to the Head of the water service office of the town, the initial water service was introduced in early 1960s and it was designed to produce 50m<sup>3</sup> of water per hour and to serve the then population size, which was below 20,000.

According to the head of the water service office of Chiro urban administration, as the actual water production could not match with the need on ground, the Oromia Regional State drilled one

borehole in 2008 to boost the water production of the town. The informant added that the Chinese asphalt road project also awarded the borehole it drilled for self-consumption in 2004, to the water service office of the town as it completed its project in the area. However, the latter two are not functioning now, because of pumping system failure and exhaustion of the borehole respectively. As a result, the residents of Chiro town are being forced to scramble over the service constructed more than four decades ago to serve the then population size, which was below 20,000.

According to consulted documents from Chiro town water service office, there are 3650 registered customers who are connected to the service directly; out of which 3538 are private households and 88 are governmental and nongovernmental organizations. The rest 34 are public tap water service points for residents not connected to water service directly. According to the Head of the Chiro water service office, the overall coverage of the water service of the town is around 45%, which is very low when compared to both the national and regional average clean water service coverage for urban areas, which is 81.31% and 89.7% respectively.

The fact that the capacity of the water service of Chiro town decreased from 50m<sup>3</sup> to 30m<sup>3</sup> per hour as the existing water wells are being exhausted and the water pumping system is also ageing from time to time has also aggravated the shortage further. Thus, the residents are getting far below the water service they need. Accordingly, there are times when residents of some parts of the town are forced to wait for more than three days before they manage to get some water. The newly expanded hillside villages are among the most affected parts of the town with this regard.

Residents of Chiro town are not surprised with the current water service falls short of satisfying their need, as they are well aware of the fact that it is not designed to serve the existing population size. What the residents are complaining about is that, the urban administration could not be visionary to forecast the problem and to tackle it before it reached the current crisis point. The residents, who participated in the group discussion on the issue, said that the water service office was not giving any attention to satisfy them with the water service it is providing.

Head of the water service office of Chiro urban administration is not taking what is happening to the provision of the water service as a problem caused by the fault of the office only. The informant argued that shortage of budget is the main reason behind inadequate and inefficient

water service in the town. According to the informant, the amount of revenue being generated from the water service charge does not match the need on the ground. The informant revealed that the water service office of the urban administration has no authority to set its water service charge rates. As it is mentioned in the literature review, Bahl & Linn (1992:470) explained that user charges can be structured in a manner they can help to meet revenue adequacy, efficiency, and equity objectives. Thus, it is obvious that the inability of the urban administration to set its service charge rates is affecting its capability to ensure at least revenue adequacy.

The informant explained further that as the office is dependent only on its own revenue and it could not generate significant amount of money to cover its costs, it devotes its entire annual budget to salaries and other running costs.

**Table 4.13:** The Chiro water service office annual budget and its performance

	2000 (E.C)	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Annual Budget</b>	577,860.40	693,051.41	1,048,622.50	1,352,200.56	1,908,468.00	1,524,831.21
<b>Performance</b>	528,326.27	599,743.96	702,548.09	868,538.53	1,586,366.60	1,116,218.34
<b>percentage</b>	91.43%	86.54%	67%	64.23%	83.1%	*73.2%

**Source:** *Chiro Water Service Office*

As it can be seen in Table 4.13 the Chiro urban administration water service office budget does not include major capital expenditures at all. As it is mentioned before, the Chiro water service office is not in a position to allocate significant amount of money for capital expenditures from the limited revenue it is generating. The absence of significant capital budget by itself indicates that the office is not involved in major capital expenditure activities at all. Thus, the capital expenditure activities of the office are mostly limited to minor maintenance works on the existing water service infrastructures with the aim to sustain the service as much as possible. The failure of the water service office to dedicate some of its financial resources to water service expansion projects in turn is hampering it not to expand its service parallel to the increasing need on the ground.

Therefore, the very serious water shortage problem residents of the town are facing now finds part of its sources in the absence of capital budget. The water service office is operating under serious financial constraints to the extent that the service is deteriorating to the worst which obviously emanates from weak revenue capacity of the urban administration and absence of the authority to set its own service charge rates and hence to determine its revenue size.

Lack of workforce is also the other problem mentioned for constraining the effort being made to provide adequate clean water in the town. The head of technical service department of the water service office claim that until the current fiscal year the office had been suffering from shortage of manpower. According to the informant, lack of financial resources forced the office to operate with a limited number of workforces, which obviously hampered the office not to implement even its recurrent budget effectively.

When it comes to planning process, the head of the water service office revealed that the planning processes of his office is not participatory that much. The informant explained that the water service office consulted the residents on its plan for the first time at the beginning of this fiscal year.

The head of the water service office of Chiro town claims that now to satisfy the daily water need of the residents, there is a need to increase the current 30m<sup>3</sup> water production capacity to 120m<sup>3</sup> per hour. He explained also that the regional state is now constructing a water project that can produce 120 to 150m<sup>3</sup> of water per day with a 100 million birr budget secured from the World Bank as a long-term loan. However, he is of the opinion that, the water service of the town should have been upgraded frequently in parallel with the population growth and he blamed the less attention given to the water service for causing the current serious problem.

This informant further explained that even though the study for the ongoing water project was commenced a decade ago, it could not be practical on time because of lack of follow-ups and attention. The manger of the municipality on his part argued that fear of the risk of being indebted that emanated from lack of confidence to manage the project in general and the loan money in particular is also the other problem that forced the project to lag behind.

#### ❖ *Clean Water Service Provision in Sebeta Town*

The water service office of Sebeta urban administration is responsible to provide above 110,000 residents with adequate clean water.

According to the Head of the customer service department of Sebeta water service office, the office has its own board of administration with eight members. However, only one of the members is representing the residents. The rest of the board members are mostly from different

sector offices of the urban administration. However, as opposed to the case at Chiro town, the mayor of the Sebeta urban administration is chairing the water service board of the town.

The informant revealed that the initial water service facility of Sebeta town was constructed in 1960s Ethiopian calendar and it was designed to serve not more than 500 households. According to the informant, it was starting from the year 1999 Ethiopian calendar that the Sebeta urban administration began to expand the service further so as to enable it satisfy the fast growing population of the town. Consulted official documents from the urban administration indicate that, the first significant water service expansion project, which elevated the water service coverage of the town to 61% was financed through contributions from the community, businesses in the town, the regional government and the urban administration itself.

However, Head of customer service department of the water service office revealed that the overwhelming population growth registered in Sebeta town then after forced the coverage of the water service to decrease down to 45% again. The informant further explained, the expansion work that has been conducted in 2003 and 2004 Ethiopian calendar with the cost of above 4,400,000 birr enabled the service coverage to rise again to 65% with water production of 5,500m<sup>3</sup> per hour. Consulted documents from the water service office revealed that, out of the total expenditure on this project, above 2,394,000 birr was covered through community contributions while the rest of the budget was allocated by the urban administration itself.

Currently the water service office of Sebeta town has 10,939 customers directly connected to the service, out of which 10,293 are residential houses. 102 governmental and public organizations as well as 544 businesses are also among the customers directly connected to the water service in the town. Residents who are not connected to the water service directly are also using above 82 public tap water service points across the town.

According to the Head of customer service at the water service office of Sebeta urban administration, the office is forced to use shift systems so as to fairly distribute the limited water it is producing among these customers. Residents who are participated in the group discussion on the issue blamed the urban administration for not making any significant effort to expand the water service equally with the fast population growth the town is experiencing. The failure to limit the expansion of the town in a manner it can conform to the real potential on the ground to

expand the water service is the major problem the residents are complaining about. Even though one can tell that the Sebeta water service provision is in a better position when compared to that of the Chiro town, the 65% water service coverage is still very low when compared to both the national and regional average clean water service coverage for urban areas, which is 81.31% and 89.7% respectively.

The budget officer of the Sebeta water service office explained that shortage of financial resource is forcing the water service office to abandon major capital expenditure activities and hence it couldn't expand the service to the level it matches the need on the ground. According to this informant, almost all the budget of the water service office focused on recurrent expenditures, to the extent that all the water service provision activities of the office limited to sustaining the existing service.

The head of customer service of the Sebeta water service office on his part argue that the amount of revenue used to be generated from the water service charge until recently couldn't cover even the running cost and salary payments of the office let alone to finance additional expansion activities. He claims also that had it not been for the financial contributions from the residents, the business community, the urban administration and the regional state, the service coverage would have been decreased significantly to the worst as the water service expansion activities conducted so far had been financed significantly through contributions.

Consulted revenue and budget performance reports from the Sebeta water service office indicated that, the expenditure performances of the office are also poor.

**Table 4.14:** The Sebeta water service office annual budget and its performance

	2000 (E.C)	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)
<b>Annual Budget</b>	6,073, 221.92	6,346,117.45	6,654,413.60	6,516,887.56	6,105,046.78
<b>Performance</b>	4,065,819.6	4,325,327.99	5,163,474.99	5,117,846.35	5,374,723.69
<b>percentage</b>	66.95%	68.16%	77.59%	78.53%	88.04%

**Source:** *Sebeta Water Service Office*

As one can understand from Table 4.14, the Sebeta urban administration is has never achieved its expenditure plan more than 88.04%, which shows that there is either exaggerated budget plan, lack of implementation capacity or absence of enough secured revenue.

According to the revenue and budget performance report documents of the Sebeta urban administration water service office, failure to generate the planned revenues in a manner it can

cover the planned budget every year is the major reason behind the failure to secure and expend the budget plans as they are. Lack of budget planning and implementation capacity is also the other possible source of the ineffective budget performance.

Despite the fact that it is argued there is a need to put in place efficient price structure for a given public service so as to ensure service welfare (Bahl & Linn 1992:241), the Sebeta urban administration is not covering its water production, distribution and provision costs through the revenue it generates from the service it is providing. As a result, the head of finance and economic development office of Sebeta urban administration explained, the urban administration is being forced to subsidize the water service provision activities from other municipality revenue sources in addition to the six million birr matching fund it contributed to the ongoing World Bank funded water project of the town. Therefore, the water service it is providing is not based on the principle of cost recovering.

According to Dillinger (1994:27), making water services dependent on subsidies and restriction on the level of charges by higher levels of government cannot realize poverty reduction effectively; it rather constrains the effort to provide efficient services. However, as opposed to this argument, the water service in Sebeta urban administration is being subsidized from other municipality revenue sources in a manner it opens loopholes to benefit non-poor residents inappropriately and it encourages overconsumption. The financial constraint it is causing on the other municipality services is also another unwanted consequence emanating from the subsidy.

When it comes to planning process, officials from the water service offices of Sebeta urban administration explained that the planning processes of their office is not participatory that much. According to the Head of the customer service department of Sebeta water service office, the water service office has established no coordinated mechanisms to participate the residents in its planning processes and it uses rather individual feedbacks as a means of shaping its services in favor of local preferences.

#### **4.2. Revenue Generation Practices in Chiro and Sebeta Urban administrations**

As it is discussed in the literature review, if local governments are endowed with significant expenditure responsibilities, they should also be empowered to generate revenue comparable to the expenditure responsibilities they are in charge of, from their own revenue sources locally.

Different ways can be used to enable local urban governments to generate significant amount of revenue from their own revenue sources locally. Devolving more productive local tax bases, giving them the space to expand their tax bases, and endowing them with the mandate to set at least their tax rates are among the mechanisms that can be used to enable the urban local governments to generate significant amount of revenue that match their expenditure responsibilities as much as possible.

Looking into the practices in Chiro and Sebeta urban administrations with this regard the researcher found out that the two towns are not given the chance to boost their own revenue to the level that matches their expenditure responsibilities. Especially the Chiro urban administration is generating very insignificant amount of money to the extent that it abandoned some of the services it is supposed to provide.

First and second grade urban administrations in ORS have four financial sources at least at legal frameworks level. Own revenue which normally known as municipality revenue, block grant transfer from the regional state which normally called ordinary budget and access to financial markets as well as community contributions and donations are legally recognized revenue sources of urban administrations

According to the heads of finance and economic development offices of Chiro and Sebeta urban administrations, revenues being generated in the towns are categorized into two based on the jurisdiction to which the revenue sources belong. The first category, which is known as ordinary revenue, made its source the regional state's tax bases in the respective towns. The second category, which is known as municipality revenue on its part made its source the revenue sources assigned to the urban administrations themselves.

The informants further explained that the only revenue considered as own revenue of the urban administrations is the municipality revenue. The ordinary revenues being generated from the revenue sources of the regional state in the respective towns are rather considered as state revenues. However, both municipality and ordinary revenues are being administered by the revenue offices of the regional state in the respective urban administrations.

The water service offices of Chiro and Sebeta urban administrations are also collecting their own revenue separately. It is the autonomous status given to the water service offices of the towns

that made them in charge of collecting the water service charges and other revenues by their own. Thus, to understand more about the revenue generation and state transfer practices of Chiro and Sebeta urban administrations, there is a need to look into the respective municipality revenue, ordinary revenue and state transfer as well as borrowing activities thoroughly.

#### **4.2.1. Own Revenue Generation Practices in Chiro and Sebeta Towns**

Own revenues of the respective urban administrations are revenues that made their sources the tax bases, service charges and fees assigned to the urban administrations themselves by the legal frameworks of the regional state. The revenues from the urban administrations' bases are grouped together as municipality revenue. However, the revenue from the water service charges in the two towns is being collected separately as the water service offices of the towns are organized separately as autonomous bodies. Therefore the researcher looked into the own revenue generation activities of the towns by scrutinizing the municipality revenue (excluding the water service revenue) on one hand and the water service revenue on the other.

##### **4.2.1.1. Municipality Revenues<sup>4</sup> of Chiro and Sebeta Towns**

As it is mentioned in chapter three, consulted documents from the Oromia Revenue Bureau (ORB) shows that taxes such as city house tax, assurance and entertainment taxes; Non taxes such as city land rent, residential and trade houses rent, municipal investment income as well as private and community contributions are among the municipality revenue sources. Service charges such as Trade and professional registration and licensing charges, housing and fencing construction license charges and bus terminal service charge, property ownership transfer-fee, sanitation service fee, and the likes are also included in the municipality revenue sources of the urban administrations.

What makes municipality revenue different from the ordinary revenue is that it made its sources, the respective urban administrations own revenue sources. As Sebeta town is in a better position with regard to economic activities when compared to the Chiro town, Sebeta urban administration generates better municipality revenue than Chiro.

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<sup>4</sup> The water service revenue is not included here as the water service provision and its revenue collection activities are being handled separately.

**Table 4.15:** Chiro Town Planned Municipality Revenue and Performance

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	AGR
<b>Planned Revenue</b>	8,515,654.00	5,209,744.00	10,202,734.00	10,010,044.00	
<b>Actual Revenue</b>	2,612,974.00	2,202,164.00	3,624,490.00	4,954,735.00	
<b>Performance</b>	30.68%	42.27%	35.52%	49.50%	
<b>Revenue Growth Rate</b>		-15.72%	64.59%	36.7%	28.52%

**Source:** Chiro urban administration finance and economic Development Office

**Table 4.16:** Sebeta Town Planned Municipality Revenue and Performance

	2000 (E.C)	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	AGR
<b>Planned Revenue</b>	75,162,250.00	117,657,611.00	178,381,800.00	75,063,765.00	128,415,899.00	
<b>Actual Revenue</b>	69,921,960.03	93,438,447.57	92,027,941.02	50,237,366.45	78,729,050.00	
<b>Revenue Performance</b>	93%	79.41%	51.59%	66.93%	61.31%	
<b>Revenue Growth Rate</b>		33.36%	-1.5%	-45.41%	56.71%	10.79%

**Source:** Sebeta Urban Administration Finance and Economic Development Office

\*The 2005 performance does not include the last quarter performance of the fiscal year.

As one can understand from Table 4.15, the Chiro municipality is not generating the revenue it has been planning to collect. That means the revenue plan of the municipality is very ambitious when compared to the actual revenue. The weak planning capacity of the municipality that emanates from lack of well-qualified planning and revenue capacity assessment workforces is one of the possible reasons behind the ambitious revenue plans.

The fact that the revenue office, which is in charge of collecting the municipality revenue, lacks incentives to abide by the municipality's plan is also the other scenario that possibly undermining the performance, as the revenue office is a branch of the revenue bureau. As opposed to the recommendation from the scholars like Bird (2011:8), the urban administrations under consideration are not allowed to set the rate of their taxes, service fees, and user charges and hence could not be in a position to determine the size of their revenue. This in turn is the other factor affecting their revenue generation performance as well.

Even though both the first and second grade urban administrations are mandated to plan their respective municipality revenues, the Head of the revenue office of Chiro urban administration claims that, in the case of Chiro town the regional state's revenue bureau also plans the municipality revenue parallel to the urban administration's plan.

**Table 4.17:** Municipality Revenue Plans by the Regional government and the Municipality

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Revenue plan by the municipality</b>	8,515,654.00	5,209,744.00	10,202,734.00	10,010,044.00	13,450,000.00
<b>Revenue plan by the Regional State</b>	4,200,000.00	3,500,000.00	3,687,462.00	4,640,226.00	5,741,972.00
<b>The actual Revenue</b>	2,612,974.00	2,202,164.00	3,624,490.00	4,954,735.00	5,067,700.50

**Source:** Revenue and Finance and Economic Development offices of Chiro Urban Administration

**Table 4.18:** The Chiro Urban Administration municipality revenue performance

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
Performance of the municipality plan	30.68%	42.27%	35.5%	49.5%	37.68%
Performance of the regional state's plan	62.21%	62.92%	98.29%	106.8%	88.26%

**Source:** Revenue and Finance and Economic Development offices of Chiro Urban Administration

As can be seen from Table 4.17 and 4.18, the revenue performances of the municipality have never reached even 50% of the respective plans. Whereas the minimum performance of the municipality revenue with respect to the plan from the regional state has reached above 62% and it is showing a steady progress towards perfection though it decreased in 2005. That means the actual performances of the annual municipality revenue plans clearly show that the municipality revenue plan from the regional state's revenue office seems to be more realistic. Therefore, one can claim that the involvement of the regional state in the affairs of the Chiro urban administration is justified in this regard.

Even though the municipality revenue of the respective urban administrations is being generated from the urban administrations' revenue sources, it is being administered by the revenue offices in the respective towns. In fact, the delegation of the responsibility to collect the municipality revenues to the revenue offices in the respective towns is helping the urban administrations to boost their revenue to some extent. However, it is likely to weaken their tax administration capability as it detaches them from the practice completely. Therefore, it seems better for the regional state to build their tax administration capacity rather than to take away the responsibility to administer their own taxes from them.

According to the Head of the revenue and the finance and economic development office of the Chiro urban administration, absence of reliable revenue planning and assessment capacity, which emanates from lack of qualified workforces, is among the reasons behind the poor municipality revenue performance. The informant mentioned absence of timely assessment and lack of reliable data that can be used to determine the revenue potentials of the municipality revenue sources as among the main factors adversely affecting the municipality revenue performance.

The informant explained further that especially lack of tax assessment experts is forcing the urban administration to use unreliable options to fill the gap, which, in their opinion, is forcing the urban administration to pay painful prices. The fact that the cadastre assessment project of the town, which has been given to locally organized TVET graduates on contract basis, is ended

up in unreliable findings is also mentioned among the painful prices the urban administration has paid so far. Consequently, in addition to the waste of significant amount of resources on the unsuccessful cadastre database project, the revenue intended to be generated from the city house tax, which in turn requires well-organized cadastre database, is not being collected properly.

The fact that all elastic revenue sources and tax bases that are favorable to local governments are awarded to the regional state is weakening the revenue capacities of the urban administrations especially that of the Chiro town. Despite the fact that Bahl & Linn (1992:474) are in favor of assigning personal income and local sales taxes to local governments as far as tax competition between higher and local authorities is avoided and viable coordination is established, these taxes are under tax jurisdiction of the regional state.

The fact that Indirect taxes such as those from services like garages, lawyers, barbershops, pensions, laundries, stamp duties, photo studios, photocopy and tailor services are assigned to the regional state is hampering the urban administrations not to generate the amount of revenue that matches their expenditure responsibilities. The assignment of non-taxes from services like business license registrations, fines on government employees, fines levied by courts, incomes from advertisements and interests from credit services to government employees to the regional state is also affecting the revenue capacity of the urban administrations adversely.

In fact, reassignment of such taxes to the local governments may aggravate the horizontal inequities between jurisdictions. However, as the devolution of taxation power increases strengthens autonomy of the local governments as well, there is a need to devolve these taxes and put in place the appropriate mechanism to correct horizontal inequities.

#### 4.2.1.2. **The Water Service Revenue<sup>5</sup>**

As it is mentioned before, the water service offices of Chiro and Sebeta urban administrations are structured as autonomous entities. As a result, water service boards of the respective towns are overseeing them and it is the mandate of the boards to determine most of their activities.

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<sup>5</sup> Even though water service revenue is considered part of the municipality revenue, the researcher chose to treat it separately as the municipalities of the two towns are not in charge of the water service provision activities directly, including water service charges in their respective towns as the water service offices of the towns are operating as autonomous bodies.

According to Heads of Chiro water service office and the customer service department of Sebeta water service office, neither the water boards nor the water service offices are mandated to set water service charge and water meter rent rates unilaterally, it is rather the water resource bureau of the regional state that has the decisive role with this regard. As it is mentioned in the literature review, user charges can be structured in a manner they can help to meet revenue adequacy, efficiency, and equity objectives (Bahl & Linn, 1992:470). Thus, it is obvious that the inability of the urban administrations to set their service charge rates is possibly affecting their capability to ensure revenue adequacy adversely.

In addition to that, unless lower levels of government are allowed to set their tax rates and to determine the level of the revenue they generate, they will never be in a position to adjust their service provision with the real preferences of their respective residents. Local residents also cannot question and make local authorities accountable for unsatisfactory service provision, if local authorities do not have the power to set tax rates and to collect taxes directly from them (Bahl and Linn 1992:32). Therefore, the fact that the water service charge and the water meter rent rates are determined by the regional state clearly indicates that the water service offices of the two urban administrations are not acting autonomously. That means the urban administrations are not determining the amount of revenue they generate and hence the size and mix of the service they are providing.

According to the informants, the bureau determined the recent increase of the water consumption charge and water meter rent rates as well. The two informants explained further that the fact that the previous water service charge rate was very low to the extent that it could not enable them to generate enough revenue to run their services is the main reason for the increase of the water service charge.

However, residents who participated in the group discussions on the issue do not agree with this idea. They blame rather the offices for focusing on compensating the revenue they are losing because of lack of water distribution, through other unfair mechanisms. The residents mentioned the 30 Birr penalty levied on customers for failing to settle water service bills on time and the 250 Birr customer-service license transfer fee as unfair way of generating incomes from the service, which is not being provided properly.

According to the Heads of Chiro water service office and customer service department of the Sebeta water service office, the 30 Birr penalty and 250 Birr customers' service license transfer fee the residents are complaining about, are also not results of the water office's decision. They claimed that, it is rather the decision of the regional state's water resource office so as to improve the customers' compliance to pay for the services they are receiving and to boost the revenue of the water service offices more.

The consulted documents from the water service offices of Chiro and Sebeta urban administrations indicate that, the decision to increase the water service charge and the water meter rent rates starting from July 2012 helped the offices to boost their revenue significantly.

**Table 4.19:** Chiro Town Water Charge Rate and Water Meter Rent per m<sup>3</sup>

Consumption of water in m <sup>3</sup>	The old tariff in Birr		The current tariff in Birr		Consumption of water in m <sup>3</sup>	The old rent tariff in Birr		The current rent tariff in Birr	
0_2 m <sup>3</sup>	3	29	4	20	0-2 m <sup>3</sup>	3	29	4	20
3_6 m <sup>3</sup>	3	57	5	30	3-6 m <sup>3</sup>	3	57	5	30
7_10 m <sup>3</sup>	4	04	6	40	7-10 m <sup>3</sup>	4	04	6	40
>10 m <sup>3</sup>	4	60	7	60	>10 m <sup>3</sup>	4	60	7	60

**Source:** Chiro Urban Administration Water Office

**Table 4.20:** The Chiro Town water-service office revenue Trend

	2000 (E.C)	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)
<b>Planned Revenue</b>	780,117.20	1,035,560.00	1,050,852.84	1,779,317.70	2,038,759.70
<b>Actual Revenue</b>	637,224.71	627,427.24	988,476.91	1,309,704.85	1,816,672.85
<b>Implementation</b>	81.68%	60.59%	94.06%	73.6%	89.11%

**Source:** Chiro Urban Administration Water Service Office

\*The performance of the 2005 revenue plan concerns only the first 9 months.

As one can understand from Table 4.19 the price structure of both water consumption charge and the water meter rent implemented at Chiro town are strongly associated with the size of water consumption. That means as the size of water consumption increases the price of the water per meter cube and the water meter rent will increase as well. This shows that inconformity with the recommendation of Bahl & Linn (1992:242), the price structure is designed in a manner it discourages overconsumption of water. Therefore, one can conclude that, in the case of Chiro water service the regional state is trying to tackle problems related to weak water production capacity with the price structure it introduced.

However, this cannot legitimize the decision of the regional state to interfere in the fiscal jurisdiction of the urban administrations. When one look into the whole revenue trends of the urban administrations, he/she can simply understand that lack of autonomy to decide on their revenue sources is impeding their capability to increase their revenue. As can be seen from Table 4.20, the water service office of Chiro town is not generating significant amount of revenue from the water service it is providing. According to the head of the water service office, the fact that the office is not authorized to set its water consumption charge and water meter rent rates hampered its capability to boost its revenue. The informant also mentioned the limited water production capability of the water service office as the other reason behind the weak revenue capacity of the office.

The fact that water service tariff for public tap water customers is different from the charge rate for customers connected to the water service individually also deserves to be discussed here. According to the head of Chiro water service office, the water consumption charge for the public tap water service customers is 12.50 birr per m<sup>3</sup>, out of which 8 birr per meter cube is to be paid for the water service office. The informant added, the rest 4.50 birr per meter cube will be for the public tap water service administrator, a person who is in charge of distributing the water according to the time schedule agreed upon by the public tap water service customers. This clearly shows that the poor is being required to pay more than the rest of the residents and it is not justifiable in any circumstance.

**Table 4.21:** Sebeta Town Water Consumption Charge Rate and Water Meter Rent per m<sup>3</sup>

Consumption of water in m <sup>3</sup>	The old water service tariff in Birr per m <sup>3</sup>		The current water service tariff in Birr per m <sup>3</sup>		The old meter rent tariff in Birr (based on water consumption)			The current meter rent tariff in Birr (based on water meter size)		
					Consumption of water in m <sup>3</sup>	Water meter rent		Meter Size	Water meter rent	
0 – 3 m <sup>3</sup>	3	29	4	50	0 – 3 m <sup>3</sup>	3	29	½ Inch	5	00
4 – 7 m <sup>3</sup>	3	57	5	00	4 – 7 m <sup>3</sup>	3	57	¾ Inch	8	00
8 - 10 m <sup>3</sup>	4	04	5	50	8 - 10 m <sup>3</sup>	4	04	1 Inch	10	00
>10 m <sup>3</sup>	4	60	6	10	>10 m <sup>3</sup>	4	60	1½ Inch	20	00
								2 Inch	30	00

**Source:** Sebeta Urban administration Water Office

**Table 4.22:** The Sebeta water service office revenue Trend

	2000 (E.C)	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)
<b>Planned Revenue</b>	5,975,983.04	5,357,637.25	6,288,386.55	6,524,399.00	6,875,554.15
<b>Actual Revenue</b>	3,329,103.45	4,003,232.88	4,198,608.19	4,469,365.35	7,112,026.16
<b>Implementation</b>	<b>55.71%</b>	<b>74.72%</b>	<b>66.77%</b>	<b>68.50%</b>	<b>103.44%</b>

**Source:** *Sebeta Urban administration Water Office*

As it is displayed in Table 4:21, consulted documents from the water service office of Sebeta urban administration also indicate that the town's water consumption price structure designed in a manner it discourages high consumption. That means as the water consumption size increases the unit price for the service also increases. The new water meter rent rate the water service office is using however is not designed in a manner it discourages overconsumption.

According to the head of customer service department of the water service office, the former water meter rent structure had been designed to levy varying water meter rent rates on customers depending on their water consumption size. However, the informant argued, as the economic activity in the town started to increase, customers with demands of different water service capacity started to emerge and the need to use water pipes and water meters with different capacities became apparent. As the capacity of the water line, a given customer prefers, depends on the customer's capacity to pay, the price structure for the water meter rent also redesigned in a manner it enables the urban administration to charge the residents with better financial capacity more. Accordingly, the bureau structured the water meter rent rates based on the water meter size the customers prefer to use.

Therefore, one can conclude that the price structure of the water meter rent implemented at Sebeta did not take the serious water shortage in the town and the need to discourage overconsumption of water into consideration. Now the urban administration is trying to discourage excess consumption of water through the water consumption price structure only. The water meter rent charge is rather targeted at revenue maximizing, as it requires the customers to pay fixed water meter rent price tag assigned to the size of the respective meters they are using regardless of the size of water they consume. Had the price structure been designed by the urban administration itself, it would have taken all the circumstances on the ground into consideration and discouraged excess water consumption habits.

As can be seen in Table 4.22, the revenue generation performance of the Sebeta water service office appeared to be poor for most of the years. Consulted performance report documents of the town's water service office claim that repeated interruption of electric power has been hampering water production and hence decreasing water sales revenue. That is why the annual revenue of the town's water service office has never been adequate to cover the expenditure need of the office in most of the fiscal years under consideration.

The annual performance report documents of the Sebeta water service office claimed also that, the water service office could not manage to secure the revenue it is supposed to get from maintenance services because of the repeated failure of the water, mining and energy bureau of the regional state to deliver spare parts and other maintenance materials on time.

Therefore, had the water service office of the town been given the mandate to procure the materials it needs for maintenance purposes, it would have avoided the risk of losing its maintenance revenue.

The fact that the water service office of the town is not mandated to set its own water consumption charge and water meter rent rates is also the other possible cause of the revenue inadequacy.

#### **4.2.2. Ordinary Revenue Generation and State Transfer**

Ordinary revenue and state transfer are related in that the latter is being secured fully or partly from the former (ordinary revenue). It is the mandate of the regional state to plan the size of the ordinary revenue from the state tax bases in the respective towns and to allocate part of or all the revenue to the urban administrations it is generated from as annual ordinary budget (State Transfer). In the case of 1<sup>st</sup> grade cities such as Sebeta town, the regional state devotes part of the ordinary revenue to the towns it is generated from as state transfer. When it comes to these 1<sup>st</sup> grade urban administrations, there is no direct grant transfer from the regional state, as the ordinary revenue being generated from their respective jurisdictions is far more than the ordinary budget (block grant) being allocated to them by the regional state.

In the case of 2<sup>nd</sup> grade urban administrations such as Chiro town, the ordinary revenue generated from the towns will be allocated to them as ordinary budget (state transfer) together with the additional transfer from the regional government directly. If the ordinary revenue

performance is above the plan, the extra revenue will be transferred to the regional state's account unless the urban administration is allowed to use it as additional budget to tackle budget deficits.

#### 4.2.2.1. Ordinary Revenue (State Revenue) Generation

Consulted revenue performance report documents from the revenue offices of Chiro and Sebeta urban administrations indicate that the ordinary revenues in the two urban administrations made their sources: tax bases, service charges and fees as well as other non-tax revenue sources of the regional state in the urban administrations excluding VAT and some other productive tax bases. Accordingly, the ordinary revenue sources include direct taxes from business profits and incomes of employees of both the regional government and the private sector. Indirect taxes from services like garages, lawyers, barbershops, pensions, laundries, stamp duties, photo studios, photocopy and tailor services are also part of the ordinary revenue sources. According to these documents, non-taxes from services like business license registrations, fines on government employees, court fines, incomes from advertisements and interests from credit services to government employees are also included in this category.

As the tax bases for ordinary revenue are relatively productive when compared to the revenue sources assigned to urban administrations, the ordinary revenue from these sources is relatively big enough to cover significant share of the urban administrations' annual ordinary budgets. As can be understood from Table 4.23 below, the ordinary revenue being collected from the regional state's tax bases in Chiro town is covering from 34.59 - 62.21% of the ordinary budget (block grant) being allocated to the town by the regional state. In the case of Chiro urban administration, the direct grant transfer from the regional state is covering the remaining part of the annual ordinary budget (block grant) so far, as the town has weak revenue potential when compared to towns in the 1<sup>st</sup> grade category including Sebeta. In fact, the ordinary revenue from the town is showing significant progress from time to time.

**Table 4.23:** Share of the ordinary revenue in the total ordinary budget of Chiro Town

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Annual ordinary budget</b>	10,028,172.00	11,739,673.00	15,550,217.00	19,539,977.00	22,776,916.00
<b>Annual ordinary revenue</b>	4,114,869.00	4,604,846.00	5,379,745.00	9,638,952.00	14,170,303.87
<b>Share of the ordinary rev.</b>	<b>41%</b>	<b>39.22%</b>	<b>34.59%</b>	<b>49.33%</b>	<b>62.21%</b>

**Source:** Chiro Revenue Office

However, in the case of Sebeta urban administration, the ordinary revenue being generated from the regional state's tax bases in the town is far more than the ordinary budget (block grant) being allocated to Sebeta urban administration. Head of the finance and economic development office of Sebeta urban administration revealed that the regional state uses the ordinary revenue it generates from Sebeta town, both to cover the town's ordinary budget and to subsidize other areas in the regional state with weak revenue capacities. The informant mentioned the relatively strong economic activity and the resulting revenue capacity of the town as the reason behind the fact that the ordinary revenue of the regional state from the Sebeta urban administration is being used to subsidize other jurisdictions too.

According to a budget officer from the finance and economic development bureau of the ORS, the bureau has the authority to determine the annual ordinary budgets (block grants) to the towns and the amount of ordinary revenue to be generated from the respective towns. Then, the informant added, the revenue offices of the regional state at the urban administrations collect the ordinary revenues based on the plans they receive from the regional state's revenue bureau. According to Heads of the revenue offices of Chiro and Sebeta urban administrations, the regional state's revenue bureau uses mostly the amount of revenue generated from these sources in the previous year as a springboard to determine the amount of the current revenue.

As mentioned before, if the performance of the ordinary revenue in a given urban administration exceeds the planned amount, the urban administration has to get permissions from the regional state to utilize the extra money. If the regional state is not willing to allow the urban administration to utilize the extra revenue, the extra revenue will be transferred to the regional state's account.

Data displayed in Tables 4.24 and 4.25 below show that, the amount of the ordinary revenues being generated from the regional state's revenue sources in both Chiro and Sebeta towns are showing progresses year after year. In fact, the ordinary revenue progress in Chiro town is not that much significant. As can be seen from Table 4.24, the average growth rate of the ordinary revenue in Chiro town is 30.77%. The average growth showed much increase because of the 79.17% revenue growth in the year 2004 Ethiopian calendar. The head of the revenue office explained that the 2004 revenue growth has been registered because of the additional workforce the revenue office hired in the previous year and because of the better implementation of

business scorecard (BSC) in the same fiscal year. This shows that the relatively less revenue growth in 2001, 2002, and 2003 has possibly been caused by lack of human resource and inefficient utilization of existing human capacity.

**Table 4.24:** Chiro Town Ordinary Revenue Plans and their Performances

	1999 (E.C)	2000 (E.C)	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	A G R
<b>Planned Revenue</b>	2,798,780.00	4,525,809.00	4,319,841.00	4,999,079.00	4,666,063.00	7,677,993.00	
<b>Actual Revenue</b>	2,754,072.00	3,755,775.00	4,114,869.00	4,604,846.00	5,379,745.00	9,638,952.00	
<b>Revenue performance</b>	98.4%	83%	95.26%	92.1%	115.29%	125.54%	
<b>Growth Rate</b>		<b>36.37%</b>	<b>9.56%</b>	<b>11.9%</b>	<b>16.83%</b>	<b>79.17%</b>	<b>30.77%</b>

**Source:** Revenue Office of Chiro Urban administration

As can be seen from Table 4.24, the ordinary revenue performance in Chiro town is showing consistent growth while the trend of the revenue plan has not been consistently progressive, which shows that there are serious planning problems or the revenue sources in the town are not predictable. The 115.29% and 125.54% revenue performance in 2003 and 2004 respectively also show that the revenue bureau lacks planning capacity or its plans that based the previous year revenue performances lacks reliability.

**Table 4.25:** Sebeta Town Ordinary Revenue Plan and Performance Trend

	1999 (E.C)	2000 (E.C)	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	AV G
<b>Planned revenue</b>	2,626,875.00	7,142,857.00	12,511,192.00	26,934,681.00	43,632,566.00	84,067,388.00	
<b>Actual Revenue</b>	4,121,711.40	11,530,288.46	27,259,647.17	44,604,380.85	53,957,180.84	99,541,112.02	
<b>Performance</b>	<b>156.9%</b>	<b>161.42%</b>	<b>217.88%</b>	<b>165.6%</b>	<b>123.66%</b>	<b>118.41%</b>	
<b>Growth Rate</b>		<b>179.75%</b>	<b>136.42%</b>	<b>63.63%</b>	<b>20.97%</b>	<b>84.48%</b>	<b>97.05%</b>

**Source:** Revenue office of Sebeta Urban Administration

As can be understood from Table 4.25, the annual ordinary revenue generation performances of the Sebeta urban administration are far more than the respective revenue plans. The 97.05% average growth is also evidence that shows the Sebeta town has a big potential because of its robust economic activity. This in turn shows that the revenue bureau of ORS could not predict the amount it can generate from its tax bases in Sebeta as the economic activity is growing fast beyond its expectation. This indicates that the regional state lacks revenue assessment and planning capacity to forecast the revenue the fast growing economic activity can generate. Thus, there is a need for the revenue bureau to boost its capacity in a manner it can handle the yield of the fast economic progress in towns like Sebeta.

When it comes to accountability of the revenue offices in the two urban administrations, there are issues that are not clear especially for the workforces in the respective revenue offices. For

every one who looks at the signboards of the revenue offices, he/she considers the offices as sector offices of the respective urban administrations because, the signboards by themselves implicate the respective offices are among the sector offices of the urban administrations.

However, the Heads of the revenue offices of Chiro and Sebeta urban administrations explained that the revenue offices in the respective towns are normally branches of the regional state's revenue bureau. When it comes to accountability, the informants added, they are accountable to both the regional state and the urban administrations. The fact that the revenue offices are in charge of administering the municipality revenue in addition to their responsibility to administer the ordinary revenue (state revenue) is the rationale behind their accountability to the respective urban administrations as well.

Therefore, if the revenue offices are to work efficiently, their accountability line should be clear for all stakeholders including the residents and workforces in the office.

#### **4.2.2.2. Fiscal Imbalances and State Transfers**

Albeit it is important to investigate the level and scope of both vertical and horizontal fiscal imbalances the urban administrations facing in detail, the fact that consolidated revenue and expenditure of urban administrations in the ORS are not available made it difficult especially to calculate the actual vertical imbalance. However, the fiscal inadequacy the urban administrations under consideration are facing and their difference in fiscal capacity is discussed in a manner it reflects the problem in this regard.

The discussions made on both expenditure activities and revenue generation performances in the urban administrations indicate that, the urban administrations in ORS in general, that of Chiro town in particular are facing serious financial inadequacy. The economic disparity between them is also creating a big gap between their service provision capabilities.

To tackle such problems there is a need to put in place a financial transfer mechanism that can fit to the situation on the ground. According to Shah (2007:26-27) clarity in grant objectives, autonomy, revenue adequacy, predictability, equity, transparency and simplicity are among the issues that need to be given the necessary attention in the effort to design viable intergovernmental transfer arrangement that can live up to its objectives.

The document prepared by the Oromia Finance and Economic Development Bureau (BoFED) with regard to ORS grant transfer mechanism, requires expenditure need estimation to focus on implementation of the regional state's policies, the development programs of the regional state's sector offices and on poverty reduction activities. Thus, one can conclude that the grant transfer is targeted at poverty reduction objectives of the regional state.

#### 4.2.2.2.1. Woreda Block Grant (WBG)

As one can see from Table 4.26, the budget performances of the last five years show that transfers from the regional state were covering 78.03% to 84.2% of the Chiro urban administration total expenditures. Therefore, based on the argument from Blochlinger & King (2006:179), the researcher concluded that the fact that Chiro urban administration is financing most of its expenditure activities through WBG is impeding its fiscal autonomy equally.

The fact that, the Town's administration is suffering from serious revenue inadequacy is also the major reason behind its dependency on grant transfers to discharge most, if not all, of its expenditure responsibilities. As it is discussed in the literature review, Bahl and Linn (1992:32) argue that for local authorities to be autonomous, they should raise adequate revenues from their local sources. Thus, the fact that Chiro urban administration is not raising enough revenue from its own source clearly indicates that its fiscal autonomy is being compromised equally.

**Table 4.26:** The Gap Between Expenditure and Own Revenue of Chiro Urban Administration

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	2005 (E.C)
<b>Total Expenditure</b>	12,641,146.00	13,941,837.00	19,174,707.00	24,494,712.00	26,710,004.00
<b>Expenditure Secured from Own Revenue</b>	2,612,974.00	2,202,164.00	3,624,490.00	4,954,735.00	5,867,456.00
<b>Expenditure Covered by WBG</b>	10,028,172.00	11,739,673.00	15,550,217.00	19,539,977.00	20,842,548.00
<b>Share of the Expenditure Covered by WBG</b>	<b>79.33%</b>	<b>84.2%</b>	<b>81.1%</b>	<b>79.77%</b>	<b>78.03%</b>

**Source:** Chiro Finance and Economic Development Office

Whereas, Table 4.27 shows that Sebeta urban administration covers most of its expenditure responsibilities through its own revenue, which puts its autonomy status in a better position when compared to that of the Chiro town. However, as it can be understood from the case study conducted on education service in the town, the inadequacy of the transfer is constraining the effort the urban administration is making to provide its residents with preference based local public goods and services. The fact that all non-municipal responsibilities are being financed through state grants is also possibly undermining the fiscal autonomy of the urban administration.

**Table 4.27:** The Gap Between Total Expenditure and Revenue of Sebeta Urban Administration

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)
<b>Total Expenditure</b>	50,428,051.48	71,773,901.62	81,359,436.52	88,761,075.94
<b>Expenditure Secured from Own Revenue</b>	35,028,329.48	50,278,003.62	51,459,699.52	56,602,795.43
<b>Expenditure Covered by WBG</b>	15,399,722.00	21,495,898.00	29,899,737.00	32,158,280.51
<b>Share of the Expenditure covered by WBG</b>	<b>30.54%</b>	<b>29.95%</b>	<b>36.75%</b>	<b>36.23%</b>

**Source:** *Sebeta Finance and Economic Development Office*

According to Shah (2007:26-27) adequacy is one of the requirements to design viable grant arrangement. The grant transfer arrangement the ORS is using now is also obviously aimed at addressing financial inadequacy together with other purposes. However, the expenditure performances that are discussed previously indicate that the transfer is not adequate to finance the expenditure responsibilities it targeted fully.

### ***Horizontal Fiscal Disparity and Grant Transfers***

As it is mentioned in the literature review, horizontal fiscal imbalances find their origin both in the revenue and expenditure side of the budget. The difference in tax capacities between jurisdictions results in difference in per capita tax revenue (Watts & Hobson, 2000:24) which in turn widens their fiscal capacity difference. Such imbalances are also among the factors that necessitate financial transfers from the higher levels of government. Therefore, to find out what the revenue capacity disparity between the two study areas looks like, there is a need to compare the revenues the urban administrations are generating from their respective own revenue sources.

**Table 4.28:** The Horizontal Fiscal inequality Between Chiro and Sebeta Urban Administrations

	2001 (E.C)	2002 (E.C)	2003 (E.C)	2004 (E.C)	Average Per-capita income
<b>Actual Own Revenue of Chiro Town</b>	2,612,974.00	2,202,164.00	3,624,490.00	4,954,735.00	<b>48.76</b>
<b>Actual Own Revenue of Sebeta Town</b>	93,438,447.57	92,027,941.02	50,237,366.45	78,729,050.00	<b>1429.24</b>
<b>Difference</b>	<b>90,825,473.57</b>	<b>89,825,777.02</b>	<b>46,612,876.45</b>	<b>73,774,315.00</b>	<b>1380.48</b>

**Source:** *Sebeta and Chiro Urban Administrations' Revenue Offices*

As the Sebeta urban administration has better economic activity than that of the Chiro town, the revenue they generate also varies significantly. Accordingly, as can be seen from Table 4.28 the least annual revenue the Sebeta urban administration generated from own revenue sources in the last four years is appeared to be 50,237,366.45 while the maximum annual own revenue the Chiro urban administration managed to collect in the last four years is 4,954,735.00.

As it is discussed in the literature review, the difference in tax capacities between jurisdictions results in difference in per capita tax revenue (Watts & Hobson, 2000:24) which in turn widens their fiscal capacity difference.

The last four years' average per-capita incomes from own revenue sources of the Chiro and Sebeta towns are also found to be 48.76 and 1429.24 Birr respectively. Therefore, the difference between the average per-capita incomes of the two towns also appeared to be 1380.48 Birr. As a result, their per capita investment on service provision activities also varies equally. Thus, their capability to provide their respective residents with quality and sufficient local public goods and services differs with that magnitude as well.

That is why, as can be seen in Table 4.8 and 4.9, the Chiro urban administration could not devote significant amount of financial resources for capital expenditures, while the Sebeta urban administration is dedicating substantial share of its municipality revenue for different capital expenditure activities including education and health. Therefore, there is a need to tackle the horizontal imbalances.

The grant transfer arrangement of the ORS is also not in a position to address the horizontal disparity in fiscal capacity along the jurisdictions at the same level. As it is indicated in Tables 4.1 and 4.2, it is evident that the Sebeta urban administration is entitled to better per-capita grant from the regional state despite the fact that it has better financial capacity than that of Chiro. For instance, the Sebeta urban administration received 271.81 Birr and 292.35 Birr per-capita grant in 2003 and 2004 Ethiopian calendar respectively, while the corresponding per-capita grant that the Chiro urban administration received in the two consecutive fiscal years appeared to be 228.68 Birr and 287.35 Birr respectively, which obviously widened the gap between the financial capacities of the two jurisdictions.

Shah (2011:29) is of the opinion that if equalizing grants are to eliminate the differences in net fiscal benefits, they should depend on relative tax capacities and relative needs for and cost of service provisions of the grant receiving jurisdictions. However, in the case of ORS the revenue capacities are not taken into consideration to apportion the grant divisible pool among jurisdictions. A budget officer from the Oromia finance and economic development office explained that the allocation of the grant transfer is focused only on apportioning the existing

financial resources among jurisdictions fairly. Population size, number of school age children and unit costs are among the factors the grant transfer formula takes into consideration.

Bahl and Linn (1994:12) on their part argued that balancing jurisdictional inequities in the ability to finance public services is among desires seems to be reflected in formula grants. As it is discussed in the second chapter of the study report, Ahmad and Craig (in Ter-Minassian, 1997:76) also claim that income redistribution elements embedded in conditional grants can be used to achieve equity objectives in the absence of equalization framework. In fact, the fact that the grant transfers are focusing all in all on expenditure responsibilities that targeted poverty reduction such as health and education is helpful to fulfill the minimum standards of the basic services with this regard. Therefore, the decision by the ORS to finance education and health services through grants is obviously helping to realize equity between jurisdictions to some extent. Had it not been for the financial transfer from the regional state that targeted poverty reduction, the Chiro urban administration would have never been in a position to provide the basic services such as education and health as its revenue capacity is very weak when compared to that of Sebeta. However, the revenue capacity difference between jurisdictions resulting from the difference in economic activity has to be looked into again if it is to address the horizontal disparity effectively.

The indirect advantages, the jurisdictions with better economic activities have, also have to be taken into consideration when allocating grants. For instance, the grant transfer arrangement apportions some of the financial resources based on the number of school age children in each jurisdiction while most of the children in towns with better economic activities like Sebeta attend their classes in private schools. As a result, the students attending public schools in such towns are likely to receive better education-service than those students in towns with weak economic activities as the financial resource received in the name of those students in the private schools is also being used by the public schools in the town. Therefore the grant transfer arrangement should also be revised and have to consider only those school age children attending public schools.

As discussed in expenditure practices of Sebeta town, the fact that towns with better economic activities can benefit from the huge potential for financial contributions and donations from the

community and the private sector is also the other indirect advantage creating difference between jurisdictions. Therefore, the capability of jurisdictions to generate financial resources through public contribution and donations from different organizations in the private sector has to also be taken into consideration when allocating grants.

#### **4.2.3. Long Term Capital Projects and Sub-national Borrowing**

Despite the fact that Liu & Waibel (in Shah, 2008:215) argued that the wide gap between revenue capacity and infrastructure needs at sub-national level necessitates sub-national borrowing, urban administrations in ORS in general and that of the study areas in particular are not using access to financial markets with this regard extensively so far.

In fact, Article 37/6 of Proclamation 65/2003 of the ORS allowed urban administrations to borrow from the federal and regional governments as well as from accredited financial institutions, city funds or similar institutions for capital expenditures with prior approval of the regional government. The Heads of the Chiro urban administration water service office and customer service department of the Sebeta water service office also claimed that they used this opportunity to fund the ongoing water projects to address the challenges they are facing in relation to water service provision. However, they are not clear with who is going to pay the finance secured from the World Bank for the water service projects through borrowing. The urban administrations are still financing their capital projects including intra-town road construction using financial resources generated locally and through grant transfers.

As a result, the urban administrations are operating under serious financial constraints, which lead to under provision or absence of basic public services. The existing deficiency in water service provision is one of the problems emanated from such shortcomings. The failure of urban administrations to exploit access to financial markets is forcing residents also to bear the costs of long-term capital projects alone as opposed to the requirement to distribute cost burdens of such projects across generations through borrowing. The decision of the urban administrations especially that of the Sebeta town to cover the cost of capital projects such as the ongoing road constructions in the town through the current own revenue is inappropriate as it defies the requirement to fund such projects through borrowing.

### **4.3. Human Resource Management Authority of the Urban Administrations**

Decentralization is all about creating enabling conditions for the local governments to respond to preferences and circumstances specific to their respective jurisdictions. However devolving expenditure responsibilities and revenue generation powers to the lower levels of government levels alone is not enough. The capacity to identify and prioritize the needs on the ground as well as the autonomy to exercise the devolved powers is equally important if it is to respond to the needs on the ground satisfactorily.

Identifying, prioritizing and addressing the preferences and circumstances on the ground in turn require, among others, human resource well suited to the respective jurisdictions. That means, each jurisdiction needs to have adequate workforce with the required capability if they are to respond to the situation on the ground. Therefore, the local governments need to have the discretion to determine on their human resource need and to manage it in their own way.

However, the practice on the ground in Chiro and Sebeta towns does not fit to the need on the ground and its consequences are constraining the effort to respond to the preferences and needs on the ground properly. Even though Dillinger (1994:18) argues that local governments should be endowed with, the authority to recruit, retain, and motivate their employees so as to provide services efficiently the practice on the ground in the two towns is different completely. The fact on the ground shows that lack of local autonomy in human resource management is affecting the urban public service provision activities in the two towns adversely.

Despite the fact that Article 43/1 of proclamation 65/2003 endowed urban local governments with the authority to recruit employees, to determine their salaries and benefits as well as to discipline and dismiss staff members in accordance with the rules and regulations of the regional state, they are not exercising their mandates freely. The interference from the regional government through zonal administrations is pervasive with this regard. In fact, the situation in Sebeta town is far better than that of the Chiro town by as Sebeta town is categorized 1<sup>st</sup> grade city and is free from zonal interferences.

According to Head of the civil service office of the Chiro urban administration, lack of local autonomy to determine on the transfer activities of civil servants to the town from other jurisdictions is constraining the urban administration's effort to provide preference based services

to its residents. The informant explained that, the fact that especially the zonal administration is involved in inappropriate transfers of civil servants to the urban administration sector offices including to the municipality, is affecting the service provision activities adversely.

The informant added that, the zonal administration transfers civil servants and even deposed political appointees with irrelevant qualifications from different *woredas* and its sector offices to the town to the extent that, the urban administration is being forced to compromise its plans to fill the vacant positions with relevant workforces that are fit to the purpose. These situations in turn are aggravating the problems emanating from lack of qualified workforces and hence undermining the quality of local public services.

As a result, the informant claims, most of, if not all, the vacant positions in the sector offices including that of the municipality are being held by employees with irrelevant qualifications, obviously undermining the administration's capability to provide quality and adequate local public services.

According to the Head of the education office of Chiro urban administration, inappropriate interferences from the higher level of government in relation to transfers of teachers and other supporting staffs is affecting the education service in the town negatively.

The informant explained further that there are times when the regional state or its delegate, the zonal administration, transfers teachers with qualifications that do not match the qualification requirements of the vacant positions both in educational background and work experience. Teachers participated in the group discussion on the issue also claim that officials from the zonal and the urban administrations are abusing the loopholes to benefit their relatives illegally compromising the education service quality.

For instance, a decision from the regional state to transfer a teacher to the town for a vacant position he/she is not qualified will certainly result in excess teachers in some of the subjects, while creating serious shortage of teachers in some other of them. The existence of shortage of teachers in some of the subjects will elevate the teacher- student ratio above the standard, which in turn will possibly affect the teaching learning process adversely.

The existence of such pervasive interference from the regional government and zonal administration clearly shows that, the Chiro urban administration practically has no devolved

power with regard to human resource management. The power to hire or to transfer employees from other jurisdictions seems rather deconcentrated to the zonal administration level.

On the other hand, education institutions standard expert at Sebeta education office claims that after Sebeta urban administration secured zonal status, the intervention from the Finfinne Hinterland Special Zone of Oromia has been brought to an end, as the zonal administration is no more authorized to oversee the activities of Sebeta urban administration on behalf of the regional state. As a result, the informant added, as opposed to the Chiro urban administration, the Sebeta urban administration has the discretion to hire teachers for 50% of its vacant positions by its own and the rest 50% of its vacant positions will be filled with transfers by the regional state based on the full consent of the urban administration.

Therefore, the discretion given to the Sebeta administration to hire at least 50% of its teachers need by its own is enabling it to minimize the damage it could face with this regard. Therefore, the urban administrations should have the autonomy at least to ensure the relevancy of the decisions from the higher levels of government to transfer civil servants.

The discretion given to the Sebeta urban administration to hire 50% of its teachers need by its own indicates that it is in a better position with regard to human resource management in the education sector when compared to that of the Chiro town. However, the fact that the regional state is authorized to decide on 50% of the vacant positions in consultation with the urban administration gives it the opportunity to intervene inappropriately.

Lack of discretion with regard to determining on human resource structure designs and salary scales is also undermining the capability of the urban administrations to provide quality and adequate public services. As circumstances on the ground in different urban areas are most of the time specific to the respective towns, a human resource structure designed to serve similar sector offices in different jurisdictions uniformly will never allow the urban administrations to have the human resource that can respond to the circumstances specific to their respective jurisdictions effectively. The point is that, for instance a town with serious problems with regard to internal road systems will obviously need more civil engineers than towns in better positions with this regard. Therefore, there is a need to allow the jurisdictions to have some discretion to determine on their human resource need.

In the same manner lack of discretion to hire some professionals with qualifications rarely available on the market with a price the market demands, also has its own impact on productions and distributions of urban public services, as failure to have mandatory professionals in place cannot be compensated. The fact that the Sebeta urban administration could not employ the full potential of its construction machineries is one of the problems emanating from lack discretion to determine on payments to attract machine operators with qualifications rare on the market. Tackling such problems also requires empowering the urban administrations to determine on salary scales and benefits of civil servants at least for some selected expertise that are scarce on the market.

## Chapter Five

### 5. Conclusion and Recommendations

The researcher scrutinized the taxation powers and expenditure responsibilities of the urban administrations under consideration thoroughly. The level and scope of their overall autonomy as well as their practical activities to provide their respective residents with preference based local public goods and services are looked into in detail. In light with the findings from the discussion, the researcher came up with the following conclusions and recommendations.

#### 5.1. Conclusion

The Chiro and Sebeta urban administrations find their source of fiscal powers and functions and their overall legal status in the provisions stipulated in the ordinary proclamation 65/2003 of the ORS. Even though the 1995 FDRE constitution structured the Ethiopian nation as a federal state with nine regional states as its constituent units, it falls short of devolving power further to the grassroots level by its own. It rather left the responsibility to establish further devolved units of government to the respective regional states. In fact, the emphasis it gave to the necessity of endowing the lower levels of government with substantial powers and functions has been monumental step towards the realization of viable local governments.

However, the spirit of the FDRE constitution with this regard is not reflected fully in the constitutions of the regional states in general and in the ORS constitution in particular. The fact that the ORS constitution failed to recognize ULGs as autonomous government units explicitly has potentially created loopholes for the regional government to undermine the autonomy of urban administrations in the ORS in general and that of the Chiro and Sebeta towns in particular.

Even though the ORS constitution recognized some urban areas as local government units together with *woreda* administrations, this was not enough measure that should have been taken to ensure devolution of significant powers to the grassroots level especially in the urban centers.

As a result, most of the urban areas in the regional state including Chiro and Sebeta towns have rather been extensions of the respective *woreda* administrations that they are serving as seats,

irrespective of the specific circumstances that differs them from the rural areas in the regional state.

The establishment of ULGs by proclamation 65/2003 of the ORS is also the other missed chance to realize autonomous units of government at grassroots level and to enable local residents to act autonomously on the issues specific to their respective jurisdictions. Had it not been for the decision of the regional government to amend this proclamation and to strip the urban areas their **“urban local government”** status and replace it with **“urban administration”**, they would have been in a position to act autonomously to some extent.

The fact that the amend proclamation-116/2006 of the ORS repealed the power of the city councils to elect the mayors and deputy mayors and awarded it to the president of the regional state undermined the autonomy of the urban local governments further. The amendment made the mayors of the respective urban administrations accountable to the president of the regional state, which weakens the power of the electorates to question and punish their respective city officials when necessary, while it creates loopholes for pervasive interventions from the upper level of government. That is why the Chiro urban administration changed at least 13 mayors in the last 10 years and forced to stay under unstable administration these all years, which in turn has obviously been undermining its capability to provide its residents with preference based local public goods and services.

Generally, the provisions in the amendment clearly reflect the strong motive of the regional government to tighten its grip over the urban administrations rather than making them responsive to the preferences of their respective electorates.

If the ULGs were recognized by the ORS constitution explicitly as autonomous units of government, the regional government would have not been in a position to strip their ULG status in a manner it undermines their autonomy. Therefore, it would have been important, at least for the ORS constitution, to recognize urban centers as devolved units of government if it were to empower local residents to decide on their own affairs autonomously.

When it comes to expenditure responsibilities, the lists of responsibilities the urban administrations in general and Chiro and Sebeta towns in particular are authorized with show that they are of a great importance in local service provision activities. Especially the mandate given

to them to provide education and health services to their residents is concrete evidence that shows the urban administrations are authorized to discharge major expenditure responsibilities.

However, this cannot be enough for one to deduce that the urban administrations are endowed fully with the deserved level of fiscal authority. The fact that there is no clear demarcation between the expenditure responsibilities of the levels of government is giving a leeway the regional government to interfere in the local expenditure competences in a manner it undermines local autonomy.

The mismatch between the expenditure responsibilities and taxation powers of the urban administrations is also weakening the urban administrations capability to provide preference based local goods and services to the worst. The fact that the urban administrations are financing almost all of their non-municipality services through the ordinary budget (block grant) they are receiving from the regional state and they could not finance their municipality services adequately from own revenue sources (municipality revenue) are among the consequences of their weak taxation powers. The huge gap between the expenditure responsibilities and the revenue they are generating from their own sources shows that the legal frameworks in place to regulate tax powers did not bestow the urban administrations with the deserved level of tax powers.

The unbalanced composition of the annual budgets of the urban administrations especially that of the block grant from the regional state is constraining the effort the urban administrations are making to be responsive to the preferences of their respective residents and circumstances specific to their jurisdictions. As only insignificant share of the ordinary budget goes to capital expenditures, the urban administrations could not be involved in major capital expenditure activities in a manner they can satisfy the needs of their electorates.

The failure of the urban administrations to tackle classroom shortages of the schools in their respective towns is one of the consequences of their inability to involve in major capital expenditure activities. Thus, one cannot expect the problems related to shortage of classrooms can be solved for good unless the share of the budget that will be devoted to capital budgets is significantly increased. As most of the budget devoted to salaries and other recurrent expenditures, there is no possibility to increase the capital budget without increasing the total

budget as a whole. In fact, the Sebeta urban administration is in a better position with this regard when compared to that of Chiro town as it has better economic activities and has the potential to generate more revenue from its own sources.

The urban administrations are not also in a position to exploit the revenue sources assigned to them effectively. They have weak authority with regard to determining their tax rates and hence the size of their revenue. As a result, they could not generate even the least amount of revenue they need to keep their services operational, let alone to satisfy the needs and preferences of their respective residents adequately. The fact that the regional state determines local tax, service charge and user fee rates made the urban administrations simply extensions of the upper level of government that are established to get the responsibilities of the regional state implemented.

The regional state controls also most of the available elastic tax bases including personal income taxes leaving the urban administrations especially that of Chiro town very weak with regard to taxation powers. Their weak tax administration capacity is also undermining their capability to exploit their revenue sources adequately.

Misuse of the limited financial resources is also the other problem affecting the service provision activities badly. The fact that, the Chiro urban administration was spending the revenue it was generating in the name of municipal services to compensate farmers evicted from their lands, so as to provide individual residents with urban lands for residential house construction is one of the factors affected municipality services adversely. As the financial resources devoted to land compensation payments was meant to be spent on municipal services, the expenditure diversion obviously forced the municipality to compromise the services it was expected to provide. As the urban land secured from farmers through compensation has been distributed to residents with better financial status, the urban administration is forcing even low-income residents to subsidize the rich.

Therefore, this expenditure decision clearly shows that, the Chiro urban administration has been violating the principles that require the establishment of strong nexus between revenue collected from and service rendered to its residents. This fiscal practice not only broke the strong relation supposed to exist between revenue collected and service rendered, but also distorted the resource

allocation by forcing the poor to subsidize residents with better financial status, including the rich.

The absence of effective grant transfer arrangements is also another problem affecting the local public service provision activities adversely. The fact that the financial transfer from the regional state is not adequate to finance fully the expenditure responsibilities it is supposed to cover, made it deficient arrangement that cannot live up to the objectives it was supposed to achieve. The non-participatory design process for grant transfer arrangement that denied most of the grant receiving jurisdictions the right to have their say on the design also undermines the acceptability of the grant transfer arrangement. The fact that the grant arrangement does not take the financial capacity of jurisdictions into consideration seriously is also widening the horizontal gap.

There are also no enabling conditions for the urban administrations to be responsive to the preferences of their respective residents. The fact that proclamation 65/2003 of the regional state did not define the expenditure assignments it provided for urban administrations clearly, especially the absence of particulars for some of the provisions provided for in the proclamation created loopholes for the upper level of government to intervene in the affairs of the urban administrations. That is why the unclear responsibilities with regard to human resource management and other responsibilities are affecting the service provision activities adversely.

Therefore, the pervasive interferences in the affairs of the local urban administrations are constraining the effort to provide preference based local public goods and services. Especially the involvement of the upper level of government in inappropriate transfer of civil servants to the urban administrations is forcing the local authorities to compromise requirements of their vacant positions in a manner it undermines the service provision activities.

The failure of the regional executive council to put in place the required guidelines that can facilitate access to financial markets for the urban administrations is also the other problem constraining local administrations' effort to diversify their financial sources.

As a result, the urban administrations in ORS could not access financial markets to finance even long-term projects forcing the current residents to cover the cost of such projects including that of road constructions alone as opposed to the requirement to distribute the burden of such costs across generations through borrowing.

Consequently, as opposed to the expectations from the electorates to be provided with preference based local public goods and services, the services the urban administrations of the study areas are providing appeared to be inefficient, inadequate, and poor quality, even though the service provision in Sebeta town is relatively better than that of the Chiro town. Absence or inadequate sanitation service; lack of teachers, classrooms, and textbooks which lead to poor quality education as well as repeated interruptions of water services are the major findings that confirm the inefficient, inadequate and poor quality services in the study areas.

## **5.2. Recommendations**

- With regard to legal frameworks, the failure of, at least the ORS constitution, to recognize urban local governments explicitly and the decision of the amend proclamation 116/2006 to strip the ULG status of the urban centers in the region undermined the autonomy of the urban administrations including that of the study areas. Therefore, there is a need to put in place strong legal frameworks that can reinstate the urban local government status of the urban centers and boost their autonomy once again. Giving urban local governments a clear recognition in the ORS constitution should be taken as a preferable option to realize autonomous and viable local government units.
- The assignment of the power to elect the city mayors and their deputies to the president of the regional state is also the major source of inappropriate intervention from the regional government. Thus, the reassignment of this power to the city councils will be helpful to ensure the provision of adequate and preference based local public goods and services, as it is a decisive factor to enable local residents to control their respective city officials.
- The mismatch between the expenditure responsibilities and the revenue generating powers of the urban administrations is very huge to the extent that the urban administrations have abandoned major capital expenditure activities and are operating under serious financial constraints. Therefore, there is a need to boost revenue-generating capacities of the urban administrations by endowing them with the power to exploit some of elastic tax bases such as personal income and other favorable revenue sources. Revenue sources such as incomes from advertisements, court fines, and taxes levied on

local businesses including barbershops and pensions should be reassigned to the urban local governments.

- The failure of proclamation 65/2003 ORS to draw visible demarcation between the expenditure responsibilities of the regional state and the urban administrations as well as absence of particulars for implementation of provisions of the proclamation is creating loopholes for inappropriate interventions from the upper level of government. Therefore, there should be legal frameworks that draw clear boundaries between the responsibilities of the two levels of government so as to minimize the possible interventions from the regional state into the affairs of the local governments as much as possible and to enhance accountability.
- The fact that the urban administrations are denied the right to set tax, service charges, and user fee rates is constraining their effort to increase their revenue and hence their budget in a manner it matches their respective expenditure responsibilities. Hence, there should be a mechanism in which, the urban administrations can determine their rates without causing distortions.
- Misuse of financial resources is also affecting service provision activities especially in Chiro urban administration by not only breaking the nexus between the revenue collected and the service provided but also forcing the poor to subsidize the rich. Hence, there is a need to create awareness on financial resource utilization and to put in place strict directives that forces local officials to spend their budgets for the right expenditure responsibilities.
- Even though, the delegation of the municipality revenue administration to the revenue offices in the respective urban administrations is helping to boost the municipality revenues of the towns, it is obvious that it is weakening their tax administration capacity as they are completely detached from revenue generation activities. Therefore, there should be a mechanism in which, the urban administrations can directly handle their revenue by their own.
- The ordinary budget (grant transfer) being allocated to the urban administrations is not adequate to finance the major expenditures it supposed to such as education and health,

and it is focused on recurrent budgets. The disparity in economic activities across jurisdictions is also widening the gap between the service provision capabilities of the urban administrations. Thus, it is important to redesign the grant transfer arrangement in a manner it tackles fiscal inadequacy the urban administrations are facing. The grant transfer arrangement should also be designed in a manner it can narrow the fiscal capacity difference between the urban administrations.

- The fact that, all stakeholders are not given the chance to participate fully in the grant transfer arrangement design process undermines the grant transfer acceptance. Therefore, there is a need to redesign the grant transfer arrangement with the full participation of all the grant recipient jurisdictions including the eligible urban administrations.
- Lack of authority to determine on human resources is hampering the urban administrations not to capacitate themselves to the level the needs on the ground require them. Thus, loosening the grip over the discretion of the urban administrations to decide the number of workforces they need and to determine the salaries and other benefits of their civil servants is very important.
- The chance to use zonal administration structure as a means to interfere in the affairs of the urban administrations is risking the urban administrations autonomy to be breached repeatedly by the regional state. Hence, there is a need to put in place a mechanism that can prevent such autonomy breaches not to happen anymore.
- The failure of the urban administrations to access financial markets is forcing residents to bear the cost of long-term projects alone and it is also causing under provision of basic services. Therefore, the regional state should facilitate for the urban administrations to get access to capital markets so as to distribute the burden of long-term capital project costs across generations and to prevent under provision of services as well.

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## Annex I

### Question Guide for Interviews and Focus Group Discussions

<p>Are the towns endowed with appropriate level of fiscal powers and functions?</p>	<ul style="list-style-type: none"><li>• What are the revenue sources that are assigned to the urban administrations?</li><li>• Do the urban administrations authorized to use all revenue sources that are appropriate to local governments?</li><li>• Is the own revenue of the urban administrations matches their expenditure?</li><li>• What percent of their expenditure is being covered from locally generated revenue?</li><li>• What percent of it is being covered by shared taxes?</li><li>• Does their revenue increasing with their expenditure need?</li><li>• Do the urban administrations assigned with productive tax bases?</li><li>• Are the revenue sources assigned to the urban administrations consistent?</li><li>• Are the urban administrations endowed the authority to, at least, set rates?</li><li>• Are there any revenue sources that are not devoted to the urban administrations while they are appropriate to be assigned to them?</li><li>• Do the urban administrations have enough tax officers and other professionals in both quality and quantity?</li><li>• Are the urban administrations retaining experienced staff members?</li><li>• What are the reasons behind for inability to retain experienced staff members?</li><li>• Do the revenues the urban administrations generate conform to their plans?</li></ul>
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<p>Are the municipalities exploiting all their revenue sources exhaustively and use their revenue effectively?</p>	<ul style="list-style-type: none"> <li>• Are the urban administrations using their authority to vary rates?</li> <li>• Are the urban administrations using their authority to vary rates?</li> <li>• Do the urban governments have effective tax assessment mechanisms?</li> <li>• Do they conduct tax assessments regularly and expand the coverage for each revenue source?</li> <li>• Do they conduct regular assessment and expand their revenue sources within their tax jurisdiction?</li> <li>• Do the urban governments have effective mechanisms to collect the revenue they assessed and planed?</li> <li>• Do they recover their cost fully from the services they render to residents?</li> <li>• Do the urban governments use appropriate mechanisms to recover development costs by imposing appropriate level of taxes on businesses that can be benefited from development activities such as road constructions?</li> <li>• Do they consider market values of properties when they levy property taxes?</li> <li>• Do they value properties regularly to capture the possible value increments of properties that can be emanated from urban development activities?</li> <li>• Are the urban governments cost effective in their tax administration activities?</li> <li>• Do the urban governments train their tax officers regularly?</li> <li>• Do the urban administrations have mechanisms in place to motivate their staff members so as to maximize their efficiency?</li> <li>• Do the urban administrations use punitive mechanisms to discourage inefficient behaviors among their staff members?</li> <li>• Do the urban administrations conduct awareness creation activities among the taxpayers so as to boost the willingness to pay taxes and other duties?</li> <li>• Do the urban administrations have effective mechanisms to prevent</li> </ul>
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	<p>corruption and tax evasion?</p> <ul style="list-style-type: none"> <li>• Are local justice bodies such as police and courts supporting urban administrations in their effort to fight corruption and tax evasion?</li> <li>• What percent of their expenditure is being devoted to capital expenditures?</li> <li>• What percent of it goes to recurrent expenditures including administration costs?</li> </ul>
<p>Are the legal and institutional arrangements adequate to guide the local fiscal autonomy of the towns?</p>	<ul style="list-style-type: none"> <li>• Are the urban administrations fully in charge of preparing and determining their budget?</li> <li>• Are the urban administrations fully in charge of preparing their plan?</li> <li>• Do the people elect the urban administrations' officials?</li> <li>• Do the urban administrations are in charge of recruiting, hiring, promoting, demoting and firing their employees?</li> <li>• Is there overlapping between the powers and functions of the higher levels of government and that of the urban administrations?</li> <li>• What difficulties are the urban administrations are facing in relation to the lack of clear boundaries between the powers and functions of the levels of governments?</li> <li>• Do the urban governments devote their revenues to the appropriate expenditure areas? (are they devoting charges and fees for goods and services with private good characteristics as well as local taxes for goods and services with public good characteristics?)</li> <li>• Are the revenues urban administrations are generating benefit oriented?</li> <li>• Are the urban administrations exploiting every mechanism at their disposal to ensure the participation of residents in planning and implementation of local development plans?</li> <li>• Do the urban administrations make their fiscal performance reports accessible for residents so as to strengthen accountability?</li> </ul>

<p>Is there appropriate intergovernmental grant transfer system that can address both vertical and horizontal fiscal gaps effectively?</p>	<ul style="list-style-type: none"> <li>• Are there significant fiscal imbalances (both vertical &amp; horizontal)?</li> <li>• What are the possible sources of the imbalances?</li> <li>• What kind of grants is the regional government providing the urban administrations?</li> <li>• Does the grant transfer include unconditional grants that can fully correct the vertical and horizontal imbalances?</li> <li>• Does the transfer include conditional matching output based grants for education and health services so as to achieve the minimum standard?</li> <li>• Does the transfer include enough capital grants for infrastructure development?</li> <li>• Does the grant system give the urban administrations leeway to utilize the grant the way they want?</li> <li>• Is the grant transfer substantial enough to live up to the objectives it is intended to achieve?</li> <li>• Is the grant they are receiving effective enough to tackle both vertical and horizontal imbalances to date?</li> <li>• Is the regional government revising the grant system in a manner it can tackle the major deficiencies, which are constraining provision of efficient, and preference based urban public services?</li> <li>• Do the urban administrations have access to capital markets?</li> </ul>
<p>Do the residents happy enough With the services the Urban Administrations are providing?</p>	<ul style="list-style-type: none"> <li>• Do the people get education, water, and sanitation services based on their preferences and their ability to pay for?</li> <li>• Do the services, the urban administrations are providing, are available in the needed quality and quantity?</li> <li>• Are the services the urban administrations are providing showing progress parallel with the need on the ground?</li> <li>• Are the urban administrations responsive enough to the questions from by the residents?</li> </ul> <p>Do the urban administrations participating their residents in planning and implementation activities?</p>

## **Annex II**

### **List of Informants from Chiro Town**

1. Tadele Yibza, Manager of the Town
2. Mekonin Beqele, Head of Finance and Economic Development Office (FEDO)
3. Tigist Mekonin, Head of Budget and Planning Department of FEDO
4. Engidaworq Belete, Head of Audit and Supervision Department of Revenue Office
5. Yeshareg Balicha, Head of Budget and Planning Department of Revenue Office
6. Gizaw Abebe, Head of Water Service Office
7. Tilahun G/Tsadiq, Head of Technical Department of the Water Service Office
8. Demisu Getachew, Head of Sanitation & Beautification Service Office
9. Dinqalem Mengistu, Expert at Sanitation and Beautification Service Office
10. Moges Mengistu, Head of Education Office

There are also other interviewees who are not willing expose their identity

- An expert from Education Office
- Two experts from Revenue Office
- An expert from Water Service Office
- Health officer from Health Office
- One elder

## **Annex III**

### **List of Informants from Sebeta Town**

1. Gonfa Mideqsa, Deputy Manger of Sebeta Town
2. Feleqe Gelmessa, Head of Finance & Economic Development Office
3. Assefa Beqele, Head of Budget & Supervision Department of FEDO
4. Adugna Gemechu, Head of Sanitation & Beautification Service Office
5. Tsehay Debele, Deputy Head for Education Office
6. Mensur Musema, Head of Teachers' Development Department of Education Office
7. Dereje Tolesa, Head of Water Service Office
8. Assefa Kebede, Communication Officer

There are also other interviewees who are not willing expose their identity

- Two experts from the Revenue Office
- An expert from the municipality
- Two n experts from Sanitation and Beautification Service Office
- Two experts from Education Office
- An expert from Water Service Office
- Two elders

## **Annex IV**

### **Informants from the Federal and Regional Offices**

1. Buzineh Tolcha, Communication Director For Ministry of Water, Irrigation and Energy
2. Dereje Alemu, Curriculum Development Expert at Oromia Education Bureau
3. Mossisa Degene, Teachers Development Expert at Oromia Education Bureau
4. Hassen Sani, Communication Expert at Oromia Water, Mining and Energy Bureau

There are also other interviewees who are not willing expose their identity

- An expert at Oromia Education Bureau
- An expert at Oromia Water, Mining and Energy Bureau