

Addis Ababa University

School of Law

Graduate Program

**SUBNATIONAL FINANCIAL AUTONOMY
IN A DEVELOPMENTAL STATE: THE
CASE OF ETHIOPIA**

**A Thesis Submitted To the Law School of Addis Ababa University for
the Partial Fulfillment of Masters Degree (LL.M) In Constitutional and
Public Laws**

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Declaration

I, Zemenu Yesigat Ayenew, hereby declare that this dissertation is original and has never been presented in any other academic institution. Where other people's works have been used and or referred to, acknowledgments have been duly made.

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Acronyms

| | | | |
|---|---------------|---|--|
| ❖ | ANDM | - | Amhara National Democratic Movement |
| ❖ | Art(s) | - | Article(s) |
| ❖ | DS | - | Developmental State |
| ❖ | Ed(s). | - | Editor(s) |
| ❖ | EPA | - | Ethiopian Privatization Agency |
| ❖ | EPRDF | - | Ethiopian People’s Revolutionary Democratic Party |
| ❖ | FDI | - | Foreign Direct Investment |
| ❖ | FDRE | - | Federal Democratic Republic of Ethiopia |
| ❖ | FY(s) | - | Fiscal Year(s) |
| ❖ | GDP | - | Gross Domestic Product |
| ❖ | GTP | - | Growth and Transformation Plan |
| ❖ | HoF | - | House of Federation |
| ❖ | HPR | - | House of People’s Representatives |
| ❖ | IGR | - | Intergovernmental Relations |
| ❖ | IMF | - | International Monetary Fund |
| ❖ | MDG | - | Millennium Development Goals |
| ❖ | MoFED | - | Ministry of Finance and Economic Development |
| ❖ | NBE | - | National Bank of Ethiopia |
| ❖ | OPDO | - | Oromo People’s Democratic Organization |
| ❖ | PSCAP | - | Public Sector Capacity Building Programme |
| ❖ | SEPDM | - | Southern Ethiopian People’s Democratic Movement |
| ❖ | TPLF | - | Tigray People’s Liberation Front |
| ❖ | WB | - | World Bank |

Abstract

Triggered by, or justified with, different factors, federations exhibit significantly variation in their respective form, nature and degree of decentralizations. Regardless of all these differences, however, the necessity of bestowing genuine autonomy for subnational governments had never been contested. Thus, it is hardly possible to think of a federation without constitutionally mandated allocations of political powers among different tiers of governments. Indisputably, a mere constitutional stipulation doesn't guarantee the financial autonomy of subnational governments despite it is mandatory and inherent in any federal system. Inspired by literatures on the impacts of the political economy of a government on its federal system, this research emphasizes on the contemporary political economy narratives of the Ethiopian government, i.e. the "developmental state of Ethiopia" and its pitfalls with respect to ensuring genuine financial autonomy of regions. Exploring theoretical foundations and nexuses between the developmental state paradigm and fiscal federalism, the study argues that the impacts of developmentalism on subnational financial autonomy are multifaceted, including its contribution for the existing fiscal imbalance. It also tries to show the impacts of the developmental paradigm on the spending autonomy of regions, which is highly constrained by the over-centralized policymaking accompanied by the mismatches between the ever-increasing federal unfunded mandates and the continuously decreasing shares of block grants. The research further points out how the developmental state paradigm has been shaping external financing, domestic borrowings and federal special purpose grants, which are entangled with stringent conditions. Scrutinizing all the challenges posed by the developmental narrative, the study finally tries to solicit the possible means of addressing the contemporary problems of subnational financial autonomy in the Ethiopian federal system.

Chapter One

1. Introduction

1.1. Background

In spite of the ever growing debates, with regard to the economic rationales of decentralization, the issue of fiscal federalism is now more of a political issue of self determination than being a matter of public welfare.¹ More importantly, it is hardly possible to think of federations without the financial resource of constituent units, which either enables or constrains them from effectively shouldering the constitutionally mandated responsibilities and the policy objectives they set.²

Like many of the federations, the post-1991 state restructuring and the Ethiopian “ethnic federalism”³ were not offshoots of the quest for economic development. Many agree, federalism was rather the best, perhaps the only, measure of the time that was taken for the survival of the country balancing forces of unity and that of diversity.⁴ But it doesn’t mean that the federal arrangement was not justified by, or criticized for, economic reasons.⁵

¹Rémy Prud'homme & Anwar Shah, Centralization v. Decentralization: The Devil Is In the Details, a Paper presented for a Conference held in Porto Alegre, World Bank , June 22, 2002

²Ronald L. Watts (2008), Comparing Federal Systems, Published for the School of Policy Studies, Queen’s University by McGill-Queen’s University Press. 3rded. P. 95

³Some scholars prefer to use terms like “multi-cultural” or “multi-ethnic” federalism to refer the existing federal arrangement in Ethiopia.

⁴See, Assefa Fiseha, Federalism and Accommodation of Diversity in Ethiopia: A Comparative Study, revised edition, Wolf Legal Publishers, Nijmegen, 2007; Fasil Nahum, Constitution for Nation of Nations: The Ethiopian Prospect. The Red Sea Press, New Jersey, 1997

⁵See, Abu Girma Moges, An Economic Analysis of Fiscal Federalism in Ethiopia, Northeast African Studies, Vol. 10, No. 2 (New Series), 2003, Pp. 111–140; Alemante G. Selassie, Ethnic Federalism: Its Promise and Pitfalls for

The Ethiopian federal system, as initiated in the Transitional Charter⁶ and reaffirmed by the 1995 Constitution of Federal Democratic Republic of Ethiopia,⁷ has introduced legislative, administrative and fiscal decentralizations which endeavored to assure the right to self-administration, the corner stone of the federation.

Generally speaking, constitutionally dictated allocation of legislative, administrative and taxation powers for both federal and subnational governments⁸ is primarily aimed at ensuring the autonomy of those tiers of government- one of the pillars of any federal system. Thus, most of the justifications and skepticisms around decentralization took the very assumption that subnational governments have constitutional, or else, stipulation that guarantee unconditional political autonomy to set priorities in light with local preferences and to allocate revenues accordingly.⁹

Nonetheless, the unpredictable incidences in domestic or global economy and politics subjected allocation of powers to continuous revisions since constitutions are “incomplete contracts” which could and should be interpreted and applied to the changing situations.¹⁰ Among these, the ever changing perceptions on the appropriate roles of the state and varied positions on state activism

Africa, The Yale Journal of International Law, Vol. 28, No.51,2003 available at <http://scholarship.law.wm.edu/facpubs/88>, last visited on 15/02/2014

⁶Transitional Period Charter, Negarit Gazette, No 1/ 1991; Proclamation to provide for the Establishment of National/Regional Self-Governments, Negarit Gazette, Proclamation No. 7/1992

⁷The Constitution of the Federal Democratic Republic of Ethiopia, Proclamation No. 1, 1995; (hereinafter referred as the FDRE Constitution)

⁸Unless there is a clear stipulation, “subnational governments”, “constituent units”, “regions”, “States”, and “regional states” are alternatively employed so as to refer members in a federal system.

⁹For a better discussion, see Charles M. Tiebout, A Pure Theory of Local Expenditures, The Journal of Political Economy, Vol. 64, No. 5, 1956; Wallace E. Oates, Toward A Second-Generation Theory of Fiscal Federalism, International Tax and Public Finance, Vol. 12, 349–373, 2005; Remy Prud'homme, On the Dangers of Decentralization, Transport Division, Transportation, Water & Urban Development Department, the World Bank, Policy Research Working Paper 1252, 1994.

¹⁰Matias Iaryczower, et al, Coming Together: The Industrial Organization of Federalism, Department of Politics - New York University, September 20, 2001, available at <http://faculty.udes.edu.ar/tommasi/cedi/dts/dt30.PDF>, last visited on 21/03/15

could perhaps been the most significant cause in redefining fiscal federalism of many federations.

Similar to most federations, however, fiscal federalism in the Ethiopian system is characterized by, mismatches between the expenditure needs and revenue capacities of subnational states, commonly referred as vertical imbalance. Overwhelming transfer dependency, accompanied by vague provisions of the Constitution regarding concurrent powers and lack of formal system of IGR, troublesomely run the Ethiopian fiscal federalism. That means, even if the risky fiscal imbalance could be primarily blamed for erosion of budgetary autonomy of regional states, the budgeting process is mainly influenced by the national socio-economic and developmental plans and programs which do not “permit much deviation from the dictates of the center”.¹¹

The ruling party, EPRDF, had been criticized for overlooking the federal arrangement mainly because of its internal structure of “democratic centralism” and its ideology of “revolutionary democracy”.¹² The ruling party underwent through periods characterized by contrasting ideological paths in the past two decades. Abbink summarized these changes in to four phases.¹³ The first phase (1991-2000) was a period of transition and stabilization followed by nationalist reconfiguration of 1998-2003, which was an aftermath of the Ethio-Eritrean war and the TPLF’s split of 2001. Whereas the remaining two phases were the incorporation of affiliate parties so as to broaden the party, which was taken place around 2003 to 2005 while the developmental state paradigm was adopted since 2005.¹⁴

¹¹ Edmond J. Keller, *Ethnic Federalism, Fiscal Reform, Development and Democracy in Ethiopia*; *African Journal of Political Science*, Vol. 7 No. 1, 2002, P. 46

¹²Jon Abbink, *Ethnic-based federalism and ethnicity in Ethiopia: reassessing the experiment after 20 years*, *Journal of Eastern African Studies*, 5:4, 596-618, 2011, P. 602 <http://dx.doi.org/10.1080/17531055.2011.642516>, accessed on 24 February 2012;Assefa Fiseha, *Ethiopia's Experiment in Accommodating Diversity: 20 Years' Balance Sheet*, *Regional & Federal Studies*, 22:4, 435-473, P. 461, 2012, available at <http://dx.doi.org/10.1080/13597566.2012.709502>, accessed on 11 October 2012

¹³Jon Abbink, *supra* note 12, P. 598

¹⁴ Though Ethiopia’s adoption of the new developmental paradigm was publically declared in 2006, the ruling elites claimed that it was adopted around 2001, immediately after the ruling party’s split. For a better discussion on this

The revival of state-led development in the 21th C would be among the changes in the governments' narrations of political economy that had been, or could possibly be, a serious challenge on the effective functioning and stability of federal systems. Due to this, there is always a danger that this change could legitimize the existing disparities between the constitutional dictates and the actual practices of subnational autonomies. In spite of all the academic debates and worries, however, the Ethiopian government appears to favor measures of recentralization at the cost of regional autonomy.¹⁵

1.2. Statement of the Problem

The nexus between developmental state paradigm and federalism remains unclear since the researches done so far are insignificant in number and limited in scope.¹⁶ Thus, it is natural to have diametrically opposite theories on the possibility of building an effective developmental state in a working federal system.

Though many are skeptic about building a developmental state in a multinational state and within a fragmented society, scholars firmly argue that the possibility of building a developmental state in federal systems would not be overruled. Some of these scholars strived to point out the possible challenges of ethnic federalism in the process of building a developmental state.¹⁷

issue see, Speech by HE Meles Zenawi for the Africa Task Force, Brooks World Poverty Institute, Manchester University, UK 3rd to 4th August 2006, available at; <http://ethioembassy.org.uk/Archive/Prime%20Minister%20Meles%20Afica%20Task%20Force%20speech.htm>

¹⁵Assefa,(2012),supra note 12

¹⁶ Emmanuel Remi Aiyede, The Political Economy of Fiscal Federalism and the Dilemma of Constructing a Developmental State in Nigeria International Political Science Review, 30: 245, 2009, available at <http://ips.sagepub.com/content/30/3/249>; Samuel Kenha Bonda, Impact of Ethnic Federalism in Building Developmental State of Ethiopia, A Research Paper Presented in partial fulfilment of the requirements for obtaining the degree of Masters of Arts In Development Studies, International Institute of Social Studies, The Hague, Netherlands, (unpublished), 2011

¹⁷Bonda, supra note 16

There are still others who tried to solicit the possible ways out from the challenges posed by federal structures.¹⁸

Developmental state, particularly its emphasis on centralized planning, from its very essence, claimed to defeat the idea of federalism.¹⁹ This postulation is supported by the fact that the period of developmentalism matched with the time when there was higher degree of centralization in a number of federal systems, including Brazil and India.²⁰

The study posits the postulation that holds, the adoption of developmental state theory overlooks the federal arrangement. Eroding fiscal (tax) autonomy of States and increasing their respective expenditure costs, the adoption of the paradigm worsens fiscal imbalances. Excessive dependence on federal transfers, in one way or another, affects the autonomy of subnational governments. On the other hand, centralized planning and policymaking, which is the inherent feature of developmental states,²¹ would ultimately restrain subnational governments from exercising their spending autonomies. Thus, exploring the existing challenges on the revenue and spending autonomies of regions of the Ethiopian federation, particularly analyzing those challenges posed by the adoption of the developmental state paradigm is the main theme of the study.

¹⁸Aiyede, supra note 16

¹⁹Govinda Rao, Fiscal Federalism in Planned Economies, in Ehtisham Ahmad and Giorgio Brosio eds. *Handbook of Fiscal Federalism*, Edward Elgar Publishing, Inc.136 West Street Suite 202 Northampton Massachusetts 01060 USA, 2006. P. 224

²⁰Ramesh Thakur, *The Government and Politics of India*, Macmillan Press Ltd, Malaysia, 1995, P. 77; José Cezar Castanhar, Fiscal Federalism in Brazil: Historical Trends Present Controversies and Future Challenges, (P. 4VIII *Congreso Internacional del CLAD sobre la Reforma del Estado y de la Administración Pública*, Panamá, 28-31 Oct. 2003), P. 4

²¹Eun Mee Kim, Contradictions and Limits of a Developmental State: With Illustrations from the South Korean Case, *Social Problems*, Vol. 40, No. 2, May, 1993, P. 231

1.3. Research Questions

The research sought to address the basic question that is raised in relation with how the developmental state paradigm has affected the financial autonomy of regional states. Particularly, the study is focused on these questions;

- Would there be, or is there any possible challenge or actual impact on the volumes of own-source revenues of the regional states, in relation to the adoption of the developmental paradigm? Would the adoption of the developmental path be one of the justifications for the existing fiscal imbalance?
- How the adoption of the developmental paradigm affects the nature and volumes inter-governmental transfers?
- Does the developmental state paradigm have an impact on the constitutional dictates of subnational planning and policymaking? What are the possible impacts of the paradigm federal and regional policies, plans and strategies?
- How far subnational borrowings, federal conditional grants as well as foreign assistances and loans are shaped by the developmental paradigm? How could the changes on such sources of revenue, if any, influence the spending autonomy of regions?

1.4. Objectives of the Study

Raising the above stated research questions, the following objectives are aimed to be addressed with this study.

General Objective

The general objective of this study is to scrutinize the nexus between the developmental state paradigm and financial autonomy of subnational governments of the Ethiopian federation.

Specific Objectives

- ↓ To investigate the impacts of the developmental state paradigm on the taxation powers of regions and that of the volumes own-source revenues of regions in the federation

- ↓ To evaluate the trends of vertical transfers, particularly the size and nature (types) of grants vis-à-vis the existing developmental paradigm of the Ethiopian government
- ↓ To assess the constitutional dictates and practices of federal and regional policymaking and planning and to analyze the impacts of the developmental state paradigm on the procedures, designs and contents of national plans and policies
- ↓ To explore and analyze the impacts of “developmental-oriented” policies, plans and funds, of the federal government, on the spending autonomies of States in the Ethiopian federation

1.5. Methodology

In order to achieve the research objectives, the study utilized both primary and secondary data. Legislations including proclamations, regulations and directives together with the policy documents comprising of the federal government’s policies, strategies and plans are among the primary data that are employed in the research. Moreover, there are official statistics and reports collected from the MoFED, EPA and NBE that are presented and analyzed in the study. On the other hand, books and journal articles on fiscal decentralization and the developmental state paradigm, as well as magazines, newspapers and Web Pages are among the secondary data that are used in the research. Moreover, the statistics available at government offices are scrutinized in light of the reports made by international actors like WB.

This study is basically a qualitative research whereby primary and secondary data are analyzed based on descriptive and evaluative methods of data analysis. The study starts with describing theoretical foundations and experiences of different states together with the historical trends and existing arrangements of the political economy of Ethiopia. Besides, deep evaluation of official data, legislations and policies is employed to thoroughly study the research problem.

1.6. Significance of the Study

Since the developmental state paradigm is a newly emerging field of scholarship, it hasn’t yet been a frequently studied area so far. The scope of the existing studies, too, is limited to the

Asian experience. In the scarcity, if not absence, of studies on the political economy of developmental state and its impacts on fiscal federalism in general, and subnational financial autonomy specifically, this research would be a groundbreaking study for the development of the new jurisprudence on the area.

By the same token, there is only a little research available on the Ethiopian developmental state, which is of course a new invention aging only around a decade. In contrast to its age, however, the studies conducted on the Ethiopian federal system are considerable in numbers and extensive in their scopes. Unfortunately, there are only a few scholars that have tried to study the nexus between the Ethiopian federal system and its developmental state paradigm. Therefore, the study could be considered as a valuable contribution for an emerging field of study.

1.7. Scope of the Study

It is not the objective of this research to study whether the developmental state theory is the right path to development of the country. Nor is the author's intention to scrutinize the feasibility of implementing the paradigm in the existing social and political structure. The study rather revolves around issues pertaining to the financial autonomy of regional states in the contemporary political economy of the country, i.e. the developmental state of Ethiopia. By the same token, talking about subnational financial autonomy could imply the revenue and spending autonomies of all levels of subnational governments to the lowest level of administration. However, the financial autonomy of sub-regional or lower levels of local governments is beyond the scope of this study.

1.8. Limitations of the Study

The major, perhaps the crucial, limitation of the study is the fact that comprehensive interviews could not be made mainly because of absence of positive responses from the side of government officials. Moreover, hadn't there been financial and time constraints, surveys and interviews could have been conducted at different regional states. Lack of up-to-date data from government offices was another challenge for conducting this research.

1.9. Organization of the Study

The study will be composed of two parts; the first part is devoted to deal with theoretical foundations of, and the nexus between, the developmental state theory and subnational financial autonomy. After briefly discussing with the historical development of state and economic restructuring in Ethiopia, the second part of the paper will cover the impacts of the developmental state paradigm on the revenue and spending autonomies of regional governments in Ethiopia.

Since the first chapter is devoted to introduction, the second chapter deals with theories of decentralization and the developmental state in three sections. The chapter begins with highlighting theories of decentralization, fiscal federalism and subnational autonomy. The developmental state theory and its nexus with subnational autonomy will be the next sections of the chapter.

Chapter three will deal with state restructuring and developmental paradigms in the modern history of Ethiopia. It particularly covers the federal structure, fiscal federalism and the developmental state theory in the contemporary Ethiopia.

Dealing with institutional and legal frameworks of fiscal federalism in FDRE, the fourth chapter will be composed of brief analysis of the fiscal imbalances and spending autonomy of regional states setting nexus with the developmental state discourse. It is composed of two parts; the first part will be devoted to analyze the impacts of the developmental state paradigm on the revenue autonomy of regions while the second part scrutinizes the spending autonomy of regions vis-à-vis the developmental paradigm. The last chapter will come up with concluding remarks and recommendations.

Chapter Two

Theories of Decentralization and the Developmental State

2.1. Introduction

In the late 20th C, many states in the world had started to take extensive measures of decentralizations on different sectors including their economy and various government structures. One of these measures was taken place in the form of decentralizing public finances through allocation of revenue and spending powers among different tiers of the government, which is commonly known as fiscal decentralization. It has to be noted that there were significant variations among these states with respect to the rationales that necessitate these measures of decentralization.

Traditionally, federalism was perceived as one form of decentralization despite there are significant differences between these two concepts. Still, it is impossible to think of federalism without a genuine allocation of expenditure responsibilities and revenue powers to the federal and subnational governments. Allocation of powers, accompanied by various tools of intergovernmental transfers, is the central theme of fiscal federalism. One of the objectives of fiscal federalism, on the other hand, is ensuring subnational autonomy of revenue generation and spending.

Similarly, it was in this period when the world had witnessed novel ideas and paradigms of development, with a particular emphasis on the Third World. The revival of State-Led Development in the late 20th C marked the birth of a new developmental paradigm, which is known as the developmental state paradigm. The paradigm had different meanings and interpretations in the stories of different states. While it was romanticized for the economic transformations in a number of Asian counties, it was blamed for the devastating attempts of the post-colonial African counties.

No doubt that there were federal states that had once adopted the developmental state paradigm whereas a couple of federations are still claimed to be developmental. In spite of the growing debates on the nature and meaning, or the advantages and disadvantages, of developmental state paradigm, scholars had barely addressed the issues involving the challenges or prospects of adopting the development paradigm in a federal arrangement.

Therefore, this chapter is devoted to deal with theories of decentralization and developmental state. While doing so, the chapter comprises of sections dealing with decentralization, fiscal federalism and subnational financial autonomy in one hand and theories of the developmental state on the other hand. Finally, the last section of the chapter tries to scrutinize subnational financial autonomy in developmental states, both the theoretical foundations and comparative overviews.

2.2. Decentralization, Fiscal Federalism and Subnational Autonomy

‘Pour gouverner mieux, il faudrait gouverner moins’

(To govern best, one needs to govern less)

D’Argenson, (A French economist of 18th C)²²

2.2.1. Decentralization: An Overview

Albeit incomprehensive, the often-cited scholarly works define decentralization as a process of transferring planning and management or revenue collecting and spending powers from the

²² As quoted in Peter Groenewegen, *Eighteenth-century Economic; Turgot, Beccaria and Smith and their contemporaries*, Routledge, London and New York, 2002, P. 211

central government to field units, levels of government or public and private organizations.²³ The term might also be employed to describe ‘situation in which public goods and services are provided’ by the private actors through market mechanisms.²⁴ Therefore, the broader interpretation of decentralization would be extended to cover economic liberalization or privatization measures.

Traditionally, striving to make provisions of public services effective and efficient together with management macroeconomic development was perceived as a crucial justification for decentralization.²⁵ Nonetheless, delineating the scope of state involvement in the economy and defining its ‘appropriate’ roles and economic functions, continued to be roots of academic and political debates. Likewise, arguments on the “right” size of governments’ taxation and spending are rarely settled in the field of public finance.

Market failures, particularly the “Great Crash” of 1929, cast a dark cloud on the laissez-faire perception of inherently well-regulated economy. The incidence marked the collapse of Adam Smith’s metaphor of the “invisible hands” of the market, and mandated “new roles” of a state apart from its traditional roles of preservation of peace and order.²⁶

At the demise of classical view of minimal role of government, John Maynard Keynes’s notion of large and active welfare state blossomed. Keynesian Welfare State ideology called for government ownership of crucial enterprises as well as reforms that could increase taxes and

²³Dennis A. Rondinelli, et al, , Decentralization in Developing Countries; A Review of Recent Experience, World Bank Staff Working Papers, Number 581, Management And Development Series, Number 8, The World Bank, Washington, D.C., U.S.A. 1983, P. 13

²⁴Ibid

²⁵Ibid, P. 9

²⁶Michael Moran , The British Regulatory State: High Modernism and Hyper-Innovation, Oxford University Press, New York, 2003,P. 8

massive government spending.²⁷ It was this theory of welfare state that shaped the traditional fascinating thoughts on decentralization, especially in the field of public finance.

Public finance, as the study of public expenditure and tax, treats decentralization as distribution of taxation and spending powers, commonly known as fiscal decentralization. Among the pioneers, Musgrave's work on "assignment of functions", (1959) was based on the Keynesian theory on the role of the government, i.e. correcting market failure, income redistribution and macroeconomic stability.²⁸

Similarly, Tiebout's theory on "inter-jurisdictional competition" or the notion of "voting with one's foot"²⁹ inspired the birth of a relatively comprehensive work of Oates - "the decentralization theorem". It deals with the economic advantages decentralization in achieving superior outputs by local governments than centrally determined and 'uniform' public goods.³⁰

When the three decades long the "golden history" of the Keynesian model of 'controlled capitalism' ended up with the unprecedented and dreadful economic crises of the 1970's, it gave rise to the re-birth of liberalism, i.e. neo-liberalism.³¹ In the mean time "New Federalism", one of the offshoots of neoliberalism, was emerged as another theory of decentralization that was founded up on the idea of public choice theory.

²⁷ Manfred B. Steger and Ravi K. Roy, *Neo liberalism; a Very Short Introduction*, Oxford University Press, New York, 2010 ,Pp. 6-9

²⁸Oates, (2005), *supra* note 9, P. 350

²⁹Tiebout, *supra* note 9, Pp. 416-424

³⁰Oates, (2005), *supra* note 9, P. 553

³¹ Eric Rauchway, *The Great Depression & the New Deal: A Very Short Introduction*, Oxford University Press, New York, 2008, P. 9

While the classical public finance theories³² were based on the economic rationales of decentralization especially, allocative efficiency and accountability (responsive government), public choice theory regards decentralization as a means of restricting the size of government, which is the main tenet of neoliberalism.³³ The logic seems simple; as competition limits monopolies in the private sector, decentralization and inter-governmental competition, would constrain the size of monopolistic federal government together with corruption and rent seeking.

While classical theories approached decentralization as a means of rectifying the failures of market liberalism, the latter advocate it as a means of achieving 'real' liberalism. Dealing with decentralization, public choice scholarship was thus devoted to design rules to limit public the size of government, contrary to that of public finance that explored public sector responses for market failures.³⁴ A brief sketch above depicts the strong correlation between theories of decentralization and economic systems or government size.

Nonetheless, both theories were not free of flaws, which attracted skeptics and critics. Classical theories of decentralization assume the existence of inter-jurisdictional variations of tastes or preferences, and consumers' manifestation thereof. However, other scholars doubt the existence of inter-jurisdictional variation of tastes, especially in developing countries.³⁵

Similarly, there is only a little empirical evidence presented supporting public choice argument of automatic reduction of government size and its rent through decentralization. No doubt that it does constrain the size of the governments whenever decentralization is accompanied by reliance

³² Terms like "Classical theories", "First Generation Theories" or "Pure theories" of decentralization and/or public finance are employed to refer the treatises of Musgrave, Tiebout and Oates, which are discussed above.

³³ Barry R. Weingast, Second Generation Fiscal Federalism: Implications for Decentralized Democratic Governance and Economic Development, September 2007, p. 10

³⁴ Charles K. Rowley, 'Public Choice and Constitutional Political Economy', in Charles K. Rowley and Friedrich Schneider, eds., *The Encyclopaedia of Public Choice*, Kluwer Academic Publisher, Dordrecht, 2004, Pp. 9&10

³⁵ Prud'homme, (1994), supra note 9, P. 7

own-source revenues of the local governments. Yet, there will be an opposite effect if the local budgets are primary dependent on transfers.³⁶

Moreover, the early works of public finance scholars would not serve as ideal formulae since most of the treatises are blamed for treating economic rationales of decentralization separately from its constitutional and political aspects.³⁷

In spite of the growing skepticisms about the feasibility of its objectives, decentralization became the common phenomenon in a number of states in the world. Most of all, the ‘pro-anti’ debates of decentralization appeared to be outdated despite the fact that scholars are continue to develop contrasting theories and counterarguments against its justifications. This is mainly because of the idea of decentralization recently became more of a political issue of politicians and the people at large.³⁸

2.2.2.Fiscal Federalism

In spite of the usual, perhaps confusing, approaches of scholars in employing the both terms interchangeably, there is a significant difference between what ‘decentralization’ and ‘federalism’ connote. Most importantly, decentralization, irrespective of its form, principally entails decisions of central governments, which is different from constitutional stipulations that forms and regulates any federal system.

It is known that decentralization might appear taking different forms including deconcentration, delegation or devolution. Deconcentration and delegation refer to transfers of administrative

³⁶ Oates, (2005), supra note 9, P. 355

³⁷ Richard Bird et al., ‘Assignment of Responsibilities and Fiscal Federalism’, in Raoul Blindenbacher and Arnold Koller, eds. , *Federalism in a Changing World- Learning From Each Other; Scientific Background: Theme Paper, Proceedings and Preliminary Speeches of International Conference on Federalism*, McGill-Queen’s University, Montreal & Kingston, 2002, P. 584

³⁸ Rémy Prud’homme & Anwar Shah, supra note 1, P.2

responsibilities and specific functions to lower levels or outside the regular bureaucratic structure, respectively, while devolution refers to transfer of administrative and financial powers to ‘autonomous and independent’ subnational units of government.³⁹

Whatever forms it might take, the nature, scope or duration of decentralization is contingent on the discretion of the center. Consequently, decentralization implies the existence of direct or indirect supervisions and controls of the center. To the contrary, federalism usually requires a written and relatively rigid constitution that requires the consent of constituent units for amendment. A hierarchical arrangement or central control is, thus, another difference between these two concepts since federalism (non-centralization) necessitates a considerable degree of autonomy or space for independent decision-making.

Apart from constitutionally established institutions and processes ensuring the representation of constituent units, facilitating intergovernmental relations and settling disputes between the constitutionally established (at least two) levels of government, a federal system necessitates distribution of legislative and executive powers as well as revenue sources ensuring some areas of genuine autonomy.⁴⁰

Particularly, financial power has both political and economic implications since effective execution of constitutionally mandated responsibilities is contingent up on resources while taxation power helps play a role in regulating the economy.⁴¹ Therefore, fiscal federalism covers these arrangements for division of legislative and executive powers as well as revenue sources among different tiers of government. Thus, fiscal federalism could be conceived as;

³⁹See, Rondinelli, et al, supra note 23, Pp. 13-28

⁴⁰ Watts, supra note 2, P. 9; George Anderson, *Federalism: An Introduction*, Oxford University Press, Toronto, 2008, Pp. 3&4

⁴¹Watts,(2008), supra note 2,P. 95

*[t]he study of the distribution of expenditure responsibilities, the allocation of taxation power, intergovernmental transfers for adjusting fiscal imbalances, the management of regional borrowing and institutional mechanisms for fiscal relations between the levels of government.*⁴²

Generally, fiscal federalism covers matters involving constitutional arrangements that lay down distributions of expenditure responsibilities and revenue raising capacities, as well as the mechanisms of adjusting horizontal and vertical imbalances. Fiscal federalism is, therefore, a study of allocation of legislative and executive responsibilities as well as taxation powers among different layers of the government. Also, the procedures and institutions ensuring vertical or horizontal transfers are the subject matters of the discipline.

In addition, all tiers of government have joint responsibilities on fiscal policy either in stabilization of spending and taxes or, in debt management, such as policy of “bail-out”. Procedures, institutional setups ensuring subnational borrowings, in particular, and the issue of stabilization and management of economy, in general, are also the subject matters of fiscal federalism.

I. Allocations of Expenditure Responsibilities

The traditional theories of public finance tried to address issues related with assignment of functions among different levels of government in light with economic rationales. Musgrave, for instance, advocated the functions of economic stabilization and income redistribution to be left for the centre while local governments should have the power on allocation of recourses. In principle, some factors should be considered in the process of dividing responsibilities in federal

⁴²Solomon Negussie, ‘Ethiopia’s Fiscal Federalism: a Constitutional Overview’, in Assefa Fiseha & Getachew Assefa, eds., *Institutionalizing Constitutionalism and the Rule of Law: Towards a Constitutional Practice in Ethiopia*, Ethiopian Constitutional Law Series Vol. III, AAU Press, 2010, (83 -120), P. 84

systems, including efficient size of programs and regional differences in needs and preferences, as well as spillovers, equity and national standards.⁴³

In contrast, expenditure responsibilities in a federal system emanate from constitutional division of legislative and executive powers. Constitutional allocation of powers, however, are influenced more by political factors than economic theories, and it is hardly possible to change so as to follow idealistic models.⁴⁴

Since finance is mainly required for the execution of their responsibilities, expenditures of various layers of government are primarily interrelated with their executive (administrative) responsibilities. It is known that, there are two models of distributing legislative and executive powers in federal systems; dualist and integrated. In a dualist approach, each level of government has exclusive power to execute its legislations and to administer its policies. Assigning responsibility exclusively to one tier of government “reinforces the autonomy of that government and it makes clear which government is accountable for policy in that area.”⁴⁵

In the integrated/ interlocking approach, allocation of executive and administrative functions, appear differently from that of legislative jurisdictions. This kind of constitutional and permanent arrangements oblige subnational governments to implement and administer significant share of federal legislations.⁴⁶

Thus, when the federation adopts the dualist (classical) model division of legislative powers has paramount importance while dealing with the scopes of expenditure responsibilities. Since legislative powers come along with the mandate of their execution, allocation of legislative powers could be equated with division of expenditure responsibilities. In the integrated approach,

⁴³Abu, (2003), supra note 5, P. 114

⁴⁴Bird et al., supra note 37, P,2

⁴⁵Watts,(2008), supra note 2,P. 21

⁴⁶ Ibid, P. 93

however, expenditure responsibilities of constituent units are much broader than legislative powers.

Federal constitutions encompass division of legislative powers, including exclusive and residual powers, shared or concurrent and framework powers, as well as implied powers between the centre and the constituent units. Some of the federal covenants adopt the option of enumerating the exclusive powers of the federal government while residual powers are left for States. Others chose to enumerate the exclusive powers of both levels of government.

As far as residual or unallocated power is concerned, the consensus seemed to be reserving it for regions with the rationale of strengthening their autonomy. However, the issue to worry about is not which level of government reserved the residual power, since its significance is dependent on the list and comprehensiveness of the enumerated powers.⁴⁷

The nature and essence of joint legislative powers have always been issues of controversy among academicians. While some scholars consider areas where both levels of government have competence as shared powers, that could be either concurrent or framework powers, others approach the notion differently.⁴⁸

Concurrent powers are areas of states' competence until the federal government involves in the area or until the matter became of federal importance.⁴⁹ Usually, the "*paramountcy clause*" in federal constitutions is applicable in cases of conflicts of federal governments and States over concurrent legislative jurisdictions. The principle is federal supremacy in case of inconsistencies

⁴⁷Ibid, P.89

⁴⁸ For instance, Watts treats shared power as a similar concept with concurrency but without supremacy clauses (the possible conflicts of jurisdictions to be adjudicated by the court of law); on the other hand, he treats framework powers as concurrent powers. See, Watts,(2008), supra note 2,Pp. 88&89

⁴⁹Assefa Fiseha, The System of Intergovernmental Relations (IGR) in Ethiopia: In Search of Institutions and Guidelines", Journal of Ethiopian Laws, 2009; Watts,(2008), supra note 2,P. 88

between the laws of the centre and that of the constituent units.⁵⁰ Framework power, which is clearly provided under the German Basic Law, requires the issuance of framework legislation by the federal government while leaving substantial room for Landers to enact legislations.⁵¹

Finally, there are implied powers that are debatable matters in many federations. Though it is not specifically mentioned in most of the federal constitutions, the notion of implied powers is directly connected with, and extended from, the enumerated powers.⁵² The ‘necessary and proper clause’ under the US Constitution could be a good illustration as it has extended the congressional legislative power on the matters that are ‘necessary and proper’ for exercising its specified powers.⁵³

II. Allocation of Taxation Powers

There are traditional economic theories, perhaps with contemporary importance, on the issues of distributing taxation powers between different levels of government. The primary factor is based on making administration easy and less costly. This is related with enhancing revenue mobilization where local governments are in a better position to collect “local revenues” while federal government is favored to tax mobile sources. The other issue is the principle of horizontal and vertical equity (redistribution).

⁵⁰ The exception from the federal predominance principle is the Canadian pension law, concurrent jurisdiction of the centre and provinces, where the laws enacted by the provinces prevail over the federal one. Watts,(2008), supra note 2,P. 87

⁵¹Article 75 of the German Basic Law

⁵² Solomon Negussie, Fiscal Federalism in the Ethiopia Ethnic-Based Federal System, 2nd ed., Wolf Legal Publishers, Netherlands, 2008, P.67

⁵³ “...which shall be necessary and proper for carrying into execution the foregoing powers and all other powers vested by this constitution in the government of the United States, or in any department or office there of “, Article I section 8 of the United States Constitution

Constitutions often encompass division taxation powers between two or more orders of government in the form of exclusive, concurrent or shared powers of taxation. Exclusive powers of taxation are equated with tax autonomy that amounts to the exclusive jurisdiction to levy and collect taxes or own-source revenue. Tax autonomy bestows both layers of government with the relative freedom to introduce or abolish a tax, to set rates or to define bases as well as to grant reliefs or holidays.⁵⁴

On the other hand, concurrency allows both tiers of the government to legislate, collect and appropriate taxes. Whereas in the cases of shared powers, federal governments have the power to levy and collect taxes while the regions have the right to share from the revenue collected.⁵⁵ However, Watts consider shared powers of taxation as areas of concurrency without constitutional limits or supremacy rules.⁵⁶ Since concurrency might cause dreadful competitions, even conflicts over tax jurisdictions, paramountcy rules help address the possible conflicts in case of conflicts between federal and subnational governments.

In general, there are two models of allocating taxation powers; the US and German models. The US/Swiss model, which underlines separations of expenditure and revenue powers between different tiers of government, allocates revenue source for each level. On the other hand, the German model puts all sources together while each level of government shares from the total revenue.

While the US model is preferred for accommodating local preferences bestowing subnational policy making autonomy, the German model would also help reduce the issues of tax competition and the urge for equalizations. On the other hand, devastating tax competitions and

⁵⁴Hansjörg Blöchliger and Josette Rabesona, *The Fiscal Autonomy of Sub-Central Governments: An Update*, OECD Network on Fiscal Relations Across Levels of Government, no.9, 2009, p. 3

⁵⁵ Solomon , (2008), supra note 32, P 125

⁵⁶Watts,(2008), supra note 2,P. 96

regional disparities are the flaws of the US model whereas the German model is also blamed for shrinking subnational revenue autonomy.⁵⁷

III. Fiscal Imbalances and Intergovernmental Transfers

The issue of transfers was overlooked in traditional theories of decentralization that presupposed joint decentralization of taxes and expenditures. Thus, each local government chooses the tax rate based on its expenditure needs, or “amount of tax-cum-expenditures”.⁵⁸ The only exception to the rule against transfers was the case of “*pigouvian* subsidies”. As per this principle, federal governments should provide subsidies or vertical transfers with the view of compensating inter-jurisdictional spillovers.⁵⁹

However, one of the common features of federal systems is the mismatch or difference between the revenue capacities of subnational governments and the resource required to finance their expenditure responsibilities. This is commonly referred as or Vertical Gap.

Vertical imbalance is measured by the share of subnational governments’ expenditures that are covered with their “own-source” revenues. Another way of measuring vertical imbalance is calculating the share of revenue generated by regions from the total revenue raised.⁶⁰

Therefore, transfers are communal features of federations since it is not uncommon to witness vertical imbalances. Because of assignment problems or “fiscal centralizations” most of, if not all, federations are characterized by mismatches of expenditure needs and revenue means of subnational governments. On the other hand, federal governments raise extra revenue or in

⁵⁷ Bird et al., supra note 37, P.591

⁵⁸ Rémy Prud'homme & Anwar Shah, supra note 1, P.3

⁵⁹ Oates, (2005), supra note 9, P. 351

⁶⁰ Solomon, (2008), supra note 32, P.166

excess their spending needs. Thus, the main reason for vertical transfers/ grants is to fill, or at least reduce, the gap between revenue means and expenditure needs of subnational units.

The other factor necessitating intergovernmental transfers is the need for correcting or reducing horizontal imbalances. There exists the issue of Horizontal Imbalance or Gap because of differences in resource capacities of subnational states. Unless there are means of correcting regional differences in economic activities or tax sources, poorer regions may be forced to lift tax rates.⁶¹ Hence, another factor for employing transfers is for the purpose of equity. Through transfers, federal governments strive to reduce horizontal imbalances so that citizens' of the nation could have similar tax burdens irrespective of the area they live.

Generally, transfers could be classified as block and specific grants. Specific/ Conditional grants are entangled with specific conditions on how to spend whereas there is no such condition in case of Block/ Unconditional grants. Block/general purpose grants, often used as means of equalization, give more spending autonomy to subnational governments. Conditional/ specific grants, on the other hand, are aimed at protecting misallocation of resources and the provision of basic services.⁶²

Furthermore, Prud'homme and Shah have pointed out other means of classifying transfers. The first one is classifying transfers as discretionary and automatic transfers. While discretionary transfers are decided by the federal government based on needs, automatic transfers are automatically transferred based on the formula set by the federal government, (formula- driven transfers).

Finally, one could also categorize transfers as open-ended and fixed total transfers. When the total amount is decided nationally and allocated to local governments, it is fixed total transfer, whilst transfers are defined based on expenditure needs of local governments, it amounts to

⁶¹ Sérgio Prado, An overview of the revenue sharing system, forum of federations, P. 10, available at http://www.forumfed.org/libdocs/2009/FFBS_RevenueShring_Brazil.pdf last visited on 24/12/2014

⁶² Solomon,(2008), supra note 32,P.193; Rémy Prud'homme & Anwar Shah, supra note 1, Pp.3&4

open-ended transfers. Most of block grants are fixed total grants as matching grants are typical example for open-ended grants.⁶³

2.2.3.Subnational Financial Autonomy-Redefined

Whether it is adopted for economic rationales of efficiency, equity and accountability, or employed as a response for ethno-cultural or political claims of self-determination, decentralization measures should guarantee financial autonomy of constituent units.

No doubt that financial capacity of subnational governments is a determining factor or constraint in the effective implementation of their constitutionally mandated expenditure responsibilities or execution of local policies and priorities. It is equally uncontroversial that subnational governments should have considerable degree of autonomy to appropriate or allocate finances.

Albeit significant discrepancies among the scholars, they consider fiscal autonomy as the most important measurement of subnational financial autonomy. Fiscal autonomy deals with tax autonomy thereby it measures the share of own-source revenue from the total subnational revenue. Basically, fiscal autonomy is equated with the ability of constituent units to access resources independently, or sub-national discretion over tax bases and tax rates.⁶⁴

Unfortunately, most of the studies on subnational financial autonomy often emphasized on the side of revenue generation leaving spending autonomy untouched. Most of these studies presuppose the autonomy of revenue collection would automatically result in the discretion to allocate resources, or spending autonomy. However, there are cases by which subnational

⁶³Rémy Prud'homme & Anwar Shah, supra note 1, P.4

⁶⁴Hansjörg Blöchliger and Josette Rabesona, supra note 54 , P. 3

governments do not exercise absolute autonomy over own-source revenue, or where their spending autonomies are curtailed.⁶⁵

Thus, federations that appeared to be “highly decentralized” in revenue generation could be “centralized” from the angle of appropriation since autonomy to tax does not guarantee absolute discretion to spend. By the same token, States could have discretion over allocating revenues other than local/ own revenues.⁶⁶ Generally, these kinds of half-baked studies would lead to erroneous conclusions of equating subnational autonomy of revenue and spending.

Subnational financial Autonomy, for the purpose of this study, embraces the constitutional allocations and practice of subnational revenue autonomy, including exclusive and shared powers of taxation as well as borrowing arrangements and transfer schemes. Moreover, cover issues related with subnational autonomy of appropriation or spending/ budgetary autonomy.

Equating revenue generation with freedom of appropriation couldn't hold water as far as there are factors that influence decisions on ‘how’ and ‘on what’ to spend it, apart from the way the revenue is raised. Therefore, financial autonomy comprises both revenue autonomy and the discretion over appropriating the revenue or spending autonomy.

Revenue autonomy, often labelled as “tax autonomy”, is primarily related with constitutionally guaranteed powers of taxation. Specifically, it implies the existence of exclusive powers of introducing or abolishing taxes, setting tax bases and rates as well as discretions over tax allowances or reliefs.⁶⁷ Theoretically, ‘own-tax revenues’ confer a relative spending autonomy than intergovernmental transfers, whereas tax revenue sharing mechanisms are better than grants.

⁶⁵ For a better discussion see, Sandra Gomes, Fiscal Powers to Subnational Governments: Reassessing the Concept of Fiscal Autonomy, *Regional and Federal Studies*, 2012, iFirst, 1 – 20, available at <http://dx.doi.org/10.1080/13597566.2012.679849> , accessed on June 20/2012

⁶⁶ Bernard Dafflon and Thierry Madiès, *Decentralization: A Few Principles from the Theory of Fiscal Federalism*, *Agence Française de Développement*, Notes and Documents No. 42, Paris, June 2011, P. 42

⁶⁷Hansjörg Blöchliger and Josette Rabesona, *supra* note 54, p. 3

No doubt that the formula stability and “unconditionality” of funds in strict tax-sharing award greater subnational autonomy than either redistributive tax- sharing (which is similar to unconditional grants) or, conditional grants that are entangled with strings.⁶⁸ Yet, even own-source revenues couldn’t be allocated autonomously since it is usual, if not always, to observe disparities between revenue autonomy of subnational states and their discretion to spend it.

Spending power is the determining factor for addressing local demand for public services or effective implementations of subnational plans and policies. This argument is contingent on both the power to make policies or to “tailor” provision of local public goods in light with local preferences and demands and the discretion in its execution, too.

2.3. The Developmental State Paradigm

2.3.1. Historical Development

A sharp contrast with the notion of “minimalist state”, whose role was limited to preservation of law and order, there was a theory that underlies the vital role that ought to be played by the state in the realization of the human and economic development. This view that perceives state as an engine for economic development was experimented early before the idea of Developmental State (DS) was emerged as a “novel” school of thought and toddler field of scholarship.

Some scholars argue that the historical rise of “developmental States’ traces its roots back to the late 16th C Europe.⁶⁹ Bagchi considers the 16th C Netherlands as the first “developmental state” followed by the developmentalism of Britain and Germany though it was that of Japan’s, which

⁶⁸ Gomes, supra note 65, p. 8

⁶⁹Amiya Kumar Bagchi, *The Developmental State in History and in the Twentieth Century*, Lectures delivered under the auspices of North Eastern Regional Centre of the ICSSR and the North Eastern Hill University, Shillong, 12-13 March 2003, Regency publications, New Delhi, India, 2004, P. 1

was managed to survive till the 20th C and emerged as the second largest industrial power in the post-war era.⁷⁰

By the late 1970s, a number of African and Latin American, as well as Eastern Europe states adopted the “State- Led Development Model” though it was disastrous for many of these states.⁷¹ These incidences led to the prominence of skepticism on the interventionist ideology or state-led development paradigm. Most of the skeptics and critics were influenced by the neoliberal paradigm which, without distinguishing between different types of state activism, generalizes government’s activity and its size, or its activism, is the cause for rent seeking.⁷²

Led by the World Bank (WB) and the International Monetary Fund (IMF), international actors and policy makers focused on the principles of market economy since 1980s. This ideological change has forced the international community to adopt the “Washington Consensus” that called for the reduction of the size and the role of States.⁷³

In the mid-1990s, however, there was the sudden economic booms in Hong Kong, Singapore, South Korea and Taiwan, often known as the “Asian Tigers”, that gave rise to reconsideration

⁷⁰ Ibid

⁷¹ Christopher Clapham, The Collapse of Socialist Development in the Third World, *Third World Quarterly*, Vol. 13, No. 1, Rethinking Socialism (1992), pp. 13-25; available at <http://www.jstor.org/stable/3992407>, accessed on 10/08/2011

⁷² Meles Zenawi, African Development: Dead Ends and New Beginnings, (2006), Unpublished paper, available at, <http://cgt.Columbia.edu/files/conferences/Zenawi-Dead-Ends-and-New-Beginning.Pdf>; P. 9 accessed on 02/04/2013

⁷³ The Washington consensus was a ten point program which was primarily proposed by IMF, WB and other Washington-based international institutions that demanded developing countries, among other things, the adoption of Structural Adjustment Program (SAP), which aimed at the reduction of the size and the role of states through reduction of public expenditures, privatizations of state enterprises as well as financial and trade liberalizations. (See, Manfred B. Steger and Ravi K. Roy, *Neoliberalism: A Very Short Introduction*, Oxford University Press, New York, USA, 2010, Pp. 19&20)

of the role of a state by policy makers.⁷⁴The “developmental state paradigm” had gloomed as the strong and persuasive argument, among different political and academic explanations for the East Asian success; this, at the same time, marked the emergence of the new field of scholarship thereof.

2.3.2. Meaning and Features

Since the DS paradigm is an emerging scholarship, most of the researches are usually devoted to come up with ‘universal definition’ of the concept from the East Asian experience. Because of this, it appears to be such a hard task to provide a clear-cut and universally agreed designation for the notion, as there are various points of disparities among the existing scholarly works.

Despite significant variations among the existing works on the area, most, if not all, scholars agreed up on or mentioned the ideological and structural components of the developmental state. In light of the ideology-structural nexus, a developmental state could be discerned as, ‘[a] state that puts economic development as the top priority of governmental policy and is able to design effective instruments to promote such a goal’.⁷⁵

Therefore, the ideological element is related with government's firm stand on making economic development as its prior mission and top agendum. Whereas state structure is associated with the institutional and administrative capacities required to implement plans and policies.

⁷⁴One could cite the World Development Report of the WB that revealed its position which holds; “the state is central to economic and social development”. (World Development Report: The State in a Changing World, World Bank, Washington, DC, 1997).

Similarly, scholars argue that such kinds of situations would be the primary reasons behind the 2005’s report of the Commission for Africa that recognized state capacity and effectiveness as the key bottleneck in Africa’s ability to meet the Millennium Development Goals (MDGs). (See, Fritz and Rocha Menocal, (Re) building Developmental States: From theory to practice. Working paper No.274, Overseas Development Institute ,London, 2006, cited in Bonda, supra note 17, P. 17)

⁷⁵Amiya Kumar Bagchi, The Past and the Future of the Developmental State, Journal of World-Systems Research, VI, 2, 398-442, Summer/Fall 2000, P. 398

I. Ideological Orientation

Developmental orientation is the primary distinguishing feature of developmental states so that economic development is prioritized above all other policies. Developmental ideology usually emanates from the consensus of the ruling elites for the sake of political survival or legitimacy since the ability to attain economic growth is conceived as the primary source of legitimacy of power.⁷⁶ Particularly economic growth is a top priority and to achieve this goal, the state shouldn't be regulatory or welfare state, but a "developmental" state.

In his masterpiece, "MITI and the Japanese Miracle", Johnson highlighted the primacy of a DS citing the experience of Japan. He contends that, any state which has an objective of achieving economic development must adopt the same priorities that Japan took. Thus, a state;

*[m]ust first of all be a developmental state – and only then a regulatory state, a welfare state, an equality state, or whatever kind of functional state a society may wish to adopt.*⁷⁷

Among the policy instruments, industrial policies took the first place or have the priority at the national level. Treating it as a vital means to achieve overall economic growth, industrial policy takes precedence over, if not at the cost of, other policy objectives such as foreign policy, income redistribution/ welfare.

Nevertheless, the priorities of a developmental state could be changed through time as its success is contingent up on policy flexibility and policy realism.⁷⁸ In other words, it is dependent on the

⁷⁶Charity Musamba, 'The Developmental State Concept and its Relevance for Africa' in *Peter Meyns and Charity Musamba (eds.) The Developmental State in Africa Problems and Prospects, Institute for Development and Peace, University of Duisburg-Essen (INEF-Report, 101/2010)*, P. 12

⁷⁷Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*, Stanford: Stanford University Press , 1982, P. 306, cited in Charity Musamba, *supra* note 76, P. 13

ability of designing policies considering the available resources and making it flexible enough to amend it in light with changes in the domestic or world politics and economy.

From the angles of economic ideologies, the DS paradigm could be treated as a counter to the neoliberal paradigm. Criticizing the neoliberal perception of market as “inherently regulated”, the proponents of the DS paradigm argue for the better roles of a state to guide and shape the market as well as to set policies and induce investments.⁷⁹

II. State Structure

A mere ideological orientation doesn't make a state developmental unless it has the capacity to implement its policy objectives. Perhaps state-structure appears to be the crucial factor that determines the success or failure of developmental states as it is the ability to mobilize the nation which matters more than its economic policy. State structure is synonymous with “state capacity”, which comprises of the ability of a state in prioritizing, policymaking and planning and as well as its capacity to mobilize resources towards national goals.⁸⁰ Thus, the concept is attached to the political, administrative and economic capacities of the state in effective implementation of developmental policies and priorities.

From the very start the state should be led by development-oriented political leadership. There has to be consensus among the ruling elites on the political and economic agenda of the country that prioritizes economic development.⁸¹ Yet it would be something else, perhaps nonacademic, if

⁷⁸Bagchi, (2000), supra note 75, Pp. 398&399; Ha-Joon Chang, *The East Asian Development Experience, The Miracle, the Crisis and the Future*, London: Zed Books, 2006, P. 116

⁷⁹ Ha-Joon Chang, supra note 78, P. 2; Meles Zenawi, (2006), supra note 72, P. 5

⁸⁰Richard F. Doner, et al, *Systemic Vulnerability and the Origins of Developmental States: Northeast and Southeast Asia in Comparative Perspective*, International Organization, 59:2 (Spring 2005): 327-361, Pp. 337&338

⁸¹Charity Musamba, “The Developmental State Concept and its Relevance for Africa”, P. 21, in *Peter Meyns and Charity Musamba (eds.) The Developmental State in Africa Problems and Prospects*, Institute for Development and Peace, University of Duisburg-Essen (INEF-Report, 101/2010).

one argues that the emergence of incorrupt or highly committed leaders ‘may partly be the luck of the draw.’⁸²

In contrast to the neoliberal model of free-market economy, DS paradigm supports active involvement of the state in the economy. Because of this, state’s capacity to promote linkages and cooperation with the private sector is a crucial factor in the process of building, and effective functioning, of any DS.⁸³

It should be noted, however, a mere embedment would entail devastating effects since the bureaucracy might be swamped by powerful, rent-seeking groups. Hence, it has to be insulated, too. The bureaucracy should be autonomous not only from the private actors, but also from the political leadership since it has to shape the behaviours of both the political officials and the private sectors, and direct them throughout their journey to their ultimate goals of attaining the common good; i.e. economic development.⁸⁴

Hence, Evans’s theory of “embedded autonomy” was sought to counter balance these two distinct interests in any developmental state: the need for establishing strong collaboration and cooperation with the private sector, i.e. embedment, in the one hand and the fear to be captured or manipulated by powerful interest groups, or bureaucratic autonomy.⁸⁵

Embeddedness embraces various concepts that are directly related with the structure and capacity of a state in penetrating and forming links with the society. It denotes a state which is capable of

⁸² Christopher Clapham, Introduction: Liberalisation, Regionalism and Statehood in the New Development Agenda, *Third World Quarterly*, Vol. 17, No. 4, *The Developmental State?: Democracy, Reform and Economic Prosperity in the Third World in the Nineties*, pp. 593-602, 1996, P. 596, available at <http://www.jstor.org/stable/3993275>, Accessed on 10/08/2011

⁸³ Peter B. Evans, *Predatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State*, *Sociological Forum*, Vol. 4, No. 4, (Dec. 1989), pp. 561-587; P. 568, available at <http://www.jstor.org/stable/684425>; Accessed: 03/12/2008

⁸⁴ *Ibid*, P. 576

⁸⁵ *Ibid*, P. 568

forming alliances and connections with key social groups that helps it to achieve its goals of transformation. When the scholars argued for the need for a state that is embedded in the society, they envisioned more than insulated and coherent bureaucracy. It is equally important to have an administrative structure, which is designed to grant incentives for private actors as well as capable to respond the ever-changing economic situations.⁸⁶

On the other hand, state should also be autonomous from the influences of private actors. Thus, the state should have competent and coherent bureaucracy that can autonomously formulate policies while it should also be in a position to create effective linkages with the private sector. Erosion of state autonomy opens the door for rent-seeking where personal enrichments prevail over long-term development of the nation. A state where the bureaucracy is captured or influenced by private elites would incline to plunder at the cost of collective welfare of citizens; these types of states are commonly known as “predatory” states.⁸⁷ Zaire could be cited as an illustration for such kinds of states where its quest for development was collapsed due to “marketization” of public decisions to private actors as rent-seeking was the “motto” of the then bureaucracy.⁸⁸

Strong and meritocratic bureaucracy is claimed to be guarantee against corruption, or one manifestation for a strong state. Thus, technocrats should be recruited and promoted based on nothing but merit. While the “appointive bureaucracy” was the crucial factor behind the failures of Brazilian and Zairian state-led developments, meritocratic and professional bureaucracies of Japan and South Korea contributed a lot for their respective developmental successes.⁸⁹

⁸⁶Evans, supra note 83, P. 569

⁸⁷Ibid, p. 563

⁸⁸Ibid, P. 570

⁸⁹Meredith Woo-Cumings, ‘Introduction: Chalmers Johnson and the Politics of Nationalism and Development’, in the book, Meredith Woo-cumings (ed.), *The Developmental State*, Cornell University Press, Ithaca and London, 1999, Pp. 13&14

2.4. Subnational Financial Autonomy in Developmental States: a Brief Note

“Finance is the tie that binds the state to the industrialists in the developmental state.”

Meredith Woo-cummings⁹⁰

2.4.1. Introduction

Changes in the global or domestic political economy have always affected the arrangements of financial decentralization in federations. The Great Depression of the early 20th C, for instance, had proved not only the collapse of laissez-faire State but also, marked an end of an era of “dual federalism”. Especially in the US federalism, it was at the remnants the classical federalism where “cooperative federalism” was gloomed. Similarly, the 1970s and 80s witnessed the rise of neoliberalism and a shift toward small-sized governments. Neoliberal thinking led to measures of federal spending cuts that brought about its ever increasing unfunded mandates, or “coercive system”.⁹¹

The 21th C also witnessed changes mainly because of globalization and increased bilateral and multilateral trade and economic development agreements. Some argue that such changes have resulted in decentralization including Shah who stated that because of the information revolution and globalization, or the “new borderless world economy” ultimately undermined the role of subnational governments. He argued that this shift signifies ‘a gradual shift to supra-national

⁹⁰ Ibid, P. 10

⁹¹ Ibid

regimes and local governance’, which is characterized by measures of tax centralizations that increased vertical fiscal imbalances.⁹²

However, this argument is still far from critics since one could possibly argue to the contrary citing the experiences of federations that witnessed strengthening of local governments in the era of globalization. For instance, globalization could be perceived as the basic factor that changed the character of the Canadian federation, but in another direction. Scholars argue that the ever-increasing economic ties between Quebec and USA, and the abrupt growth of Quebec’s economy thereafter, have been exacerbating regional disparities and horizontal imbalances in the Canadian federation.⁹³

Therefore, it is not plausible to hold that international integrations would always mean measures of centralization that curtail regional financial autonomy. Incorrect, too, is treating globalization as a blessing for local governments that strengthens their economic capacities or ensures their fiscal viability. However, it is undeniable fact that there are multifaceted changes witnessed in relation to the birth of globalization. In other words, the global economic change of the 21th C has serious impacts on the characters of federal systems as it was in the 20th C.

This section is devoted to deal with the nexus between the DS and degrees of financial decentralization, particularly in the federal systems. Dealing with the impacts of “developmentalism” on the financial autonomy of states necessitates assessing the possible impacts of the paradigm on the existing degrees of financial decentralization in the federal system. It is known that revenue powers and spending autonomies of subnational governments would be scrutinized while studying about financial decentralization (autonomy) in a federation.

⁹² Anwar Shah, Some Emerging Imperatives for Cities and Regions Facing Globalization and the Information Revolution, *Federations: What’s New in Federalism Worldwide?*, *Federations*, Vol. 6 No. 1 February/March 2007

⁹³ Richard M. Bird and Robert D. Ebel, ‘Fiscal federalism and national unity’ in Ehtisham Ahmad and Giorgio Brosio (eds.) *Handbook of Fiscal Federalism*, Edward Elgar Publishing, UK, USA, 2006, P. 511

2.4.2. Subnational Autonomy vis-à-vis the DS Theory: An Overview

The study of the nexus between the DS paradigm and financial autonomy of subnational governments urges scrutinizing the experiences of other federal systems that are still developmental, or that had once tested it. Indisputably, India, Brazil, Malaysia and South Africa would be in this list. Therefore, it would be vital to assess the experiences of these states so as to study the possibility of sticking the balance between the two competing interests. Besides, such comparative analysis would help to solicit the possible measures that Ethiopia should take.

One may cite the Indian federalism as a better example for accommodating these competing interests. Mainly, because of the fact that it is one of the working federations in the world through an ever improving federal practice though centralized in design. For instance, the success stories of Indian states are also often cited as evidences for the multifaceted importance of federalism for economic development.⁹⁴ At the same time, India became one of the largest economies in the world, largely because of the DS paradigm it had practiced.

The tricky point is, however, India never been, or achieved, both at the same time. The time when its federalism has started to witness positive changes marked the end of its developmentalism. Or it is possible to say, Indian federalism has blossomed at the demise of its DS.

Until the mid 1990s, socio-economic policymaking powers of States were constrained in the Indian federal system. That is why the time when opposition parties started to take power in state governments, is praised for the development of the Indian federalism. At the same time, the period was considered as the “beginning of the end” that dismantled the operating system of the Indian DS.⁹⁵

⁹⁴ Ash Narain Roy, India’s states follow divergent paths; Kerala, Bihar and Gujarat pursue economic development in three different ways. (Federations, Dec. 2010-Jan.2011, Forum of Federations), Pp. 6&7

⁹⁵ Bagchi,(2004), supra note 69, Pp. 37& 47

Generally, the history of most of these federal systems reveals that it is difficult say it is “always possible” realize an effective DS while, at the same time, preserving subnational autonomy, or vice versa. In other words, some of the governments had strived to accomplish one of the interests at the cost of the other. On the other hand, the “centralized” federal arrangement had been the vital reason for their success.

First, the constitutional allocation of powers is too centralized in some of these systems whereby there is a little or no possibility of having diversified policies, plans on legislations. For instance, socio-economic planning was allocated under the concurrent list with the overriding powers of the federal government in the Indian Constitution.⁹⁶ Thus, it was possible for the federal government to centralize such areas under the concurrent list.

Moreover, the existence of dictatorial or undemocratic governments in some of the states had been a reason for erosion of constitutional stipulations in their respective eras of developmentalism. For instance, the era of the Brazilian DS (from 1964-1988) was accompanied by extensive recentralization measures of the military dictatorship government.⁹⁷

Similarly, because of the dominant party system whereby the Union and most of the states were controlled by the Congress Party, it was easy for the Indian federal government to take centralization measures. For instance, in the Indian federation (of 1950s to 70s), centralized planning as well as taking education to concurrent list (which was originally exclusive power of states), were achieved without any trouble from states.⁹⁸

⁹⁶List III, Seventh Schedule of the Constitution of Republic of India (as modified up to 1stDecember, 2007)

⁹⁷See, José Cezar Castanhar, *Fiscal Federalism in Brazil: Historical Trends Present Controversies and Future Challenges*, (P. 4VIII Congreso Internacional del CLAD sobre la Reforma del Estado y de la Administración Pública, Panamá, 28-31 Oct. 2003), P.3

⁹⁸ R. Srinivasan, *Mission Accomplished: Centralization of State's Fiscal powers*, available at, http://www.academia.edu/2432418/Centralization_in_Federal_India Last visited on 22/02/2015, Pp 7-11

2.4.3. The Impacts of DS Paradigm on Subnational Revenue and Spending Autonomy

According to the comparative study of Anwar Shah, taxation powers are highly centralized in the federations of Malaysia and South Africa and it is centralized in Brazil, India, and Russia.⁹⁹ On the other hand, the study shows India, Malaysia, Nigeria, Russia, and South Africa, face critical problems of vertical fiscal gaps. While South Africa and Malaysia are still claimed to be developmental, all the other federations had been experiencing the DS paradigm for decades.

Albeit inconclusive, studies of Shah and others show developmental states in general are over-centralized. Therefore, it needs a proper analysis on the nexus between the developmental state ideology and degree of financial decentralization.

Lessons from the East Asian experience would tell us how governments were employing various fiscal and regulatory tools to promote exports and attract foreign investments, as well as, to mobilize resources and capital around national priorities. Apart from setting national priorities as well as formulating national policies and plans, the nation should be capable to influence investment flows.

Basically, the success of any DS hinges on its institutional ability to mobilize investments around national priorities. With this motive of directing investment flows, many states had relied on centrally organized institutions that are expected to employ extensive financial and regulatory measures. Therefore, in any DS the existence of strong and autonomous a central institution, which usually aims at controlling and shaping the flows of resource and capital, is indisputable. For instance, the East Asian and European countries were able to influence investment patterns

⁹⁹Anwar Shah, 'Comparative Conclusions on Fiscal Federalism, Comparative Conclusions' in Anwar Shah (ed.), *The practice of Fiscal Federalism : Comparative Perspective*, McGill-Queen's University Press, Montreal & Kingston, London, 2007, Pp. 371-74

and sectoral mobility in the economy through financial incentives such as tax breaks and credit-based systems.¹⁰⁰

The DS paradigm mandates big-sized governments that make excessive spending to finance mega projects. Thus, federal governments take extensive tax reform measures in view of collecting the required amount of revenue. For instance, the Brazilian State-Led Development was accompanied with tax reform measures that had drastically limited subnational tax autonomy.¹⁰¹ However, the federal government was able to finance its “ambitious plans” through radical revenue recentralization where the federal government was able to collect 75% of the total revenue in 1980.¹⁰²

Contrary to their limitations on revenue generation, the DS ideology will result in broadening expenditure responsibilities of regional governments. Unless there is proportional increase on the revenue side, there is no doubt that any increase in the expenditure needs of a state would automatically amount to growth in the vertical imbalance in a given federation.

In India, for instance, ‘fulfilling the demands of a developmental state’ was the primary responsibility of the state governments, i.e. 60% of the total national expenditure, while their own-source revenue was only about 35%.¹⁰³ This data makes degree of vertical imbalance around 0.42, which is one of the worst degrees of vertical imbalance in the history of the federal system.

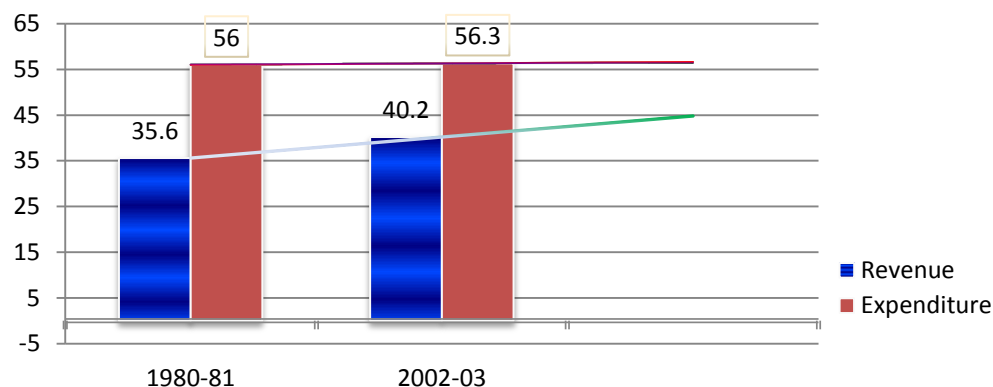
¹⁰⁰ Woo-Cumings, *supra* note 89, p. 11

¹⁰¹ Castanhar, *supra* note 97, P.3

¹⁰² *Ibid*, P. 4

¹⁰³ R. Thakur, *The Government and Politics of India*, Macmillan Press Ltd, Malaysia, 1995, P. 62

Graph 2:1 Trends of States' Aggregate Expenditures and Revenues in the Indian Federalism (1980-81 and 2002-03)



Source: Public Finance Statistics, Ministry of Finance of the Government of India¹⁰⁴

As it is clearly shown in the Graph 2:1 the revenue capacity of regional states (as percentage of the total revenue collected in the nation) has increased significantly throughout the years; i.e. there was an increase from 35.6% of 1980-81 to 40.2 in 2002-03. Whereas the percentage share of states' expenditure remains almost constant. Due to this, the coefficient of vertical imbalance became 0.29, which signifies how economic liberalization has improved subnational fiscal autonomy in Indian federation.¹⁰⁵ In other words, the significant decrease of vertical imbalance (from 0.42 to 0.29) would illustrate how the adoption of the DS paradigm had been affecting subnational fiscal autonomy.

The other issue is related with subnational policymaking autonomy. It is known that one of the basic tenets and economic importance of federalism is the possibility of experimenting

¹⁰⁴ This data is computed and presented by Govinda Rao, *Changing Contours in Fiscal Federalism in India*, P. 7 available at <http://www.econ.hitu.ac.jp/~kokyo/APPPsympo04/PDF-papers-nov/Rao-Final2.pdf>, last visited on 12/09/2014

¹⁰⁵ The vertical Imbalance index measures the percentage shares' of the aggregate revenue and expenditure of States from that of the national total. It is computed as; Vertical Imbalance (VI) = $1 - [(SR/TR) / (SE/TE)]$ where SR is aggregate revenue of States and TR is the national total revenue. Similarly, SE indicates the combined regional expenditure while TE is the total expenditure of the nation. Scholars agree that, in normal situations, the index should not be greater than 0.5. See, Eshetu Chole, 'Issues of Vertical Imbalance in Ethiopia's Emerging System of Fiscal Decentralization', in Eshetu Chole (ed), *Fiscal Decentralization in Ethiopia*, AAU Press, 1994

diversified policies at subnational level. Particularly, it is a critical issue in a federation designed as a means to address social and economic inequalities, and to accommodate ethnic, cultural and religious diversities.

Theoretically, legislative autonomy is a vital element of the classical idea of dual federalism where both tiers considered as autonomous areas of legislation and execution. It is thus with a relatively lesser importance in executive federalism where subnational governments are entitled with insignificant powers of legislation as well as the prevalence of areas of concurrence or shared powers trivialize subnational autonomy of policy making.

In the political histories of many federations, there were extensive reforms on subnational policymaking powers, mostly because of the incidences of domestic or international politics or economy. For instance, the late 20th C Mexico or Russia during the time of Putin, had witnessed federal governments' restrictions on the relative degree of subnational governments' autonomy in devising their respective policies.¹⁰⁶

The issue of maintaining the equilibrium between national uniformity and subnational flexibility is not a new concept in the history of federalism. Due to the changes in the global and domestic politics or macroeconomics, federations have faced with the issue of policy making and execution though many shifts have been made in the process. Similarly, lack of clear rules governing shared / framework powers may affect the idea of leaving substantial room or margin of appreciation for regional policymaking. Besides, constitutional powers had been witnessed being taken by, or surrendered to, the federal government.

In particular, the necessity of “cohesive state” for the formation of a DS demands centralized structures, which seldom accommodates diversity. Trying to address diversified interests is considered as the fundamental reason behind the failures of many states, which once strived to build a DS. In other words, a state could be effective DS only when it is able to be a “cohesive-

¹⁰⁶Weingast, *supra* note 37, p. 7

capitalist state” whereas states with “fragmented multi-class societies” are seldom conducive for the rise of a DS.¹⁰⁷

A DS needs central institutions that devise too comprehensive national policies and strategies unlike the usual types of general policies set by central governments for the realization of economic developments and social welfares. These exceptionally detailed policy documents of a DS necessitate and result in its frequent involvements, of the central governments, in local affairs. Because of this, there is a danger against the conventional principle of subnational autonomy of setting policies based on local preferences and cultural distinctiveness. Specifically, the principle of flexibility might lose its place for coherence and uniformity.

Dealing with the potential challenges on the implementation of national industrial policy in a DS, Aaron Tesfaye admits that there might be a challenge posed by diversified policies at federal and State levels. The author, thus, recommends the necessity of making subnational policies in line with national policies. In other words, he proposes the conformity of subnational policies with centrally formulated policies of federal governments.¹⁰⁸

In his piece, which is prepared with a particular emphasis to the Ethiopian DS, Aaron argues that this is not uncommon challenge as classical federations had also once faced with these kinds of dilemmas.¹⁰⁹ However, those federations, which were allegedly confronted this challenge, are not mentioned in his paper. Nor did the author point out through what means they were able to strike the balance between uniform implementations of national policies and subnational autonomy of devising distinctive policies.

¹⁰⁷ Atul Kohli, *State-Directed Development: Political power and Industrialization in the Global Periphery*, Cambridge Univ. Press, UK, 2004, Pp. 11-14

¹⁰⁸ Aaron Tesfaye, *Federalism and the Developmental State in Ethiopia: Some Strategies*, a paper presented at the 5th International Conference on Federalism, December 2010.

¹⁰⁹ Ibid

Developmental states are plan-rational states that set long-term national plans with the view of achieving the prior assumptions and projections for the growth of each segment of the economy.¹¹⁰ Thus, one of the common features of developmental states is formulation of consecutive national plans, usually for a period of five years.

The primary problem of centralized economic plans is related with the wrong postulations of those plans, which presuppose the uniformity of needs or preferences throughout the nation. While commenting on the post-independence Indian economic planning, K.Sanathanam observed that its implicit assumption was there is a uniformity of policies of the Union and the States as well as identical implementations at both levels of government.¹¹¹

Therefore, the underlining assumption in the Indian form of centralized planning was the uniformity of policy priorities all over the country, which defeats the very purpose of decentralization. The fact that developmentalism usually pushes for policy coherence is also another issue of a great concern. It is rather palatable to argue that “developmentally-oriented” governments could not expect diversified policies while they are working for universal applications of uniform policies.

¹¹⁰ Kim, *supra* note 21, P. 231

¹¹¹K.Sanathanam, quoted in R.Srinivasan, *supra* note 98, Pp. 7&8

Chapter Three

3. State and Economic Restructuring in Ethiopia

3.1. Introduction

Attempts of nation building and economic development characterize the modern history of Ethiopia. While nation building projects were accompanied by conquests and other measures of state restructuring, the quests of development were perused through adopting of a variety of development paradigms.

The post-1991 state restructuring measures had brought the federal arrangement in Ethiopia, for the first time after the failed the Ethio-Eritrean federal arrangement of 1952-60. Among the peculiar features of the federal arrangement, the organization of States, or an “ethnic federalism” and the “unconditional” rights of secession, are frequently mentioned by scholarly works as well as in political debates.

At the demise of socialist-led development and command economy, the post-1991 economic restructuring were sought to achieve economic liberalization and market economy. A decade after the collapse of the military dictatorship, the ruling elites had adopted a new developmental paradigm, i.e. the developmental state paradigm.

Therefore, this chapter deals with histories of state and political restructuring of pre and post 1991 Ethiopia. Particularly, there are chapters dealing with state restructuring in the modern history of Ethiopia as well as the contemporary federal structure together with the existing arrangements of fiscal federalism. Moreover, the chapter comprises of parts dealing with various paths that were taken by different Ethiopian leaders, including the contemporary developmental paradigm.

3.2. State Restructuring in the Modern History of Ethiopia

3.2.1. A Brief Note on the Ethiopian Federalism

Though the history of ancient Ethiopia traces its roots back to the Axumite civilization, its modern history begins around 1850s. Since then, the Ethiopian history had witnessed various ambitious attempts of building a ‘civilized and unified Ethiopian Empire’. Emperor Tewodros II (1855-1868) was the first ruler who started the projects of modernization and “nation building”. Particularly, it was this era when ethnicity, the overriding mobilizing factor since the 1960s, was explicitly recognized for the first time.¹¹²

The visions and ambitions of Tewodros II to build a “unified Ethiopian Empire” were realized during the reign of Emperor Menelik II, the time when the contemporary boundaries of the country were formed. However, the Ethiopian Empire state was characterized by a decentralized monarchy where the units had important powers like collection of taxes, preservation of local security and regulation of trade.¹¹³

It was during the reign of Emperor Haile Selassie I (1930 – 74) that marked the end of decentralized government, and the emergence of highly-centralized unitary state. There are various consequences of these centralization measures including the end of the autonomy of the kingdoms, and the removal of the powers of regional rulers thereof. Importantly, the State’s failure to accommodate linguistic, cultural and religious diversities, which were offshoots of the incorporations, had resulted in the Marxism-Leninism inspired notion of ‘question of

¹¹²Merera Gudina, “The Problematic of Democratizing a Multi-cultural Society: The Ethiopian Experience,” Conference paper presented at Immigration, Minorities and Multiculturalism In Democracies Conference, Ethnicity and Democratic Governance MCRI project, October 25-27, 2007 Montreal, QC, Canada), P. 4

¹¹³Bahru Zewdie (1991),A History of Modern Ethiopia, 1855–1974. Athens, Ohio: Ohio University Press. Cited in Assefa Fiseha, (2012), supra note 12, p. 439

nationalities'.¹¹⁴ Generally, these measures were ended up with the “state crisis”, which inspired the students’ movements and the emergence of political parties since the 1960s.

Nevertheless, there had been an everlasting debate among scholars and politicians with regard to the state crisis, which was emerged with the formation of centralized state. These diametrically opposite stands and contradictory views regarding their interpretations of history vary from “nation building” to “colonialism”.¹¹⁵

At the collapse of the absolute monarchy with the 1974 revolution, the Provisional Military Administration Council (PMAC), also known as “Derge” (which is a Ge’ez term for Committee), took power. Since the military junta had took power after the revolution, which was triggered by socio-political and economic oppressions, it was expected to address the basic questions of the time, “land to the tiller” and “nationality question”.

Perhaps, it is vital to mention some of the promising measures that were taken in the beginning. The land reform measures of 1974 and 1975 as well as the right to “Nations and Nationalities” recognized by the National Democratic Revolution Program (NDRP), could be mentioned here. NDRP could be considered as a progressive document due to its radical move in recognizing the issue of “nationalities”, the document underlines the necessity of according the right to self determination in its forms of regional autonomy, establishment of local governments and the right to use their languages as well as determining their political, economical and social life.¹¹⁶ However, the military government failed to keep its promises and continued with the centralist measures as its predecessors until it is overthrown by the coalition of armed forces in 1991.

¹¹⁴Assefa,(2012),supra note 12 p. 439

¹¹⁵Assefa categorizes “the centrist and mainstream Ethiopian writers”, such as Tekle-tsadiqMekuria, in to the group that advocates the theory of “nation building”. See Assefa,(2012),supra note 12 P. 440; whereas there are also others who interpret the scenario as ‘internal colonialism.’ Assefa Jalata Oromo Nationalism and Ethiopian Ethnocratic Politics, Horn of Africa, Vol.20, 2002, P. 43

¹¹⁶ Program of the National Democratic Revolution of Ethiopia, Section Two, Item 5, Addis Ababa, April 1976, cited in Patrick Gilkes, (1982), “Building Ethiopia’s Revolutionary Party”, (MERIP Reports, No. 106, Horn of Africa: The Coming Storm, pp. 22-27), P. 26. Available at, <http://www.jstor.org/stable/3011494>

The “London Peace Conference” laid the foundations for state restructuring measures, which was conducted at the eve of the demise of the military junta in 1991. The Transitional Charter’s recognition of self-determination and self rule (*de facto* federalism) was later reaffirmed by the FDRE Constitution that marked a federal system (*de jure* federalism) in 1995.

Considering the “ethnic factor” as a crucial factor for its organization, it might be labeled as “ethnic-federalism, the Ethiopian federalism is treated as a pioneer in Africa, if not in the world.¹¹⁷ Ethnic-based federations strive to organize constituent units, which are manifestation of self rule and local autonomy. Ethno-national groups are, thus, bestowed with the right to self-administration as well as the opportunities to influence central policies, together with a guarantee against policies of assimilation or exclusion.¹¹⁸

As an ethno-national (also known as ethnic- federalism), majority of the regional states, i.e. six of the nine states, were established as the “homelands” of the major ethno-nationalist groups. Besides, these regions are named after the dominant ethnic group/s in the region.¹¹⁹ Underlining the historical oppressions against various “Nations, Nationalities and Peoples” (NNPs), the

¹¹⁷Clapham states that it is a novel idea that existed almost nowhere in the world, which makes Ethiopia the first to experiment it before ‘almost any state world wide.’ See, ‘Introduction’, in David Turton, (ed.) *Ethnic Federalism, the Ethiopian Experience in Comparative Perspective*, James Gurrey Ltd, 2006, P. 1 However, there are others who claim that there were socialist federations, which had employed ethnic-based federalism once. See, AlemHabtu, Multiethnic Federalism in Ethiopia: A Study of the Secession Clause in the Constitution, *Publius*, Vol. 35, No. 2, Spring, 2005, pp. 313-335, <http://www.jstor.org/stable/4624714>; accessed on, 20/04/2011

¹¹⁸Assefa,(2012),supra note 12Pp. 443&444

¹¹⁹ The Tigray, Afar, Amhara, Oromo and Somali States are named after the ethnic group that has majority in the respective regional state, whereas the BeninshangulGumuz regional state is dominated by the Berta (Benin) and Gumuz ethnic groups.

Constitution recognized and celebrated its “owners”.¹²⁰ As building blocks of the federal system, there is a special place devoted to deal with the rights’ of the NNPs in the federal covenant.¹²¹

The Constitution further acknowledged both internal and external forms of self-determinations including the recognition of their rights to organize, and to be proportionally represented at subnational or subregional entities, as well as the “unconditional” right of secession, the most fundamental form of self-determination.¹²²

3.2.2. Fiscal Federalism in Ethiopia

Fiscal federalism embraces concepts including division of expenditure responsibilities and revenue powers among different tiers of the government in a federation as well as fiscal imbalances and means of transfer mechanisms.

The foundations of the contemporary fiscal federalism of Ethiopia were laid down in the transitional period, particularly with the enactment of the proclamation that dealt with division of expenditure responsibilities and revenue powers of the central and regional governments.¹²³

This section is devoted to briefly deal with constitutional allocation of expenditure and revenue powers, for the federal government and States, together with vertical and horizontal imbalances and vertical transfers in the Ethiopian federal system.

¹²⁰ Unlike many other constitutions of the world, the FDRE Constitution preferred to begin stating with “We Nations, Nationalities and Peoples...” whereby making them the “makers” or “owners” of the Constitution. (See, the Preamble of the FDRE Constitution)

¹²¹See, the preamble together with articles 8, 39, 47, 93 of the Constitution.

¹²² Articles 39/ 2&3, 46(Art 39/5) of the FDRE Constitution

¹²³A Proclamation to define the Sharing of Revenue between the Central Governments and National/Regional Self-Governments, Proclamation No. 33/1992

I. Allocation of Expenditure Responsibilities

A. Legislative Powers

As long as division of legislative powers is concerned, there are exclusive as well as shared and residual powers of legislation in the federal system. Federal law making powers are stipulated under articles 51 and 55 of the Constitution including areas that mandate uniformity as well as civil and criminal matters.

Apart from their residual powers the legislative powers of States could be discerned from enumerated powers under article 52 of the Constitution including the power to organize police forces and civil servants. In the federal covenant, States are bestowed with powers to make or amend their respective constitutions as well as to issue and implement socioeconomic development policies, strategies and plans.

Shared powers in the Ethiopian federal system could appear either in the form of concurrency or framework powers. Concurrency bestows States' with power of legislation as long as the matter is not covered by the federal acts. In other words, States could make laws on matters that are stipulated under concurrent lists until the center start to exercise its legislative power on the area or until the federal government seizes it or federalizes such power. For instance, States could make penal laws on matters that are not covered by the federal criminal law (Art 55/5).

Unlike the German Basic Law, but similar with many other federal covenants, the issue of framework power is not clearly stipulated or specifically mentioned under the FDRE Constitution. However, there are a number of areas that require the federal government enact framework legislations while leaving significant place for States' to cover the details.

For instance, the Constitution empowers the federal government to, 'formulate and implement the country's policies, strategies and plans in respect of overall economic, social and development matters' (Art 51/2). At the same time, as per article 52/2/C it is the power of States,

‘to formulate and execute economic, social and development policies, strategies and plans of the State’.

Reading of these provisions cumulatively with articles 77/6 and 55/ 10, one could firmly argue it is a framework power that requires the federal government to set and implement general socio-economic and developmental plans and policies of the country. At the same time, the Constitution envisaged detailed legislations as it guaranteed subnational policymaking over socioeconomic matters that are specific to their respective regions.

Watts tried to distinguish between decentralization of jurisdiction and decentralization of decision making at the federal level so as to discern degree of legislative decentralization or subnational autonomy.¹²⁴ According to Watts, decentralization of jurisdiction is related with scope of jurisdictions of each tier of government and the degree autonomy or freedom from control while exercising allocated powers.¹²⁵

The important enumerated powers as well as the residual power of States are manifestations of the scope of expenditure decentralization in the Ethiopian federal system. For instance, their autonomy in the making or amending of their respective constitutions as well as their powers of policymaking over matters including social, economic and developmental issues could be mentioned here.

The absence or “intentional disregard” of ‘federal supremacy clause’ could be also another illustration for the substantial degree expenditure autonomy envisaged by the federal covenant. The principle of federal supremacy was intentionally disregarded from the federal constitution mainly for the better protection of the autonomy or the right to self-determination of Nations, Nationalities and Peoples. Nonetheless, one of the interesting issues relating with the revised constitutions was the adoption of the “supremacy clause”. However, there are provisions that set

¹²⁴ Watts,(2008), supra note 2,Pp. 171&172

¹²⁵ Ibid

‘conformity with the federal laws’ as a prerequisite on States’ laws included in each one of the revised constitutions of States.

Exception to other federal systems is the Ethiopian federalism, which adopted the system by which the federal government unilaterally decides the size of the grant pool. As per the Constitution, the role of the Second Chamber, i.e. the HoF, is limited to determining the grant formula that would be employed for calculating each regional state’s share.¹²⁶

B. Executive Powers

It is known that there are significant variations among federations with regard to division of executive jurisdictions in general and the relation between legislative and executive powers of any layer of governments. The way of allocating legislative and executive powers has direct implications of how expenditure responsibilities are divided among various layers of government.

In other words, differences with models adopted result in disparities among federations with regard to how expenditure responsibilities correspond with legislative and executive powers. In the dual model (US model), expenditure responsibilities go along with legislative powers while in the integrated (German-model) subnational spending are far beyond their legislative jurisdictions.

As a rule, the FDRE Constitution adopted a dual model of allocating legislative and executive powers. As per article 50(2), both tiers of government have legislative and executive powers on matters that fall under their respective jurisdictions. Therefore, division of expenditure responsibilities in the Ethiopian federal system, in principle, corresponds with allocation of legislative powers.

¹²⁶ Article 62/7 of the FDRE Constitution (the Amharic version)

Nevertheless, expenditure responsibilities of States are not limited to their legislative jurisdiction since there are provisions that stipulate conditions whereby States would administer federal laws. For instance, the federal government is given with legislative power over land and natural resources while administration of the law is the mandate of States (Art 52/2/d). There is also another possibility of administering federal laws whenever the latter specifically transfers this power through delegation (Arts 51/5 & 50/9).

Furthermore, scholars argue that there are cases by which the federal government's role is limited only to make laws leaving their administration for States. Under article 51 (3) the federal government has the power to set national standards of public health, education, science and technology though the provision of these public services is reserved for States. Moreover, federal powers that are not stated under article 51, but included under article 55, could be perceived as matters that require for States' administration.¹²⁷

II. Assignment of Revenue Powers

Allocations of revenue powers among various tiers of governments are one of the pillars of a federal arrangement. Generating revenues for execution of expenditure responsibilities as well as playing a vital role in macroeconomic regulation are included under the manifold functions of taxation powers.¹²⁸

Recognized as an indispensable element of a federal system, allocation of revenue powers has a significant coverage under FDRE Constitution. In its part dealing with division of powers between the federal and regional governments, the Constitution dictates the general principle of

¹²⁷Solomon argues that article 55 deals with powers of the federal legislative house, the HPR, so that it is all about federal legislative powers only. Thus, matters that are not listed under article 51, but included in this provision could be perceived as matters over which the center makes laws while the administration is reserved for States. (Solomon,(2008), supra note 32,P. 74

¹²⁸Watts,(2008), supra note 2,P. 96

levying and collecting taxes from their respective revenue sources.¹²⁹ There is also a part that is devoted to deal with division of taxation powers under different titles; these are the federal and States' exclusive powers of taxation as well as concurrent and residual (undesigned) areas of taxation.

Nevertheless, there are some peculiar features of allocation of taxation powers under the FDRE Constitution. First of all, there are a couple of non-tax revenues that are included under the section dealing with jurisdictions of taxation though it is titled as "powers of taxation". One could mention charges and fees.¹³⁰

A. Exclusive Powers of Taxation

Under article 96, matters including custom duties, import-export taxes, income, profit, sales and excise taxes on federally owned enterprises are included under exclusive tax power of the federal government. It shall also levy income taxes on air, sea and rail transport services as well as personal income taxes on federal government employees and that of international organizations. There are also exclusive tax sources of States, including personal income taxes on employees of States and private enterprises as well as rural land use fees and agricultural income taxes. Moreover, income tax, royalties and land use fees on small scale mining, and income taxes on inland water transportation and rental houses are allocated under exclusive taxation powers of States (Art 97).

Except customs duties, tax base is not a criterion in the division of exclusive taxation powers under the FDRE Constitution. Rather, it is the tax source that is employed to allocate revenue powers, which is argued to be important in addressing the problems of taxing the same income or

¹²⁹ Art 51/10 and 52/ 2/e of the FDRE Constitution

¹³⁰ Some revenue sources that could not be perceived as taxes are included under the lists of both the federal and States' powers of taxation. Charges and fees could be mentioned here.

transaction by both tiers of government.¹³¹ For example income tax on employees of the federal government and that of international organizations is a federal jurisdiction while regional governments have a power to taxes on the incomes of the employees of private enterprises and that of the regional government.

B. Shared/ “Concurrent” Powers of Taxation

Despite it is titled as “concurrent powers of taxation”, the meaning of article 98, or how should the provision be interpreted were issues of controversy. If the provision is perceived as “concurrent power”, the possible conflicts would lead to constitutional adjudications in a federal covenant that doesn’t recognize federal paramountancy/ supremacy clause.

Though the amendment of this provision was unanimously decided by the joint sessions of the HoF and HPR, it has not yet been effective.¹³² In practice, the provision is implemented as if it dictates “revenue sharing”, by which the federal government to levy and collect taxes under the concurrent power whereas States would share the proceeds.

Since 2003/04 a formula is developed by the HoF to decide the federal and regional governments respective shares of revenue collected from joint source. As per the formula, both shall have equal shares (50: 50) of the proceeds from direct taxes levied on companies and that of large-scale mining and petroleum. On the other hand, from indirect taxes on companies and royalties, the formula dictates the 70:30 and 60:40 shares of the federal and regional governments, respectively.¹³³

¹³¹ Solomon,(2010), supra note 42,P. 84

¹³² Minutes of the joint session of the House of Peoples Representatives and the House of Federation, Miazia 2, 1989 E.C. cited in Solomon, (2010) P.87

¹³³ The minutes of the decision of the HoF on its 2nd ordinary meeting on March 13, 2003, HoF Archive (cited in Solomon,(2010), supra note 42,P. 107

C. Residual Powers of Taxation

The last issue is related with residual tax powers or “undesigned powers of taxation” which is stipulated under article 99 of the Constitution. The provision is an exception to the rule of residual power of States under article 52/1. Therefore, matters regarding the allocation of undesigned/ residual tax sources should be decided by the joint sessions of the two federal houses, the HPR and HoF.

Nevertheless, the issue regarding what does “undesigned tax” means is far from clarity. According to Tadesse, the term is not clear whether it means taxes that are not mentioned by name or by substance.¹³⁴ For instance, VAT is not “mentioned by name” but there is a general terminology, i.e. sales tax. Therefore, it would be “undesigned” tax if the term refers to taxes that are “unmentioned by name” though its substance is mentioned.¹³⁵

There are still some taxes such as gift and inheritance taxes as well as stump duties that are not included under the Constitution, which are undoubtedly among residual taxes. Moreover, since the FDRE Constitution employs tax sources as the basic criterion for allocating revenue powers, there is a high probability of residual taxes Ethiopian federal system. For instance, excise tax on private enterprises and individuals as well as income tax on bank interests and royalty from patent rights were found to be residual taxes though income and excise taxes in general are mentioned in the Constitution.¹³⁶

¹³⁴Tadesse Lencho, *The Ethiopian Tax System: Excesses and Gaps*, Michigan State International Law Review Vol. 20, No. 2, Pp 327-380, 2012, P. 333

¹³⁵ The issues with regard to the allocation of taxation powers were raised immediately after the introduction VAT in Ethiopia. Still, the issue of VAT continued being a reason for confusion and academic debates. First, the joint session of the federal houses decided VAT as a federal tax it, which seems that it was treated as “undesigned” matter. Paradoxically, the federal government later agreed to share the revenue from VAT levied on regional sources. See, Proclamation No. 285/ 2002 and Tadesse Lencho, (2012), P. 333

¹³⁶Excise taxes on individuals and income tax on royalty from patent rights of individuals are decided to be state taxes while an income tax from bank deposit is now a federal tax. On the other hand, excise taxes on private enterprises and on royalty from patent rights of enterprises are decided to be joint tax sources. See, the joint session

III. Fiscal Imbalances and Arrangements for Vertical Transfers

Watts advocates for employing a variety of criteria to measure financial decentralization in any federal system. These include the extent of federal government's revenue before transfers and its expenditure after transfers, in relation to the nation's total as well as the size and character of transfers.¹³⁷ Though the federal government's share from the total revenue helps to measure "own-source revenue" of states, Watts doubts the importance of the amount of the federal government's expenditure since it also includes expenditures funded by transfers.

Despite this, however, assessment of both the share of federal government's revenue and its expenditure from the total government revenues and expenditures is one means of calculating the vertical imbalance in a federation. As the extent of vertical imbalance negatively relates with the autonomy of constituent units, so does the amount of vertical transfers. However, the nature or character of transfers has significant effect on the degree of their dependency.

Similar to other federal systems, there Ethiopian federal system faces the challenges of fiscal imbalance; both vertical and horizontal imbalances. However, it could be possible to say the degree of fiscal imbalances would make the federal system unique. Be it measured with the mismatches between the expenditure needs and the available revenue at regional level or the relative share of States from the national total revenue and expenditure, the degree of vertical imbalance in Ethiopia is abnormally high.

Regional governments' own-source revenue covers only less than 20% of their total expenditures while the rest is to be covered by federal grants.¹³⁸ Figures of vertical imbalance, which is measured by calculating their aggregate shares from the total national revenue and expenditure, show similar results. For instance, in 2003/04 FY, States' share of the national total revenue less

of the HOF and the HPR, October 7, 2003 and October 8, 2004, cited in Getachew Mengeste, *Intergovernmental Fiscal Transfers In Ethiopia: Challenges And Some Options (A Comparative Study)*, (AAU) (Unpublished), P. 66

¹³⁷ Watts,(2008), supra note 2,P. 174

¹³⁸HoF, the New Federal Budget Grant Distribution Formula, 2007, P. 7

than 15% while their expenditures comprise more than 30% of the total. This raised the degree of vertical imbalance to be greater than 0.6.¹³⁹The over-centralized constitutional assignment of revenue sources as well as institutional and capacity related problem of tax administration at regional level, are frequently mentioned as factors for the existing vertical imbalance.

Similarly, there is a huge disparity among regional states' per capita capacities of revenue generation, often known as the degree of horizontal imbalance. In 2006 FY, for instance, Somale and Gambella, were respectively, able to cover only 6.1% and 7.9% of expenditures from their own-source revenue while Dire Dawa and Tigray covered 22.3 and 28 percent respectively. On the other hand, significant share of revenue responsibilities are allocated to regional states.¹⁴⁰

There are general stipulations in the FDRE Constitution that refer to the allocation of federal grants.¹⁴¹ In the Ethiopian federal system, unconditional/ block grants comprise the largest shares of vertical transfers. However, the federal government could also employ specific or conditional grants to States emergency, rehabilitation and development assistance", as well as to redress natural or man-made disasters or to help the least advantaged NNPs.¹⁴²

Arrangements for vertical transfers in the Ethiopian federal system pose two serious issues. The primary issue is related with the principles and institutional arrangements of determining the total grant pool. On the other hand, setting the grant distribution formula or the formula by which the grant is appropriated among States is also a basic question regarding block grants.

As long as the first issue is concerned, the total amount of grant could be determined either by the unilateral decision of the federal governments, or through the involvements of the constituent

¹³⁹ Abu Girma Moges, Fiscal Federalism and Its Discontents: Theory and Policy, Paper prepared for the 3rd EAF-EARO/CADPR-WMU International Symposium on Ethiopian Development Studies, June 17-18, 2005, Addis Ababa, Ethiopia, P. 16

¹⁴⁰ Grant formula of 2007, P. 4

¹⁴¹ Art 62/ 7, together with arts 41/3, 43/4 , 89/1 and 94 of the FDRE Constitution

¹⁴² Arts 94/2, 89/3, and 89/4 of the FDRE constitution

units. Some of the federal systems recognize the participation of States in the process of determining the amount through negotiations or based on the constitutionally set ratios as in the cases of Russia and German federations, respectively. It might also be unilaterally determined by the federal governments up on the recommendations of independent commissions similar with the arrangements that exist in Indian and South African federations.¹⁴³

In the Ethiopian Constitution, the amount of the grant/ or the grant pool is subjected to a unilateral decision of the federal government. The grant pool of each Fiscal Year is prepared by the federal executive and become effective after the approval of the legislature. Particularly, it is the MoFED, which is empowered to estimate the total amount of “budget subsidy” to regional governments, or the grant pool.¹⁴⁴ Then, the federal lower house, i.e. the HPR, approves it the amount/ size of the “subsidy” together with means of financing.

¹⁴³Solomon,(2010), supra note 42,P. 107

¹⁴⁴Article 19/d of the Federal Financial Administration Proclamation No. 648/2009

3.3. The Post-2001 Economic Restructuring and the Developmental State of Ethiopia

The eyes of the Japanese thus opened up and they became rich...[A]sia and China have started to follow the path of Japan with determination. Emperor Menilik should have followed the same path, but he didn't.

Gebrehiwot Baykedagn¹⁴⁵

The issue of building developmental states in Africa in the age of globalization, in spite of its novelty, took only a few years to be the heart of academic and political debates. One of the most heated debates enquires the feasibility of building developmental states in Africa.

Skepticisms against the possibility of building an effective DS in Africa emanate from different experiences and varied perspectives, including the ‘impossibility theorem’, which doubts the possibility of emulating the Asian experience in Africa. On the other hand, the opponents of the ‘impossibility theorem’ criticize it as naïve since it a mere deduction from past experiences. Besides, the theory is blamed for being inconclusive that failed to scrutinize exogenous factors that could halt developmental commitments to the ground.¹⁴⁶

In spite of all the criticisms and skepticisms, African States seem to agree on the importance of state activism or, the vital roles of the government for the overall development of a nation. A couple of states on the other hand, took the road towards state activism and publically declared that they are “developmental”.

¹⁴⁵Gebrehiwot Baykedagn State and Economy of Early 20th Century Ethiopia, 1924, p. 39quoted in Messay Kebede , Gebrehiwot Baykedagn, Euro-centrism, and The Decentering of Ethiopia, Journal of Black Studies, Vol. 36 No. 6, PP. 815-832, 2006

¹⁴⁶ For detailed discussion on the both sides of arguments, see Thandika Mkandawire, Thinking about Developmental States in Africa, Cambridge Journal of Economics, 25: 2001

3.3.1. Quests for Development in the Modern History Ethiopia

The post-independence era was marked by the introduction of Modernization theory in developing countries. The theory propagated the urge for “modernizing” (Westernizing) traditional legal systems of developing countries. Nevertheless, modernization theory was short-lived since it was “ethnocentric”, which failed to appreciate the divergence of social values and political structures of the Third World and the West.¹⁴⁷

At the demise of modernization theory, Socialist (State-Led) Development or Dependency theory was prevalent in the developing countries. Contrary to modernization paradigm, dependency theory advocated for import substitution and protectionist economy. Sadly, Socialist or State-Led Development of the Third World failed to be realized because of weak state machineries as well as since the state consolidation measures led to diversion of resources away from economic production.¹⁴⁸

In contrast to the “decolonization” narratives of most of the African states, development was perused in the 20th C Ethiopia through emulation of a model in the already developed world; some might call it as the “politics of emulation.”¹⁴⁹ The trend of looking for benchmarks goes as back as the beginning of Ethiopia’s modern history in the mid-19th C.

Emperor Tewodros II was the first to be inspired by foreign model, particularly the Russian model (an Orthodox Christian State). That is why the name of Emperor Tewodros’s cannon was given for the remembrance of Russian victory over British and French invaders. The canon was,

¹⁴⁷Lan Cao, Law and Economic Development: A New Beginning?, Texas International Law Journal, Vol.32:545, 1997, Pp 551-55

¹⁴⁸ Clapham, (1992), supra note 71, Pp. 21-23

¹⁴⁹ Christopher Clapham, (2006), Ethiopian Development: The Politics of Emulation, Commonwealth & Comparative Politics. Vol. 44, No. 1, 108–118, P. 109

thus, named after the great fortress of Russia, which had significant impact for its victory at Crimean war; i.e. Sebastopol.¹⁵⁰

Similar with other countries in the developing world, the 1960s and 70s, Ethiopia had hosted doctrines of development which were inspired by modernization theory of development. There were, thus, purposive economic development projects including an attempt to build dams on the Blue Nile (Abbay), which could be the “lost opportunity” for Ethiopia.¹⁵¹

Post revolution policies that are emulated from Russia and China resulted in land reforms that led to nationalization of all land, followed by the establishment of state farms and agricultural producer cooperatives, settlement and villagization programs were sought to be keys to success.¹⁵²

“Marxism inspired” dependency theory had been prominent in the late 1970s and 80s though it failed to achieve its goals as state-owned farms were inefficient and import-substitution was also unsuccessful till the country had adopted “mixed economy” in 1990. Sadly, this development model, which was assumed to be genuinely suited to the State and implemented with enormous dedication, was with inherent problems which resulted in famine as well as civil war and de facto disintegration of the State.¹⁵³

¹⁵⁰Ibid, p. 108

¹⁵¹ Elias N. Stebek, Ambiguities and Inconsistencies in the ‘prescriptions’ Toward ‘Development’, Mizan Law Review, Vol. 6 No.2: 312,2012,P. 330

¹⁵² Clapham, (2006), supra note 149

¹⁵³Ibid, Pp. 114-15

3.3.2. Ethiopia- On the Roads to the DS (Since 2001)

Some scholars believe the DS theory is a recent phenomenon in the Ethiopian politics and economy, which was one of the aftermaths of the 2005 popular election.¹⁵⁴ Contrary to this scholarly argument, documents prepared by the government and/or the ruling party as well as invoke the paradigm state the developmental theory was one of the reasons for the TPLF split in 2001.¹⁵⁵ According to these documents, the conception of the DS paradigm dates back to the late 90s though the paradigm is fully articulated around 2000 and 2001.¹⁵⁶

It is indisputable, however, that there were a number of policy documents that have direct implications on the developmental paradigm, early before it was declared publically. These documents issued by the government or at party level had extensively covered the desired economic growth of the nation as well as the necessity of different forms of state activism and selective intervention including setting priorities, infrastructure development and through building cooperation with investors.¹⁵⁷

These official documents of the government, published by the federal Ministry of Information, could be relevant in the study of both the developmental paradigm of the country as well as the federal-state relations since the year 2001. It could be easily witnessed that the lion's share was taken by policies covering a number of social and economic affairs, particularly those alleged to have direct impacts on realization of economic development, which is frequently mentioned as the priority of the nation.

¹⁵⁴Messay Kebede, (2011), Meles Zenawi's Political Dilemma and the Developmental State: Dead-Ends and Exit, in Geza Hayet (comp.), Debate on the Developmental State by Ethiopian Scholars, available at <http://hayet11.blogspot.com> accessed on 11/05/2013

¹⁵⁵ Speech by Meles Zenawi, supra note 14

¹⁵⁶Ibid

¹⁵⁷ Ethiopian People's Revolutionary Democratic Front Programme (EPRDF) (2001). Addis Ababa, Ethiopia. Available at; <http://www.epdrf.org>

Declaring economic growth is a top priority, most of these documents emphasized on the commitment of the government for realizing national economic development (developmentalism).¹⁵⁸ Similarly, vital role of the government in guiding industrial transformation and its leading role in overall development of the country is discussed in the policy documents. Particularly, the need for working in cooperation with the private sector while at the same time, preserving bureaucratic autonomy (embedded autonomy) is one of the concepts that are frequently mentioned.

Though the government has frequently argued the flawlessness of the developmental paradigm and praising it for the rapid economic growth of the country, the DS of Ethiopia is still an underling theme in political and academic debates. Critics argue against the appropriateness of the paradigm as well as doubt the success stories of government.

Among other things, the issue of democracy and human rights took a special place in the criticisms launched against the developmental ideology. On the other hand, there are skepticisms around the feasibility of building an effective developmental state in the country. Particularly, the challenges posed by the ethnic federalism are frequently mentioned as the crucial problem.

I. Nation-wide Mobilization

Bagchi strongly argues that “the three basic requirements” for the formation of any DS are, abolishing practices of non-market coercion, universalization of literacy and building nationalism.¹⁵⁹ Regardless of their natures and characteristics, these measures should be designed with the view of mobilizing the general public on the way to implement national priorities thereby achieving an overall economic growth. Thus, extensive measures that are aimed at universal education, nationalism and market reforms are indispensable elements of any DS.

¹⁵⁸Bagchi (2004), supra note 69, P. 3

¹⁵⁹Ibid

Moreover, all of these measures are interrelated and interdependent, which couldn't be treated independently. For instance, universalization of elementary education is usually designed to implant innovative consciousness and nationalism feelings in the minds of the people.¹⁶⁰ As strong nationalism and the creation of nation-wide public had contributed a lot for the success of DS in many countries like Japan and China as well as South Korea and Taiwan, state formation in the Russian federation had negative impacts on creation of nationalism thereby contributing for its failure.¹⁶¹

Nationalism could be seen as effective collectivity in the forms of collective assurance, collective insurance and collective actions.¹⁶² On the other hand, ethno-nationalism is considered as an impediment in the building of an effective DS. Conversely, institutionalizing ethnonationalism in Ethiopia allegedly defeats this principle due to the special place given for diversity at the cost of unity.

Particularly, scholars argue the ethnic-based federalism and ethno-nationalism in Ethiopia has a downbeat impact on the formation of a DS.¹⁶³ Rather than striving for the common good and solidarity for national development activities, the right to self rule, and ethnic federalism celebrate “distinctiveness of a particular people”, which might have risks of making each group perceive itself as separate.¹⁶⁴

Moreover, ethnic-based federal system in Ethiopia is considered as causing non-market coercions. It is argued that the federal arrangement limits the free movement of labour and capital across the ethnic enclaves. Fears and suspicions because of the “unconditional” right of

¹⁶⁰Ibid, Pp. 4&5

¹⁶¹Ibid

¹⁶²Ibid, P. 5

¹⁶³See, Bonda, supra note 16

¹⁶⁴Alemante G. Selassie, supra note 3, P. 68

secession are likely to heighten the risk of investing outside the “ethnic home regions”.¹⁶⁵ Due to the dichotomy of “insiders” and “outsiders”, people are not usually happy and willing to work in the area outside their ethnic home regions.¹⁶⁶

In spite of these challenges, the Ethiopian government has been aggressively working and it has been taking extensive measures to make the ground fertile for the rise of a DS. For instance, one of the targets set in the GTP period is increasing primary education enrollment to 100%. However, many are still skeptics about the Ethiopian educational policy, especially with regard to quality of education, highlighting its failures so far in the production of qualified technocrats. Critics say, the system lacks uniformity and nationalist themes, which would be obstacles in the creation of a new national consciousness, based on the lessons taken from the past history of the nation.¹⁶⁷

In the face of all these challenges, the ruling elite have been working on the project of building a strong national identity. Whether it was an offshoot of Ethio-Eritrean war¹⁶⁸ or it was triggered by the adoption of the paradigm, the ruling party had frequently mentioned its commitment for building national consensus since 2001. It seems indisputable that celebrations of the Nations, Nationalities and Peoples’ Day (since 2006) and the National Flag Day (since 2008), were parts of these measures towards strong nationalism.

According to Messay, the Great Renaissance Dam project is highly nationalist project since it aims at mobilizing the people toward a common national goal, by particularly through reviving

¹⁶⁵Alemayehu Geda , ‘The Political Economy of Growth in Ethiopia’ in the book: *The Political Economy of Growth in Africa*, Cambridge University Press, 2007, p. 13

¹⁶⁶Bonda, supra note 16, P. 28

¹⁶⁷Messay Kebede, (2011), supra note 154, p. 9

¹⁶⁸ For instance, Abinik states that it was after the Ethio-Eritrean war that the policy of “national unity”, or “The EPRDF version of pan-Ethiopianist national discourse”, became a central theme of public statements and seminars. Jon Abbink, supra note 12, P. 612

the historical “grudge” against Egypt’s control over the Nile and urging for individual contributions, regardless of ethnic belonging.¹⁶⁹

Some of these shifts were also witnessed together with the revisions of State constitutions in 2001&2002. One of the novel ideas introduced in the revised constitutions was setting prerequisites or necessary conditions that are required to claim the right to secession. However, it has to be noted that these provisions are carbon copies of the Transitional Charter, which had set conditions for secession rights of ethnic groups.¹⁷⁰

While mobilizing the nation against the common enemy, however, states usually construct a ‘unitary nationalism’, which seldom tries to accommodate ethnic nationalism.¹⁷¹ That is why moves there are fears against any moves for creating strong national identities in multiethnic federal systems.

II. “Ethnocracy” Vs. Meritocracy

In any DS, the bureaucracy should be meritocratic in such a way that it follows merit-based recruitment and selection as well as performance-based evaluations and promotions. Johnson pointed out the contribution of merit-based recruitment and carrier paths for Japan’s success where the civil service was built with the most talented graduates of top universities.¹⁷²

One of the factors for the collapse of a DS paradigm in Zaire, in the time of Mobutu Sese Seko, was lack of meritocracy. It was “Predatory” or, a failed developmental state since bureaucratic appointments were based on political affiliations and interpersonal connections. The same

¹⁶⁹Messay Kebede, (2011), supra note 154, P. 11

¹⁷⁰It has to be recapitulated that Article 2/C of the Transitional Charter provided that the right to secession could be claimed only when the right to self-determination of NNPs is ‘denied, abridged or abrogated’.

¹⁷¹Bagchi, (2000), supra note 75, , P. 433

¹⁷² As cited in Evans, supra note 83, p. 573

characterizes the post WWII Brazilian developmentalism where the frequent source of jobs was political appointment that favors ‘connection rather than competence.’¹⁷³

In the post-1991 Ethiopia, key political and administration posts have remained in the hands of individuals from the indigenous ethnic communities in line with the right of the ethnic self-administration discourse in Ethiopia’s ethnic federal principles. Sadly, among regional government officials of some regions like Benshangul-Gumuz, Afar, and Gambella, there were many who did not even attend a level of education above elementary school.¹⁷⁴ Putting aside constitutional pledges, ethnic affiliation is allegedly the main, if not the only, criterion in the actual practices of political and other key bureaucratic appointments.¹⁷⁵

Since 2001, the Ethiopian government has issued a number of policy documents that were published by the then Ministry of Information. One of the fascinating issues about these documents was there are various sections that emphasize the necessity of building a meritocratic bureaucracy. In other words, these policy documents were manifestations of the government’s commitment to build a DS in general, and its obsession on ‘meritocracy’ in particular.

Nevertheless, these documents encompassed some issues that contradict with the existing state-structure, or ethnic-federalism. Thorough reading of these documents help someone notice some of dictates of the government might be inconsistent with the spirit of the federal covenant. For instance, the policy frameworks dealing with meritocracy could erode the principle of “equitable representation” of NNPs.

Art 39/4 of the FDRE Constitution has encompassed the guarantee for NNPs recognizing their right to proportional representations at the federal and regional administrations. Likewise,

¹⁷³ Ibid, P. 577

¹⁷⁴ Bonda, supra note 17, P. 28

¹⁷⁵ Berhanu Gutema Balcha, Restructuring State and Society: Ethnic Federalism in Ethiopia, SPIRIT – Doctoral Programme, Aalborg University, Denmark, 2007, (unpublished), P. 228, Available at, http://vbn.aau.dk/files/50021793/spirit_phd_series_8.pdf, last visited may 17, 2013

regional constitutions have provisions that are carbon-copies of that of the federal covenant. These guarantees are perceived as manifestations of “internal” self determination or the right to self administration, which is the cornerstone of the Ethiopian federal system.

Nonetheless, as it is stated under one of these policy documents, the government had begun to strive for meritocracy at the cost of self-determination. The Civil Service Reform document argues, a claim for ethnic representation at regional civil services has nothing to do with the constitutional principle of self-determination (self-administration). It further stipulated that “as long as the community is able to elect the political leadership, it is possible to say the right to self- determination is fully 100% realized.”¹⁷⁶

This statement could overshadow the constitutional guarantee of Nations, Nationalities and Peoples to self-administration and equitable representation in federal and regional civil services. How much meritocratic bureaucracy is needed, it should not be achieved at the cost of self-determination of nations and nationalities. Most of all, unless it is accompanied by education and capacity-building activities, as the Ethiopian Civil Service has been doing, the idea of meritocracy might be devastative in a country where the previous systems were discriminatory that marginalized many ethnic groups.

III. Challenges of Building a “Democratic” DS in Ethiopia

Since the time when it was publically declared, Ethiopia’s “new” form of DS, i.e. the “democratic developmental state”, became a center of academic and political debates. Such criticisms or scepticisms originate mainly from the conventional perception of developmentalism. Usually, a DS is equated with a dictatorial government that is hostile for democracy and rule of law.

¹⁷⁶ FDRE Capacity Building Strategy and Programs, (Ministry of Information, 2002), PP. 212&13

This theory was shaped by the classical works of DS, in which state autonomy was associated with authoritarianism. For instance, Johnson argued that the foundation of state's autonomy was its "soft authoritarian character".¹⁷⁷ It is known that, almost all successful developmental states were dictatorships that were led by tyrants at the times of their rapid industrializations.¹⁷⁸

Authoritarianism is commonly perceived as an inherent trait of any DS, while others treat it as an engine behind the success of any DS. Scholars believe that dictatorship is a warranty for rulers against any risks, including any risk threatening their power for quite a long time. This is considered as a guarantee that inspires them to concentrate on achieving economic development rather than making short-term policies.

Traditionally, the autonomy of a DS was measured comparing its strength with that of civil societies. Thus, it had been argued that a DS could be built where the role of civil societies is negligible.¹⁷⁹ Similarly, one of the post-2005 legal reforms was undertaken on the civil society law, which is one of the most controversial laws of Ethiopia. Among other things, it was

¹⁷⁷ As cited in Sehen Bekele and Tsegaye Regassa, *Democratization in a Developmental State: The Case of Ethiopia, Issues, Challenges, and Prospects*, Paper Presented at the Policy Forum of UNDP Ethiopia, on 28 July, 2011, UNDP Ethiopia, No.1/2012, p. 12

¹⁷⁸ The stories of developmental states in Japan and Brazil are frequently mentioned as exceptions to the rule because of the democratic character of the governments. (See, Kim, *supra* note 21).

Nevertheless, the Japanese and Brazilian experiments of democratic developmentalism had been debatable. For instance, Brazil had experienced dictatorships in its era of developmentalism, such as the era of military dictatorship (1964-1980). Moreover, Brazil was an "intermediary state" that failed to build an effective DS. (See, Evans, *supra* note 83) Likewise, Japan's architects for its latter development were dictators of the "Meiji era", setting aside the pitfalls of "one-party rule" on democracy. (See, Sehen Bekele and Tsegaye Regassa ,*supra* note 177; Ebrahim Shabbir Deen, *The developmental state: An illusion in contemporary times*, Review, *African Journal of Political Science and International Relations* Vol. 5(9), pp. 424-436, October 2011, P. 429 Available at <http://www.academicjournals.org/AJPSIR>

¹⁷⁹ Christopher Clapham, *Introduction: Liberalisation, Regionalism and Statehood in the New Development Agenda*, *Third World Quarterly*, Vol. 17, No. 4, *The Developmental State?: Democracy, Reform and Economic Prosperity in the Third World in the Nineties*, pp. 593-602, 1996, P. 597, available at <http://www.jstor.org/stable/3993275>, Accessed on 10/08/2011

criticized for limiting the role of non-governmental organizations in the process of building democratic order, thereby curtailing democracy and human rights.¹⁸⁰

The government officials believe both democratic and developmental state would be built on a “dominant party or dominant coalition democracy.”¹⁸¹ The ruling elites argue that the system could not be labelled as undemocratic as long as the system accommodates ‘free, fair and periodic’ elections or as long as there is protection of citizens’ rights to form and join political parties. Citing the story of the coalitions in the Scandinavian countries as well as the Japanese, officials argue that winning elections repeatedly or long-span of power could not always be a manifestation of lack of democratic order.¹⁸²

The ruling elites’ commitments to transform EPRDF to a “vanguard party” had been recently made public through different party/ government document. Particularly, these documents expressed the ruling elites’ intention to make the ruling coalition as a “vanguard party” that could be able stay in power for decades.¹⁸³

Nonetheless, planning for “long-lasting” political powers defeats the principles of democracy. Basically, it is antagonistic for democracy by curtailing different virtues of a democratic order, including the notion of “sovereignty of the people or, free elections”. So far, officials are insisting on building a “democratic” DS, despite it seems to be contradictory with the party’s policy of “vanguard party”.

¹⁸⁰ Charities and Societies Proclamation, (Proclamation No. 621/2009); See also, Adem K. Abebe , Rule by law in Ethiopia: Rendering constitutional limits on government power nonsensical, CGHR Working Paper 1, Cambridge: University of Cambridge Centre of Governance and Human Rights, April 2012; Assefa,(2012),supra note 12, P. 463

¹⁸¹Meles Zenawi, (2006), P. 13

¹⁸²Ibid, P. 12

¹⁸³See, *Yetehadisow mesmimer ena ye'ethiopiahidassie*, November 2010, Addis Ababa (A document which was presented at the recent discussions of senior government officials held with university instructors)

Chapter Four

4. The Developmental State and Regional Financial Autonomy in Ethiopia

4.1. Introduction

The chapter is devoted to deal with the impacts of federal governments' statutory reforms and regulations that are taken for the implementations of uniform policies and national priorities throughout the nation. Largely, the nexus between these measures of federal governments and degrees of subnational revenue and spending autonomy would be dealt under this chapter.

This chapter posits a couple of premises on the possible impacts of federal government's policies on the financial autonomy of States. The basic hypothesis is that the need for state activism in a DS would result in financial recentralization in a federal arrangement. This is to mean that there are pushes for revenue recentralization because of the ever increasing costs of federally sponsored mega-projects. Similarly, federal governments could employ various regulatory tools that are designed to control the movement of resources and capital around national priorities.

Therefore, the various measures that are taken on the way to the "developmental state of Ethiopia" vis-à-vis degree of revenue and spending of States in the Ethiopian federal system, which is the main theme of the research, would be discussed hereunder.

4.2. The Developmental State Vis-à-vis Revenue Autonomy of Regions in Ethiopia

While studying the revenue autonomy of State governments, it is crucial to look in to their autonomy in generating revenues as well as the volume of such revenues. Revenue autonomy of subnational governments is principally linked with their power and capacity to levy and collect the revenue that is required for executing their expenditure needs. The power to levy taxes is a fundamental attribute of revenue autonomy since it is such power that distinguishes autonomous (own-source) revenues from other types of revenues. Moreover, tax autonomy allows regional governments to decide the size or amount of their autonomous revenues.

However, tax autonomy might be constrained by of federal governments' regulatory tools including harmonization measures. For instance, centralized institutions and their coercive measures, which are aimed at controlling and directing investment flows, might be antagonistic with revenue autonomy of subnational governments.

Looking at the provisions the FDRE Constitution dictating powers of taxation, it appears that both levels of government have powers to 'levy and collect' taxes in their exclusive jurisdictions, or tax autonomy.¹⁸⁴ The principle of tax autonomy is directly related with the power to levy autonomous taxes that is manifested in the autonomy to introduce tax and to set tax bases as well as to set or change tax rates and tax holidays.

¹⁸⁴Articles 51(10) & 52(2)(e) of the FDRE Constitution

4.2.1. Centralized Mobilization of Investments and Subnational Tax Autonomy

Subnational “tax autonomy” might be constrained by federal governments’ policies and other regulatory tools such as the policy of harmonization. Similarly, there is a statutory limitation in the Ethiopian federal system that obliges harmonization of both the federal and regional governments.¹⁸⁵ In spite of the constitutional decree of the power to levy taxes, the regional governments have failed to exercise this power so far in the Ethiopian federal practice. So far, States failed to enact their respective tax laws whereby federal legislations were employed to levy and collect taxes even at regional level.¹⁸⁶

Measures of uniform tax bases or tax rates in the Ethiopian federation could hardly be justified with the possible dangers of inefficient tax competitions. Even though ‘race to the bottom’ is frequently mentioned as one of the dangers of fiscal decentralization, this argument is rather inconclusive since it lack concrete evidences. Thus, the danger of ‘race to the bottom’ competitions could not be a palatable argument despite it is an often-cited justification for harmonization measures.¹⁸⁷

Moreover, advocates of tax harmonization measures presuppose the existence of free movement of labour and capital across jurisdictions where investment flows are driven by economic motives only. However, investment decisions in Ethiopia are highly influenced by socio-political factors, than purely economic grounds. For instance, it is argued that the contemporary state

¹⁸⁵ Article 57 of the Federal Government Financial Administration Proclamation No. 57/1996

¹⁸⁶ Timothy R. Muzondo et al, Ethiopia: Introduction of a VAT and a Presumptive Income Tax and Reform of the Income Tax, International Monetary Fund, Fiscal Affairs Department, 2000, p.21, cited in , Tadesse Lencho, Income Tax Assignment under the Ethiopian Constitution, Mizan Law Review, Vol. 4 No. 1,2010, P. 43

¹⁸⁷ Pierre Salmon, ‘Horizontal competition among governments’, in “Ehtisham Ahmad and Giorgio Brosio, eds. *Handbook of Fiscal Federalism*, Edward Elgar Publishing, Inc.136 West Street Suite 202 Northampton Massachusetts 01060 USA, 2006. P. 80

restructuring discourages free movement of labor and capital across the ethnic enclaves and heightens the risks of investing outside the “ethnic home region”.¹⁸⁸

The second reason could be the constitutional guarantee against discriminatory tax laws of States.¹⁸⁹ Harmonization could be one of way of safeguarding citizens against prejudiced States’ tax laws, or any tax legislation that discriminates taxpayers with their ethnic or other backgrounds.

The only tax sources that were not harmonized were agricultural income tax and land use fees over which regional governments have been exercising their powers of enacting tax legislations. Therefore, States were able to autonomously set tax bases and rates on these sources. Studies on the practice of levying agricultural income tax revealed that the variations among regional practices is not limited to that of tax rates, but also there are discrepancies regarding how the tax rates are set. For instance, Oromia, Benishangul-Gumuz and Gambella adopted progressive tax rate scale, while Tigray and Harari preferred to put fixed amount per hectare. On the other hand, some regions, like the Amhara regional State, follow a system of varying the rate based on different factors like the location or nature of the land.¹⁹⁰

I. Recent Reforms on Taxation Powers and Revenue Recentralization in Ethiopia

Striving for the achievement of its ambitious development plan or for the realization of an effective DS of Ethiopia in general, the Ethiopian government has initiated extensive reform measures. Among these reforms, wide-ranging measures of revising tax legislations and organizing centralized offices of trade and investment could be mentioned. The federal

¹⁸⁸ Alemayehu Geda, ‘The Political Economy of Growth in Ethiopia’, in the Benno J. Ndulu, Stephen A. O’Connell et al. (eds.), *The Political Economy of Growth in Africa, 1960-2000, Volume 2, Country Case Studies*”, Cambridge University Press, 2007, P. 133

¹⁸⁹ Article 100/3 of the FDRE Constitution

¹⁹⁰ The New Federal Budget Grant Distribution Formula (2007), House of Federation, Economic and Social Study Department, Addis Ababa, P. 24

government has promulgated a number of investment proclamations and regulations that stress on enhancing the environment for investment, including establishment of offices, easing procedures and setting financial and other kinds of incentives.

No doubt that these measures were basically aimed at easing procedures of taxation, which is one of the factors affecting investment decisions. In spite of Ethiopia's lowest rank in doing business, as long as paying taxes is concerned, it stood at a relatively better position. In the easiness of doing business, Ethiopia placed at the 111th place while its rank in paying taxes (measured through total hours and number of payments and per year as well as the total tax rate as percentage of profits) is 40 from the total 183 countries.¹⁹¹

Among these reform measures, the changes witnessed on the division of powers with regard to administration of large-scale agricultural investment lands and comprehensive reforms on investment-incentive legislations are directly related with mobilization of investments. Particularly, these measures were triggered by various factors including the need to promote domestic investors and attract foreign direct investments. The content and impacts of these reforms are briefly dealt hereunder.

A. Agricultural Investment Land Administration

Land reforms took a pivotal role in the formation of any DS especially reforms that are directed toward abolishing non-market coercions. Bagchi argues that the extensive pro-peasant reforms of land laws were the basic features of developmental states since the 16th C.¹⁹² It is not possible to say these reforms should always result in private ownership of land. The reform directed toward "institutionalized possession" could also be treated as a positive move for the rise of any DS. For example, in Singapore, which was one of the great economies that brought the "Asian Miracle",

¹⁹¹The International Bank for Reconstruction and Development and the World Bank, *Doing Business in a More Transparent World: Comparing Regulation for Domestic Firms In 183 Economies*, 2012, P. 95. Available at <http://www.doingbusiness.org/Reports>

¹⁹²Bagchi,(2004), supra note 69, P. 4

the government was successful in affording housing and protection of private property rights through state ownership of land.¹⁹³

In contrast, the Ethiopian government had not adopted the system of private ownership of land. However, in the existing state ownership of land, there are extensive reforms undertaken by the government. The primary illustration is the practice of centralizing administration of investment land. The Constitution bestowed States with the power of administration of land and natural resources while the legislative power is reserved for the federal government. Recently, the federal government has taken the power of administration of investment land away from regional governments. The law was enacted after the federal government has allegedly “induced” regional governments to delegate their power of administering land.¹⁹⁴

Though it is still possible to give varying explanations for the federal government’s move, it is hardly possible to rule out DS ideology from the possible postulations. It is indisputable that organizing a central office, whose mandates are controlling and directing mobilization of investments throughout nation, necessary prerequisite for building an effective DS.

Similarly, the Ministry of Agriculture is entrusted with administration of agricultural investment lands. Moreover, a specialized agency is launched under the Ministry. The “Agricultural Investment Land Administration Agency” is established with the aim of facilitating agricultural investment and land administration.¹⁹⁵

As per the argument of higher government officials the central motive behind centralization measures was to make sure “there are no mishaps” through transparent procedures and, by

¹⁹³ Ha-Joon Chang (2011), Institutions and economic development: theory, policy and history, *Journal of Institutional Economics*, 7: 4, 473–498. Pp. 481&482

¹⁹⁴Assefa,(2012),supra note 12, P. 464

¹⁹⁵ See, Article 19/1/o of Proclamation no. 691/2010; A Proclamation to Provide for the Definition of Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia; as well as The Council of Ministers Regulation No. 283/2013.

making investors “interact with one entity.”¹⁹⁶ Particularly, it was argued that the government took a lesson from the problems occurred in Gambella regional state; “the mystery of Karuturi’s land lease” which is known by expression as.¹⁹⁷

B. Federal Tax Incentives

The next issue is directly related with the urge for setting various schemes of investment incentives for the realization of effective DS. Setting schemes of tax exemptions is one of the common types of investment incentives. On its move towards DS, the Ethiopian government has started to take different measures that reinforced its commitment of attracting foreign investments together with encouraging domestic investors.

Because of frequent amendments, a number of investment and investment incentive proclamations and regulations had been introduced in the two decades old Ethiopian federalism. Thus, it would not be far from truth if one argues that there seldom exists any law that is amended as frequently as investment incentive regulations.¹⁹⁸

¹⁹⁶ Meles Zenawi interview with Mary Fitzgerald, “The New Breadbasket of the World?”, Irish Times, 30 January 2010, Cited in Understanding Land investment deals in Africa Country report: Ethiopia, the Oakland Institute, 2011, P. 28

¹⁹⁷ The State Council of Gambella leased a huge plot of land (300,000 ha) with significantly low rate of rent (15-20birr per ha), to Karuturi, an Indian floriculture industry. The government admits that the case was one of the reasons for federalizing powers of administering large-scale agricultural investments.

¹⁹⁸ For instance, Proclamation No. 280/ 2002, (Investment Proclamation); Proclamation No. 373/ 2003, (Investment (Amendment) Proclamation), and Proclamation 769/2012, (Investment Proclamation) could be mentioned among the proclamations. As long as Regulations are concerned, the following are issued by the Council of Ministers with regard to investment incentives;

Regulation No.7/1996 (Investment Incentives Council of Ministers Regulations); Council of Ministers Regulations No. 9/1996 (Investment Incentives (Amendment) Council of Ministers Regulations); Council of Ministers Regulations No.36/1998 (Investment Incentives Council of Ministers (Amendment) Regulation); Council of Ministers Regulations No. 84/2003, (Council of Ministers Regulations on Investment incentives and Investment Areas Reserved for Domestic Investors); Regulation No. 146/2008, (Council of Ministers Regulation to Amend the Investment Incentives and Investment Areas Reserved for Domestic Investors Regulation)

Part of these measures was the Council of Ministers regulation on investment incentives, which took attracting foreign direct investment (FDI) and transfer of technology as underlining principles.¹⁹⁹ As it is appealed by the doctrine of State Directed Investments, the regulation embraced income tax exemptions and exceptions of payments of customs duty.

II. Impacts on Regional Revenue Autonomy

Revenue autonomy of States in its narrow sense implies the extent of own-source revenues as a percentage of the total revenue required to execute constitutionally mandated expenditure responsibilities. These reform measures were effective in increasing the federal finance through enhancing the tax administration system. The federal tax laws, at the same time, extended the scope of the federal taxation powers. Or, the laws exacerbated the statutory limitations on tax/revenue autonomy of States.

The overextended scopes of investment incentive laws and the centralized land administration system have multifaceted implication on the federal system. Generally, the impact of these measures is not limited to the revenue powers of States, but these changes could also be challenges on the effective functioning of Ethiopian federalism

Being exceptions from the harmonized tax system, the power to issue agricultural income tax legislation and to set the rate of land use fees had been areas where States enjoy a relative autonomy of taxation. The power to levy taxes or tax autonomy bestows States with powers of setting and varying tax bases and rates as well as exclusive power of making tax holidays. However, recentralization of States' autonomy to levy taxes is the primary consequence of the recent measures of the federal government.

¹⁹⁹ Investment Incentives and Investment Areas Reserved for Domestic Investors, Council of Ministers Regulations No. 84/2003.

Recentralization of land administration bears another issue since the notion of “upward delegation” is not recognized under the Ethiopian Constitution. It was intentional disregarded in the making of the Constitution fearing the dangers of measures of centralization, as it is “hinted” at the minutes of the Constitutional Assembly.²⁰⁰ Currently the federal land administration agency is in charge of concluding lease agreements as well as setting and varying land use fees. It has to be noted that the revenue collected by the federal government will be transferred to States. However, this measure has ultimately limited the relatively unrestrained autonomy of States to set and change tax rates (land use fees). Besides, many scholars do not consider such kinds of revenues as own-source revenues.²⁰¹

Similarly, the applicability of income tax holidays, declared by the federal investment incentive law, is not limited to the areas of taxation that are reserved for the federal government. Rather, the regulation extended its scope of application to the areas that are exclusively reserved for States under the federal covenant. The regulation, under article 2/5, specifically stipulated its scope while defining “income tax” as business profit taxes ‘categorized as the revenue of the Federal Government, Regional Governments or as their joint revenue.’ Hence, the regulation provided various schemes of income tax exemptions to investors including exemptions from State tax sources.²⁰² Therefore, the primary issue pertaining to the federal government’s measures is limitation on States’ powers to levy taxes, including their autonomy over tax rates and holidays in their exclusive jurisdictions.

One of the peculiar features of the investment incentive regulation is the extension of tax-exemption periods (duration of tax-holidays) for investments located in underdeveloped Regions

²⁰⁰Assefa, (2012), supra note 12, P. 447

²⁰¹ Ronald Watts, Decentralization and Recentralization: Recent Developments in Russian Fiscal Federalism, Working Paper (2), Institute of Intergovernmental Relations, Queen’s University, Kingston, 2007, Pp.3&4

²⁰² For instance, there is 2-7 years exemption from agricultural income tax (which is exclusive jurisdiction of states) if the investor exports 50 percent of his/her product or supplies 75 percent of his/her product as production input to an exporter. (Council of Ministers Regulations No. 84/2003)

States.²⁰³ This difference in the period of tax-holidays among different States could be justified with the principle of equitable redistribution of resources.

The other issue is related with the principle of adverse impact. The principle of adverse impact imposes a limitation up on both tiers of the government from exercising their powers of taxation in such a way that detriments or adversely affects the powers of the other.²⁰⁴ It should be noted that this principle has a constitutional guarantee under the Ethiopian federal system, as per article 100/2 of the FDRE Constitution that has expressly set this limitation on both the federal and state governments.

Whatever justifications might be given, the federal government's statutory limitations on States' tax autonomy would negatively affect the volume of their own-source revenue. At least in the short run, exemptions on dominant tax sources of regional revenue amounts to decline in their revenue size. Likewise, States' role in setting or varying agricultural land use fees is undermined after the federal government is "delegated". Moreover, there is a financial implication of delegation in the Ethiopian federalism since States are obliged to cover the costs of administering the "delegated" function.²⁰⁵

Changes in the administration of agricultural land and statutory tax exemptions for investors are, therefore, measures that overlooked the principle of adverse impact. Important to note that as land use fee is one of the dominant tax sources of States, federal tax exemption law covered some of the principal sources of subnational taxation.²⁰⁶

²⁰³ Article 4/7, Council Of Ministers Regulations On Investment Incentives And Investment Areas Reserved For Domestic Investors, (Council Of Ministers Regulations No. 84/2003),

²⁰⁴Taddese Lencho, The Ethiopian Tax System: Excesses and Gaps, Michigan State International Law Review, Vol. 20:2, 328, P. 346

²⁰⁵Article 94/1 of the FDRE Constitution

²⁰⁶ In 2003 FY, rural land use fee amounts to 4.4% of the total regional tax revenue while agricultural income tax comprises of 4.5% of tax revenues. These figures are rising to 6.05% & 5.25%, respectively during 2006/07-2010/11 FYs as it is depicted in the data computed from MoFED. (See, The New Budget Formula (2007)); and also, Tegegne

Similarly, recentralization of the power to administer agricultural investment land has drastically limited the roles of tax competition among States. States' autonomy over agricultural income taxes and land use fees could make them engage in tax competitions. At the same time, relative tax autonomy could also be one way of attracting investments and maximize revenue.

Recentralizing land administration, and by making itself as the “only entity” to deal with investors (of large-scale land investments); the federal government may aspire to reduce the prevalence of rent-seeking and corruption. However, if the federal acts are politically motivated then it would amount to discrimination as it would ultimately be jeopardize investment flows and proportional development of States. Unfortunately, there are cases by which the federal government has been allegedly influenced investment decisions of investors with its direct access to order or control the nationwide flows of agricultural investments.²⁰⁷

First of all, this kind of act appears to be against the often-cited principles of decentralization, including Tiebout's theory of consumers “choice by foot”. Moreover, the federal government's politically motivated decisions on mobilization of private and public investments are against the constitutional limitations of ‘non discrimination’ and/or ‘adverse impact’. Controlling the movement of private investments, the federal government has restrained States' power of attracting investors and their opportunity of maximizing their revenue from agricultural income tax and other tax bases.²⁰⁸

Gebre-Egziabher, ‘Decentralization and Regional and Local Development’, in Dessalegn Rahmato et al. (eds.), *Reflections on Development in Ethiopia: New Trends, Sustainability and Challenges*, Forum of Social Studies, Addis Ababa, 2014), P. 138

²⁰⁷There are a number of reports on federal government's direct involvement in decisions of investors including where to invest. For instance an investor who asked for an agricultural land in Benishangul-Gumuz Region was “taken around” by the federal government “to look at different land areas”. The Oakland Institute, supra note 196, P. 28

²⁰⁸ Large-scale farming, particularly labour-intensive ones, could increase employment rates and business activities in the area; this in turn, enhances the revenue capacity of the region.

Similar measures were taken and exactly the same challenge was posed on subnational governments in other federations, which had once been developmental. Tax harmonization measures were criticized in India mainly since it has constrained states from mobilizing additional revenue needed for financing the Five Year Plans.²⁰⁹

By the same token, it was only when the 1988 Constitution was adopted that the DS-oriented fiscal policy measures of the federal government came in to end in the Brazilian federal system. Induced by subnational governments, the Constitution had abolished the federal government's power to grant exemptions state and municipal taxes.²¹⁰

4.2.2. Big-sized Government and Revenue Recentralization in Ethiopia

I. Introduction

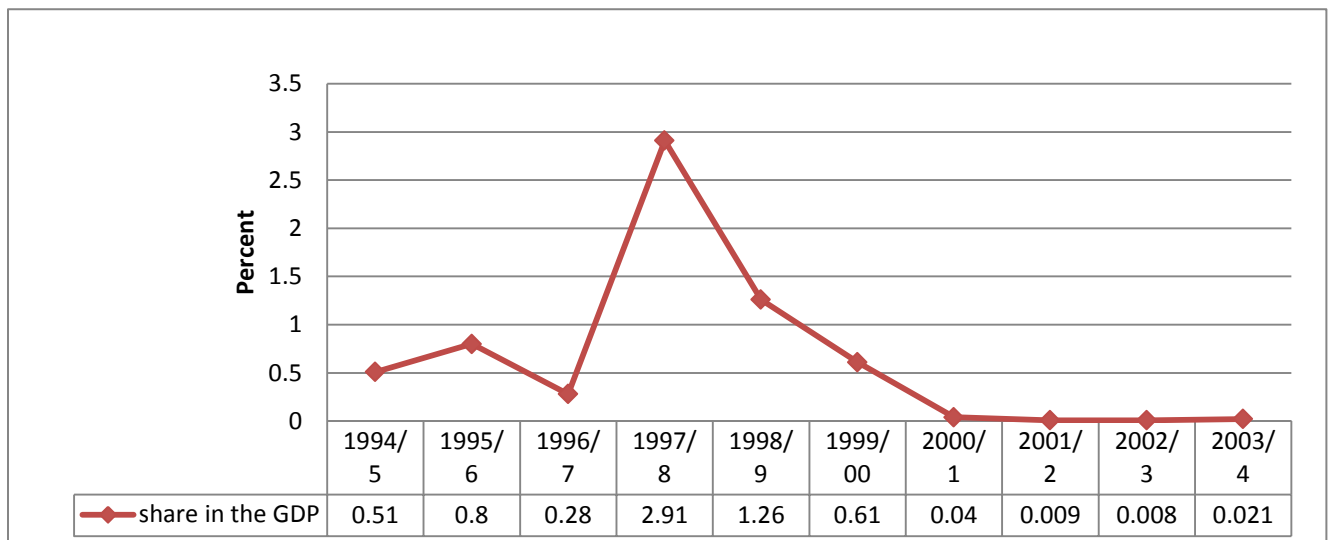
At the demise of the socialist regime, market economy was declared by the Transitional Government of Ethiopia. Ever since that time, the Ethiopian government was able to make comprehensive measures of market economy including measures of privatizing state-owned enterprises. Moreover, external factors, particularly the Structural Adjustment Programs (SAP), had attributed for the aggressive course of privatization in the country. Making loans and donations conditional up on liberalization measures, the World Bank and International Monetary Fund were able to 'twist the hands' of Least Developing Countries (LDCs) making loans and donations conditional including Ethiopia.

²⁰⁹R.Srinivasan, *supra* note 98, p. 12

²¹⁰Mônica Mora and Ricardo Varsano, Fiscal Decentralization and Subnational Fiscal Autonomy in Brazil: Some Facts of the Nineties, *Instituto De Pesquisa Econômica Aplicada, Texto Para Discussão* No.854, 2001, p.3

Nonetheless, the government was not ‘comfortable’ with the economic reform programs initiated with IMF and WB, and started reacting against the reform initiatives since the late 90s.²¹¹ Opposing the central doctrine of neoliberalism, the Ethiopian government chose a “slower and moderated strategy” of privatization early before the DS of Ethiopia is declared. It is known that the opponents of neoliberalism advise that aggressive measures of privatization in non-competitive environment might possibly be devastating.²¹²

Graph 4:1: Privatization Proceed as Percentage Share of the GDP



Sources: The Ethiopian Privatization Agency (2004) and World Bank (2004)

As it is depicted in the figure, the Ethiopian economy has started to witness its worst performances of privatization, particularly since 2001/02. This was the lowest even compared

²¹¹ Speech by HE Meles Zenawi, supra note 14

²¹² Brian Snowdon, “Redefining the Role of the State”, an interview with Joseph Stieglitz on building a ‘post-Washington consensus’, World Economics, Vol. 2, No. 3. July–September 2001, P. 58

with poorly performing countries.²¹³ The share of privatization revenues from the country's GDP fall from 2.91 and 1.26 in 1997/98 and 1998/99 to 0.009 and 0.008 in 2001/02 and 2002/03.

II. Public Enterprises and DS in Ethiopia: Implications on Fiscal Imbalance

Big-sized governments or the DS paradigm in general, are usually perceived as anti-decentralization measures since economic decentralization (privatization) is included under its broader interpretation. To put it differently, “state activism” in a DS contradicts with the neoliberal perception of decentralization that juxtaposes decentralization with small-sized governments.

Therefore, Ethiopia has started to witness a policy shift that was geared against neoliberalism through ‘delaying and preventing the introduction of reforms that would reduce the state to the proverbial night watchman.’²¹⁴ According to the 2009/10 data from Ethiopian Privatization and Public Enterprises Agency (PPESA), there are more than eighty large public enterprises operating in different sectors including agriculture, manufacturing, construction, transport, hotel, and tourism.²¹⁵

Some of these enterprises that the government is reluctant to privatize are romanticized as “milking cows” because of the huge amount of tax and nontax revenue collected. On the other hand, these enterprises have significant contributions for the existing financial centralization in the Ethiopian federal arrangement.

First, since these enterprises are owned by the federal government, the latter has been able to collect the lion share of the total non-tax revenue of the country. At the same time, these

²¹³JesiahSelvam, A. Meenakshisundararajan and T. Iyappan, Privatization and Capital Accumulation: Empirical Evidences from Ethiopia, AJEP Vol. 12, No. I, June 2005, P. 71

²¹⁴Speech by HE Meles Zenawi, supra note 14

²¹⁵ As cited in Ethiopia: Macroeconomic Handbook 2011/12, Access Capital Research, December 30, 2011, P. 59

enterprises are significant sources of federal taxes since the Constitution assigned both levels of government to levy and collect (most of) taxes on their respective enterprises.²¹⁶ Therefore, state governments are barely benefited from public enterprises in the contemporary arrangement. In other words, regional governments collect almost nothing in the form of proceeds (tax or nontax revenue) from public enterprises.

It is known that other federal systems had, or they still have, huge public enterprises in their attempts to realize economic growth through policies of developmentalism. What makes the Ethiopian case different is that the contribution or effect of these enterprises on the degree of fiscal imbalance or financial recentralization. Unlike the Ethiopian federal system, public enterprises are perceived for their productive contributions in subnational finance. For instance, state governments were able to own public enterprises in the Brazilian federal system. Due to this, the proceeds of these enterprises had contributed a lot in financing subnational expenditure needs in the late 70s.²¹⁷

It appears to be the commitment of the federal government that matters since privatization creates a slight opportunity of widening the scope of regional revenue sources and capacities without making constitutional amendments. That is why scholars recommend privatizing the state-owned public enterprises as a solution to address the existing vertical imbalance since it might help increase the regional tax base.²¹⁸

For instance, through privatization, the power to levy tax on incomes of employees of the enterprise, which was under federal government's exclusive area of taxation, would automatically shift to States.²¹⁹ Moreover, the process of privatization of public enterprises

²¹⁶Except income from remainders of employees which is the state power (Arts. 96(3)& 97(7) of the FDRE Constitution)

²¹⁷Mônica Mora and Ricardo Varsano, *supra* note 210, P. 2

²¹⁸Lovise Aalen, *Ethnic Federalism in a Dominant Party State: The Ethiopian Experience 1991-2000*, Report R 2002: 2Chr. Michelson Institute Development Studies and Human Rights, P.75

²¹⁹Article 97(1) of the FDRE Constitution

would enhance the volume of shared-revenue of regional governments since company profit tax, sales tax and tax on dividends fall under areas of joint taxation.²²⁰

Some years back, it is palatable to doubt the relevance of article 98/2 of the Constitution that states shared jurisdiction of public enterprises that are jointly established by the federal and state governments. This is because there was no jointly established enterprise, and the federal government was ‘aggressively engaged in privatizing state-owned enterprises rather than establishing new public enterprises’.²²¹

Unfortunately, the political economy of developmental state has pushed the government to work on the otherwise. The need for an active catalyst state that takes the leading place in the industrial transformation has resulted in the establishment of state-owned enterprises. Thus, the government is making massive spending on the expansion of the existing enterprises and the establishment of new state-owned chemical and engineering companies.²²²

Despite its commitment to privatize most of the public enterprises, the government is still reluctant to privatize some of the enterprises that could have been significant revenue sources for regional states. For the realization of an effective DS, the government should be able to make excessive spending particularly on infrastructural developments. As it is making huge public spending, some of the enterprises are the significant sources to cover the costs of its expenditures.

It has to be noted that one needs to be optimist to expect significant changes in the contributions of privatization bearing in mind the current practice that shows the drastic limitations of regional

²²⁰ Though Sales tax is not mentioned in the English version, the Amharic version, which prevails in cases of inconsistencies, included it. See, article 98/2 cum article 106. Excise tax is omitted in both versions despite its existence in practices, which ‘seems to be a slip of pen’. See, Solomon, (2008), p. 142

²²¹ Solomon,(2008), supra note 32,p. 142

²²²See, The FDRE Growth and Transformation Plan (2010/11-2014/15), Volume I: Main Text, (Ministry of Finance and Economic Development, Nov. 2010)

states in the administration of such kind of tax sources. In spite of the possible regional variations and huge discrepancies between the potential and actual revenues, no doubt that privatization enhances the revenue capacity of regional states.

4.2.3. Impacts of the DS Paradigm on Fiscal Decentralization

Since 2001, some shifts were witnessed two decades old Ethiopian federalism with respect to the actual practice allocated powers. This period might be named as the “era of recentralization” where the federal government has begun employing different measures that overlooked subnational autonomy. Or, it was the time when States’ started to “surrender” their constitutionally dictated powers.

With the adoption of the DS paradigm, “big-sized government” become the fundamental trait of the Ethiopian government. Government size measures governments’ total spending as percentage of the total national GDP. ²²³ The Ethiopian DS is characterized by large-scale public investments with a particular emphasis and excessive public spending on capital expenditures. On average, government spending made up 19.5 % of the GDP throughout the FYs from 2005/06 to 2010/11. ²²⁴ Similarly, the 2012/13 & 2013/14 FYs data prepared by the Ethiopian Investment Agency reveals that the share of public investments is still significant accounting for around 31% of the total investment capital. ²²⁵

Similarly, large-scale public expenditures were planned to play a vital role in the economy during the GTP period. Because of this, public spending comprises of 41% of the total GDP of the country during this period. (See the table 4.2 below) Moreover, the largest share of

²²³Luiz R. De Mello Jr Fiscal Decentralization and Intergovernmental Fiscal Relations: A Cross-Country Analysis, World Development, Vol. 28, No. 2, pp. 365-380), 2000

²²⁴Access Capital, supra note 215, P. 8

²²⁵ National Bank of Ethiopia Quarterly Bulletin, Fourth Quarter 2013/14 Fiscal Year Series, Volume 30 No. 4, (Addis Ababa, 2014), P. 101

government spending goes to capital expenditures, which is expected to cover around 60% of the total government expenditures. This makes Ethiopia on the top of the other African countries where the average share of capital expenditure is around 25 percent.²²⁶

Table 4.2: Trends of Public Spending in Ethiopia (2011-15)

| | | | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2010-15 |
|----------------------------------|---------------------|--|---------|---------|---------|---------|---------|
| Public Sector Spending | Off-budget Spending | | 29% | 23% | 15% | 8% | 19% |
| | Budgetary Spending | | 20% | 21% | 22% | 24% | 22% |
| | Total | | 49% | 45% | 37% | 32% | 41% |
| Capital (Budgetary) Expenditures | | | 12% | 12% | 13% | 14% | 13% |

Source: Growth and Transformation Plan (2010/11-2014/15)

Thus, the GTP period is characterized by the steady growth of public spending, measured as the ratio of the total GDP of the country. Increasing public spending entails, among other things, procedures that are designed to enhance the revenue capacity of the government including tax revenues. Therefore, the Ethiopian government has been working on boosting its revenue capacity so as to cover the costs of public-sector expenditures.

The relatively large size of the government's revenue and expenditure is thus an evidence for existence of big-sized government in Ethiopia. On the other hand, big-sized government, according to the public-choice school of thought, is antagonistic to decentralization. In other words, measures that are aimed at boosting the revenue capacities of governments as well as increasing the shares of public spending are perceived as moves of 'recentralization'.

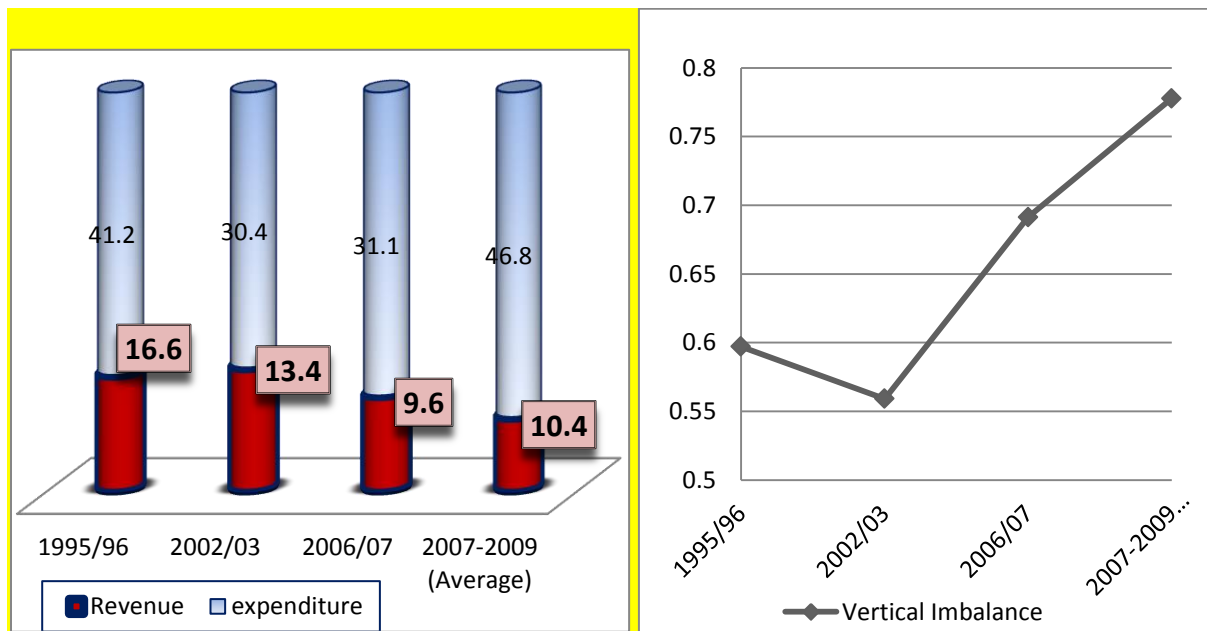
Therefore, the move toward the DS of Ethiopia, particularly since 2006, could be considered as a measure that is directed against the early promises of decentralization in the polity. In other words, the measures taken by the federal government could be considered as instruments of

²²⁶Access Capital, supra note, 215, Pp. 3&10

recentralization. This could be one of the manifestations that revealed the Ethiopian government’s encounter with the neoliberal advocates. Big-sized government in the contemporary Ethiopia refutes neoliberal’s perception of decentralization, while its resistance to economic liberalization is, in general, a move against neoliberalism.

By the same token, States’ share in the aggregate national revenue has been drastically decreasing since 2001 while their shares of total expenditure remain constant. This trend had attributed for the ever-increasing vertical fiscal imbalance in the federal system especially since 2006. Though vertical imbalance had always been an issue to worry about in the federation, the degree has been growing overtime.

Graph 4.3: Trends of Aggregate Regional Revenue and Expenditure as a Percentage of the Total National Revenue and Expenditure and Vertical Imbalance



Source: MoFED, WB

No doubt that the post-2001 measures of the federal government had exacerbated the problem of fiscal imbalance. As it has been stated before, some of the federal governments’ measures have significantly limited subnational tax autonomy thereby reducing the States’ aggregate revenue

volume. On the other hand, the growth of government-owned public enterprises had been significantly contributing for the federal government being both tax and non-tax revenue sources.

Therefore, fiscal measures that are motivated by the DS theory have multifaceted implications on the degree of financial recentralization. These measures not only extended the powers of the federal government, but also constrained subnational revenue autonomy.

Expanding the federal government's revenue capacity and drastically limiting subnational revenue powers on the other hand, these measures had significantly contributed for the existing degree of vertical imbalance. Generally, the degree of vertical imbalance in the federal system is relatively high, even when it is compared with the degree of imbalance that existed in other federations at their respective eras of developmentalism.

4.2.4. Developmentalism and “Sharing the Pie”²²⁷

The principle mandating both layers of to have equitable shares of the national revenue is recognized by the federal covenant. Article 95 encompassed this principle, albeit vaguely, which requires ‘sharing the pie’ among the tiers of the government taking the federal arrangement in to account. No doubt that this provision is referring to vertical transfers. The reason is that this provision would not be discerned as citing own-source taxes since the Constitution has allocated taxation powers.

Unlike many other federal covenants, however, the FDRE Constitution failed to set a fixed number, either for the base or the ceiling of the grant pool. In the absence of such a rule specifying the minimum amount, it is not clear about what amounts to the “right” share of regional states from national revenue.

Consequently, the percentage shares of grants are unpredictably varying throughout the years as it could be easily observed at the graph. For instance, grants to regional governments comprise

²²⁷This idiom is taken from the cover page of federations, Vol.6, No.1, Feb/March, 2007

around 30.9% of the federal government's total revenue in three fiscal years from 2000-02. However, its share in the total revenue was declined to be 26.9% from 2011-13. (See graph 4.4) The results would not be as "good" as this if we interpret the principle of "national revenue sharing" broadly. It is clear that regional governments' revenue share would be drastically reduced if this principle is perceived in such a way that it embraces their respective shares' of own-source revenue. Adding up the average regional tax revenues of 15.6% during 2000-02 FYs with the 30.9% block grant would make the subnational governments' revenue share rise to 46.5%. Nevertheless, the eventual decrease of subnational tax-revenue in 2006 (9 %) would shrink subnational governments' share in total revenue to be no more than 36.9 %.

It had been stated that, the process of determining the grant pool in the Ethiopian federal system involves deciding the costs of "non-discretionary" expenditures of federal government. Then, there would be a procedure of setting the minimum expenditures of States based on the national plans.²²⁸

One has to note that, "non discretionary" expenditures, such as salaries of employees, are included under recurrent budgets. Whereas, the percentage shares of federal recurrent expenditures are almost constant throughout the GTP period. Recurrent expenditure, which was 8.4% of the GDP in 2009/10, would be 8.9% while federal government's capital expenditures would rise from 10.3% to 12.6% in the period.²²⁹

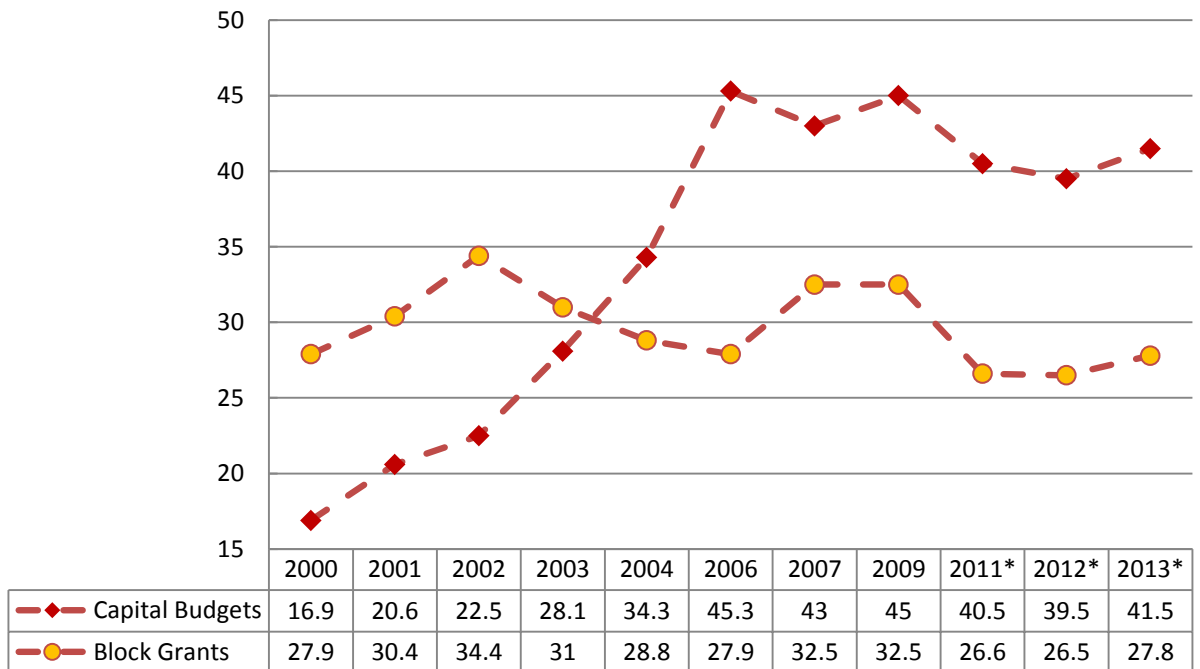
Hence, it is plausible to consider the federal recurrent budget as a constant variable. Consequently, studying trends of the grant pool entails a close look at the correlation between federal capital budgets and block grants. Therefore, it is possible to scrutinize trends of federal

²²⁸ Getachew Mengeste, Intergovernmental Fiscal Transfers In Ethiopia: Challenges and Some Options (A Comparative Study), Addis Ababa University, School of Graduate Studies, School of Law, (Unpublished), Pp. 98&99

²²⁹ The FDRE Growth and Transformation Plan (2010/11-2014/15), Volume I: Main Text, (Ministry of Finance and Economic Development, Nov. 2010), P. 33

and State governments' respective share from the national total revenue through assessment of size of the block grants.

Graph 4.4 Trends in the Percentage Shares of Block Grants and Federal Capital Expenditures to the Federal Budget (2000-2013)



* Excluding funds Transferred in the form of MDG grants to Regions

Source: Federal Budget Proclamations of the Respective Fiscal Years

With the view of meeting the needs of a DS, huge amount of federal budget is allocated for capital expenditures. The Ethiopian fiscal federalism has been witnessing dramatic increases of capital expenditures in the federal budget. Since 2001 the federal capital budgets relative share from the total had been alarmingly increasing. Of course, its 16.9% share in 2000 FY had been almost tripled, and comprises 45% of the total budget in 2009 FY.

Conversely, block grants-total budget ratio had been falling compared with that of the federal government's total expenditures (federal capital and recurrent budgets). Sadly, the situation went from bad to worse since the 34.4% share in 2002/03 fiscal year has reduced to cover only less than 27% in 2011/12 and 2012/13 fiscal years.(Graph 4.4) The trend continued being the same

in 2014 FY whereby capital expenditures of the federal government increased by 24.6 percent while there was a 10.6 percent decline registered on the side of regional transfers.²³⁰

It is clear that one of the factors that have adversely affected the States' share of the grant pool is the alarming increase of capital expenditures of the federal government. In other words, there would be inevitable decrease in the grant pool as long as there is increase in the federal government's expenditure. Therefore, there are possibilities by which the estimated costs of States could be undercut by the federal government.

One of the paradoxes of a DS is, thus, while subnational governments are expected to cover significant shares of expenditures, federal governments tend to reduce the size of funds transferred to subnational governments. Usually, there could be a tendency of cuts from the total pool of federal transfers because it also needs huge finance to cover its expenditure needs.

For instance, the 1968 cut of transfers in the Brazilian federalism had resulted in a reduction of its size almost by half.²³¹ By the same token, investment plans, which exceeded the actual or available savings, led to cuts in the total pool transferred to states in the Indian planned economy. This had forced states to introduce distortive taxes whereby subnational governments strive to cover their expenditure needs by increasing the tax burdens of citizens.²³² This kind of situation is peculiar to developing and planned economies where national plans are too elastic than it could be covered with the available fund.

²³⁰ National Bank of Ethiopia Quarterly Bulletin, Fourth Quarter 2013/14 Fiscal Year Series, Volume 30 No. 4, (Addis Ababa, 2014), P. 97

²³¹ Mônica Mora and Ricardo Varsano, supra note 210, P. 2

²³² Ehtisham Ahmad and Giorgio Brosio, 'Introduction: fiscal federalism – a review of developments in the literature and policy', in Ehtisham Ahmad and Giorgio Brosio, (eds.), *Handbook of Fiscal Federalism*, Edward Elgar Publishing Limited, UK, USA, 2006, P.16

4.3. The Developmental State and Spending Autonomy of Regions

Spending autonomy of regional states is directly related with their discretion to appropriate their finance. In the study of spending autonomy of subnational states, it is necessary to look in to the constitutional stipulations on the powers to set and execute their priorities as well as statutory and financial limitations on the autonomy to spend.

Federations that are treated as ‘highly decentralized’, from the angles of revenue generation, might not always be equated with decentralized in bestowing high degree of spending autonomies. For instance, there are cases whereby subnational governments might be constrained from appropriation of their revenue through national regulations that oblige mandatory spending of significant share of revenue on particular areas.

The Brazilian federal system could be a best example illustrating this idea. Even though it could be treated as highly decentralized since own-tax revenue comprises of around 77 % of total States’ revenues (adding Shared Revenues raises the number to 95%), subnational governments do not have discretion over 45% of it because of national statutory limitations.²³³

To the contrary, some of the federal systems that are characterized by over-centralized revenue powers might have constitutional stipulations that oblige federal governments to employ “regionally differentiated policies”. Albeit it is perceived as centralized, the similar constitutional stipulation in the Australian federation bestowed subnational governments with a considerable degree of spending autonomy.²³⁴

Regional budgeting in Ethiopia involves the process of setting regional priorities and appropriation. However, since State governments are highly rely on federal grants, the process of

²³³Gomes, supra note 65 Pp. 12&13

²³⁴Anwar Shah, supra note 99, p. 374

budgeting basically embraces the processes of disbursing the regional revenue (mainly transferred through grant), among different sectors as well as subregional administrations.

Therefore, the study of subnational spending autonomy should be approached from the angles of their finance and their independence in preparation and execution of their budgets. Particularly, the primary issue is related with total finance available at regional treasuries. This necessitates looking at the nature/type of regional finances through making distinctions among own-source and shared revenues as well as grants.

In cases where the States are not able to cover costs of non-discretionary recurrent budgets, the nexus between federal grants and regional autonomy is more complex than the traditional perceptions about the possible impacts of grants. In the study of impacts of vertical transfers on subnational autonomy, the conventional perception is emphasizing on nature of federal grants than the size or shares' of transfers. For instance, block grants allegedly confer a better degree of autonomy than conditional grants, which are entangled with strings on the process of appropriating funds.²³⁵

Despite the fact that block grant took the lion share of vertical transfers in the Ethiopian federal system, it could not be possible to rule out its impacts on regional autonomy of spending. One of such impacts is the possibility of making States to feel obliged to go in line with federal policies in spite of the “unconditional” nature of such grant.²³⁶

Be it conditional or unconditional, or whether it is automatic or discretionary, reliance of States on vertical transfers has strong correlations with their autonomy. Likewise, the continuing increases witnessed in the degree of vertical imbalance in the Ethiopian federal system have been making States be at the mercy of federal transfers to cover the expenditure costs at regional level. Regardless of the natures or characters of these grants, the degree of reliance on vertical transfers

²³⁵Gomes, supra note 65, P. 8

²³⁶Lovise Aalen, supra note 218, P. 78

had been creating “conformist” States, which could not deviate from federal initiations or policies.

It should be noted that the federal government has the power to audit and inspect the appropriation of the finance that had been transferred as conditional or unconditional grants. While the power to audit might be justified by the principles of fiscal prudence and accountability, the current financial administration law goes beyond this. The law stipulated that there is a possibility for the federal government to administer regional budget if it is delegated by the latter.²³⁷

4.3.1. Socio-economic Policymaking and Planning Autonomy of Regions in the “Era of Developmentalism”

I. Introduction

Though it might not always be justified by Oates’ ‘laboratory federalism’, no one thinks of a federal system without a relative autonomy of subnational governments in setting their own priorities. Federalism accepts, perhaps urges, the powers of the federal government to set national socio-economic plans and minimum standards. Yet, it is equally important to preserve some space for subnational discretion and flexibility. Even in the absence of significant powers of legislation, regional governments are usually bestowed with constitutional guarantees for innovative administration of federal legislations.

As it is observed from the experiences of federal systems, economic affairs usually fall under shared powers of both tiers. Apart from practical difficulties, this measure is primarily aimed at balancing two competing interests. On the one hand, there is a need for protecting states’

²³⁷ Article 68/4 of the Federal Government of Ethiopia Financial Administration Proclamation, Proclamation No. 648/2009

autonomy to design policies based on their particular interests and their cultural distinctiveness. On the other hand, the need for ensuring free trade and development, calls for federal jurisdiction over the matter.

In most of the federations, social and economic matters are usually treated as matters of concurrency, which remain at the hands of states only as far as it is not taken over by the federal government. In practice, such powers are recentralized/ federalized, or had been subjected to measures of unitarilization.

Therefore, it is possible to argue that the Ethiopian federal system, by its design, is relatively decentralized. In the absence of supremacy clause, no doubt that the Constitution bestowed a considerable autonomy for States to devise and implement development and socioeconomic policies and plans. Uniformity of policies in the one hand, and the necessity of preserving regional autonomy of policymaking on the other hand, call for serious consideration and thorough study.

II. Building a DS and National Policymaking and Centralized Planning in Ethiopia

As a developmental state is, “neither socialist ... nor free-market ...but something different: the plan-rational capitalist developmental state ... [which links] interventionism with rapid economic growth”,²³⁸ it is characterized by a political economy of growth with the “comprehensive economic development plans, long-term goals, and projections for the entire economy”.²³⁹ Thus, there is always a danger of too detailed national policy documents that might shrink the space for regional appreciations. The same problem exists in the Ethiopian federal practice where the

²³⁸ Woo-cummings, supra note 79, Pp. 1&2

²³⁹ Kim, supra note 21, P. 231

national policies are too comprehensive that makes one wonder what is left for regional governments.

Making national policies “general” so as to let States devise specific socioeconomic development policies based on local preferences and specific circumstances is the only way out. The basic question to be raised here is how “general” federal policies should be, so as to strike the balance between uniformity of regional appreciation? Most importantly, could it be possible for regional states to adopt different narratives and paths of development in the contemporary ideology of the Ethiopian development?

When asked about the issue, the federal government officials argued for the practical possibility of accommodating both interests. The following statement could be a steppingstone to study the position of the federal government on the matter.

*What the federal government does is set the national framework for development... [W]ithin that common framework, the various regions are free to devise their own development strategies.
(Emphasis added)*

Meles Zenawi,²⁴⁰

The above statement could be understood as an argument that strengthens the notion of framework legislation, where the federal government policies and strategies should encompass general principles and standards that are applicable nationwide.

However, deep scrutiny of it shows the federal government’s stand on the matter is not sound in principle and, it does not convey the actual practice, either. One could say, even at the highest government official level, the contemporary understanding on national development policies and subnational autonomy is in a manner that compromises the federal covenant.

²⁴⁰ Interview with Meles Zenawi, the late Prime Minister of Ethiopia, Federations, Dec.2010/Jan 2011, P.17

The primary flaw of the above statement is associated with the conceptual and practical differences that emanates from the meanings of the term policy and strategy in political science. Generally, strategies are perceived as detailed documents designed for the implementations policies. If the above statement is examined in light with this definition, the policy related matters are believed to be federal matters whereas the autonomy of regional states is lessened to freedom ‘to devise their own development strategies.’

However, this interpretation doesn’t seem the spirit of the speech since it is known that apart from policies, the federal government has been formulating strategies and instruments even in the areas where it has shared power.²⁴¹ Most of all, it violates the federal Constitution that empowers and mandates regional governments to devise their socioeconomic development “policies and strategies”²⁴².

The other, perhaps more constructive interpretation of allocation of socioeconomic policymaking powers in the Ethiopian federation is approaching it ‘in relation to the contents of power of the respective governments.’²⁴³ This is to mean that, the federal government issues policies concerning matters under its jurisdiction and so do the states. For instance, federal policies cover matters involving tertiary education²⁴⁴ while the remaining, i.e. from elementary to technical educations, should be covered by regional policies.

How much convincing it might seem, this kind of division of power barely exists in the contemporary Ethiopian federal practice. More importantly, the DS, in principle, is not suited for

²⁴¹ For example, the Rural Development Policies, Strategies and Instruments of the Government of FDRE (2001), The Ethiopian Industrial Development Strategy (2002)

²⁴² Article 52/2/C of the FDRE Constitution

²⁴³ Solomon, p. 71

²⁴⁴ The trend had been changed with the coming in to force of the Revised Higher Education Proclamation, whereby States are bestowed with the power to establish higher education institutions and involve in tertiary educations. See Higher Education Proclamation No. 650/2009

multi-level decision-making and policy variations. For instance, education is considered as the founding brick as well as the pillar to any developmental state. While primary education should be directed towards achieving universal literacy and creating nationalism, technical and vocational trainings are designed to realize industrial transformations. Similarly, producing skilled and professional labor required for the civil service and industries as well as research and technology exchange should be the missions of tertiary education.

On the move toward a DS, the federal government prepared a number of policy documents on different socioeconomic matters including education. The contents of these documents are not limited to the federal matters only. The documents rather covered matters that fall under the jurisdictions of regional states including primary and secondary education as well as technical and vocational trainings.²⁴⁵

Of course, the federal government has the power has the power to set national standards for education whereby the contemporary practices of centralized administrations of quality assurance and certifications could be justified.²⁴⁶

The issue to worry about allocated powers versus the practice of education policymaking is that the documents prepared by the federal government could hardly be treated as national standards or frameworks. Being too detailed and comprehensive, these documents had barely left a “substantial” place for regional governments thereby constraining the notion of subnational flexibility.

In general, a close look at the existing practice illustrates the tendency of recentralizing policy related matters in the Ethiopian federal system. Foremost, the regional governments are not yet

²⁴⁵ The Education and Training Policy and its Implementation, Ministry of Education, (Mega Printing Press, Addis Ababa, 2002) (Amharic)

²⁴⁶ Graduates of technical and vocational centers and colleges are expected to sit for exams prepared and administered by the federally organized Centers of Competence (COC). See, Proclamation to Provide for the Organization of a Technical and Vocational Education and Training System(Proclamation No. 391/2004); Art 51/3 of the FDRE Constitution

started to exercise their powers of independently devising socioeconomic policies and strategies. Rather, they had been simply adopting and implementing national socio-economic and developmental policies and strategies after being approved by the central committee of the ruling coalition.

The next issue is related with the absence of rules that limit the comprehensiveness or depth of federal policies and strategies. Particularly, there is a danger emanating from the nature of DS that could not be viable without detailed policy documents. The FDRE Constitution does not stipulate clear rules and limitations on the policymaking powers of the federal government.

Unlike the case in the German federalism, there are no statutory limitations or precedents from constitutional interpretations on the “rule of essentiality” or on the exercise of framework powers in general. Interestingly, the 2006 constitutional amendment ended the notion of framework powers in the German federalism. This reform was made mainly because of the increased compliments of the Land governments claiming that the federal government legislations were detailed and it was interpreting the notion of essentiality too broadly.²⁴⁷

No wonder that the contemporary practice of policymaking in the Ethiopian federation is eroding the constitutional provisions and the basic tenants of federalism. The paramount issue at stake however, should be whether it is possible to build a developmental state where the constituent units have the power to devise their own policies. Or, could the federal government be able to set and implement national policy preferences without compromising the autonomy of the constituent units is an issue to worry about.

Furthermore, the role of the federal government is not limited to issuing development policies and strategies, but also national economic plans. As of 2001, planning became the salient feature of the Ethiopian economy. This begun with the Sustainable Development and Poverty Reduction Program (SDPRP) of 2002/03–2004/05, designed mainly for the realization of agricultural

²⁴⁷ Carolyn Moore, Wade Jacoby & Arthur B. Gunlicks (2008): German Federalism in Transition?, German Politics, 17:4, 393-407, p. 398

development and poverty reduction. Realizing the flaws of its predecessor, A Plan for Accelerated and Sustained Development to End Poverty (PASDEP) of 2005/06–2009/10, was designed with a broader scope. Currently, the ambitious Growth and Transformation Plan (GTP) of 2010/11-2014/15 had been aggressively implemented in Ethiopia.

The idea of economic planning in federal arrangements had been debated fearing its possible impacts on the overall functioning of the federal system. Particularly, the issues in relation to scope or the breadth and depth of these plans as well as the area left for the appreciation of subnational governments should be scrutinized.

Not surprisingly it was the federal government's obsession for uniform implementation of the priorities of a DS that gave birth to various regulatory and financial measures. However, one could wonder whether scopes of federal policies could be extended to exclusive spending jurisdictions of States, and whether States are obliged to implement priorities of the federal government at the cost of local preferences and priorities.

Primarily, the GTP presupposed uniform applications of national policies and programs, as well as the plan itself, throughout the nation. Therefore, it is not designed in the way that accommodates subnational diversities in preferences and priorities or policies and plans. Moreover, the plan is based on wrong assumptions with respect to its growth projections and calculation of the expenditures required. Particularly, there is an issue to worry regarding the projections on the matters, which are allocated under the shared jurisdictions of both tiers. In the process of setting plans of growths in coverage/ ratios and calculation of their respective expenditure costs, there are tacit assumptions, which are limited to assuming the extensive implementations of national policies by States. Rather, it appears to presume the existence of uniform methods and similar costs of executions at different regions.

Contrary to political and scholarly arguments²⁴⁸, Ethiopia has continued to be cohesive state similar to the Asian developmental states. Applicable throughout the country, the policy documents of the federal government rigidly dictate the goals, priorities and strategies of building the developmental state. Looking at these documents, one can easily understand how it could be difficult for regional states to deviate from the national policies and strategies as well as economic planning.

So far, regional governments have been adopting and aggressively implementing socioeconomic development programs of the federal government. This includes construction of cobblestone roads in the area of infrastructure development and the development of small and micro enterprises as part of the industrial policy.

Sadly, some of the federal government initiatives could have been successful, hadn't been uniformly adopted and implemented. Apart from the political principle of self-rule, the unsuccessful but costly national programs, the water preservation program, had overlooked idea of economies of scale.

If the federal government centralized policymaking and planning powers and, if the discretion of regional governments is limited to devise specific strategies (to implement national policies and strategies) could never be equated with the legislative autonomy of subnational units in the case of framework powers. Rather, it is more similar with the notion of concurrent powers, like in Germany, that guarantee flexibility of states while administering federal legislations, after the matters are federalized. In its two decades old federal practice, the federal government is playing a vital role, by taking supremacy in determining the indices of social and economic developments of Ethiopia.

²⁴⁸ See, Aaron Tesfaye (2010), and Meles Zenawi's interview, supra note 240

4.3.2. National Plans and Unfunded Mandates

I. Unfunded or Partially Funded Mandates and Subnational Autonomy

In the study of how “unfunded” or “partially-funded” federal mandates could influence subnational spending autonomy, one would probably cite the American federal experience. It was the era of President Ronald Reagan (1981-89), which had witnessed a shift from fiscal to regulatory tools whereby federal regulations shape subnational spending and allocation of resources. Of course, it was the period that marked the end of the majority of federally-sponsored programs by eroding the notion of "no money, no mandate".²⁴⁹

Unfunded mandates of the federal government coerce States either to increase tax burdens or to give-up their priorities in favor of federal policies. Similarly, there is a critical issue raised in relation to the partially funded federal mandates whereby state and local governments cover some shares of the cost whereas the rest is covered by the federal grants, often called matching grants. Influencing the decisions of local governments, a system of partially funded mandates had downbeat impacts on the effective functioning of the federal system. The traditional case of the City of Blacksburg is worthy to be mentioned here. The city “deliberately under-maintained its own roads in order to become eligible for road-fund support from the Commonwealth of Virginia.”²⁵⁰

Generally, vertical transfers had played, and still playing, significant roles in shaping local policies since policymakers designed grant programs that suit their political agenda. That is why

²⁴⁹ John Kincaid, From Cooperative to Coercive Federalism, *Annals of the American Academy of Political and Social Science*, Vol. 509, *American Federalism: The Third Century*, pp. 139-152 , (May, 1990), P. 150

²⁵⁰C. Rowley and F. Schneider, (eds.), the *Encyclopaedia of Public Choice*, Kluwer Academic Publisher, Dordrecht, 2004, P. 110

some scholars prefer to use ‘opportunistic federalism’ than calling the period as the era of coercive federalism.²⁵¹

II. The DS and Unfunded Mandates in Ethiopia

The allocation of legislative and executive powers in the FDRE Constitution, as it is stated already, brought multifaceted problems in determining the expenditure responsibilities of each layer of the government. While the federal government has the power to set minimum standards of health, education and science regional states are entrusted with delivery of these services. This practice calls for deep scrutiny on the legislative-executive relations between the federal and regional governments.

Particularly, the issue of “unfunded mandates” of the federal government is an issue to worry about. Moreover, the adoption of the DS paradigm could make the problem worse. DS, in principle, prioritizes development over other role of the state including its role in macroeconomic regulation/ stabilization. However, most of development-related matters are usually allocated under the expenditure responsibilities of subnational governments.

That is why the GTP has set over ambitious plans and targets including on the areas that regional governments have jurisdictions. However, the issue still remains as to how could regional governments fulfill their obligations and meet the projections of the plan unless there are ways of financing. For instance, as stated under the GTP document “poverty related expenditures” are planned to consume around 70.5% of the total national expenditure during the period.²⁵² Finance becomes a critical issue in a nation where the regions’ share from the total “poverty related expenditures” is more than 60%.

²⁵¹Tim Conlan, From Cooperative to Opportunistic Federalism: Reflections on the Half-Century Anniversary of the Commission on Intergovernmental Relations, *Public Administration Review*, Rethinking the Foundations of Public Administration: A Senior–Junior Exchange, September / October, 2006

²⁵² GTP P. 39

Similar issues could be raised in relation with the grant formula of 2009 adopted by the HoF.²⁵³ The revised grant formula was prepared with a special emphasis on the mismatches between revenue capacity and expenditure needs of States. While calculating the expenditure needs and revenue potentials of States, the expert team made assessments of major revenue sources and expenditures of States for the previous five years.

Particularly, revenue potentials of States were calculated after the consideration of major tax sources, which comprise 80% of their total revenue. On the other hand, the formula was set by determining costs of financing States' expenditures taking some of the indicators in to account. Particularly, States' expenditure responsibilities that have consumed more than 90% of their total spending were considered.

Amazingly, a number of expenditure areas are included in the formula though the matters were not prioritized before, nor had significant shares from regional expenditures. While emerging international issues like environmental protection are incorporated, the inclusion of most of these "new" obligations of States is "justified" by "national policies and priorities". For instance, micro and small scale enterprises and urban development were included in spite of their minimal shares from regional expenditures.

In general, unfunded mandates of the federal government have downbeat impacts on subnational autonomy both from the angles of revenue generation and spending powers. With the view of implementing national plans or meeting national standards, States need additional finance or extra-budgets or they should give-up their priorities. States are obliged either to give up their own priorities or to raise taxes in order to implement the federal mandates. Indisputably, this is one of the characteristics of coercive federalism.

On the other hand, there are arguments that underline the crucial role of the HoF in determining the grant pool. Despite it is more of a broad interpretation of constitutional stipulations, this

²⁵³The Federal Democratic Republic of Ethiopia House of Federation The Federal Budget Grant Distribution Formula to Regional States, May 2009

argument states that the house involves, perhaps indirectly, in the process of setting the grant pool, through its role in determining expenditure needs of States.

As it is stated before, with the inclusions of “new” priorities at the grant formula, it is possible to say the expenditure responsibilities of States had been extended by the HoF. If it is not accompanied by measures enhancing revenue capacities, any increase on the expenditure side would automatically result in an increase of vertical imbalance.

If the House is contributing, still indirectly, for the increases in degree of vertical imbalances in the federal system, it should make changes on the grant pool so that States could cover the costs of these “new” areas of spending. In other words, the House should increase the size of the pool proportional to the amount required for these areas of spending. Nevertheless, the HoF doesn't directly involve in determining the grant pool. In the absence of arrangements that guarantee its involvement in the process, any procedure that increases the responsibilities of subnational governments would amount to coercing them.

As it could be seen from graph 4.4, the bare minimum shares' of regional governments was registered in 201/12 and 2012/13 FYs (26.6% and 26.5%, respectively). The irony is, the time when regional states were expected to perform “new” expenditure needs matched with the time when they got the ever least share of national revenue. Moreover, it is an evidence for to argue stating the federal government could deviate from the estimations stipulated under the grant formula, especially when it faces financial stress.

Generally, there are plenty of issues to worry about regarding sizes of block grants in the Ethiopian DS, which is characterized by overstretched long-term goals and ambitious plans. The ambitious GTP of Ethiopia extended the expenditure obligations of both levels of the government. Unlike regional governments, the federal government can either borrow money from external sources or issue bonds and bills, whenever it faces budget deficit to finance its projects.

Despite the fact that the federal government has been continually employing various statutory tools and it has been increasing costs of regional expenditures, the relative shares' of the grant pool from the total had seldom increased. Since grants are the main sources of regional financing, there should be corresponding increases on the relative size of federal transfers or the percentage shares of block grants from the total national revenues.

Therefore, the alarming increases on subnational expenditure obligations, which are not accompanied by means of financing their costs, had been affecting subnational autonomy in the federal system. Therefore, in such kinds of circumstances States had no other choice than abandoning their priorities. Aggressive implementations of federal unfunded mandates, at the cost of local programs, seemed to be the only way out for States.

4.3.3. Subnational Borrowings and Supplementary Budgets

Big-sized government, which makes huge spending on infrastructure and energy developments, characterizes any DS. Due to the alarming increase of costs of financing projects or its capital budget, the federal government employs various means of generating revenue. Additional finance or, supplementary budget, is usually allocated for different projects when the allocated revenue budget is insufficient, when it is not allocated at all or whenever the expenditure budget is insufficient.²⁵⁴ On the other hand, States are not allowed to borrow from foreign sources in the Ethiopian federal system. Moreover, the centralized allocations of fiscal and monetary policymaking powers help the federal government restrain the States' borrowing autonomy.²⁵⁵

Unlike the Indian federal practice, which had once witnessed the introduction of distortive taxes of states, there is just a tiny possibility of since the power to vary tax rates is constrained in the Ethiopian federal practice. Similarly, chances for additional finance are very limited at regional

²⁵⁴ Article 2/12 of The Federal Government of Ethiopia Financial Administration Proclamation, Proclamation No. 648/2009

²⁵⁵ Art. 51/7& 55/10 of the FDRE Constitution

level because of the over-centralized system of subnational borrowings unlike the Brazilian federal system, where the states were able to offset deficits through borrowings together with issuance of bonds.²⁵⁶

State governments' direct access to borrow is perceived as one manifestation of regional autonomy. Generally, any limitation on the power to borrow from domestic or international sources has negative correlations with financial autonomy of the constituent units. However, the impact significantly varies based on the nature of these constitutional or statutory limitations as well as the role of State governments in the decision making process.

As it is stipulated under the federal legislation, domestic borrowing is subjected to the discretion of the federal government or it not automatic. Being convinced of the feasibility of the project and whenever the State's request is justifiable, it is MOFED that is entitled to the borrowing ceiling, which is going to be deducted from the regional government's share of federal grant in the next fiscal year.²⁵⁷ Therefore, the federal government is bestowed with the power to enact laws, which dictate the conditions for State borrowings from domestic sources.

Finally, there are a couple of issues that should be mentioned regarding subnational borrowings and spending autonomy in the federal system. First of all, States' autonomy of borrowing is highly restrained in the Ethiopian federal arrangement. It is highly centralized even when it is compared with other federal systems with centralized subnational borrowing arrangements. Shah's comparative study on most of the federations revealed, all of the federal systems, but Nigeria, follow "golden rule" (for capital expenditures only) on subnational borrowings.²⁵⁸

Therefore, the practice of States' borrowings in the Ethiopian federal system is characterized by a number of elements of over-centralization. Most of all, the constitutional and statutory

²⁵⁶Mônica Mora and Ricardo Varsano, *supra* note 210, P. 19

²⁵⁷ Art 65, The Federal Financial Administration Proclamation No. 648/2009

²⁵⁸Shah, *supra* note 99, 374

limitations on subnational borrowings had constrained played a pivotal role in constraining States possibility to get additional finances, in general.

First of all, it is the discretion of the federal agency whether to accept or to reject the application of a State for borrowing. While doing so, the Ministry evaluates relevance and feasibility of the proposal in light with national policies and priorities.²⁵⁹ Therefore, States could borrow only for the purposes of financing projects of federal importance or whenever the projects are found to be consistent with centrally set priorities. In other words, it could be difficult for States to borrow money unless the proposed/ or an ongoing project is considered “important” on the eyes of the federal government.

Moreover, it is not correct to consider (domestic) loans as additional or supplementary budgets since it is going to be deducted from the block grant of the next fiscal year. (Proclamation No. 648/2009). Nevertheless, the issue of looking for additional revenue, which is required to finance partially funded or unfunded projects, is the challenge of States as it is for the federal government. Most importantly, there is a necessity of frequently revising expenditure budgets in a nation where a double-digit GDP growth is accompanied by a double-digit inflation.²⁶⁰

4.3.4. Sources of Funds for Grant

In the Ethiopian federation, the federal government never collects in excess of its expenditure needs. From 2004/05-2009/10 international assistance covered around 20% of the national total revenue while external and domestic loans financed 15% of the total expenditures.²⁶¹ The trend

²⁵⁹ See, Financial Administration Proclamation No. 57/1996 and Regulation No.17/1997

²⁶⁰ From 2003/04 to 2009/10 Fiscal Years, Ethiopia has registered 11.3% average growth of real GDP. Similarly, there was an average inflation rate of 17% during the same period, excepting the 2.8% rate in2009/10. (Macro Annual Report on Macroeconomic Developments (2009/10), Ministry Of Finance And Economic Development, Economy Policy and Management Directorate , Jan 2011, Addis Ababa)

²⁶¹ Ibid

shows relying on foreign financing continues to be the significant source of government revenue especially in the era of the DS of Ethiopia.

The GTP barley dealt with means of financing the excessive spending on capital expenditures that is expected to rise to cover 58.9% of government's total expenditure throughout the GTP period. For instance, capital expenditures comprise 13% of the GDP while total tax revenue is only 12% of the GDP. Because of this, there is considerable share of external assistances and foreign donations in the economy.

In fact, one of the special features of developmental states is the ability to collect the necessary finance from domestic and external sources. The East Asian developmental states, as many agreed, wouldn't have been successful, hadn't there been extensive schemes of financial assistances from the West, particularly from the United States.

Similarly, Ethiopia's geo-political and strategic importance for the United States, among other things, made Ethiopia "the world's second largest recipients of total external assistance".²⁶² Similarly, external assistances/ donations for the realization of the MDG also comprise significant share of government's revenue.

From 2006-2011, the share of international donations (grants) amount around 3.7% of the GDP of the country. Likewise, around 15% of the government's revenue was collected from international assistances. (See, table 4.5, below). Besides, financial deficits were financed by domestic and international loans. Because of this, unconditional grants to regions are composed of three categories of revenue sources: the central treasury, foreign assistances and loans.

²⁶²Human Rights Watch, "Development without Freedom", 19 Oct 2010, P.4

Table 4.5. International Donations' Ratio to the GDP and to the Block Grants

| Fiscal Years | | | 2006/0 | 2007/0 | 2008/0 | 2009/1 | 2010/1 | 2011/1 |
|--|------------------|--|--------|--------|--------|--------|--------|--------|
| | | | 7 | 8 | 9 | 0 | 1 | 2 |
| Total Government Revenue(As percentage of the GDP) | Tax Revenue | | 10.1 | 9.6 | 8.6 | 10.7 | 10.8 | 10.5 |
| | Non-tax Revenue | | 2.6 | 2.6 | 3.3 | 2.6 | 2.7 | 1.4 |
| | Grant (Donation) | | 3.2 | 3.2 | 4.3 | 3.2 | 4.5 | 3.2 |
| Shares of Donations in the Block Grants (%) | | | 43.7 | 40.5 | 38.2 | 34.9 | 32.2 | 23.1 |

Source: MOFED

Sadly, the ever increasing debts and donations would have adverse impacts on various affairs of the nation. And, curtailing spending autonomy of State governments could be one of such drawbacks of foreign assistance and loans. Because of the tight strings attached and the higher degree of uncertainty, regional governments do not consider foreign aids and loans as actual grants.²⁶³ In general, external finances have multifaceted impacts on regional spending autonomy. Regional budgeting is affected by uncertainty of the fund, whereas conditions attached to these funds curtail their subnational governments' discretion on appropriating the finance.

As it could be witnessed from the above data, throughout the fiscal years (from 2006/07 to 2011/12) the share of international assistances on average is around 35.4% of the total amount of funds devolved as block grants. Moreover, it is anticipated that there would be around 11% expenditure deficit in the period of GTP.²⁶⁴

This deficit is planned to be financed, mainly through domestic and external borrowings. In other words, there would still be significant share of external loans from the block grants throughout

²⁶³ Solomon,(2008), supra note 32, Pp. 216&224

²⁶⁴GTP, P. 40

this period. Amazingly, the debt of the country has been tripled and its share of the GDP has increased from 10.3% to 25.3% between 2007/08 and 2010/11 FYs.²⁶⁵

In order to address budgetary and off budget deficits that is projected in the GTP, it was proposed that there is “no better solution” than privatization measures. Studies showed that the government would collect approximately 132 billion Birr (\$7.7) through privatizing the “BIG_5’s”; i.e. the Ethiopian Airlines, Commercial Bank of Ethiopia, Ethiopian Insurance Corporation, Ethio Telecom, Ethiopian Electric Power Corporation).²⁶⁶

Nevertheless, inspired by the success stories of Asian developmental states, which had run mega enterprises, the Ethiopian government chose a move against privatization. Thus, external donations and loans continued to be significant sources of the growth of the country’s GDP. Similarly, “unconditional” grants are still composed of large shares of “conditional” funds financed by foreign loans and donations.

4.3.5. General Spending Powers and the “Federal Special Funds”

The traditional view on expenditure responsibilities assumes the spending power of each tier of government is limited to constitutionally legislative/ administrative jurisdictions dictated by constitutions. Yet, federal governments of many federations usually make spending even at exclusive jurisdictions of states while states in some federations also exercise similar power of spending.²⁶⁷

This principle of general spending power is, though debatable, rampant in a number of federations either through explicit recognitions of constitutions or being legitimized through

²⁶⁵MoFED, “Public Sector External Debt”, Statistical Bulletin (2006/07-2010/11)

²⁶⁶ Access Capital, supra note 215, Pp 59-64

²⁶⁷Watts, (2008) supra note 2, P. 100

judicial reviews. For example the Canadian courts and the Spain Constitutional Court (with certain limitations) affirmed general spending powers which decided that federal spending power is not limited to its legislative jurisdictions. Whereas the constitutions of Australia, India and Malaysia have ‘explicitly’ recognized general spending powers by allowing federal grants for any purpose, even under state jurisdictions.²⁶⁸

The New Deal could be one of the illustrations for general spending power of the federal governments and its impacts on subnational spending autonomy. One of the aftermaths of the great depression in the American political economy was big sized government necessitated by the new roles of State to recover from the evils of the market failure. The mismatch between the ever increasing subnational spending and the drastically reduced revenue of States brought an unusual degree of vertical imbalance.²⁶⁹

New Deal measures in the US federalism, for instance, extending federal powers helped it employ instruments of macroeconomic regulations through centralized and uniform policies. It was then the concept of ‘funded mandates’ was introduced in the US federal system. It was an arrangement by which States and local governments administer uniform policies of the federal government in return for federal transfers. Nevertheless, funded mandates could make subnational governments mere smaller units implementing federal programs at the cost of their own policy priorities.

In the Ethiopian federal system, there are possibilities whereby the federal government directly involves in the area of States’ spending. This could be affected either through transfer of conditional grants, or direct involvement of the federal government in the execution of federal projects. For instance, the FDRE Constitution authorizes the federal government to allocate

²⁶⁸ Ibid, Pp. 100&101

²⁶⁹John J. Wallis and Wallace Oates, ‘The Impact of the New Deal on American Federalism’ in Michael D. Bordo, Claudia Goldin and Eugene N.White, (eds.)*The Defining Moment: The Great Depression and the American Economy in the Twentieth Century*, University of Chicago Press, 1998, P. 174, available at, <http://www.nber.org/chapters/c6892>; John Kincaid, P. 140

conditional/ specific grants even in the exclusive jurisdictions of States. This kind of vertical transfer from special funds could be considered as an “implicit transfer”.²⁷⁰

With the view of building an effective DS in Ethiopia, the federal government prioritized areas, prepared national policies and programs. Some of these policy areas and development programs have overextended scopes of application including the areas that are constitutionally allocated for States. Striving at achieving its development projections, the federal government obliged to implement its policy priorities throughout the nation.

One of the various means to realize the implementation of federal policies is employing specific grants or the notion of funded mandates of the federal government. This kind of federal specific funds include productive safety net, road fund, public sector capacity building, piloted local investment grant and local infrastructure development fund for cities.²⁷¹

For instance, in 2004, the Public Sector Capacity Building Programme (PSCAP) was introduced with a view to achieve institutional transformation and improve implementation capacities at all tiers of the government. It was an ambitious project aimed at changing attitudes and bureaucratic behaviors as well as the state-society relations. Especially, the program was sought to transform the “three aspects” state-society nexus, which are inclusion, accountability and cohesion.²⁷²

While bureaucratic “inclusion” could be perceived as a rule dictating the need for penetrating social organizations, its “accountability” is a guarantee against rent-seeking behaviors. Thus, it is possible to say that both principles are mandating bureaucratic embedment and its

²⁷⁰Solomon,(2008), supra note 32,P. 237

²⁷¹ Piloted projects are considered to be one among the common features of developmental states. (see, EbrahimShabbirDeen, The developmental state: An illusion in contemporary times, African Journal of Political Science and International Relations, Vol. 5, No. 9, pp. 424-436, October 2011; P. 427, available at <http://www.academicjournals.org/AJPSIR>

²⁷²World Bank, Project Appraisal Document On A Proposed Credit to the FDRE for a Public Sector Capacity Building Support Project, 2004, cited in Sarah Vaughan, Revolutionary democratic State-building: Party, State and People in the EPRDF’s Ethiopia, Journal of Eastern African Studies, V. 5, No. 4, 619-640, P. 630

insulation/autonomy, which is the fundamental trait of a DS paradigm. Moreover, “coherence” dictates uniform implementations of such policies and building a kind of ‘centralized’ or uniform bureaucracy.

Furthermore, as a federal project, it was designed and coordinated by the then Ministry of Capacity Building. Therefore, the introduction of PSCAP is an illustration for the fiscal tool employed by the federal government so as to make its programs implemented by regional states, and to build a DS, in general.

General spending powers allow federal governments, either to make direct spending on certain areas, or to employ grants for the implementations of their priorities. While direct and unilateral use of federal spending power is criticized as intrusion on subnational jurisdictions, conditional grants are contested for undermining regional autonomy. Moreover, the federal government is bestowed with the power to audit and supervise the appropriation of funds by the respective State.

Furthermore, some of these transfers are designed to create competitions among subnational governments. This was manifested in the competition among 19 cities on the Urban Local Government Development Program.²⁷³ Inter-state competitions, among other things, could be a reason for “race-to the bottom” competitions, or it would result in subnational policy shifts so as to comply with the federal initiatives.²⁷⁴

This is the reason why, in some federal systems, the federal government should get the consents’ of subnational governments concerned before spending at their exclusive jurisdictions. This

²⁷³World Bank, Ethiopia Public Finance Review Report No. 54952-ET 2010, P. 23

²⁷⁴The American Recovery and Investment Act (ARRA) could be a similar, perhaps a best illustration for this. The act required a “race to the top” competition of states for additional education grants, which, allegedly, made at least 10 states change their legislations for the purpose of being eligible for federal funds. See, Alan Greenblatt, “Obama woos state and local governments’ with federal funds”, *Federations*, Dec. 2010/ Jan. 2011, p.3

necessitates a working intergovernmental relation, and it is usually effectuated through the representations' of States at the second chambers.²⁷⁵

These federal special purpose grants had been a significant share of regional expenditure in the Ethiopian federal system. In 2005/06 FY, for instance, money transferred as special purpose grants had accounted for around 21% of regional total spending.²⁷⁶ Surprisingly, the alarming growth of the size of specific-purpose grants had made it cover around 50% of regional total spending in 2009 FY²⁷⁷. In spite of the existing problems on regional spending autonomy, special-purpose transfers are expected to grow with the implementation of the developmental paradigm.

²⁷⁵ Formal arrangements could exist either by Constitutional recognitions, as it is in Germany, or through Constitutional interpretations like the case of the US Supreme Court. Likewise, the federal-provincial agreements in Canadian federation could be examples of informal arrangements. See, R. L. Watts, 'Processes For Adjusting Federal Financial Relations: Examples From Australia And Canada', in Paul Boothe, ed. *Fiscal Relations in Four Countries: Four Essays*, Ottawa: Forum of Federations, 2003, **P.3**

²⁷⁶ Marito Garcia & Andrew Sunil Rajkumar, *Achieving Service Delivery Through Decentralization in Ethiopia*, World Bank Working Paper No. 131, 2008, P. 28

²⁷⁷ World Bank, *Ethiopia Public Finance Review Report No. 54952-ET 2010*

4.3.6. Procedures and Institutional Setups for Intergovernmental Relations

I. Introduction

The ever changing situations in the global or domestic economy and politics gave rise to new roles of states. This in turn requires reallocation of powers and responsibilities among different tiers of government, which could be possible either through constitutional amendments or by constitutional interpretations. However, the usual, perhaps the best, way of addressing such kinds of issues is devising effective mechanisms of intergovernmental cooperation.

Cooperation calls for, among other things, devising procedures and institutional arrangements facilitating intergovernmental cooperation or relations in general. Arrangements should also target towards guaranteeing active roles of subnational governments in shaping or influencing national or federal plans and reassurance of local autonomy.

Shah analyzed the considerable variations among federations in the ways that subnational could influence national policies. In the federations that have clear demarcations on federal and state institutions (“interstate” federalism), this role is effected in the Intergovernmental relations of the legislatures and executives of the two. In the “intrastate” federalism, because of the supremacy of national legislations, state governments are represented at, and have direct voice in, the second chamber.²⁷⁸

The usual institutional set up is a bicameral legislature, one of the houses is claimed to accommodate the interests of constituent units. Nonetheless, purposes, arrangement/structure, powers and other factors affecting the functions of an institution count a lot than its mere existence. The appointment of its members by the national government has made the Canadian system ‘ineffectual’, despite its extensive powers to pass and reject bills.²⁷⁹

²⁷⁸ Shah, supra note 99, P. 374

²⁷⁹ Brian Galligan, ‘Institutions of federalism and decentralized government’, in Handbook of Fiscal Federalism, P. 535

Similarly, the increased areas of interdependence among different layers of government marked the era of cooperative federalism, in federal systems that were originally conceived as dual models. The American federation of mid 1950s is characterized by the establishment of the Commission on Inter-governmental Relations (Kestnbaum Commission), recognizing grants-in aid as instruments of cooperative government, underlined the necessity of national action while preserving a space for “cooperative or independent State action”.²⁸⁰

II. The DS Paradigm and the Need for IGR in Ethiopia

The Ethiopian federal arrangement lacks formal institutional setups that accommodate regional interests at the federal level. The federal system has non-legislative second chamber, the House of Federation, where the interests of regions are barely represented.²⁸¹ The upper house, in the Ethiopian federal system, is weak both institutionally and functionally. Furthermore, unlike “interstate” federal arrangements, the Ethiopian federalism lacks formal intergovernmental relations.

In spite of these flaws of the system, there are still a number of factors that push for an institutionalized and working IGR in the Ethiopian federal practice. The primary justification would be the fact that there are some matters that lay under the shared powers of both tiers of the government. Assefa, for instance, mentions the presence of framework and concurrent powers as one of the factors that call for institutionalized systems of IGR, basically for effectively exercising their powers through cooperation.²⁸²

²⁸⁰ Tim Conlan, *supra* note 251, P. 664

²⁸¹One could mention exceptions including its power to authorize the HPR to make laws on civil matters that are necessary for establishing “one economic community” (arts 55/6 & 62/8), of constitutional interpretation (art 62/1) and to prepare formulae for revenue sharing between the federal and State joint sources and that of block grants (art 62/7).

²⁸²see, Assefa Fiseha, *The System of Intergovernmental Relations (IGR) in Ethiopia: In Search of Institutions and Guidelines*”, *Journal of Ethiopian Laws*, 2009

Particularly, the adoption of the DS paradigm urges for effective procedures and institutions of intergovernmental relations. Without the mechanisms of vertical and horizontal cooperation, it would be hardly possible to imagine a state that effectively balances subnational autonomy and developmentalism. Some of the issues that could be raised regarding this point are discussed hereunder.

First of all, in a federal practice whereby federal policies and plans are adopted and uniformly implemented by subnational governments, like the case of Ethiopia, federal policies and priorities should be, as far as possible, reflections of the preferences and priorities of constituent units. Federal government's vision to penetrate and to be embedded with the society could be realized only through subnational governments. Aggressive implementations of national plans and policies as well as centrally set priorities require nation-wide mobilization starting from the grass root level. Hence, it is possible to hold that any constitutional guarantee for subnational policymaking would pose risk on the coherence of policies at different tiers of the government. The principle of coherence is the pillar of developmental states that mandates the necessity of similar, if not identical, policies that are uniformly implemented throughout the nation.

Therefore, confrontations could emerge since there is a high possibility of witnessing situations whereby subnational priorities contradict with, or at least deviate from, that of the federal government. Fears against such kinds of resistances push for soliciting the possible ways out though there is no better solution than guaranteeing subnational governments' involvement in the formulations of national plans and policies.

However, the Second Chamber in the Ethiopian federal system doesn't directly engage in the formulations of national policies and plans. The process of making national policies or plans is

all about the one-sided action of the federal government. Formulated by the executive organ, national plans and policies are adopted by the federal parliament, i.e. the HPR.²⁸³

It is known that the federal government has the power to make spending at the exclusive jurisdictions of States. The fact that the expenditure responsibilities of both tiers of the government are not limited to their legislative powers is another factor that necessitates for vertical cooperation, i.e. cooperation between the federal and regional governments.

Thus the next issue is related with “general spending power” especially when it is at the exclusive jurisdictions of States. In general, the federal government strives to achieve uniform implementations of its policies throughout the nation employing various tools. This kind of federal powers might be effective through the transfer of “conditional” grants to regional governments. At least in principle, there might be cases whereby subnational governments decline to administer federal laws even refusing federal funds.

Moreover, the federal government could also delegate subnational governments to administer its laws and policies. While doing so the federal government is obliged to cover the costs of administering these mandates that are delegated to regional governments.²⁸⁴ However, this kind of vertical transfer i.e. transfers to reimburse the costs of administering delegated functions hadn't been witnessed in the Ethiopian federal experience.²⁸⁵ In the future, this could be a reason for regional states resistance against the general spending powers of the federal government.

To sum up, the adoption of the DS paradigm could be considered as a guiding-light for the formation of different forms of IGRs in the federal system. DS needs nation-wide mobilizations in order to effectively implementing federal policies and plans throughout the nation. This urges

²⁸³ Art s77/6 & 55/10 of the FDRE Constitution

²⁸⁴ Arts 50/9&94/2 of the FDRE Constitution

²⁸⁵ Solomon, (2008), P. 238

for the cooperation of regional and subregional governments in mobilizing the public and executing national priorities.

4.3.7. Dominant One-Party Rule and Democratic Centralism in Ethiopia

The exceptional, perhaps usual, way of intergovernmental relation in the Ethiopian federal system appeared to be an “informal” one.²⁸⁶ This type of relation exists in the form of “vertical” communications through party channels. The communication channel starts from the central committee of the ruling party to the lowest level.

In practice, the national development plans and policies are prepared by the central committee of the ruling coalition to be the basis for the party’s plans.²⁸⁷ The system of “dominant party rule” in the contemporary Ethiopia, whereby the ruling coalition has a majority both at the federal and regional legislations, has almost closed all the possible windows of hope about having diversified policies in the nation.

Because of the governing principle of the party, i.e. “democratic centralism” national policies and plans are simply devolved through “top-down approach”, to various levels of the party structure.²⁸⁸ This process made subnational policies and plans the offshoots of the policies or plans of the federal government.

²⁸⁶See, Assefa Fiseha, (2009), supra note 282

²⁸⁷ EPRDF is a coalition led by its Central Committee composed of the representatives of the member parties; TPLF, ANDM, OPDO and SEPDM.

²⁸⁸ See, Article 7 of the EPRDF Programme titled as “The principles of organization and operation of the Front”

What makes this situation worse is that the process of policymaking, which was shaped by the developmentally-oriented ideology. This ideology is allegedly fashioned by the “top-down” approach that ignores the role of the society in the national policymaking.²⁸⁹

Likewise, the principle of democratic centralism mandates uniform applications of central policies and programs starting at the lower level possible.²⁹⁰ There are also cases that could help us understand the pitfalls of the centralized party system on spending autonomy of governments. As it is stated in the WB report, there was a case whereby a Wereda administration’s decision on budget allocation is reversed after facing resistance from the regional government that stated the appropriation by the Wereda is against “uniform development”.²⁹¹

Democratic centralism not only refutes the essences of democracy, but it is also the antithesis of the principles of federalism. For instance, scholars often mentioned centralized party system as one of the critical challenges posed on the South African federal system.²⁹²

²⁸⁹ Abbink, supra note 12, P.598

²⁹⁰ It is clearly stipulated, under the programme, that “decisions will be announced downwards throughout the hierarchy” and decisions, tasks and programs of the party should be implemented by member national organizations in the respective region that they are administering. (Arts 7/3&4 of the EPRDF Programme)

²⁹¹ Edmond Keller, supra note 11, P.41

²⁹² Watts,(2008), supra note 2,P.50

Chapter Five

5. Conclusion and Recommendations

5.1. Conclusion

It is possible to argue that the FDRE Constitution sought to achieve the financial autonomy of subnational governments, which could be manifested in their respective autonomy of revenue generation (taxation) and that of spending (appropriation). Nevertheless, in its two decades federal experience, there has been a highly centralized revenue generation as well as a very limited spending autonomy of regional governments in the Ethiopian federal system.

Running through all the frequently mentioned challenges and problems of the Ethiopian fiscal federalism, the study has emphasized on exploring the possible impacts of the developmental paradigm on the existing challenges and issues regarding the financial autonomy of states. As it could be discerned from the findings of the study, the adoption of the DS paradigm has been worsening the existing problems regarding the financial autonomy of regions in the Ethiopian federation.

The primary finding of this study is that, even theoretically, there are difficulties of building strong and effective developmental states, while at the same time preserving the genuine autonomy of subnational governments. Comparative conclusions drawn from the experiences of some of the federations, such as Brazil and India, revealed that the states were able to be developmental at the cost of, or eroding the tents of their respective federalism. Thus, these federations were too centralized than ever during their respective eras of DS.

One of the findings of this research is that there are a number of measures, which are primarily the offshoots of the DS paradigm that were taken overlooking the federal covenant. As long as revenue autonomy of regional states is concerned, some of these measures have serious impacts on the taxation autonomy and the revenue volumes of regional states.

The recent act of “upward delegation” of the power to administer land was allegedly unconstitutional act of taking away the power to levy the tax from States. Similarly, due to the fact that the scopes of applicability of federal tax incentive legislations are extended to the exclusive jurisdictions of regions, the federal government exempts investors from regional taxes. Justified with the developmental paradigm, such measures have undermined the constitutionally dictated revenue autonomy of regions apart from affecting the volume of own-source revenues.

The over-centralized allocation of revenue sources, together with weak tax administration at regional level, is blamed for being a reason to the existing fiscal imbalance in the Ethiopian federal system. On the other hand, economic liberalization was proposed to be one of the means that could improve regional revenue, without a need of having constitutional amendment. Nevertheless, the study shows that the government won’t liberalize the economy in the near future mainly because of the developmental ideology it has adopted.

Similarly, the research shows that the existing centralized processes of making policies and strategies are now backed up by the DS ideology, which calls for coherence of nationwide economic policies and priorities. Besides, the establishment of national planning office at the federal executive was a manifestation of the contemporary developmental path, which is “plan-rational” political economy. By doing so, the government has “formalized” the informal channels of national planning, which was previously undertaken by the central committee of the ruling coalition.

Budgeting, in a planned economy, could be considered as a process of cascading national plans to the lower level. Thus, the Five Year Plans could be divided on yearly bases so as to prepare annual budgets in Ethiopia. On the other hand, these plans are derived from national short and medium term policies and strategies. Therefore, it is necessary to deal with regional policymaking and planning so as to study spending autonomy of regions.

It is known that federal policies and strategies had been criticized for being too comprehensive and shrinking the scope for regional policies. In spite of the constitutional dictate, hence,

regional states haven't yet fully exercised their respective powers of policy making. The introduction of the DS paradigm has made things worse. Cohesive nature of developmental states had been witnessed in Ethiopia whereby the government has been aggressively centralizing such powers. Therefore, States of the Ethiopian federation failed to experiment workshops of policies and programs. Contrary to Oates expectations by his theory of "laboratory federalism", States are more of the laboratories of the federal government.

5.2. Recommendations

As it could be recapitulated from the previous discussions, the adoption of the DS paradigm has further limited the revenue autonomy and capacity of regions. Similarly, subnational autonomy of spending has been affected badly with the introduction of the developmental path. Having underlined the fact that the adoption of the DS paradigm has been exacerbating the existing problems of subnational financial autonomy, it is necessary to suggest possible ways and means of improving the system.

One of the fundamental issues that might be raised with regard to subnational revenue autonomy is the constitutionality of centralization of taxation powers in Ethiopia. As it had already discussed, the adoption of the DS paradigm has extended the existing challenges of subnational tax autonomy. Among such challenges, the "upward delegation" of land administration as well as the overextended scopes of federal investment laws could be cited.

Thus, revisiting the provisions of the Constitution is the primary solution to be proposed in order to address the existing the over-centralized allocation of revenue powers. However, it would rather be palatable to call for the actual implementations of the dictates of the federal covenant since the prevalence of disregarding constitutional stipulations is one of the findings of the research.

No doubt that, States should be in charge of setting rates of the taxes that are allocated under their exclusive jurisdiction. Indeed, regional governments lack all the required level of competence, skill and expertise to define tax bases or to set tax rates. Let alone independently setting rates of taxes, so far regional governments are not capable to administer (collect) taxes that are assigned to them. Nevertheless, regional governments should not be devoid of their inherent right of levying taxes in spite of all the challenges they are facing with. It would rather be palatable if the federal government aggressively works on building or improving the capacity of regional governments so as to make them capable of levying and administering their revenue sources.

Similarly, neither regional governments' competence nor federal governments' ambition would justify the existing practice of centralization of taxation powers. It is also a paradox that the federal government, which advocates for harmonization measures claiming it as the only means of protections from adverse impacts, has eroded the principle through exempting investors from regional taxes. It is not difficult to imagine how tax autonomy could bestow States with a lot of opportunities, which are inherently related with "competitive" federalism. Nor could one deny the possibility of facing the challenges of unrestrained autonomy of adopting tax laws. Tax harmonization laws could be enacted as guarantees against discriminatory tax legislations. However, tax harmonization should not always be perceived as standardization of tax-bases or uniformity of tax rates. All objectives of the federal government could be achieved through capacitating regional governments as well as by implanting systems of vertical and horizontal cooperation.

Without a need of looking for constitutional amendment, there are a number of possible means of improving the revenue capacity of regions. Though the DS orientation has overlooked its realization so far, privatization of state-owned enterprises would be one of such means of expanding the revenue sources of regions. So as to strike the balance between these two competing interests, the government should undertake limited privatization. Limited privatization involves the process whereby the government privatizes only some of the shares' of the enterprises; for instance by reserving "50%+1" shares from such enterprises. While doing so, the government could attain both ends, i.e. making state-owned enterprises engines of

transformation and building an effective developmental state in one hand and expanding the revenue sources of regions on the other hand.

Looking at the challenges posed by the current system of determining the grant pool, it would rather be an urgent task to find ways of addressing the problem. The primary way out would be making the percentage share of block grants from the federal annual budget constant. However, setting a fixed amount to be transferred to regional governments would be criticized for a lot of reasons including rigidity. The better solution is thus, organizing an independent organ that would be in charged with determining the grant pool.

As long as policymaking powers are concerned, every federal system faces a dilemma of having uniform policies and preserving subnational autonomy. The question becomes a critical issue in developmental states since the developmental paradigm calls for uniformity of national priorities and universal applicability centrally-set policies and plans. So far, the Ethiopian government seemed to have chosen policy coherence at the expense of regional autonomy. However, it is possible to accommodate both interests through various means including through Intergovernmental Relations.

The primary proposition for bridging the gap between the constitutional stipulations of regional policymaking powers and the actual practice of centralized and cohesive state would be limiting the powers of the federal government. Unlike concurrent powers, the federal government may not centralize matters that are allocated under its framework powers. Despite its ambiguity, a close look at the provisions of the Constitution dealing with powers to make socio-economic policies, plans and strategies would lead us believe it is a kind of framework power. It has to be noted that federal governments are obliged to leave a reasonable space for subnational governments while exercising framework powers. The same analogy applies here; the federal government shall make all its policies and plans general so that regional governments could also be able to exercise their constitutionally dictated mandates.

The other way of achieving this goal is by making the planning commission an inter-state organ where regional governments would have representations. By doing so, the interests of regional

governments would be incorporated in the five-year plans made by the federal government. Therefore, ensuring the representations of States at the federal policymaking or planning offices, it is possible to make them influence central plans or policies, too. Similarly, if there was a working system of IGR, it would not be too difficult to preserve subnational flexibility while executing the federal mandates. This may require either the revision of the Constitution or statutory actions.

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