

ADDIS ABABA UNIVERSITY

SCHOOL OF GRADUATE STUDIES

DEPARTMENT OF PUBLIC ADMINISTRATION AND MANAGEMENT

A CRITICAL EXAMINATION OF FISCAL AUTONOMY OF
ADDIS ABABA CITY ADMINISTRATION

A THESIS SUBMITTED TO SCHOOL OF GRADUATE STUDIES,
ADDIS ABABA UNIVERSITY, IN FULLFILMENT OF THE
REQUIREMENTS FOR THE DEGREE MASTERS OF PUBLIC
ADMINISTRATION

PREPARED BY: HELEN DEGEMU

DECEMBER, 2010

ADDIS ABABA, ETHIOPIA

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MASTERS OF PUBLIC ADMINISTRATION PROGRAM

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Abstract

This thesis paper describes the fiscal autonomy of Addis Ababa City Government using primary and secondary sources of data. The constitutional and legislative frameworks have been critically examined in order to determine whether they would create conducive environment within which Addis Ababa would be able to exercise optimum degree of autonomy in its local government. The study also incorporates close analysis of the revenue sources and the degree of control the City has over these sources; spending autonomy and fiscal importance as well as transfers and borrowing frameworks of the City.

The findings of the study indicate existence of enabling environment in which Addis Ababa City Government can enjoy better degree of fiscal autonomy. With substantial expenditure responsibilities and productive revenue sources, Addis Ababa City government has the opportunity to strengthen its fiscal position. However, the increasing trend of its actual expenditure, Addis Ababa City Government is required to take appropriate actions to increase its revenue and involve the community in service provision process. It is also found in practice that except differences in their constitutional statues, Addis Ababa and Regions tend to have similar expenditure responsibilities and revenue powers. The major difference in their IGFRs goes to the size and system of Federal government transfers. While Regional governments are found highly dependent on block grant transfers, Addis Ababa is found relatively deprived of the transfer system. The study concludes that Addis Ababa City Government has better comparative and competitive advantages to exploit the geographic, economic and administrative opportunities to enhance its fiscal autonomy. Finally, the paper forwards important recommendations to policy makers and government officials as well as to prospective researchers.

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Acronyms

AU	African Union
BoFED	Bureau of Finance and Economic Development
DLDP	District Level Decentralization Program
EU	European Union
FDRE	Federal Democratic Republic of Ethiopia
IGFRs	Inter Governmental Fiscal Relations
IGFT	Inter Governmental Fiscal Transfer
IGRs	Inter Governmental Relations
MoFED	Ministry of Finance and Economic Development
NBE	National Bank of Ethiopia
PSCAP	Public Sector Capacity Building Program
SN	Sub National
SNGs	Sub National Governments
UMDP	Urban Management Development Program
UN	United Nations
UNDP	United Nations Development Program
VAT	Value Added Tax

Chapter One

Introduction

1.1. Background

In recent years, fiscal decentralization has been advocated world wide. These years have witnessed an extra-ordinary proliferation of decentralization and local governments around the world (Kwon, 2002; pp: 2). Although decentralization involves political, fiscal and administrative dimensions, according to Smoke (2000), much of the literature focuses on the fiscal dimension of decentralization since intergovernmental fiscal relations is behind much of the rationale for decentralization in general. In general context, fiscal decentralization deals with how tax revenues and public expenditures are distributed among the different tiers of a government (UNDP, 1999). The degree to which fiscal decentralization should be pursued, however, is not obvious. Empirical evidence to justify or discredit the pursuit of fiscal decentralization in developing countries is scant or mixed. None of the claims on either extreme- that fiscal decentralization retards economic development and has a variety of undesirable macroeconomic effects; or that it improves local service delivery and enhances government accountability to local citizens- has been adequately tested (Smoke, 2000). UNDP (1999) proposes the idea that decentralization should not be taken as an alternative to centralization both, are needed. The complementary roles of national and sub national actors need to be determined by balancing the most effective ways and means of achieving desired objectives. It is best, therefore, to think the extent of decentralization as a continuum rather than an either-or proposition (Rosen, 1985).

In the context of developing countries, Kwon (2002) states that the conventional wisdom may remain true in developed countries, but it is not the case in developing countries. Elhiraika (2007) added that only few developing countries have adopted comprehensive political, fiscal and administrative decentralization. As a result, most empirical studies on the subject are limited to developed countries. According to Weingast (2006), the approach of much of fiscal analysis of developing countries is deficient because it does not require sufficient detailed examination of existing reality to ensure that the assumptions postulated in the fiscal system model are

congruent with reality; that the recommended changes can in fact be implemented, or that if implemented, they will remain in fact produce the desirable results.

Ebel and Yilmaz (2002) also argue that there are serious methodological issues in the empirical studies on measuring fiscal decentralization mainly due to misspecification of the fiscal decentralization variables. Writers such as Prud'homme (1990) measure the degree of fiscal autonomy using variables including: (1) the importance of local taxes to central taxes (share of local tax to total tax); (2) the importance of local expenditure to the central expenditure and (3) the importance of central subsidies to local resources (self-reliance rate of local governments). These measures are defined on the basis of a single dimension of fiscal decentralization: expenditures going through sub-national budgets and revenue raised by Sub National Governments (SNGs). However, there are several limitations on this measurement. It is silent about expenditure autonomy and it does not distinguish whether taxes are "own-source" or not (Liu, 2007; Bell, et al at, 2006). Unlike the traditional method for measuring fiscal decentralization, that is, the revenue and expenditure ratios, experts in public finance have been more concerned with qualitative aspects of fiscal decentralization such as the power of SNGs to decide issues such as the appropriate tax base, tax rate, regulatory framework for borrowing, nature of Inter Governmental Fiscal Transfers (Liu, 2007).

In Ethiopia, the major fiscal reform is mainly explained in terms of fiscal decentralization (Gashahun and Mehari, 2006). Following the downfall of the strongly centralist Derge regime in 1991, the transitional government was established that implemented extensive economic reforms and a radical form of fiscal decentralization with in a unique political landscape of ethnic federalism (Derrese, 2003). Accordingly, Ethiopian fiscal decentralization reform followed the political imperative of establishing a federal political structure. Currently, Ethiopia is among those African countries that have constitutions in which self-rule and the existence of local governments is explicitly and formally recognized (Smoke, 2000). Furthermore, the government has introduced constitutional, administrative and institutional reforms to deepen and broaden the decentralization process to Woredas and Municipalities through District Level Decentralization Program(DLDP) and Urban Development Program(UDP) respectively in 2001 (World Bank, 2003; Deresse, 2003; MoCB, 2004). Empirical studies on the performance of Ethiopian fiscal

decentralization (such as World Bank, 2003, Smoke 2000) take the reform measure as locally-initiated effort of the government to meet its political, economic and administrative policy objectives. The comparative study of Ndwa (cited in Deresse, 2003) identified Ethiopia as one of highly decentralized country in Sub-Saharan countries from the perspective of political decentralization.

Despite such endeavors in the political decentralization, review of available studies on the performance of Ethiopian fiscal decentralization reveals the fact that it has not been able to create the expected fiscally autonomous sub-national governments (SNGs). According to the comparative study of Ndwa (cited in Derrese, 2003: pp; 14), Ethiopia is one of the least fiscally decentralized countries in the world. Paulos (2009) also concludes that the reforms failed to create autonomous regional governments as they are still highly dependent on central subsidy. For instance, according to the study of Derrese (2003; pp: 24) central subsidy covered 71.5 and 63.9 percent of the Regional expenditures in 1993/94 and 2001/02 respectively. World Bank (2003) identifies the weak capacity of Regional governments as the main challenge to enhance their fiscal autonomy. Furthermore, Fjeldstad (2001) criticize Ethiopia's system of intergovernmental transfer (IGT) for following a less transparent system. Derrese (2003) identifies the existence of high vertical and horizontal fiscal imbalance as basic features of Ethiopia's fiscal decentralization. Finally, Abu (2003) argues that Ethiopia's fiscal federalism in the context of ethnic politics and de facto political centralization continues to hamper the realization of economic potentials of the country and hence constrains efforts to address core economic problems.

Some of the reviewed studies on Ethiopian system and performance of fiscal decentralization fail some important elements from the perspective of this study. First, most of these studies used data that failed to incorporate and demonstrate recent trends. For instance, paulos (2009), Derrese (2003), and the World Bank (2003) have not considered the comprehensive decentralization program of the government after 2001 where far-reaching constitutional and institutional reforms were under taken through the DLDP and UDP. Thus, the findings are not able to show us whether lower tier are getting more fiscal powers or not. Second, most of these studies fail to provide information about the status of local governments (Zones and Wordas) since their focus

was mainly on the Regional governments. Third, they measured degree of fiscal decentralization mainly on the bases of quantitative indicators. Revenue and expenditure ratios were used neglecting the degree of Region's autonomy over their revenues and expenditures (for instance, own revenues and spending autonomy of Regional governments were not separated from the general revenue and expenditure). Accordingly, these studies fail to properly address issues of 'fiscal autonomy' of Regional governments. Fourth, most of these studies focus on the aggregate level of fiscal decentralization neglecting the performance variations among Regional governments. Finally, the intergovernmental fiscal structure in Ethiopia marginalizes local governments in urban centers. Neither the Federal Constitution nor the Regional Constitution explicitly state urban areas in the government structure of their respective states. But, urban local governments in Ethiopia have been left out from empirical studies on Ethiopia. Studies tend to generalize their findings of Regions or/and Zones /Woredas to represent the status of urban centers.

Addis Ababa City's fiscal relationships with the Federal Government demonstrates the only constitutional asymmetry in the country. The 1995 Federal Constitution does not give the City equal status to the Regional governments, nor does it leave its arrangement to be addressed within one of Regional governments like other urban local governments in the country. Addis Ababa, thus, becomes the only urban local government in the country to be governed as a component part of the Federal Government with explicit constitutional protection to have 'full measure of self government'. Accordingly, Addis Ababa is a Chartered City having a local government whose detailed functions, powers, duties and responsibilities are emanated from a particular legislation of the National government. Here, one thing needs to be considered that Dire Dawa is also another City established as a 'City Administration' by government law, but having no direct constitutional mandate of self-government. Despite the unique asymmetrical treatment of the City, there found little or no study addressing local government and fiscal autonomy of the City in a comprehensive manner. Furthermore, using aggregate revenue data, most studies concluded that Addis Ababa has better revenue sources and collection performance ignoring the real revenue autonomy and 'own source revenues' of the City as well as the higher expenditure needs of the City, and these studies, hence, fail to demonstrate the actual fiscal autonomy of the City.

Despite some endeavors to study the progress and challenges of Ethiopian fiscal decentralization, mainly sponsored by donor agencies, local government finance in Ethiopia, is either totally ignored or too little is known. So far there is no comprehensive empirical government finance literature, which is devoted to the analysis of models that have actually been implemented in practice or proposed as appropriate candidates for implementation. In view of this the study seeks to contribute towards the embryonic literature on local government finance in Addis Ababa as well as, document review and primary sources of data. Therefore, it is in line with this vein, this paper focused on describing the fiscal autonomy of Addis Ababa through qualitative and quantitative measurements using financial data between 1993/94 to 2008/09, having the Regions' performance as a comparative bench mark.

1.2. Statement of the problem

As of 1995, the Federal Constitution makes Ethiopia a federal state in which the Regional governments have been provided with substantial expenditure responsibilities and revenue power. Addis Ababa, the area of this study, has not the status of "Regional government" because the Constitution organizes the City as one of the integral component part of the Federal Government, but with full measures of self-administration. The system of Ethiopian intergovernmental fiscal relations in the case of Addis Ababa witnesses the exceptional position of the City and the existence of asymmetry in the country. Unlike the Regional governments, therefore, the specific powers and functions of the City have been defined by legislations of the Federal Government, rather than the Constitution.

Therefore, this paper argues that empirical studies on fiscal status of Addis Ababa City Administration should have addressed this unique position of the City in the structure of intergovernmental relations in the country. Unfortunately, the available studies have not adequately taken this particular aspect of the City in their analysis. Thus, there is no sufficient understanding on how the differences in the structure between Regional governments and Addis Ababa affect the degree of fiscal autonomy of the City. In addition, most of studies on the area usually overstate the actual "fiscal autonomy" of the City due to deficiency in their methodology to incorporate important elements of fiscal autonomy. These studies rely on the

share of aggregate revenue and expenditure of the City as an indicator of the degree of fiscal decentralization. Failing to include elements of political power of the City's local government; to differentiate the aggregate and own revenues of the City and to assess the relative expenditure needs of the City, most studies as well as government officials claim Addis Ababa as a more fiscally autonomous sub national unit of the country.

Thus, the problem statement of this study is that the prior studies have failed to provide comprehensive and clear understanding on the recent performance of IGFRs in Ethiopia in general and in Addis Ababa City in particular as these studies were not able to consider the asymmetry in the ways the City is treated differently using contemporary measurements of fiscal autonomy.

1.3. Research questions

The following questions are expected to be answered by the findings, the interpretation, and the conclusion of the study.

- I.** Have the constitutional and statutory mandates of Addis Ababa provided an adequate enabling framework to enhance its fiscal autonomy?
- II.** Is Addis Ababa able to set and prioritize its own economic and functional expenditure pattern?
- III.** Does Addis Ababa City have adequate control over its own budget and accounts?
- IV.** How far does own-sources revenue of the City cover its expenditure?
- V.** Over which revenue sources does Addis Ababa have the authority to set their bases and /or their rates?
- VI.** Does the fiscal status of Addis Ababa differ from the Regions' ? How?

1.4. Objectives of the study

1.4.1 General objective

The study aims at describing fiscal autonomy of City Government of Addis Ababa.

1.4.2 Specific objectives include:

- I.** Identifying constitutional and statutory bases for ‘local self_ government’ of Addis Ababa City.
- II.** Determining the degree of spending autonomy and fiscal importance of Addis Ababa City Administration.
- III.** Identifying the revenue sources of the City and demonstrating the actual revenue collection trends in comparison with Regions.
- IV.** Describing the degree of revenue autonomy of Addis Ababa City Administration.
- V.** Examining the type, size and consistence of Federal Government transfers to Addis Ababa City Administration and its impacts on its fiscal autonomy.
- VI.** Assessing borrowing power and its regulatory system as well as the practice of Addis Ababa City.
- VII.** Highlighting the ‘intra-city’ fiscal decentralization within the City.
- VIII.** Forwarding relevant recommendations for corrective actions as well as for further studies.

1.5. Significance of the study

The current fiscal decentralization reform in Ethiopia has only less than two decades. It demands substantial studies and debates from different points of view so that valuable feedback would be produced in its practice. With in this direction, the primary significance of this study would be its contribution of reducing the knowledge gap on the status of fiscal autonomy of Addis Ababa City Administration through employing both qualitative and quantitative aspects of fiscal decentralization. The study further manifests the recent trends of measurements of fiscal decentralization. The study also may be a starting point of further studies in the area with different perspectives. Finally, the City Administration could use findings and recommendations of the study as a feed-back to improve the fiscal status of the City.

1.6. Operational definition of variables

Liu (2007) indicates that the flaw in the empirical analysis of fiscal decentralization is the measurement of fiscal decentralization, and Vo (2006) added that the measurement of fiscal decentralization has been very crude. The same would be true in this study. Thus, it is found important to identify the indicators applied in the study as well as to present how these indicators have been measured to describe the degree of fiscal autonomy of Addis Ababa City Administration. Accordingly, the following are the main variables used in the study measured qualitatively and quantitatively,

- I. National enabling framework:** This deals with assessing the constitutional, legislative and policy frameworks at the country level so as to determine the existence of conducive macro level framework within which the city could optimize its degree of fiscal autonomy.
- II. Spending autonomy:** As one of the pillars of fiscal decentralization spending autonomy of Addis Ababa, was employed as a variable to describe fiscal autonomy of Addis Ababa measured qualitatively and quantitatively. Qualitative measurements include the existence of locally elected government and its ability to set the City's economic and functional expenditure patterns as well as the scope of its mandate to make local laws and its budgets. Quantitatively, spending autonomy of the City was analyzed the amount, pattern, composition and type of the City's actual expenditure for 1993/94 -2008/09 fiscal years comparing with that of the Regions'.
- III. Revenue autonomy:** Describing fiscal autonomy of Addis Ababa requires determining the degree of autonomy the City has over its revenues. Qualitative measurements include the fiscal power of the City to determine the base or/and rate as well as assess and administer its revenues. This helps to differentiate the revenue sources of the City to be categorized as 'own source revenues' of the City. Own revenue ratio and own-tax ratio are used to measure the revenue autonomy of the City.

- IV. Borrowing:** This assesses the legal mandate of the City to borrow money and the objectivity and formality of regulatory requirements, if any.
- V. Transfers:** Measured qualitatively and quantitatively, this includes transparency, consistence and adequacy of the Federal Government transfers made to the City.
- VI. Intra – city fiscal decentralization:** The fiscal power of lower tiers of the City Administration was analyzed in terms of their legal base for local government autonomy, of their expenditure, revenue and borrowing mandates. These elements have been measured qualitatively as well as quantitatively.

1.7. Research methods

This section presents the details of how the study was conducted. It explains the descriptive approach employed to describe the degree of fiscal autonomy of Addis Ababa City Administration; sampling technique; data sources and collection methods; and the techniques used to present and analyze the data.

1.7.1. Design of the study

The study was designed in such a manner that incorporated qualitative and quantitative elements so that the City's fiscal autonomy would be touched adequately. Descriptive type of research was used as objectives of the study focused mainly on describing and interpreting fiscal autonomy of Addis Ababa. Thus, the descriptive approach would enable to describe, compare, contrast, classify, analyze and interpret various elements of fiscal power of Addis Ababa. In support of the idea of Ebel and Yilmaz (2002) that the statistics in expenditure, revenue, transfers and borrowing alone do not identify the degree of local government fiscal autonomy as it gives a limited representation of fiscal decentralization, inclusion of qualitative and conceptual analysis was found important apart from quantitative approach. Qualitative type of research was utilized to describe, analyze and interpret various elements of fiscal autonomy of the City such as existence of constitutional and legislative bases of the City for its local government, the degree of its mandate to prioritize its socio-economic policies, revenue sources over which the City has the fiscal power to determine their base or/and rate, and its mandate to retain its revenue fully.

The regulatory framework for borrowing and the system of transfers to the City were also analyzed qualitatively. To further perceive the actual degree of the city's fiscal autonomy, quantitative research was also used.

The data obtained from Ministry of Finance and Economic Development (MoFED) and Bureau of Finance and Economic Development (BoFED) was analyzed and interpreted so as to determine, describe and interpret the City's tax- revenue autonomy, non-tax revenue autonomy, own-revenue ratio; fiscal independence and importance.

1.7.2. Sampling design, procedures and sample size

Intending to describe, analyze and interpret the fiscal autonomy of Addis Ababa City administration, the study employed financial reports of BoFED and MoFED to get much of quantitative data. Moreover, higher officials and senior officers from BoFED and MoFED were interviewed to get more explanation on some issues. Non-probability sampling technique was used focusing on a limited number of informants whom the researcher selected strategically so that their in-depth information would give optimal insight in to issues that required detail explanation. In line with this frame work, the study adopted the following sampling procedures to select interviewees and determine the number of their interviewees.

The first step was initiated from the discussion with the advisor of the paper. He recommended the writer of this study to contact Head of BoFED, currently, she is the Head of Revenue Agency. The Advisor recommend her as she has been well-informant in the broader area of public finance (as she has specialized in the area) in addition to her position to have first hand data on fiscal aspects of the City. Thus, Head of BoFED was selected as an interviewee according to the snowball or referral non-probability sampling technique. But, further efforts were made to ensure she could be reliable data source so that the biase in selection merely on the basis of recommendation would be minimized. Secondly, the Head of BoFED referred to other senior officers in Bureau and Revenue Agency to acquire further data. The criteria of her recommendation was the departments from which the data were required and their experience on their position. Accordingly the Advisor for the Head of BoFED has become one of the

interviewees, he supplied important data particularly on the borrowing ,transfers and spending practices of the City. For questions related to the revenue performance of the City, two senior officers in the Revenue Agency working in the position of “Tax Assessment and collection senior officer” were selected based on her recommendation as well as they were thought well-informant and resourceful about revenue-related issues. Generally, four interviewees were selected from BoFED and Revenue Agency based on “Snowball” sampling technique, but with the intension of their position to provide reliable and accurate data.The technique facilitated the primary data collection efforts. It made easier to distinguish the right data sources due to direction of Head of the BoFED to get access the relevant officers without the usual beureaucratic procedures to get data in other public institutions.

The third step was searching for more data that were inaccessible at the City level. These included the fiscal policy at the country level, the national system of IGFR, and sub-national borrowing, and financial data of Regional governments. To acquire these data, the Director for Treasury Directorate and Macro Economy Policy and Management Core Process in Ministry of Finance and Economic Development (MoFED) were selected purposively as the required data were available there in. Thus, a total of six interviewees were used to gather primary data from MoFED, BoFED and Revenue Agency. Non-probability sampling was utilized to select these respondents. Hence, there found no need of increasing the number of interviewees since the required data to meet objectives and answer questions of the study was obtained sufficiently.

1.7.3. Sources of data and data collection methods

Primary and secondary sources of data were employed so that the research questions and objectives were met optimally. Data from secondary sources were gathered from document reviews such as legislations, financial reports, books, journals and so on. Particular emphasis was given to empirical studies conducted on fiscal autonomy using recent measurements. Website addresses of MoFED, BoFED and the Parliament were exhaustively used to obtain related legislations. Financial data obtained from MoFED and BoFED were also used as secondary sources of data to describe, compare, analyze and interpret the practice and trend of revenue,

expenditure, transfers and borrowing of Addis Ababa City against that of Regions. For expenditure and revenue of Addis Ababa and Regions, 16 years of data (1993/94 - 2008/09) from MoFED were analyzed so that the trend could be demonstrated under border time-series perspective. But, due to doubts on the accuracy of data, there are some deviations of fiscal years. For instance, expenditure data of Regions were found for only 15 fiscal years. Furthermore, planned revenue and transfers of the City were limited to 5 and 6 fiscal years due to lack of accurate data. Primary data was collected through interviews to get detail data from the right sources.

In-depth interview was selected as primary data collection technique due to the fact that the respondents were only six so that managing it would not be difficult; and interview was also an appropriate technique to get detail and complete data since the face-to-face communication was able to facilitate two-ways communication and feedback mechanism. The interview was made individually with jotting down their answer on paper and structuring it home usually in the same day of the interview. Except with the Director for Treasury Directorate, minimum of three contacts were made with other interviewees. Interview schedule was used as data collection instrument. Open ended and semi-structured questions were forwarded to the interviewees. The interview questions were forwarded face-to-face. Moreover, uninterrupted communication was also made with Head of BoFED through e-mail.

1.7.4. Data analysis techniques

The data was analyzed qualitatively and quantitatively. Commonly accepted indicators of fiscal autonomy in the literature have been used as a benchmark against which the data was analyzed. The data was analyzed in such consistent manner being organized as the national enabling environment, spending autonomy, revenue autonomy, transfer, borrowing and intra-city fiscal decentralization. In each of these elements qualitative dimensions come first and quantitative analysis follows. Tables and Figures also contributed a lot by presenting the data in a simplified and comprehensive fashion.

1.8. Limitations of the study

Fiscal autonomy of a SNG is a by-product of various factors such as political, administrative and institutional. It was hardly possible to assess all these factors. Accordingly, the first limitation of the study is that it has not incorporated the impacts of these factors on the City's fiscal autonomy. Secondly, the study may not reason out some of its findings as it is a descriptive research. Thirdly, it was observed that the financial data management at the BoFED as well as Revenue Agency was so poor that it was not possible to get reliable data, particularly on borrowing and transfers. Furthermore, the absence of the data resulted in incorporation of data on transfers in to six fiscal years and on borrowing in to seven fiscal years. This would create inconsistency of analysis. Finally, the study has not employed sophisticated models to analyze the data due to lack of the necessary access and skills in the area.

1.9. Scope of the study

Scope of this study is confined with describing the fiscal autonomy of Addis Ababa City using secondary and primary data as well as 16 years (1993/94-2008/09) of financial data and brief assessment on the fiscal position of Sub-Cities. The reviewed literature focused on fiscal decentralization in the connection with fiscal autonomy of SNGs, and hence other forms of decentralization were not touched in detail. Furthermore, the study does not incorporate the analysis of the impacts of fiscal autonomy on service delivery, efficiency, accountability.

1.10. Organization of the paper

The paper is organized with in four chapters, excluding the pre-pages and annexes. Chapter one introduces the background, problems, objectives and methodology of the study. The second chapter presents the reviewed literature on fiscal decentralization and fiscal autonomy. In chapter three, data presentation, analysis and findings of the study are entailed. Finally, chapter four concludes and recommends based on the analysis, findings, interpretation and implications.

Chapter Two

Review of Related Literature

2.1. Introduction

The concept of decentralization in general and that of fiscal decentralization in particular is vast and broad with varying meaning and application so that detail review and presentation on each element would be difficult. This chapter provides the reviewed literature on fiscal decentralization in general and fiscal autonomy of Sub National Governments (SNGs) in particular. It highlights the conceptual frameworks as well as assumed advantages and disadvantages of fiscal decentralization; the trends and the current status of fiscal decentralization reforms, particularly in developing countries; the national enabling environment, expenditure assignment and spending autonomy, revenue assignment and revenue autonomy, Inter Governmental Fiscal Transfers (IGFTs), borrowing and fiscal autonomy of SNGs and its measurements.

2.2. Conceptual frameworks of fiscal decentralization

Decentralization is a complex and multifaceted concept that spans fiscal, political and administrative dimensions. While measuring decentralization is equally complex, the fiscal flows to, from and among different levels of government can be used to assess aspects of fiscal decentralization (World Bank, 2004). Although there are several ways to describe the process of fiscal decentralization, Martinez-Vazquez and McNab (2001, pp: 2) indicate that its essence is captured by the two related processes of either “delegation” or “devolution” of fiscal authority. They further state that in either case, decision making power on the composition of expenditures and often on the composition and level of revenues is shifted to separately elected SNGs. Fiscal decentralization can be broadly defined as public sector with more than one fiscal tier, ignoring any constitutional distinction between a unitary and a federal state (Conyers, 1990). UNDP (1999) views fiscal decentralization as the core of any effort to reform the public sector. According to Oates (1972), fiscal decentralization refers to the degree of independent decision-making power in the provision of public services at different level of government. However,

Kwon (2002) argues that the concept of fiscal decentralization needs to be seen on a continuous spectrum rather than being dichotomously centralized or decentralized. According to Weingast (2006: pp, 5), federalism, and decentralization more generally, encompasses a wide range of different political-economic systems, not one, whose political and economic properties vary widely.

Much of the literature focuses on the fiscal dimension of decentralization since intergovernmental fiscal relations is behind much of the rationale for decentralization in general (Smoke, 2000). Fiscal decentralization has been a pressing issue in the academic discipline of public finance as well as empirical economics for years (Liu, 2007). According to Litvack et al (1998) decentralization – the assignment of fiscal, political, and administrative responsibilities to lower levels of government- is occurring world wide for different reasons, at different places, and through different means. Fiscal decentralization has been one of the major interests of economists, development specialists, multilateral development agencies and governments (Halder, 2007). In addressing the background deriving forces of decentralization, Litvack et al (1998) made three points clear. First, global political changes have given focus to local demands and the need to bring economic and political systems closer to local communities. Secondly; the size of government needed to manage economic systems has also been changed in response to technological changes and world wide integration of factors market. Finally, the collapse of central economic systems has encouraged regional and economic process that facilitated decentralization.

Various theories and hypotheses have been developed arguing for decentralization as a necessary condition for promoting efficiency of service delivery, good governance, democracy and economic development. However, empirical research testing the theories and hypotheses of decentralization has come up with mixed results (Dib, 2007). In addition to this, explaining and measuring the implementation of decentralization reforms through unambiguous and established variables have been problematic. In line with this; empirical evidence to justify or discredit the pursuit of fiscal decentralization in developing countries is also scant and mixed (Smoke, 2000).

2.3. Arguments for and against fiscal decentralization

Fiscal decentralization has been an important topic for many years now. It has recently become a central concern, especially in developing and transition economies which try to find a way to manage the public side of their growth process (Kwon, 2002). For, Bahil (2009), the most important benefit of fiscal decentralization is the welfare gain that comes from moving governance closer to the people. Several accepted theories provide strong rationale for decentralized decision making on the grounds of efficiency, accountability, manageability, and autonomy. George Stigler (cited in Shah, 1994: pp: 46) identifies two principles of jurisdictional design: a representative government works best the closer it is to the people; and people should have the right to vote for the kinds and amounts of public services they want. The principles of “fiscal equivalency”, from the literature of public choice, also propose equating the political jurisdiction with the benefit area (Shah, 1994). A related idea, the “corresponding theory principle”, is proposed by Oates (1972). According to this principle, the jurisdiction determining the level of provision of each public good should include precisely the set of individuals that consume it. Finally, according to the “decentralization theorem”, each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalize benefits and costs of such provision (Shah, 1994).

The basic rationale for decentralization is the proximity of the government to the people. In theory –if not always in fact- decentralization makes it possible for people to have greater influence on the decisions of government that affect their lives (Ahmed, 1997). Oates (1972) argues that for certain public goods or services such as local public goods, providing them in a decentralized fashion can increase efficiency and accountability in resource allocation because local government can be better tailored to the geographical beneficiaries so that local preferences and needs would be better recognized. Further more fiscal decentralization places sub-national governments in competition with one another. Hence, pressure from inter-jurisdictional competition may motivate local governments to be innovative and accountable to their residents and to foster local economic prosperity rather than costly market intervention, service to interest groups, and corruption (Weingast, 2006).

The tendency in the literature on fiscal decentralization to place emphasis on advantages not disadvantages/limitations is, however, a misplaced emphasis. It is a misplaced because decentralization does not suit all conditions in countries, or for that matter, circumstances prevailing over different historical periods (Oyugi, 2000). Accordingly, Elhiraika, (2006; pp, 4) shows that assignment of expenditure and financing responsibilities to sub-national government can adversely affect service delivery in different ways. Ahmed et al. (2005) also identifies a number of common factors leading to the adverse effects of fiscal decentralization. These factors include lack of capacity at sub-national government levels; misalignment of responsibilities owing to incomplete decentralization; political capture by local elites; and a soft budget constraint that leads to over borrowing by sub-national governments. With out proper fiscal and political mechanisms, Falleti (2005) argues against the devolution of power to sub-national officials and shows that it can augment distributional conflicts, foster sub-national authoritarianism, and exacerbate patronage.

Other studies (Prud' homme, 2000; Kwon, 2002) indicate the theoretical arguments for and the conventional wisdom of fiscal decentralization may remain true in developed countries. They hold that the conventional argument that decentralized provision of public goods will increase efficiency in resource allocation may not be applicable in developing countries. The reason is that most developing countries do not meet implicit or explicit assumptions posed by fiscal decentralization theory. In developing countries, for example, local voter preferences may not be as readily reflected in local budget outcomes because they have weak administrative capacity to carry out their own fiscal decisions. Without independent decision making capacity in determining the quantity and quality of public goods provided and sources of finance that internalize the costs, decentralized provision local public goods may not increase efficiency. They also argue that in many developing countries where land and labor markets do not function well and democracy is at its infant stage, the assumption that people can move easily between jurisdictions or make their voices heard through the political process is not realistic. Elected officials often lack incentives to keep their promises because of a gross mismatch between available resources and promised expenditure. Therefore, even if elected official wanted to fulfill their mandates from their voters, they can not do so due to lack of resources.

Weingast (2006) indicates that poorly designed decentralization has made things worse in some developing countries. In these countries, greater freedom will not result in greater responsiveness to local citizen welfare, but instead greater authority and resources allow local officials to create a larger scope for the system of local rents and corruption. An alternative to this across the boarder decentralization is to decentralize in a series of steps; the Chinese successfully employed this strategy. Martinez-Vazquez and McNab (2001) indicate that there is often confusion in the terminology of fiscal decentralization in developing countries. What some developing countries call fiscal decentralization is actually nothing more than the geographical deconcentration of central bureaucracy and service delivery. But, without geographic similarities, deconcentration has little to do with fiscal decentralization.

However, the real issue is probably not whether there should be fiscal decentralization-it is happening and will continue to happen in many countries; rather, the issue is how to structure an appropriate balance between local autonomy and central control that will allow the potential benefits of fiscal decentralization be realized without undermining national objectives(World Bank,2001). As Litvack et al (1998) observes decentralization is neither good nor bad for efficiency, equity, or macroeconomic stability; but rather its effects depend on institution-specific design. Therefore, the discussion on centralization and decentralization should not be perceived as a situation in which each a single government controls all aspects of activities, or the opposite extreme in which each community operates with total autonomy. It is best, therefore, to think the extent of decentralization as a continuum rather than an either-or proposition (Rosen, 1985). Moving forward with fiscal decentralization requires considerable capacity. Enhancing local government autonomy requires to mobilize own resources from the local community and reduce financial dependency on the central government where the local community is rich and those potential revenue bases, but it has limited capacity to assess and collect the revenue. Katorobo (2004) has identified autonomy, revenue adequacy, equity, predictability, simplicity, and hard budget constraint as basic principles of fiscal decentralization.

2.4. Fiscal autonomy of sub-national governments and its measurements

Fiscal decentralization has to do with the degree of fiscal autonomy and responsibility given to SNGs. It is a subject on policy agenda in many developing, transitional and industrialized countries (Bahl, 2000). According to Bell et al (2006), a key characteristics of fiscal decentralization is the degree of autonomy that SNGs have over revenue raising and spending decisions. For Vo (2007, pp: 2), fiscal autonomy and fiscal importance of SNGs are two of the cornerstones of fiscal federalism literature. Fiscal autonomy of SNGs, implies that, to some extent, SNGs can arrange their own sources of revenues by exercising their taxing powers to cover costs occurring in the provision of public goods and services.

Fiscal autonomy of SNGs is fundamental and important feature of fiscal decentralization. However, fiscal autonomy is only one aspects of fiscal decentralization, which also depends on the proportion of national fiscal activity undertaken by SNGs, or their fiscal importance (Vo, 2007). Bell et al (2006) view ‘fiscal autonomy’ of SNGs as necessary condition to realize full benefits of fiscal decentralization, but it is not sufficient to guarantee such an outcome. Decentralization and local autonomy have often been regarded as synonyms, i.e. more extensive decentralization automatically mean more extensive local autonomy. However, such a comparison is a simplified one. Instead, decentralization needs to be regarded as a process with rendered meaning within a framework of which local autonomy is a means to meet the set objectives (Lohmus, 2008). According to Chapman (1999) there is a difference between the local government autonomy and local government fiscal autonomy. Local government autonomy is a far broader examination of the jurisdictions politics, its ability to respond to relative changes in aggregate community preferences. Local government fiscal autonomy is a narrower concept. Chapman (1999) takes local fiscal autonomy as one of the necessary conditions for local autonomy to exist. Fiscal autonomy relates to the ability of the local jurisdiction both to raise enough revenues from the local economy and then to determine how to spend those revenues. Fiscal autonomy refers to the ability of the jurisdiction to set tax rates and establish the revenues base without outside influence as well as having the ability to provide the service levels that are demanded by the jurisdiction’s citizens.

Various studies confirm the importance of developing measures of fiscal decentralization that capture the degree of autonomy SNGs have in revenue raising decisions (Bell, et al 2006). However, conventional indicators of fiscal decentralization are not able to reflect the real degree of fiscal autonomy of SNGs (Nobou, et al, 2005). Vo (2007) further states that measurement of fiscal decentralization in studies of public finance has been very crude. Typically, either revenue or expenditure from SNGs has been employed without taking in to account the fiscal autonomy of lower level of governments. According to Liu (2007), the most apparent flaw in the empirical analysis of fiscal decentralization is the measurement of fiscal decentralization. Most of the empirical studies aimed at measuring the degree of fiscal decentralization have been primarily focusing on quantitative aspects of revenue and expenditure ratios of SNGs from the total revenue and expenditure of the nation. But, although the share of SNGs in total government spending or revenue gives us an idea about the relative importance of SNGs in total public sector, neither of them is a perfect measure of fiscal decentralization (Ebel and Yilmaz, 2002). Too often, the standard approaches to developing indicators of fiscal decentralization fail to take in to account the different degree of decentralization and the true decision making authority localities over revenues and expenditures. Furthermore, absence of qualitative indicators for measuring fiscal decentralization is one of the main problem remain unsolved in the empirical analysis literature.

The current and most widely used indicators of fiscal decentralization, sub-national governments' revenue and expenditure ratios, have been criticized as a too-simplistic measure to accurately gauge the degree of fiscal decentralization among the nations (Liu, 2007). Halder (2007) also notes that the inconsistency of measures of the degree of fiscal decentralization has produced different and sometimes opposite correlation. Unlike the traditional method for measuring fiscal decentralization, experts in public finance have been more concerned with qualitative aspects of fiscal decentralization such as the power of SNGs to decide issues such as the appropriate tax base, tax rate, regulatory framework for borrowing, nature of IGFTs (Liu, 2007). Recent works (such as World Bank, 2004; Vo, 2006; Liu, 2007; Ebel and Yilmaz, 2001) have attempted to create comprehensive qualitative indicators and variables for more accurate measurements of fiscal decentralization focusing on key fiscal, political and administrative variables at the national and local levels. Moreover, Bahl (1999) also indicates that a measure

of fiscal decentralization should reflect the key characteristics of a fiscally decentralized system including the existence of locally elected council and locally approved budget. Prud' homme (2001) emphasizes the need to consider the election rules by stating that there is no decentralization without relatively independent and politically responsible SNGs. Bell, et al (2006) stresses the necessity of considering fiscal decentralization as a comprehensive system including the basic structure of government and institutions that support accountability. Thus, indicators of fiscal decentralization need to include indicators of fiscal decentralization-revenue raising and spending decentralization-as well as political decentralization.

The local government's own revenue share of total revenue is defined as "autonomy power" of SNGs by Akai (2005; pp: 7). Thus, local government's autonomy is high if all fiscal needs are financed that reflects the degree of fiscal independence. For Chapman (1999: pp: 10), the ability to command resources and the ability to spend those resources in ways that reflect citizen tastes and preferences are measures of local government fiscal autonomy. There is local government revenue autonomy as well as local government expenditure autonomy. Therefore, for Chapman, there are two components to fiscal autonomy: a gaining resource component and a spending resource component. While a jurisdiction does not need to have total control over each component, it should have the ability, at a minimum to influence each of the components at the margin. The independent fiscal decision-making power at different levels of government might be measured in terms of the fiscal importance of each level of government (known, 2002). Stein (cited in Dib,2007) in his study on Latin America applies spending as a percentage of Gross Domestic Product(GDP) on the product of the degree of fiscal decentralization (measured by the ratio of sub-national spending to total government spending); vertical imbalances (measured by the ratio of government grants to total local government revenues); and an index of borrowing autonomy.

Katorbo (2004) notes, however, measures of expenditure and revenue shares can be very misleading. It is vital to interpret their meaning in terms of analysis of the contingent factor. He gives an example of Uganda case where large majority of central revenues come from taxes on exports, on remittances, and donors. The dominant economy of the sub national government is subsistence peasant agriculture. To expect the sub national governments to raise own funds is not

practical. And so the level of autonomy that they may exercise is circumscribed by these contingent factors. The above paragraphs present the concepts of fiscal autonomy of SNGs as well as the complexity associated with its measurements. But, further discussion is required as to clearly measure the degree of fiscal autonomy that is the result of comprehensive framework of fiscal decentralization. Thus, the following sections deal with the elements of effective Inter Governmental Fiscal Relations (IGFRs) and their quantitative and qualitative measurements in line with their relationships with fiscal autonomy of SNGs.

2.4.1 National enabling environment

An enabling environment for fiscal decentralization can begin with the constitutional or legal mandates for some minimum level of autonomy, rights and responsibilities for sub-national governments. This provides a foundation on which to build decentralization. A number of elements appear to be critical in establishing a sustainable enabling environment for fiscal decentralization. These include:-

I. Constitutional framework

The greatest protection of transferred powers to sub-national governments is when provisions are entrenched in the constitution; this would support decentralization and strengthen decentralized levels of government. But it does not by any means guarantee successful fiscal decentralization. There are many countries with constitutional clauses and laws on SNGs that have not managed to decentralize successfully (Smoke, 2000).

II. Institutional framework

Effective fiscal decentralization system requires appropriately empowered institutions and mechanisms for coordinating the complex activities typically associated with fiscal decentralization. These promote checks and balances, separation of powers, and avoidance of conflicts of interest. The absence of institutionalized authority allows the center to threaten sub-

national jurisdictions who seek policy independency (Weingast, 2006). Shah (2004) adds the fact that designing effective institutional frameworks for IGFRs helps to coordinate policies.

III. An adequate political will

Even if there are legislative provisions for the establishment of decentralized governance, they will remain unimplemented unless there is a political elite, or leadership, that has very high commitment and belief in the goodness and benefits of decentralized governance (Katorobo, 2004). This political commitment should be strong, pervasive and enduring. Smoke (2000) further argues that in most developing countries decentralization programs have been failed as they have been embarked by the pressure of international budgetary pressure in the absence of a genuine national commitment.

IV. Public policy and legislative framework

Fiscal decentralization issues, needs and problems should be systematically assessed and evaluated by a taskforce or a study commission leading to policy proposals and recommendations. According to Katorobo (2004), such sound policy analysis is the essential foundation for public policy frame works that will enable the government to formulate and design feasible and sustainable decentralization policies and programs. The risk of fiscal decentralization by government policies without legislative frameworks is that governments can withdraw the transferred powers any time. And such transfers and withdraws can be erratic and disruptive, leaving sub national governments unable to plan on the basis of uncertain expectations. Local government legislative frameworks clarify and specify transferred powers and resources; they define what powers are the exclusive domains of each level of government and which functions are shared between tiers of government (Smoke, 2000).

2.4.2 Expenditure assignment and spending autonomy of sub-national governments.

The first fundamental step in the design of a system of IGFRs should be a clear assignment of functional responsibilities among different levels of government (McClure and Vaillancourt,

2006). Instability and controversy in the practice of decentralized systems has followed when pertinent legislation was silent or unclear about competencies and expenditure obligations of different levels of government (Vazquez, 1998). It is argued that expenditure assignment is the means to determine government financial needs. In a properly structured fiscal decentralization system, money always follows functions, not precede them (Smoke, 2000). The focus on the revenue side of decentralization and the neglect a clearer assignment of expenditure responsibilities has been a common problem in the decentralization reforms of many developing countries (Vazquez, 1998). Countries also fail to define a comprehensive decentralization strategy before commencing reforms and devolving expenditure responsibilities. Vazquez (1998) further states that designing the other important pieces of a system of decentralized finance (notably, revenue assignment, transfer, and borrowing) in the absence of clear expenditure assignment is “to put the car before the horse”.

The traditional theory of fiscal federalism identifies three major functions for the public sector (Oates, 1972). The theory assigns the stabilization and redistribution functions to the national government, while it assigns a significant role to sub-national governments in allocating resources (Fjeldstad, 2001). Fiscal and monetary policies are the two main instruments of macroeconomic policy. The stabilizing role is assigned to the central government because: (1) sub national authorities have very few or no incentive to undertake economic stabilization policies; and (2) lower level of governments often lack the necessary macroeconomic instruments to carryout such policies (World Bank, 2000). However, a decentralized fiscal system may make macroeconomic policies more difficult to implement (Prud' homme, 1995).

The principal responsibility of income distribution is in the hands of the central government because of mainly three reasons; (1) it is only the central government that is in a position to redistribute resource from the wealthier to poorer local governments; (2) differential local redistribution programs would be expected to create problems if factors are mobile; and (3) local governments tend to have access to revenue sources that are not easily levied in a way that is progressive with respect to income (Prud' homme, 1995; Smoke,2001). But, empirical studies find that SNG could also play significant roles in the function of income distribution (Ebel and Yilmaz, 2002)

The literatures and empirical studies assign a significant role of resource allocation to sub-national governments. If preferences are heterogeneous across jurisdictions, which is most likely the case, decentralized decision-making power as to the provision of local public goods and services improves efficiency by tailoring services to the preferences of the local populations (Fjeldstad, 2001). The main argument is that local governments are closer to the local population and can identify their choice and preferences better than the central government. Dabla-Norris and Wade (2002) argue that sound and efficient decentralization requires a close correspondence between responsibility and decision making authority. Moreover, as long as there is close relationship between the benefits from the public services and taxes on the local taxpayers, there is additional incentive to utilize resources efficiently and cost effectively. The theory also recognizes the need for local authorities to exercise choice in the provisions of public services that are of higher demand instead of resorting to the unitary solution (Smoke, 2000; Derese, 2003).

Finally, when there are a large number of decentralized governments, there is likely to be greater experimentation and innovation (i.e. healthy competition among local governments) in the provision of local public goods, potentially leading to improvement in overall efficiency of resource allocation (Derese, 2003). On the other hand, the central government will be responsible for functions with strictly national benefits where economies of scale are important and functions with national redistributive or social insurance objectives (Sewell and Wallich cited in Abate, 2009).

I. Spending autonomy of sub national governments

Spending autonomy consists of the ability of SNG to determine initial expenditure patterns and to change expenditure patterns. Katarobo (2004) further argues that SNGs should be independent in setting their own expenditure priorities. If priorities are given by centralized structures, then it is not decentralization, because SNG is being treated essentially as an appendage of central government.

Devolution of spending decisions achieves efficient and locally accountable service provision. Full spending autonomy under devolution would imply that SNGs are fully able to set their own economic and functional expenditure patterns. Generally, fiscal decentralization is interpreted as devolution of decision-making authority to a lower level of governments (Akai, 2005). The degree of autonomy may differ across different jurisdictions classifications (e.g., health, education). A higher degree of revenue autonomy should be reflected in a higher degree of expenditure autonomy. For example, the predominance of tied and discretionary grants will mean that local governments have limited autonomy over expenditure (Vo, 2006). The structure of LG responsibilities and resources makes a substantial differences to its discretion – its ability to make decisions over the nature and levels of local services. For example, a LG should have more ability to determine its level of expenditure if it obtains a significant proportion of its revenue from local taxes and charges which it can vary (Davy, 2003). Oates (1972) argues that the greatest efficiency is achieved when budgetary choices are made by local officials elected by local people who have to meet the full cost of their decisions through local taxes.

Both quantitative and qualitative indicators have been introduced to measure the degree of expenditure decentralization Oates (1972), for instance, developed “expenditure ratio” i.e., share of expenditure of SNGs form that of the total government’s. Halder (2007) subtracted the grant amount in measuring expenditure ratio to avoid double counting. Vo (2006) used sub-national share of expenditure as an indicator of the relative importance of SNGs. Accordingly the larger the portion of the total public spending cake attributable to SNGs, the higher the degree of fiscal importance and the more likely it is that the benefits from the law of subsidiary will be realized. It is however argued that the focus on the ratio of sub national expenditure does not identify the degree of local expenditure autonomy (Ebel and Yilmaz; 2002). As Musgrave (1959) has pointed out, local governments which acts central expenditure agents do not reflect expenditure decentralization in a meaningful sense, just as centrally collected but shared taxes do not constitute true revenue decentralization.

The key question to ask therefore is whether SNGs have the autonomy to prioritize particular functional and economic expenditure areas. It is therefore important to examine the degree and quality of decisions-making autonomy of SNGs over decentralized service delivery across

economic and functional categories; and the degree of autonomy of SNGS have over inter-sectoral allocations as well as for the management of expenditures within a sector such as, recurrent vs. capital expenditures (Bell, et al 2006). Falleti (2005) incorporates another dimension, i.e the policy making authority, which measures the degree of autonomy of sub-national officials to design, evaluate, and decide on issues concerning a specific policy area. Devolution of spending responsibilities would require a local government that has: (i) a democratically representative and autonomous local political authority; (ii) a clear mandate to provide a wide range services; (iii) control of the local executive and the technical staff; and (iv) the authority to make and enforce local laws (Bell, et al, 2006).

Bahl (2006) identifies the following factors that would affect the degree of expenditure decentralization: the degree to which local councils are popularly elected and the degree to which local councils appoint and dismiss the chief local operating officers; whether the number and salaries of local government's are determined by the local or the central government. Bell, et al (2006; pp: 27) have adopted scoring methodology to measure the degree of spending autonomy of SNGs in six core areas: i) broad control over policy and budget, ii) civil service, iii) standard setting and regulations, iv) service delivery, v) administration: and vi) monitoring and evaluation. In terms of intergovernmental balance of power, Falleti (2005) includes the territorial representation of interests in the national legislative, which reports the average degree of overrepresentation of the sub national units in the lower and upper chamber of congress. Though revenues can be more directly mapped across a spectrum of degrees of autonomy, the expenditure side poses greater challenges. First, it will typically be very difficult to map respective expenditure items to a particular level of autonomy, especially if these are financed by different sources. Second, such a mechanistic mapping as more readily amenable to the revenue side does not appear to be feasible on expenditure side. Moreover, it is still difficult to quantitatively measure the allocation of authority (Akai, 2005) and it may not prove to be equally difficult to substitute with proxy variables.

2.4.3 Revenue assignment and revenue autonomy of sub-national governments

If fiscal decentralization is to be a reality, sub national governments must control their own sources of revenues. Sub national governments that lack independent sources of revenue can never be truly enjoy fiscal autonomy (McClure and Vaillancourt, 2006). According to McClure and Vazquez (1998) a rational assignment of taxing powers helps provide each level of government control over its fiscal destiny. It allows choice in the level of public spending at each level by government. The question, then, is which revenue sources can and should be assigned to sub national level of government and how these assignments are to be effected. However, there is no uniform agreement among policy makers about which taxes should be assigned to which level of government (Musgrave, 1983).

I.Principles of revenue assignment

Though there is no ideal assignment of taxes between central and lower levels of government a set of tax assignment rules has been established in the theory of fiscal federalism. Fjeldstad (2001) underlined the point that these principles of tax assignment are related to the respective responsibilities of central and lower tiers of government in macroeconomic stabilization, income distribution and resource allocation. Litvack et al. (1998) summarized the following principles of tax assignment: (1) taxes suitable for economic stabilization, progressive re-distributional taxes, personal taxes with progressive rates, and tax bases distributed highly unequally between jurisdictions should be levied by central government; (2) local governments should tax revenue bases with low mobility between jurisdictions (such as land and real estate) in addition to applying user charges wherever possible; and (3) benefit taxes and user charges may be appropriately used by both central and local government.

Bahl and Bird (2008; pp: 8) suggested four basic principles for assigning revenues to SNGs. First, sub-national taxes should not unduly distort the allocation of resources. Second, to the extent possible governments at all levels should bear significant responsibility at the margin for financing the expenditures for which they are politically responsible. Third, ideally own-source revenues should be sufficient to enable at least the richest SNGs to finance from their own

resources all locally provided services that primarily benefit local residents. Fourth, to the extent possible, SN revenues should burden only local residents, preferably in relation to the perceived benefit they receive from local services. To the extent possible, services provided by government should be financed by user charges and fees; to Musgrave (1959) this is both fair and efficient, in the sense of encouraging responsible use of the national economic resources. Each level of government should be assigned taxes that are related to the benefits of its spending. This indicates the resource allocation benefits of relating taxes to benefits paid.

II. Revenue autonomy of sub- national governments

In most empirical studies, the degrees of revenue decentralization has been measured quantitatively as the share of SNGs revenue to the total revenue of a country neglecting the degree of control SNGs have over their revenues and own sources of revenue over which SNGs have policy autonomy (Vo, 2006). For instance, Oates (1972) introduced “revenue ratio” that compares the SNGs revenue with that of the total government as one of the standard measure of fiscal decentralization. Halder (2007) also applies revenue ratio excluding grants as a composite measure of fiscal decentralization. Recent work on revenue decentralization has sought to not just capture the extent of revenues (e.g., local revenues as share of total government revenues), but to measure the actual degree of autonomy localities have over revenues. Broadly, this can be seen as a continuum along three types of revenues: own-sources of revenues, shared revenues, and a variety of transfers (Bell, et al, 2006). In term of the degree of fiscal autonomy of SNGs, more emphasis needs to be given to the “own revenues” than the total revenues of SNGs. The key point is that unless local governments do not have some significant degree of freedom alter the level of and composition of their revenues neither local autonomy nor local accountability is meaningful (Bahl and Bird; 2008). Accordingly, recent trend indicates incorporation of “own revenues” in the measurement of fiscal autonomy of SNGs. Bird (2000) defines own revenues as taxes; (i)that are assessed by SNGs; (ii) for which SNGs set the rate; and (iii) the revenues accrue to the SNGs.

Furthermore, OECD (2002) classified the tax revenues of local governments in to eight categories based on the degree of the local control over the rate and base of a tax. Accordingly,

SNGs have total or significant control over the taxes of which SNGs set the rate or/and base as well as they set revenues split between central and local governments, whereas local fiscal autonomy is limited or non-existence where the central government sets tax rates and bases and revenue split formula. Non-tax revenues are included in “locally owned revenues”, while fiscal transfers are not included. McLure and Martinez (2006), however considers grants from a higher-level government as “own revenues” provided that the grants are determined in an objective way and are guaranteed by the constitution or legislation of long-standing. Bahl and Bird (2008; pp; 6) define a completely local tax as one that satisfies six distinct conditions: local governments can decide whether to levy the tax or not; determine the precise base of the tax; decide the tax rate; in the case of “direct” taxes assess the tax imposed on any particular taxpayers; administer the tax and get to keep all they collect. In the real world, however, many taxes may possess only one or two of these characteristics, and the “ownership” of the levy may be unclear.

Due to recent emphasis given to “own-revenues” of SNGs, empirical studies on fiscal decentralization have taken “own-revenues” as one of the key indicator of fiscal autonomy of SNGs. For instance, Nobou, et al (2005) defines the autonomy indicators as the local government’s own revenue share of its total revenues as an indicator of the degree of fiscal independence of SNGs. Other writers, such as Vo (2006) take the greater share of SNGs expenditure funded from SNGs own sourced revenue as an indication of higher degree of fiscal autonomy of SNGs. Uchimura and Suzuki (2009) also measure local fiscal autonomy simply as ratio of local own revenue to local total revenue. Local government’s autonomy in setting tax rates and determining tax bases is an important and an integral part of fiscal autonomy (Bahl 2009). Vo (2006) considers this autonomy as a necessary condition for a significant level of fiscal autonomy of SNGs. The discretion to set the tax rates and/or bases helps SNGs adjust their revenue by varying the rates and/or the bases in response to fiscal demand for publicly provided goods and services so that the flexibility and the potential for creativity by SNGs for efficiency will be increased. Bahl and Bird (2008) stress that the most critical aspect of sub national taxing power is who is politically responsible for setting the tax rate. Despite the fact that the technical background and principles of tax assignment are useful in IGFRs, practical experience shows that country-specific factors have a significant role to play (Fjeldstad, 2001).

2.4.4 Inter Governmental Fiscal Transfers (IGFTs)

IGFTs is one of the most important aspects of fiscal decentralization. The distribution of the tax bases and the demand for public goods and services does not follow symmetrical pattern and this gives rise to the emergence of fiscal imbalances. Vertical fiscal imbalances are the results of allocation of functions the cost of which is higher than the sources of revenues assigned to local governments. Horizontal fiscal imbalance on the other hands rises due to uneven distributions of economic resources and economic activities across regions where as expenditure requirements are spread more evenly. Thus, the problems of fiscal imbalances require measures that include the provision of transfers as well as policies that promote balanced growth of regional economies (Eshetu, 1994). Bird and Smart (2002) state that IGFTs are neither inherently good nor bad. What matters are their effect on such policy out comes as allocative efficiency, distributional equity and macroeconomic stability. The most critical aspect of IGFRs is thus not who gives them or who gets them but their effects on policy objectives. Intergovernmental transfer programs serve multiple and often interrelated objectives. First, they help cover sub national units fiscal imbalances, and supplementing inadequate local own-government revenues to improve the ability of sub national units to meet their expenditure responsibilities. Second, IGFTs can be used to meet national redistribution objectives, helping to offset fiscal capacity differences among local governments- maintaining horizontal fiscal balance.

An equalization transfer may have two distinct rationales; (1) to provide the necessary underpinning for the decentralization in general, by equalizing to some level of fiscal capacity of territorial entities, thus putting all closer to the same footing with respect to incentives; (2) to provide sufficient resources to enable all local governments, even the smallest and poorest, to provide basic package of local services; transfer can be used to encourage local expenditures on particular goods and services that exhibit externalities or are considered to be basic needs that should be distributed less equally than the ability to pay for them-matching grants. While of course rendering local governments more susceptible to central influence and control, matching grants may also have the important political advantages of introducing an element of local involvement, commitment, accountability and responsibility of the aided activities (Smoke, 2000; Shah, 1994).

Intergovernmental transfer may take different forms, depending on the underlying rationale for the transfer. In most literature of fiscal decentralization, transfers are broadly categorized into unconditional and conditional transfers. Unconditional transfers can be spent on any expenditure functions. No conditions are attached to the use of unconditional funds. They are given on a per capita basis or/ and formula. On the other hand, conditional transfers have conditions attached to them. The conditionality refers to earmarking by the central government to finance certain services such as primary education, primary health services, water supply, agricultural extension, roads, etc. Such earmarking of grants will of course limit the autonomy of the local governments and; hence, partly negating the arguments for decentralization (Slack, 2007; Builey, 1999; Oates 1999).

I. The design of transfer and its impact on fiscal autonomy

Since circumstances and objectives differ, no simple uniform pattern of transfer is universally appropriate. A good IGFTs system is the one, which manifests transparency, predictability and autonomy in its design. A grant's design should reflect the situation and objectives. Shah (1994) gives the following practical examples.

- Situation: fiscal deficiencies caused by spending needs being greater than revenue-raising capacity calls for non-matching transfers; changing in taxing responsibilities or tax base or revenue-sharing mechanisms.
- Situation: different net fiscal benefits in, or fiscal imbalances among, different jurisdictions calls for general non-matching equalization transfers.
- Situation: benefit spillover calls for compensation through open-ended matching transfer, with matching rate determined by the benefit-spill out ratio.
- Situation: ensuring minimum standards of service delivery across the nation calls for conditional non-matching transfers.

Intergovernmental fiscal transfers are compromise solutions in the debate over the division of revenue authority and expenditure responsibilities. The degree of autonomy a system of transfers gives local governments in making their budget decisions depends on the structure of the system (Bahl, 2000). According to the OECD typology (2002), the main distinction is between general

grants and specific grants. General-purpose grants are those which can be used as if they were the receiving SN government's own tax revenues. These grants can be distributed according to some measure of taxable capacity and/or expenditure needs (related to objective criteria) or own-tax effort in such a way that an increase in the level of local taxation for a given SNG results in an increase in the amounts grants under conditional grants, the central government can control local expenditures. Discretionary grants, on the other hand, include grants which the central government may or may not distribute and which are distributed at the expense of the government.

II. Inter governmental fiscal transfers and local autonomy

According to Bahl (1998), there is no optimal grant structure. Some do push fiscal decentralization and local autonomy but others, particularly in the developing world, are more concerned with tax effort, equalization, or the stimulation of local expenditures on particular activities. Bahl and Bird (2008) argue that given political realities one can not usually decentralize significant revenues to SNGs without having in place an intergovernmental transfer system to offset at least some of dis-equalizing effects that would otherwise occur. Bahl and Bird (2008) state that heavy reliance on intergovernmental transfers drives down the tax price of public services and increases the upward pressure on SNG expenditure.

One of the policy choices in transfer design concerns the degree of autonomy enjoyed by recipient SNG jurisdictions in using the funds from a transfer instrument. Greater SN autonomy also means that the central government has less control over how the funds are spent. Along this dimension, Schroeder and Smoke (2004) classify transfers into three broad categories. First, general-purpose allocations give a SNG full autonomy over the use of transfer funds (within the legal limits of decentralized functional responsibilities). A recipient jurisdiction can allocate the money for whatever purpose it desires. Second, sectorally limited block allocations permit the recipient government to choose how funds are to be used, but only within a particular sector (such as health, education). Finally, specific-purpose transfers can be highly restrictive in how the funds are spent. Restrictions may apply to choices between labor and non-labor inputs and/or for particular spending plans.

2.4.5 Sub national government borrowing and the regulatory framework

Developing an adequate local access to investment capital is one of the important pillars of fiscal decentralization. Local borrowing is an important source for financing long-term development projects such as roads, bridges, and water works. Local borrowing for such projects is justified on the ground that the benefits of these projects often last decades; thus, future taxpayers should bear the costs of these projects (Mochida, 2006). Sub-national governments in many developing countries get much of their capital budget from intergovernmental transfers, but some decentralized governments, typically states, provinces, and large cities, are able to borrow in some countries (Smoke, 2000). Hicks (1946), however, warns that borrowing freely for current needs put local governments in danger of bankruptcy, a situation which never be allowed to arise.

Borrowing must comply with all legal requirements. Before borrowing money, it is crucial to determine any restrictions on: the amount of debt which can be incurred, types of debt, maturity dates, and the process to be followed. Constitutional provisions or statutory laws are the most common means of limiting local government's ability to borrow money. These laws are usually targeted at tax supported obligations because the debt is secured by a pledge of tax revenues. There may be a limit on the percentage or type of assets that can be pledged. It is prudent financial management to limit the ability to pledge revenues to local government assets through borrowing. Establishing an effective debt management program helps preserve the local government's long term fiscal viability. Ahmed (1999; pp, 104) identifies the benefits of effective debt management program to a local government. Accordingly, effective debt management program helps to:

- Establish parameters that limit the power to borrow money and avoid potential abuses.
- Provide a way to finance capital investments within the local government's capacity to repay the loans.
- Establish sound debt management practices that support creditworthiness.
- Save money on interest charges by selecting appropriate debt instruments and structures

The development of regulatory frameworks for sub national borrowing in emerging economies since the late 1990s is the direct result of, and response to, sub national fiscal stress and debt crisis (Liu, 2008; pp: 174). A comprehensive regulatory framework consists of two parts (Liu and Waibel, 2008). The first part addresses ex ante controls and regulations and the monitoring of SNG's fiscal position; the second [art deals with ex post restructuring in the event that a SNG becomes insolvent. Ex ante borrowing regulation and ex post insolvency mechanisms complement each other. According to Smoke (2000), the approach that a central government takes towards enhancing sub-national government access to loans depends on the fiscal context. In case where decentralized governments are relatively strong, efforts to develop direct access to capital markets make sense, but the central government must regulate municipal bond markets, develop and enforce credit limits, and stop bailing out sub-national governments that default on their debt. In more typical cases, where sub-national government investment responsibilities are smaller and they are fiscally weak, some type of municipal development fund will be generally the correct approach. Municipal credit institutions are initially regulated or managed and substantially capitalized by central governments. This approach gives central fiscal authorities considerable control over borrowing activities of sub-national governments.

2.5. Conclusions

Chapter two of the paper presented reviewed materials on IGFRs, fiscal decentralization, major elements of IGFRs fiscal autonomy of SNGs and its measurement. Since the conceptual frameworks of fiscal decentralization and fiscal autonym are broad and immense, priority was given to those issues having direct relevance to the analysis of the study. Generally, fiscal decentralization could frame with four major elements, expenditure assignment, revenue assignment, IGFTs and borrowing. Moreover, effective fiscal decentralization strategy requires enabling national environment. But, the success of fiscal decentralization to create fiscally viable local governments and to meet its promises often depends on the political reality and the specified situation. Finally, there is growing consensus to incorporate both qualitative and quantitative elements in order to measure the real degree of fiscal autonomy of SNGs.

Chapter Three

Data Presentation, Analysis, Findings and Interpretation

3.1 Introduction

As it is stated in the earlier discussion, a study on the degree of fiscal decentralization is required to incorporate qualitative and quantitative indicators in order to reflect the actual degree of autonomy Regions have over their revenues, spending pattern as well as the effects of transfers on their autonomy and the independence of local officials, which are also very important to implementing fiscal decentralization. Based on this comprehensive nature of fiscal decentralization, data obtained from primary and secondary sources are presented, analyzed, and interpreted as follow so that findings could be drawn there from. Thus, the constitutional and statutory frameworks, spending autonomy and fiscal importance, revenue sources and revenue autonomy, nature and trends of transfers, and borrowing power of the city are included in this chapter. Financial data of Regional governments has been briefly examined so that the study would be framed with national comparison.

3.2. Background of the study area

Addis Ababa city was established in 1886 by Emperor Menlik II. Apart from its role as a local government for its residents, Addis Ababa is also the seat of the Federal Government, the Oromia Regional State, the African Union, the Economic Commission for Africa, and other regional and international organizations. It is found at 09.03⁰ North latitude and 38.43⁰ East longitudes. Addis Ababa city lies between 2,326 and 3,000 meters above sea level. The city has a total population of 3,147,000, hosting nearly 30 percent of the urban population of the country. The population has been increasing with an average growth rate of 2.94 percent. Rural migration accounts for about 40 percent of its population growth. The City covers a total area of 530.14 square kilometers with an average density of 5936 people per square kilometer (Abate, 2009; UN-HABITAT, 2008). Addis Ababa is the largest City of the country, the prime center of business, social, economic and political activities of the country.

Article 49/2 of the constitution explicitly gives the residents of Addis Ababa a “full measure of self government”. In parallel with the provisions of the constitution, it was through Proclamation No.87/1997 that Addis Ababa was designated as a Chartered City Government with considerable degree of self rule. New legislation was issued in 2003 to revise the charter. Accordingly, Ethiopian Federal Parliament enacted the Revised Charter Proclamation No 361/2003. The Charter made some amendments in the previous law. The City has been also reorganized in to three tiers of administration; namely, the City Government, 10 Sub-Cities, and 99 Kebeles. Furthermore, Articles 52, 53, 54, 55, 56, 57, 58, 59 and 60 of the Revised Charter Proclamation No. 361/2003 explicitly state budgetary and fiscal powers and functions of the City Government. The status of Addis Ababa City within the institutional frameworks of the country differs from “the Regional Governments” of the Federation as the City is organized as component part of the Federal Government. Hence, it is subordinate to the Federal Government. However, Dire Dawa has some similarity to Addis Ababa as it is also a “Chartered City” under the control of the Federal Government. Being a capital city of a national government; a political and diplomatic center of the country and the continent; a primate city with high concentration of socio-economic infrastructure and services; and the seat of Oromia Regional Government, Addis Ababa City is also different from Dire Dawa. Accordingly, the City’s fiscal status may not represent Dire Dawa.

3.3. Constitutional and legislative foundation of local self-government

As it is to be recalled from the discussion in chapter two of this paper, the degree of fiscal autonomy of a SNG is significantly influenced by the nature of constitutional, statutory, and institutional frameworks. In line with this premise, it is crucial to assess the constitutional, statutory and institutional frameworks in terms of their support for optimum fiscal autonomy of Regions in Ethiopia, particularly for Addis Ababa City Administration. Providing a constitutional basis for local governments strengthens their position more than what could be granted by just government legislation. Constitutional provisions that explicitly express the legal mandate of SNGs for self government would reduce the central governments intentions to reduce the power of local governments.

In Ethiopian context, the Constitution of the Federal Democratic Republic of Ethiopia Proclamation No. 1/1995, the issue of self-rule and self government has been addressed explicitly. Article 88 (1) of the Constitution lays down the principal objective of the government as “...guided by democratic principles, government shall promote and support the peoples’ self rule at all levels”. The Constitution leaves the issues of local governments to be handled by respective States. But, it demands State Governments to govern lowest units in such a manner that grants adequate power of self-government. Furthermore, the Constitution provides the extreme rights to the nations, nationalities and peoples of the Country through Article 39 by guaranting them the right to session. For that matter, the Constitution and the ethnic based federal structure of the Country was designed as a mechanism to resolve problems coming from its diversity. Therefore, the overall sprit of the Federal Constitution is pro-decentralization and self government. Hence, it is under this framework the fiscal autonomy of Addis Ababa would be described.

Concerning the Constitutional status of Addis Ababa, Article 49/2 of the Constitution explicitly secures the residents of the City a “full measure of self-government” though the same Article in section 2 makes the City Government accountable to the Federal Government. The phrase “full measures of self-government” would include the right of residents to vote and participate in the formulation, implementation and evaluation of development programs. Presumably, this power would also include the power to raise and manage revenues and administer its staff. It is therefore possible to argue that the Constitution of FDRE provides protection for the residents’ right to govern themselves. It is however important to remember the empirical fact that constitutional protection for Regions is only the necessary but not the sufficient condition so as to have fiscally viable Regions. This is because, some countries that provide no constitutional guarantee for their Regions are found more decentralized than some countries with constitutional protection for their Regions.

Enabling legislations that clearly assign appropriate power, functions, and responsibilities to Regions is another important element that helps the realization of fiscal decentralization objectives fruitfully. Accordingly, the FDRE Constitution in Article 42 states that particulars of the rights of Addis Ababa residents would be determined by law. Actually, the National Self –

Government Establishment Proclamation No. 7/1992 recognized this right even before the promulgation of the 1995 Constitution. In parallel with the provisions of the Constitution, it was in 1997 that Addis Ababa was designated as a “Chartered City Government” with considerable degree of self-rule. But by taking into account experience gained in its application and by looking into the organization and management of the City from the perspective of democratic principles and good governance as well as contemporary trends of growth and development, the Federal Government revised Proclamation No. 87/1997 by the new Charter Proclamation No. 361/2003. This Revised Charter of the City Government is the current comprehensive statutory framework of the City.

In line with the stipulation of the Constitution that the residents of Addis Ababa have full power of self-government, the Revised Charter aims at creating conditions which enable the City to maximize the achievements of its development objectives by giving due account to the best wishes and diligence of its residents and by relying on its development potentials. Furthermore, the Charter also provides the City with legal personality, which is thought one of the most favorable conditions for better fiscal autonomy of municipalities. It also requires the City Government to create favorable conditions of living and work as well as to facilitate conditions in which residents determine the over all operations of the City and become beneficiaries of its development. Accordingly, the Revised Charter gives the City legislative, judiciary and executive powers and organs.

3.4. Expenditure responsibilities and spending autonomy of Addis Ababa City Government

The successful implementation of a fiscal decentralization strategy requires both devolving decision making responsibility to Regions as well as political decentralization as a means of holding local decision makers accountable. As stated earlier in literature part, the amount and share of Regions expenditure (expenditure ratio) alone would not fully express the expenditure autonomy of Regions. Thus, spending autonomy and fiscal importance of Addis Ababa City Government would be described with qualitative indicators in this sub-section within the following dimensions.

3.4.1. Local government of Addis Ababa and its spending autonomy

One of the fundamental elements in the area of fiscal decentralization is the argument that Regions should have the autonomy to prioritize particular functional and economic expenditure areas. Proclamation No. 361/2003 defines the scope and degree of expenditure responsibilities of Addis Ababa City Government. Thus, this section examines provisions of the Proclamation to provide highlights on the status of spending autonomy of the City Government within the following parameters.

A. Presence of representative and autonomous political authority

Devolution of spending responsibilities requires a local government that is popularly and democratically elected. Budgetary choices should be made by local officials elected by local people who have to meet the full costs of their decisions through local taxes. The Constitution of FDRE as well as Proclamation No. 361/2003 provides the City's resident the right to be governed in the framework of "self-rule" or "self-administration". In part three, Article 12(1) of the Revised Charter declares that members of the City Council need to be elected by residents of the City. Accordingly, the City Council becomes the highest legislative organ of the City. The Council has power to promulgate proclamations, policies, and plans under its jurisdictions (Article 14). The City has also locally appointed executive organ to be formed by the political party or parties occupying the majority of seats of the City Council (Article 13). The Mayor is the Chief Executive Officer of the City, while the City Manager is the Executive of municipal services. Furthermore, the City Council has the power to appoint the Mayor, Manager and President and Judge of the City Courts as well as of the Chief Auditor. And, the City Cabinet acts as a committee model of executive branch of the City. It is important to note that the City has also judicial organs (Article 10). The provisions of the Revised Charter, therefore, affirm the presence of locally elected City Council and then executive organ of the City. This is in line with the notion that there is no decentralization without relatively independent and politically responsible Region.

The political and administrative authority of the City is not however, parallel to the Regional Governments'. Regions' powers and functions emanate from the constitution like in any federal countries. They administer their respective regional issues as per their own constitution. By any legal procedures, the Federal Government does not have the power to amend any of the provisions in the constitution with out the consent of Regions. Thus, they have strong constitutional mandate to exercise their autonomy. Addis Ababa City Government has been the result of government's legislation though the Constitution lays down the general principle within which the City can have "full measures" of self-governments. Thus, the Federal Government can change the "Charter". The degree of powers and functions of the City Government can be altered depending on the political view of the Federal Government. Furthermore, the Federal government can dissolve the City Council and, the City Council and the Mayor are also accountable to the Federal Government as well as to the electorate.

B. The authority to make and enforce local policies and laws

Local governments should have the authority to make decisions that will benefit the local residential as they are expected to be closer to the people and hence easily know their needs and preferences. In this case, Proclamation No. 361/2003 defines the legislative, executive and judiciary powers, and functions of the City Government. Accordingly, the City Government has the powers and functions to approve and implement economic and social development plans; issue and implement policies concerning the development of the City; issue the master plan of the City; approve loan agreements; and issue regulations. The City Government has also executive powers and functions over matters that have not specifically been included in the details of the powers and functions of the executive organs of the Federal Government. This would mean that the City has executive powers over issues excluding those given to Federal Government by Article 51 of the Constitution, such as defense, foreign policies, currency and other related functions in respect of over all economic, social and development matters. Accordingly, the City Government has broad functional responsibilities under its jurisdiction defined unrestricted provided that these powers and functions are given to the Federal Government through the Constitution and other relevant legislations.

C. Clear Mandate to Provide a Wide Range of Services

One of the basic arguments for fiscal decentralization is that lower tiers of government are at best positions to provide local public goods and services more efficiently. And, this requires clear assignment of functional responsibilities. From this perspective, Addis Ababa City Government has a mandate to provide both state and municipal functions and services to its residents. Provision of state services like education and health are like Regional governments. Article 11(7) clearly indicates that the City Government is responsible to identify, determine and organize municipal services; to provide efficient, effective and equitable services through the use of a variety of service delivery alternatives. Two important factors give the City Government significant discretionary power over its expenditure patterns. First, the Revised Charter secures the right of the City Government to prepare, approve and administer its budget. Hence, the City's budget is not expected to be approved by the Federal Government. Having full autonomy over its budgets, Addis Ababa can determine the level and mixture of functions and services to be provided to the residents. Locally prepared, approved and administered budget is expected to reflect the needs and preference of the local residents. Hence, through its budget, the City Government can prioritize its provision of services based on the needs of its residents. In order to reflect the needs and preferences of the residents, the Revised Charter proclaims the rights of residents to participate and get full information about the City budget (Article 7). Second, as it will be seen later, Addis Ababa is relatively fiscally independent since the role of transfers from the Federal Government is insignificant in terms of financing its expenditure.

D. Administrative powers of the City's Government

This element of spending autonomy would help examine the degree of control the City Government has over its internal structures, condition of empowerment, appointment and dismissal of the chief local operating officers. The City Government has been given the mandate to reorganize the City's structure within the broad framework of the Charter. The Federal Government, through the Revised Charter determines the City's structural framework consisting of the City Government, the Sub-City and the Kebele. But, the City Government is given the power to organize Sub-Cities and Kebeles. Article 31(2) of the Revised Charter empowers the

City Government to organize new Sub-Cities or Kebeles, or to reorganize existing ones taking in to account the opinions of the respective residents, suitability of service delivery, urban development plan and the size of population. It is in line with this power; the City Government reorganized the structure and number of Kebeles and, changed the status of “Kebeles” in to “Woredas” in 2010.

Another important aspect of administrative authority of the City Government is the degree of control it has on the determination of the administration and working conditions of employees and officials of the City. It should be noted that autonomy of Regions on salaries, size, benefits and promotion of their employees is an integral part of fiscal decentralization. The issue of providing flexibility to local levels in determining wages and job requirements is an important element of local government’s discretionary power. In our case, the City Government, according to Article 2(c) and 1(7), has the power to determine the entire relations between the City Government and its officials and employees concerning hours of work, salary, leaves, payments due to dismissal, health and safety, compensation to victim of employment injury, grievance procedure and other similar matters. It is therefore possible to summarize the discussion in the above paragraph that residents of the City have explicit constitutional right to have locally elected law making body as well as locally appointed executive officials with substantial degree of functional responsibilities and the mandate to budgetary choices. But, it should be noted that powers and functions of the City government have been defined by a separate law of the Federal Government so that it would not be logical to equate it with that of the Regions’.

3.4.2. Expenditure trends of Addis Ababa City between 1993/94 and 2008/09

It is stated earlier that the Revised Charter Proclamation No. 361/2003 empowers the City Government to bear full expenditure required for providing services and functions to its residents. In line with this general framework, it would be better to see the actual expenditure trend, composition and progress of the City. Table 3.1. reveals the expenditure data in terms of type and sector of expenditure. The 16 years (1993/94-2008/09) data was reorganized and summarized within three categories each consisting of 5 years data and as to be used as reference of the latest trends, data for 2008/09 was organized separately.

Table: 3.1. Trends and composition of expenditure of Addis Ababa (1993/94-2008/09)- in million Birr

Fiscal years	Sector	Capital	Recurrent	Total
1993/94-1997/98	Economic	736.66	157.10	893.76
	Social	383.75	375.98	759.73
	General and administrative	41.64	576.95	618.58
	Total	1,162.05	1,110.03	2,272.08
1998/99-2002/03	Economic	1,334.19	209.20	1,543.39
	Social	571.65	983.92	1,555.57
	General and administrative	314.05	1,056.46	1,370.51
	Total	2,219.89	2,249.58	4,469.47
2003/04-2007/08	Economic	6,840.89	1,019.06	7,859.95
	Social	821.62	1,641.72	2,463.34
	General and administrative	564.88	1,483.78	2,048.66
	Total	8,227.40	4,144.56	12,371.96
2008/09	Economic	3,718.30	309.23	4,027.53
	Social	75.80	614.34	690.14
	General and administrative	253.60	635.22	888.82
	Total	4,047.70	1,558.79	5,606.49
Total		15,657.49	9,062.96	24,720.00

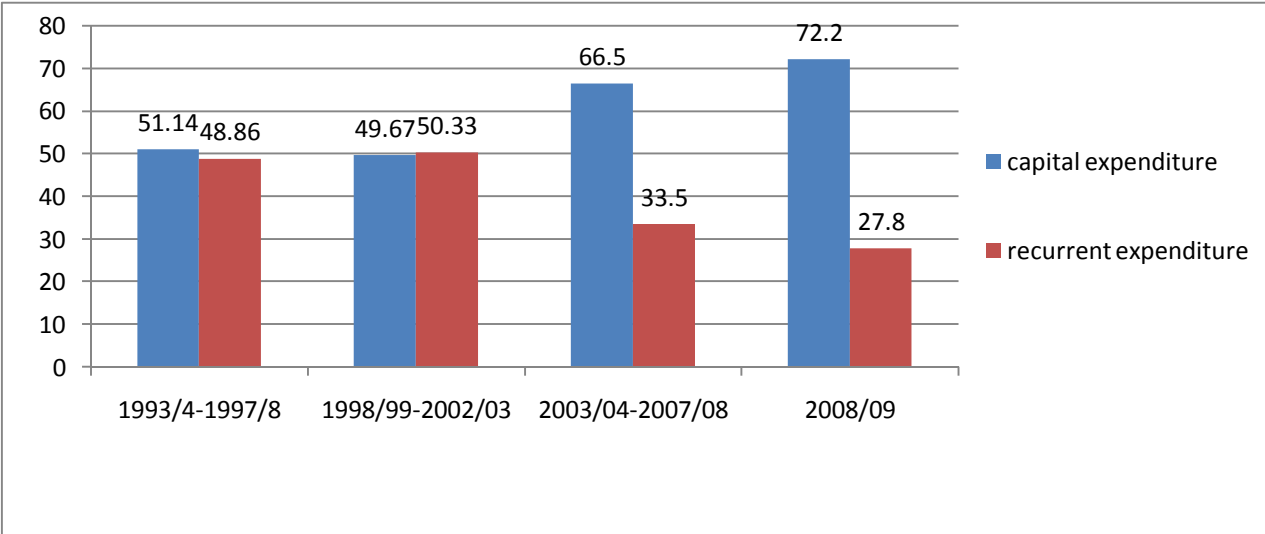
Source: Own compilation of various years data from MoFED

Table 3.1. indicates that Addis Ababa had incurred a total expenditure about 24.72 billion Birr in economic, social, and general and administrative sectors for capital and recurrent expenditure accounts between 1993/94 and 2008/09 fiscal years. About 17.98 billion Birr or 72.73 percent of the total expenditure was incurred during the 6 recent fiscal years (from 2003/04-2008/09); indicating the increasing spending trend of the City after 2003/04. This period coincides with the Federal Government’s revision of City’s Proclamation No. 87/1997 by Proclamation No. 361/2003, which brought substantial change at least in governance and institutional frame work of the City. Following the enforcement of the Revised Charter, interim “Mayor” along with new

Cabinet was appointed by the Government. The new administration had initiated new development programs focusing mainly on housing development, road construction and micro and small scale development programs. Furthermore, it was during 2002/03 that the government turned its face to the “totally” neglected urban centers of the country; and for that matter Addis Ababa is not exception to this. Keeping in mind the inflationary impact, the recent trend witnessed substantial spending of the City Government. For instance, the expenditure in 2008/09 alone constituted more than 22.68 percent of the total expenditure of the City during 16 years, and 276.76 percent of the total expenditure for the first five fiscal years (1993/94-1997/98)

Composition of capital and recurrent expenditures is one of the critical elements in the study of public finance. The distinction between capital and recurrent expenditure is most apparent in developing countries, where the government seeks ways and means to increase the volume of domestic capital formation. It gives some clues about the spending behavior of the local governments as to whether they are development or consumption-oriented. In the case of Addis Ababa City Government, the recent trend shows the emphasis towards development capital projects. As Table 3.1 and Figure 3.1 exhibits, during the study period, capital expenditure amounted Birr 15.657 billion Birr, which is nearly 63.33 percent of the total expenditure of the City.

Figure 3.1: Combination of capital and recurrent expenditure (in percent) (1993/94-2008/09)



Source: Own compilation of various years data from MoFED

Figure 3.1 further depicts that except for 1998/9-2002/03, where recurrent expenditure exceeded capital expenditure by 0.66 percent, the capital expenditure of the City was higher than the recurrent expenditure. Further more, as of 2003/04 capital expenditure out weight recurrent expenditure significantly. For instance, using 1993/94 as the base year and compare it to 2008/09; while total expenditure increased by 18.32 folds, the capital expenditure increased by 31.7 folds. And the 42.75 percent share of the capital expenditure in 1993/94 substantially increased to 72.2 percent in to 2008/09. The analysis of the data from various dimensions indicates the increasing inclination of the City Government towards a capital budget. This is a good financial indication due to the role of capital budget on financial planning, budgetary decision making, and its contribution to financial solvency.

The recurrent and capital expenditure of the City can be also broadly grouped under Administrative and General, Economic and Social services and Development expenditure respectively .Administrative and General Services and Development expenditure include such activities as the City’s Council, Mayor Office and so on. Economic sector includes production activities in the agricultural, industrial and economic activities. Finally, social development and services include such activities like education, health, urban development and welfare. In line with this vein, the priority given by the City Government to these sectors need to be addressed. As Table 3.1 indicates that in almost all fiscal years, the Economy sector absorbed the highest expenditure amount than the Administrative and General, and Social sectors. Accordingly, out of the total expenditure of 24.72 billion Birr, 14.32 billion Birr or nearly 58 percent was spent on the Economic sector. To indicate the two extreme trends, 33.33 percent share of the economic sector in 1993/1994 increased to 71.8 percent in 2008/09. Specifically, the capital economic sector absorbed 80.67 percent of the total capital expenditure of the City with in the study period. The economic development sector had 63.40, 60.12, 83.14 and 91.86 percent share of the total capital expenditure for 1993/94 – 1997/98, 1998/99 – 2002/03, 2003/04 – 2007/08 and 2008/09 fiscal year respectively. The highest share of capital expenditure to the economic sector could be justified by the extended policy attention given to housing development, road construction and other infrastructural development activities.

3.4.3. Fiscal importance of Addis Ababa

The ratio of sub-national expenditure indicates the degree of their fiscal importance within the national fiscal system. Thus, in this sub-section the expenditure trend of the City is analyzed in comparison with the trends in Regional expenditures so that it would be possible to understand how Addis Ababa City is fiscally important in the national context. Accordingly, the expenditure trend of the City is compared with that of the Regional governments and Dire Dawa.

Table 3.2: Expenditure of Addis Ababa, all Regional Governments and Dire Dawa (1993/94-2007/08) – (in million Birr)

Fiscal year	Regions and Dire Dawa			Addis Ababa			Total		
	Recurrent	Capital	Total	Recurrent	Capital	Total	Recurrent	Capital	Total
1993/94-1997/98	10,513.82	5,409.99	15,923.80	1,110.03	1,162.05	2,272.08	11,623.85	6,572.04	18,195.84
1998/99-2002/03	17,710.58	6,482.86	24,193.80	2,249.58	2,219.89	4,469.47	19,960.16	8,702.75	28,662.91
2003/04-2007/08	39,850.00	9,072.43	48,922.50	4,144.56	8,227.40	12,371.96	43,999.50	17,299.83	61,294.39
Total	68,074.80	20,965.28	89,040.10	7,504.17	11,609.34	19,113.51	75,578.97	32,574.62	108,153.59

Source: Own compilation of various years data from MoFED

Table 3.2 indicates the actual expenditure of Addis Ababa and the nine Regional Governments as well as Dire Dawa City Administration during 1993/94-2007/08 fiscal years. Hence, these sub-national governments spent about 108.15 billion Birr collectively; of which Addis Ababa spent about 19.11 billion Birr- 17.67 percent expenditure of the SNGs in the country. Thus, the ten Regions shared the remaining 82.33 percent. Furthermore, the expenditure share of Addis Ababa had increased from 12.49 during 1993/4- 1997/8 to 20.18 percent during 2003/04 – 2007/8. Therefore, the recent trend indicates that Addis Ababa has spending responsibility which accounts for one – fifth of the total Regions expenditure. This may strengthen findings of some studies indicating the very low share of Regional government’s expenditure to the expenditure of the National Government. The expenditure responsibilities and decision making powers on capital projects is an important element of effective fiscal decentralization. Hence, the expenditure data in Table 3.2 can be divided into capital and recurrent categories. At gross level,

out of the total expenditure of 108.15 billion Birr, about 70 percent was allocated for recurrent expenditure. Regions and Dire Dawa, on the other hand, used only 23.54 percent of their expenditure for financing capital development projects. This implies the weak responsibilities and/ or capacity of Regions in the country for capital projects. This is in line with the finding of Paulos (2009; PP; 69) that indicates the diminishing Regional governments' power on capital projects. As it is stated earlier, this is not the case for Addis Ababa because the expenditure pattern of the City witnessed the priority given to capital expenditures. For instance, out of the total capital expenditure of Regions in the Country 32.57 billion Birr – (about 35.64 percent) was spent by the City.

The remaining point is to put the actual expenditure of the City in the framework of its implications on spending autonomy of Addis Ababa. The amount of the City's expenditure is not sufficient to generalize about the degree of its spending autonomy. The contribution of transfers from the National Government has its own impact on the degree of the City Government as to where and how to use the money. In this context, Addis Ababa has more discretion to spend its money on the prioritized areas. This is mainly due to the fact that the City has received insignificant amount of fiscal transfers, and hence the City becomes relatively free from the conditionalities and constraints attached with the transfers regarding to the use, patterns, and size of its expenditure. This in turn would give, atleast in theory, the City the discretion to provide public goods and services based on its own priorities as well as the needs and preferences of its residents. This is particularly important in the Country where Regional governments are highly dependent on the Federal Government grants.

3.5. Revenue sources and autonomy of Addis Ababa

Addis Ababa City Government is responsible for providing wide range of state as well as municipal services. As it is explained earlier, the actual expenditure of the City is so high that requires proportional power to raise revenues to finance these expenditure needs. In this section, effort is made to present the sources of revenue, the degree of autonomy the City has over these sources, the actual revenue the City collected from 1993/94 to 2008/09 and adequacy of the

revenue. The Revised Charter Proclamation No. 361/2003 serves as the legal framework for the revenue sources and powers of the City.

3.5.1 Revenue sources

Broadly speaking, the Charter defines the revenue-related mandates of the City and the degree of control it has over its revenue sources. Addis Ababa City Government, according to Article 11 of the Charter, has the power to determine and collect taxes, duties and services charges out of the sources of income specifically given by the law; to revoke taxes and penalties imposed as per the law; to participate in income generating activities. But, as it was noted in chapter two, Regions may not have similar control over their revenue sources. In terms of fiscal autonomy, the power to determine the rate or/and base of their revenue sources provides optimum degree of fiscal autonomy. It is not practical, however to allow Regions this power for all revenue sources. Thus, the degree of their control over their revenues varies among revenue sources depending on their nature. Thus, revenue sources can be organized in to three broad categories based on the degree of the City's fiscal power of determining their base, fixing their rate, assessing, collecting and determining these revenues.

A. Revenue sources over which the City has fiscal power to determine their base and/or rate

Fiscal powers of Regions to determine bases and/or rates of their revenue sources is the commonly accepted criteria of high revenue autonomy since this power provides better own revenue and marginal revenue qualities of revenue assignment. Under this context, Addis Ababa City is empowered to fix rates, assess and collect revenues from the following sources. The first source of revenue under this category is land use autonomy. The power to administer municipal land as well as to fix land use fees provides urban areas with substantial revenue autonomy. Apart from its mandate to prepare and approve its master plan, Article 52(2) gives Addis Ababa the power to fix and collect land use fee, urban land rent and urban house tax in the City. Since urban land is the most productive revenue base of municipalities, land use autonomy implies substantial potential of the City to raise more revenue there from. Under the “urban land-lease”

system, Addis Ababa can optimize its revenue provided that the land management system is improved. Secondly, the City has also the power to fix and collect road-user-vehicles charges, and rentals from houses and other properties owned by itself; fix and collect royalties, fees on licenses issued and services provided by itself. Thus the City has full control of its non-tax revenues. Finally, the City can levy municipal taxes and duties as well as fix and collect service charges. Generally, the City determines the rates of non-tax revenues and municipal taxes. And, the City adopts its own legislations to administer revenues from these sources.

B. Revenue sources over which the City has full retaining power; but not empowered to fix their rates.

The second category of revenue source includes those the city has the power to assess, collect and administer but having no mandate to determine their rates. It is the power of the Federal Government to fix the rates of these revenues. These revenues include employment income tax within the City; profit, excise and turnover taxes from individual businessman and its public enterprises; rental income tax; stamp duty; patent right gain tax; and capital gains on property situate in the city.

Generally, Addis Ababa City collects, administers and assesses these revenues as per the Proclamations and Regulations of the Federal Government. Thus, for instance, Proclamation No. 286/2002 and Regulation No. 78/2002 define the rates and procedures for income taxes, and Proclamation No. 308/2002 applies to turnover tax. The City, therefore, follows these legislations in assessment, collection and administration. But, this is not unique to Addis Ababa, all Regional government adopt the rate and procedure of these taxes from the Federal Government without any modification. Addis Ababa has no fiscal power of determining the rates of these revenue sources. Senior Officer of Tax Assessment and Collection, the interviewee from (BoFED) states that it is the mandate of the Federal Government to fix the rate of these “state taxes” for the purpose of macroeconomic stability and equity. And, the City’s power to collect and fully retain revenues from these sources alone has provided profound revenue performance to the City.

There are some issues worth mentioning. First, though article 52(8) gives the City fiscal power to assess and collect stamp duty on contracts and agreements as well as on title deeds registration executed in the city, the Federal Government took this service from the City Government along with the subsequent revenue as of 2005. According to Senior Officer of Tax Assessment and Collection, the reimbursement of this revenue is quite irregular and sometimes the City failed to receive nothing from these sources. Second, though the City hosts and serves most of corporate companies in the country, it does not receive profit, excise or/and turnover taxes from these companies. But, Regions share these revenues with the Federal Government based on the provision of the Federal Constitution. The Senior Officer and Head of the Agency said that the City Government has been claiming for sharing these revenue sources. But, the Federal Government has neglected it by arguing that the City has been collecting revenues from other sources that should have been used by the Federal Governments. For instance, taxes from rent and employment income from private limited companies and employment income tax from non-government organization belong to Federal Government, but the Government allows the City to collect these revenues. Hence, this advantage of the City would compensate the lack of corporate taxes. Third, although property tax constitutes the major revenue source for large urban areas like Addis Ababa, it is relatively insignificant mainly due to outdated and inefficient property registration and valuation system of the City Government. Finally, Article 52(5) states that the City would receive value added tax (VAT) collected by the Federal Government. But, according to the Head of Revenue Agency, VAT does not belong to the category of “shared tax” since it is the Federal Government that determines the rate and base of VAT throughout the Country. Value Added Tax,

Generally, City of Addis Ababa has absolute revenue autonomy on municipal tax and non-tax revenues due to its legitimate power to determine the rates of these revenues. Thus, revenues the City earns from these sources can be considered as “own revenues” of the City. Through its discretionary power to fix rates of these revenues, Addis Ababa can completely influence the amount and mixture of its revenue from these sources. The City’s revenue earned from other direct and indirect taxes can be hardly taken as “own revenues” because it is the Federal Government that determines the base and rate of these revenues. The City has minimal control over these revenues. Nevertheless, the City is given the power to assess, collect and administer

revenues from these sources, as per the law of the Federal Government, with full retaining and spending autonomy. Thus, though the City has limited autonomy over these sources from revenue side, these revenue sources provide substantial spending autonomy to the City as it can utilize these revenues for any purposes.

3.5.2. Revenue collection performance of Addis Ababa City Government

It is believed that Regions need to have some independently owned revenue sources and the capacity to utilize these sources exhaustively in order that they would be fiscally viable units. In this direction, the revenue power and sources have been discussed previously. In this section the actual revenue collection performance from existing sources is discussed.

Table 3.3: Revenue sources, collection performance and trends (1993/4- 2008/09) - in million Birr

Fiscal Years	Internal Revenue Sources				
	Taxes			Non-Taxes	Total
	Direct Taxes	Indirect Taxes	Total Taxes		
1993/94-1997/98	862.43	353.46	1,215.89	720.56	1,936.45
1998/99-2002/03	1,762.15	511.53	2,273.68	1,443.97	3,717.65
2003/04-2007/08	5,244.80	1,854.04	7,098.84	4,551.24	11,650.08
2008/09	1,359.60	574.00	1,933.60	1,043.20	2,976.80
Total	9,228.98	3,293.00	1,2521.98	7,758.82	20,280.80

Source: Own compilation of various years data from MoFED

Table 3.3 reveals that Addis Ababa collected about 20.28 billion Birr from tax and not tax revenue sources. There are tax and non tax revenue sources. The trend in revenue collection performance of the City is also similar to its expenditures regarding the substantial increase of figures since 2003/04. In 2008/09 alone the City was able to collect more than what it collected in five fiscal years between 1993/94-1997/98. Further more, the 2008/09 revenue of the City (2.98 billion) is more than 15 times of revenue in 1993/94 (184.7 million Birr). The City earned about 61.74 percent of its revenue from taxes of which 73.7 percent was earned from direct

taxes. Indirect taxes contributed 16.23 percent to the City's total revenues. The City also collected about 7.76 billion Birr from non-tax revenues, constituting nearly 38.3 percent of the City's total revenue collected between 1993/94 and 2008/09.

The financial data from Ministry of Finance and Economic Development (MoFED) could be also further analyzed to see the contribution and time trend of specific revenue sources in comparative context with the Regional governments. Broadly the revenues of Addia Ababa City can be classified as tax and non-tax revenues.

A. Tax revenues

It is discussed that Addis Ababa has the mandate to collect tax revenues as per the provisions of the Revised charter Proclamation No. 361/2003. And, Table 3.3 indicates taxes had 61.74 percent share of the total revenue of the City from 1993/94 to 2008/09. Now, emphasis is given in the detail analysis on the composition, trends and size of the City's tax revenues comparing with that of the Regions'.

I. Direct Taxes: The City collected these taxes from personal income, rental, profit, agricultural land use, capital gain and other taxes. As it is to be recalled from the previous discussion, except for land use and agricultural income taxes, the City Government has no right to determine the rate of these revenues. The Federal government through Income Tax Proclamation No. 286/2002 and Regulation No. 78/2002 determines the rates of these taxes. Hence, these revenues do not belong to the "own-revenue sources" of the City. Nevertheless, the City has full retaining power and the discretion to use them for any purposes of the City. Hence, these taxes have their own contribution to strengthen the City's fiscal autonomy. The size and trend of revenues from direct taxes collect by Addis Ababa City Government during 1993/94-2008/9 fiscal years is presented by Table 3.4 comparing with Regions and Dire Dawa.

Table 3.4: Direct tax revenues of Addis Ababa (1993/94- 2008/09) – (in million Birr)

Direct Tax Revenues	1993/94-1997/98			1998/99-2002/03			2003/04-2007/08			2008/09			Total		
	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total
Personal Income Tax	238.72	626.22	864.94	718.80	1204.39	1923.19	2176.80	3268.74	5445.54	696.39	1176.91	1873.33	3830.71	6276.26	10107.48
Rental Tax	21.23	8.95	30.18	115.50	14.07	129.57	185.43	34.19	219.59	42.43	11.89	54.32	364.59	69.10	433.66
Profit Tax	358.10	888.10	1246.20	509.60	981.50	1491.10	1160.40	725.32	1885.72	175.30	201.82	377.12	2203.40	2796.74	5000.19
Agricultural Income Tax	0.39	405.11	405.50	0.44	585.10	585.54	1.22	601.70	603.00	0.46	135.95	136.41	2.51	1727.86	1730.45
Land Use Fees	224.93	373.78	598.71	206.27	566.88	773.10	1356.73	685.25	2041.98	241.30	145.61	386.91	2029.23	1771.52	3800.70
Capital Gain tax	18.00	2.51	20.51	211.48	10.36	221.84	68.28	38.99	107.27	23.84	5.66	29.50	321.60	57.52	379.12
Others	0.93	0.55	1.48	0.49	150.91	151.40	295.91	1062.71	1358.62	179.53	188.34	367.87	476.86	1402.51	1879.36
Total	862.43	2305.22	3167.52	1762.15	3513.20	5275.80	5244.80	6416.98	11661.72	1359.25	1866.21	3225.46	9228.91	14107.71	23330.48

Source: Own compilation of various years data from MoFED

As Table 3.3 and 3.4 indicate, Addis Ababa City collected about 20.28 billion Birr from internal sources; of which 61.74 percent was received from taxes. Table 3.4 shows the contribution of direct tax sources in comparative perspective with Regional governments. During the study period, 9.23 billion Birr was collected from direct taxes which contributed 45.51 percent to the total revenue of the City. The figure indicates that direct taxes have been the most productive revenue sources of the city. The trend in the contribution of direct taxes to the city also indicates consistence as it contributed about 44 percent of the total revenue in 1993/94-1997/98. Addis Ababa as well as Regions collected about 23.3 billion Birr from direct taxes. From this total revenue, Addis Ababa alone had 39.56 percent share. This implies better revenue potential of the City. The City is center of socio-economic activities, leading to concentration of labor force, business firms and related infrastructures. This is usually thought as the main reason for better revenue of the City. Employment income tax is collected from employment within the City excluding employees of Federal Government and Oromia. The City collected 3.8 billion Birr from employment tax , having 18.9 and 41.24 percent share of the City's total revenue and direct tax revenues respectively. Furthermore, the contribution of personal income tax to the City's revenue increased to 23.40 percent in 2008/09 from 12.33 percent in 1993/94.

Addis Ababa received 37.90 percent of the total revenue collected by all sub-national governments of the Country from personal income tax. Next to personal income tax, the City collected the largest direct tax revenue from individual profit tax that contributed about 2.2 billion Birr (10.87 percent of the total City's revenue), and this is about 44 percent of profit tax collected by all Regions. Land use fee also indicated better position of Addis Ababa than Regional governments. Out of the total revenue collected by all Regions i.e. 3.8 billion Birr, the City alone had earned about 2.03 billion Birr that is 53.42 percent. The introduction of land lease system in the City has been provided as the main reason for high revenue from land use fees by the interviewees.

Table3.5: Indirect taxes of revenues (1993/94-2008/09) – (in million Birr)

Indirect Taxes	1993/94-1997/98			1998/99-2002/03			2003/04-2007/08			2008/09			Total		
	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total
Excise Tax	0.78	6.78	7.56	7.22	7.71	14.93	24.60	106.35	130.95	5.44	14.22	19.66	38.04	135.06	173.10
Turnover Tax	145.77	466.07	611.84	243.48	630.84	874.32	658.75	387.56	1046.31	188.78	76.12	264.90	1236.78	1560.59	2797.37
VAT	-	-	-	-	-	-	662.67	457.71	1120.38	208.89	156.96	365.85	871.56	614.67	1486.23
Stamp and Duty Tax	206.87	64.84	271.71	260.83	114.70	321.53	508.02	156.94	664.96	170.90	90.10	261.00	1146.62	372.58	1519.20
Total	353.46	537.69	891.11	511.53	699.25	1210.78	1854.04	1108.56	2962.60	574.01	337.40	911.41	3293.00	2682.90	5975.90

Source: Own compilation of various years data from MoFED

II. Indirect taxes:

Addis Ababa also collected 3.29 billion Birr from indirect taxes, having 16.22 percent of its total revenue 1993/94 – 2008/09 fiscal years. These sources include excise tax, turnover tax (TOT), value added tax (VAT) on goods and services; and stamp and duty tax. Accordingly, as of 2003/04 VAT has become one of the significant revenue source from which the City collected 0.87 billion Birr constituting 58.6 percent of VAT from all Regions. However, TOT and stamp and duty tax were the two sources from which the City collected largest revenue having 1.23 and 1.14 billion Birr respectively. But, revenue from stamp and duty tax has been becoming one of the most productive revenue sources of the city. Revenue collected from this source in Addis Ababa is about three folds than the Regions', on the other hand better position to collect more revenues of ToT and excise tax than Addis Ababa. Generally, 55 percent of the Regions indirect tax revenue was collected by Addis Ababa City.

Table 3.6: Non- tax revenues of Addis Ababa (1993/94-2008/09) – (in million Birr)

Non-Tax Revenues	1993/94-1997/98			1998/99-2002/03			2003/04-2007/08			2008/09			Total		
	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total	Addis Ababa	Regions	Total
Charges and Fees	64.29	175.32	239.61	66.90	197.76	264.66	745.67	822.22	1567.89	25.42	81.98	107.40	902.28	1277.28	2179.56
Sales of Goods and Services	118.17	276.70	394.87	165.92	382.77	548.85	80.60	785.92	866.52	20.60	120.00	140.60	385.29	1565.55	1950.84
Government Investment	1.03	7.93	8.96	1.47	32.95	34.42	552.97	324.02	876.99	2.10	38.74	40.84	557.57	403.64	961.21
Capital Revenues	0.03	0.44	0.47	0.03	6.17	6.20	538.61	62.80	601.49	302.59	16.51	319.10	841.26	86.00	927.26
Municipal Revenues	-	-	-	-	-	-	2342.35	53.84	2396.19	666.40	20.70	687.10	3008.75	74.54	3083.29
Others	536.95	413.64	950.59	1209.67	543.25	1752.92	291.04	358.28	649.32	26.01	74.33	100.34	2063.67	1388.87	3452.17
Total	720.47	874.50	1594.50	1443.99	1162.43	2606.42	4551.24	2407.16	6958.40	1043.12	352.26	1395.38	7758.82	4795.88	12554.70

Source: Own compilation of various years data from MoFED

III. Non-tax revenue sources

As Table 3.6 reveals that 7.76 billion Birr (38.30 percent of the City's total revenue) was collected from non-tax revenue sources. Municipal revenues were found increasingly important. But, accurate and appropriate data were not available about the municipal revenue for fiscal years before 2003/04 and incorporated in the analysis in to non-tax revenues. During 2003/04 – 2008/09, the City received about 3 billion Birr from municipal sources and this is about 14.85 percent of the total revenue. Revenues from charges and fees, and capital revenues yield 0.9 and 0.84 billion Birr respectively. The City also collected 0.94 billion Birr from sales of public goods and services and government investment. Other sources such as pension contribution, extraordinary and privatization proceeds contributed about 2 billion Birr. The total non-tax revenue collected by the City in the study period had 61.80 percent of the collected non tax revenue by all Regions.

To summarize the revenue collection performance of the city, Addis Ababa City Government collected total revenue of 20.28 billion Birr in the past sixteen fiscal years, which has about 48.38 percent share of revenue collected by all SNGs. This indicates the relative better revenue collection capacity of Addis Ababa than any of Regional governments and Dire Dawa City Administration. It is noted that Regional governments in Ethiopia have so weak revenue collection capacity that they are highly dependent on the Federal Government transfers to discharge their functional responsibilities. However, this is not the case for Addis Ababa.

3.5.3. Analysis of fiscal capacity and revenue autonomy of the City

I. Matching between revenue and expenditure of Addis Ababa

In most developing countries, sub-national governments including municipalities have inadequate own revenue to finance the increasing needs for public goods and services. In line with this vein, it is important to see how far the revenue trend went in line with expenditure of the city. This is particularly crucial important point for Addis Ababa as it does not receive

substantial federal government transfer to fill its fiscal gap and the capital market is at infant stage leading to limited borrowing to finance capital expenditure.

Table 3.7 Revenue and expenditure balance of Addis Ababa (1993/94-2007/08) – (in million Birr)

Fiscal Years	Addis Ababa			Regions		
	Expenditure	Revenue	Percent of Revenue to Expenditure	Expenditure	Revenue	Percent of Revenue to Expenditure
1993/94-1997/98	2,272.08	1,936.45	85.22	15,923.80	3,716.78	23.34
1998/99-2002/03	4,469.58	3,716.12	83.14	24,198.80	8,376.86	34.62
2003/04-2007/08	12,371.96	11,650.60	94.17	48,922.50	21,582.72	44.12
Total	19,113.54	17,278.19	90.40	89,040.10	33,676.36	37.82

Source: Own compilation of various years data from MoFED

Table 3.7 indicates the fact that there is significant difference in revenue capacity between Addis Ababa and Regions including Dire Dawa. This is the problem of horizontal fiscal imbalance among Regions in Ethiopia. Addis Ababa City was able to cover nearly 91 percent of its expenditure with its internal revenue. Furthermore, its fiscal capacity increased to 94.17 percent in 2003/04 – 2007/08 from 85.22 percent in 1993/94 – 1997/98 fiscal years. This is encouraging performance even comparing with municipalities in developing countries. The better self – reliance performance on its own revenue gives further implication when we compare it with other Regions. Regional governments were able to finance only 37.82 percent of their expenditure by their internal revenue on average. Let alone their total expenditure, their revenue was not sufficient to cover their recurrent expenditure. The collected revenue (33.67 billion) covered only 49 percent of their recurrent expenditure (68.07 billion). But, they had shown significant improvement as their self-reliance ratio increased from 23.34 percent in 1993/04 – 2007/08 to 44.12 percent in 2003/04 – 2007/08.

Better capacity to rely on own revenue to finance expenditure provider better fiscal autonomy to Regions. This is because it would reduce fiscal dependence on central government and the subsequent interference. In this case, Addis Ababa is in a better position. But, this better position has come from the unevenly concentration of the Country’s economic activities, business firms and socio-economic infrastructures at the City. But, better financing capacity of the City alone can not lead to firm conclusion about adequacy of its revenues. Residents of the City live in object poverty, sub-standard living condition, problem of unemployment and lack basic social services. From the point of this view, it is important to see how the City utilized its existing revenue potential. The City has not yet studied its potential sources. Head of Finance and Economic Development Bureau of the City expressed that the World Bank has a plan to make study on potential revenue sources of the City by 2010/11 fiscal year.

II. Revenue autonomy analysis

As it is indicated in chapter two, the reliance on aggregate revenue to analyze revenue autonomy of Regions is a misleading approach. Thus, the recent emphasis is towards own revenue of Regions where Regions have the power to determine the rate/base of their revenues, or/and they have saying power on revenue sharing mechanisms. Based on the criteria of OECD (2002), the revenue sources of Addis Ababa City can be categorized as “own-revenues” and “dependent revenues” based on the power of the City to determine rate and/or base of the revenues. Thus, the City’s own revenues include municipal revenues, non-tax revenues and land use and agricultural income taxes. Indirect taxes and direct taxes (excluding land use and agricultural taxes), on the other hand, are classified as “dependent revenues” since the city has no saying on the base and rate of these tax revenues. Table 3.8 below presents the revenue autonomy of Addis Ababa.

Table 3.8: Domestic revenue of Addis Ababa: own revenue, and dependent revenue (1993/94-2008/09) – (in Million Birr).

Own Tax Revenue	Non-Tax Revenue	Municipal Revenue	Total Own Revenue	Dependent Revenue	Total revenue
2,031.74	4,750.07	3,008.8	9,790.61	10,490.24	20,280.08

Source: Own compilation of various years data from MoFED

Own revenues of Addis Ababa include three broad categories. Tax revenues of which the City is empowered to determine their base and/or rate are grouped as “own tax revenues. The Revised Charter, Article 52, gives the City the power to fix the rate and collect urban land and levy income taxes from agricultural activities. Hence, urban land and agricultural incomes are the only tax revenues for which the rate is determined by the City and they are taken as “own tax revenues”. During 1993/94-2008/09, the City collected about 2.03 billion Birr from these tax revenues though 99.8 percent of which was derived from urban land use fees. In line with the OECD (2002) classification, the City determines the rates of non-tax revenues such as fees and charges from the provision of services and goods. Finally, the municipal revenues collected from the provision of municipal services are also included into “own revenues” of the City as it has full discretionary power to fix their rates. These revenues are obtained from municipal taxes, rental income, service charges and sales of goods and services. The City earned about 9.79 billion Birr from the three broad categories of own revenues.

On the other hand, revenue categories under “dependent revenue” of the City refer those revenues for which the City lacks legal mandate to fix their rate and to determine the base so that its autonomy over these revenues is only to assess, collect and retain them. These include all indirect taxes and direct taxes excluding agricultural and urban land use taxes. Finally, the City received insignificant and irregular fiscal support from the federal government. This will be addressed in detail later. Transfers to the City is excluded from the analysis because of the lack of reliable data that covers the entire study period; and since amount of transfers to the city is so insignificant its impact would not be significant. Thus, during the study fiscal years, the city received a total of about 20.28 billion Birr from own revenues, and dependent revenues. The implications of these revenue sources in terms of fiscal autonomy of the city are presented in the following paragraphs. The necessary condition for a significant level of fiscal autonomy is that SNGs themselves have the discretion to set the tax rates and/or bases so that they can adjust their revenues by varying the rates and/or the bases in response to fiscal demand for publicly provided services. It is in line with this assumption that the relatively higher tax revenues of the Addis Ababa requires further analysis in terms of the degree of the City’s control over the base and/or the rates of its tax revenue sources.

Thus, tax-autonomy of Addis Ababa can be computed as the ratio of its tax revenues on which it has control over rates and/or base from its total tax revenues. The data from Table 3.3 indicates that during the study fiscal years (1993/94-2008/09) Addis Ababa collected nearly 12.52 billion Birr from direct and indirect tax sources. As Table 3.8 reveals about 2.03 billion Birr was received from own tax revenues.

Thus, Tax-Autonomy of Addis Ababa can be computed as follow.

$$\begin{aligned}
 \text{Tax-Autonomy Ratio} &= \frac{\text{sum of the city' own tax revenue}}{\text{total tax revenue of the city}} \\
 &= \frac{2.03 \text{ billion Birr}}{12.52 \text{ billion Birr}} \\
 &= 0.16
 \end{aligned}$$

Thus, though Addis Ababa City received about 61.74 percent of its revenue from tax sources and 42 percent of taxes collected by all Regional governments in Ethiopia, the real fiscal autonomy over its taxes is below 17 percent .The tax autonomy ratio implies Addis Ababa has full control over 16 percent of its total tax revenues. This manifests the dominance of National Government over tax resources in the Country. And, in most developing countries the real tax-autonomy of Regions is insignificant. But, tax autonomy would have improved fiscal position of the city if it had been given more power over some of its bases and/or rates. Addis Ababa has, on the other hand, full fiscal autonomy over its non-tax and municipal revenues. As Table 3.3 revealed Addis Ababa City had collected about 20.28 billion Birr from its internal revenue sources. The revenue collected by the City was also found the highest of any Region in the country having 48.4 percent of the revenue collected in all regional governments. But, consideration of the aggregate collected revenues alone as an indicator of the degree of fiscal autonomy of the city may fail to properly understand the actual autonomy of the city over its revenues. Recent empirical works on measurement of fiscal decentralization urges to distinguish between aggregate revenues and own source revenues.

To put our case within this framework, Table 3.8 distinguish own revenues, dependent revenues and fiscal supports of the city based on the degree of it control over these sources. In order to measure the real revenue of autonomy of the city, own-revenue ratio has been used as an indicator of local fiscal autonomy as well as fiscal independence of the City. Thus, the City’s own revenue, as depicted in Table 3.8, has three broad sources: the owned tax revenues, non-tax revenues and municipal revenues. During the study period, the city was able to collect 2.03, 4.75 and 3 billion Birr from tax, non-tax and municipal own revenue sources respectively; and hence a total of 9.79 billion Birr was collected from all these own-revenue sources. Accordingly, the own-revenue ratio of Addis Ababa can be computed as follows.

$$\begin{aligned}
 \text{Own-revenue Ratio of Addis Ababa} &= \frac{\text{Total Own Source Revenue}}{\text{Total Revenue of the City}} \\
 &= \frac{9.79 \text{ billion Birr}}{20.28 \text{ billion Birr}} \\
 &= 0.48
 \end{aligned}$$

The implication of this “own-revenue” ratio is that the City has full discretionary autonomy to control about 48 percent of its total revenue. Under comparative perspective from the fiscal status of Regional government, Addis Ababa has better revenue autonomy. The statutory mandate of the City to fix rates of its non-tax revenues is behind its relatively strong position. For instance, the non-tax revenue constituted about 48.5 percent of its total own revenues. The wide range of municipal services as well as the City’s power to levy these revenues has also increased the share of its own-revenue by contributing 30 percent. The “own-revenue” measure of the City further implies degree of the City’s dependence on revenues on which it has less or no control.

Fiscal dependence of Regions has been measured as the ratio of SN grant revenues excluding general-purpose grants with objective criteria and unconditional specific grants over total sub-national revenues. Under this measurement, Addis Ababa would have insignificant degree of fiscal dependence since it received very small fiscal support. But, the contemporary measurement indicators introduce new variable to be incorporated in the measures of fiscal dependence. Accordingly, revenues other than “own source” revenues tend to be “dependable

revenues”. Thus, fiscal dependence of Addis Ababa can be measured as the ratio of dependent revenues and transfers over the total revenue of the City. That means:

$$\begin{aligned} \text{Fiscal Dependence Ratio of} &= \frac{\text{Dependent revenues}}{\text{Total revenue of the city}} \\ \text{Addis Ababa} &= \frac{10.49 \text{ billion Birr}}{20.28 \text{ billion Birr}} \\ &= 0.52 \end{aligned}$$

Accordingly, the City had no or little control on nearly 52 percent of its revenues. The emerging emphasis on fiscal powers of Regions to determine the rate and/or base of their revenue has increased the ratio of its dependence. For instance, the City has the power to assess and collect all indirect taxes and large part of direct taxes, and it has also the mandate to retain these revenues for its spending purposes. But, the City has no mandate of determining either the base or the rate of these revenues. Therefore, these revenues are excluded from the City’s own revenue and incorporated in to “dependent” revenues. But, these revenues have positive and direct impact on spending autonomy of the City.

The revenue autonomy of Addis Ababa City measured by ratio is significant when compared it with the experience of transitional and developing countries. For instance, the study of Ebel and Yilmaz (2002) on fiscal decentralization of six transitional countries of Eastern Europe indicates that own taxes (where SNGs set tax rate and/or tax base) constitute less than 7 percent of SNGs total revenue in average which is much less than that of Addis Ababa. The study of Ebel and Taliercio (2005) also strengthen the earlier finding. According to the study in 10 developing countries in Europe, SNGs own tax revenue is also less than 13 percent of their total revenues. In African context, Smoke (2001) indicates the fact that South Africa has relatively better “own revenue” ratio by its SNGs, having about 37 percent of their revenues. The study of Taliercio (2005) in 6 East Asian Countries provides the following findings. From the 1992 to 2002, own-source revenues in the Philippines composed 34 percent, on average, of local governments’ total revenue. In Indonesia, own-source revenues accounted for about 39 percent of total revenue at

the provincial level, but only 7 percent at the city level. But, SNGs in China, Cambodia and Vietnam earned less than 5 percent of their total revenues from their own source revenue. It is therefore possible to argue the fact that the own-revenue and own –tax revenue ratio of Addis Ababa is not insignificant from the experience of some developing countries.

3.5.4. The Challenges in revenue collection performance of Addis Ababa

Addis Ababa City has better revenue collection trends during the study fiscal years than any of the Regions in the country. The City contributed 48.4 percent of the total revenue collected by all Regions during 1993/94- 2008/09 fiscal years. Furthermore, the City was able to finance 90.4 percent of its expenditure from internally collected revenue. This is important because the real fiscal autonomy of a Region depends on its ability to provide public goods to its residents from revenues collected from its jurisdictions. In this premise, the relatively better revenue collection trends of Addis Ababa needs to be further analyzed in accordance with its adequacy. To meet the expenditure needs of the City. In this case the problem is how to clearly quantify the expenditure needs of the city. Actual expenditure may not be the correct reflection of the needs for public goods and services. To the minimum, the budget (plan) expenditure can be used as an appropriate indicator of the expenditure needs of the city. The data obtained from BoFED indicated that the City planned to spend Birr 25.6 billion Birr for five fiscal years (2004/05-2008/09). During the same fiscal years, the city collected about 12.21 billion Birr. Hence, by taking the planned expenditure as an appropriate indicator of the expenditure needs, the internally collected revenue would have financed only about 47.6 percent of the needs ($12.21/25.6 \times 100$).

This is quite important problem to Addis Ababa because: first, the amount of transfer from the Federal Government is so insignificant that the opportunity to fill the fiscal gap would be closed. Second, due to under-developed capital market and poor practice of the City to finance its capital projects through borrowing is also unreliable source to fill the gap. Thus, the remaining opportunity is to utilize its revenue sources exhaustively. But, the current practice indicates poor records of the City even to collect its planned revenue. The following Table compares the actual revenue of the City with its plan for 2004/05-2008/09 fiscal years.

Table 3.9 Planned and actual revenue (2004/05-2008/09) – (in million Birr)

Fiscal Year	Planned Revenue	Actual Revenue	Percent
2004/05	4,102.00	1,896.50	46.23
2005/06	3,476.40	1,659.51	47.74
2006/07	5,160.00	2,349.40	45.53
2007/08	6,371.00	2,976.03	46.71
2008/09	8,838.00	3,336.03	37.74
Total	27,947.40	12,217.70	43.71

Source: Own compilation of various years data from BoFED

Table 3.9 witnessed the degree of poor trends in the revenue collection of the City. It was able to collect 12.22 billion Birr from the planned 27.95 billion Birr, indicating 43.71 percent collection performance of the city. The inconsistency of the City's collected revenue against the expenditure needs of the City as well as its own plan needs comprehensive policy and administrative measures so that the city would be able to provide public goods and services effectively and efficiently. The following Table also indicates how the actual expenditure of the City has been increasing at faster rate than its revenue.

Table 3.10: Growth rate revenue and expenditure (2004/05-2008/09)

(in million Birr)

Fiscal Year	Revenue		Expenditure	
	Amount	Annual Growth Rate	Amount	Annual Growth Rate
2004/05	1,896.50	-	1,834.37	-
2005/06	1659 .51	12.50	2,116.11	15.34
2006/07	2,349.40	41.57	2,517.94	18.99
2007/08	2,976.03	26.67	3,942.24	56.60
2008/09	3,336.03	12.09	4,027.53	2.20
Average	2,443.54	16.95	2,887.60	23.28

Source: Own compilation of various years data from MoFED

As Table 3.10 shows the City was not able to increase its revenue in line with the increasing expenditure. The City's actual expenditure increased at an average annual growth rate of 23.28 percent, while the revenue increased at 16.95 percent. Thus, it will be the challenge of the City to collect revenue sufficient to cover the expenditure. In order to understand the reason for the underutilization of the City's revenues and inability to collect the planned amount, and to get information about the corrective actions intended to improve the revenue-collection performance of the City, questions were forwarded to the interviewees from Revenue Agency of the city. It follows in the following paragraphs.

The interviewees, Senior Officer of Revenue Assessment and Collection and Head of BoFED, give emphasis to the inefficient tax information system as the major challenges of the City prohibiting the optimum utilization of its revenue potential. There has not been updated and reliable data about tax payers. As a result of this problem, tax assessment and administration became inefficient. The City Government in collaboration with Federal Revenue Authority introduced various measures to improve the tax information system in the City. Furthermore, through the aid of World Bank, a foreign company is planning to study the overall revenue potential of the City. Weak enforcement capacity of the city is also a problem of proper revenue collection. Currently, the Revenue Agency organized a new department, consisting of legal advisors and prosecutors, to support the Agency in its efforts of taking legal actions against tax evaders. The interviewees also listed other problems such as lack of qualified personnel, attitude problems of the tax payers as well as the employees of the Agency, and institutional.

Fiscal autonomy of Addis Ababa city would not be strengthened with partial efforts of the City Government unless mechanisms are established by which the residents could contribute their part. Residents need to share some of the costs of the local services they consumed. In this case, there found no compiled data indicating the share of residents in the financing of services. The Head of BoFED indicates the fact that the City Government recognized the role of residents in service delivery. And, the City plans to earn about 600 million Birr from resident's contribution for 2010/11 fiscal year. Various teams have been organized to mobilize the community at the grass root level.

3.6. Access and significance of Federal Government transfers to Addis Ababa

Transfer to Regions has both positive and negative impact on their fiscal autonomy of Regions. The degree of autonomy a system of transfers gives local governments in making their budget decisions depends on the structure of the system. In Ethiopian context, IGFRs can be best described by the existence of high vertical and horizontal fiscal imbalances. But, the case somehow differs to Addis Ababa. The conditions and objectives for financial support to the City from the Federal Governments are stated in Article 55(1) of the Revised Charter. It indicates that the City Government may be granted financial aid by the Federal Government, as found necessary to properly discharge its responsibilities. But, the support is intended for emergency, rehabilitation and development purposes as well as for expenditures on programmes having a developmental value of country wide effect. Additionally, the City Mayor is expected to prepare and propose to the Federal Government the amount of support needed by the City. However, the practice in the previous fiscal years indicates the fact that Addis Ababa has received insignificant financial support from the Federal Government.

Currently, Addis Ababa is excluded from the regular intergovernmental transfer system of the country, which is more dominated by the block grant system. Addis Ababa stopped receiving recurrent budget transfers and capital budget transfers since 1900/2000 and 1996/97 respectively. The financial data obtained from MoFED indicates that during 1999/00 and 2007/08 the City received only 0.3 million Birr from the block grant transfer from treasury of the Federal Government. But, the data of Bureau of Finance and Economic Development (BoFED) of the City provides some figures under “Federal Government subsidy” account during 2003/04-2008/09 fiscal years. The incorporation of these accounts into “transfer” to the City, however, is not accepted by the interviewees. For instance, a Senior Advisor for the Head of BoFED argued that the “Road Fund” is not the transfer from the Federal Government, rather it is allocated from the independently established “fund” to promote road development in the country. Further, the road fund given to the City is not displayed in the budget of the government. Other categories of the “transfers” are not part of the City’s budget. The City spent them on behalf of the Federal Government. These include Public Basic Service (PBS) for education, agriculture, health and water projects; and Public Sector Capacity Building Program (PSCAP).

Table 3.11: Federal Government transfer (2003/4-2008/9) – (in million Birr)

Form of Transfer	Fiscal year						
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	Total
Recurrent Subsidy	0.10	3.70	40.10	0.11	0.10	-	44.11
Capital Subsidy	1.80	-	1.30	-	-	-	3.10
Road Fund	18.60	20.30	20.70	27.28	43.12	27.03	157.03
Total	20.50	24.00	62.10	27.39	43.23	27.30	204.52

Source: Own compilation of various years data from BoFED

As Table 3.11 indicates, throughout the period Addis Ababa received 204.52 million Birr “financial support” from the Federal Government, and it covered only 1.1 percent of its expenditures and constituted 1.3 percent of its total revenue. The road fund constituted 76 percent of the total “subsidy” and 21 percent was allocated to recurrent expenditure. Financial support of the Federal Government for capital projects was only 3.10 million Birr. The insignificant amount of the City’s transfer is extremely exceptional from the highly-transfer dependence of Regional governments.

Table 3.12: Share of Federal Government transfer to Regions’ expenditure (2003/04-2008/09) in million Birr

Item	Fiscal years						Total
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	
Regions Expenditure	7816.70	8814.70	11396.60	13,385.60	19880.90	26725.40	88019.90
Regional Transfers from Federal Government	5021.42	5497.26	7071.47	9365.08	13532.50	16348.50	56836.15
Percent of Transfer from Regions Total Expenditure	64.00	62.00	62.00	69.00	68.00	61.00	64.00

Source: Own compilation of various years data from BoFED

Table 3.12 shows the fact that Regional governments had been highly dependent on Federal Government transfers to discharge their expenditure responsibilities. The Federal Government granted a total of 56.84 billion Birr to Regions -including Dire Dawa. The grant covered almost 64 percent of the total expenditure of Regions in the six fiscal years. Furthermore, the dependency of Regions on government transfers failed to show positive improvement during the period since the average dependence ratio remains 64 percent which is similar to 2003/04. This finding reaffirms the conclusion of various studies on the performance of Ethiopian fiscal decentralization indicating that the reform failed to create fiscally autonomous Regions due to their extreme dependence on Federal Government transfers. Giving further explanation on the overall performance of fiscal decentralization of the country is beyond the objective of this study. But, the aforementioned brief facts help to put the analysis into national context so that its impacts on fiscal autonomy of Addis Ababa would be clearly described. Under this framework, the insignificance of the Federal Government fiscal support to the City required to be assessed in terms of its impact on the fiscal autonomy of the City.

The insignificant level of transfers may promote the spending autonomy of the City since conditionalities associated with the transfers would not be imposed on the City. Thus, budgetary autonomy of the City would not be reduced. One of the problems in Ethiopian context is that most of capital expenditures, particularly those in social development sector, are financed by the Federal Government so that the policy autonomy of Regions in the sector has come to be reduced. Regional governments' dependence on federal transfers also provides a good example of how transfer adversely affects the efforts of Regions to raise more own revenues. But, it should not be concluded that absence of transfers necessarily increase fiscal autonomy of the City. Fiscal autonomy is more related to the fiscal power of Regions to provide public services efficiently and effectively through mainly locally raised revenues. Unless the City is not able to provide the services efficiently and effectively due to lack of resources, the need for transfers is not questionable. The poor status of socio-economic infrastructure and services, the high poverty and unemployment level, and the long-aged neglect of the City undoubtedly increase the expenditure needs of Addis Ababa. But, this is the overlooked issue of the City by policy makers. Furthermore, its role as a capital City of the country and Oromia Regional Government is failed to be considered.

The insignificance of the City's transfer should have some policy direction from the Government. As transfers needs to be analyzed based on its effects depend on how it helps to meet government objectives such as stabilization, equity and efficiency. Therefore, the insignificance of transfers to the City should be linked to the overall objectives of the government IGFT policies. Proclamation No. 33/1992 identifies objectives of IGFTs mainly focusing on promotion of development; narrowing vertical and horizontal fiscal imbalances and promotion of foreign currency earning projects. The Constitution also indicates the equity- based and balanced Regional development orientation of government transfer. Under this national framework, the remaining point would be to put the very low amount of transfer to Addis Ababa in this context and examine whether it is justifiable or not. Addis Ababa, as most of its African counter parts, is a primate City hosting large majority of the Country's socio-economic infrastructures, services and functions. It has unevenly concentrated economic firms and activities. Due to this uneven concentration, it has better potential revenue sources and the capacity to collect the largest amount of revenue in the Country, next to the Federal Government. Accordingly, it has better self reliance ratio and better financing capacity than Regions. Contrary to Addis Ababa, the dependency of Regions on the Federal transfers is high (64 percent) so that without it most of the States could not cover even their recurrent expenditures.

There is also high horizontal fiscal imbalances among Regions. According to Treasury Directorate Director in MoFED therefore, providing substantial transfer to Addis Ababa would be against the equity based objective of the Government. Thus, according to him, though there is no formal policy guidelines that hinder the City from receiving transfers, the equity-based IGFTs system of the country as well as the relative better revenue potential of the City are sufficient enough to exclude the City from IGFTs system. Furthermore, the current emphasis on equity-based transfer system automatically puts Addis Ababa out of the system. This is mainly due to the choice of variables and their relative weight in the Federal budget grant formula that makes the City in unfavourable conditions. The situation of Addis Ababa is adversely related to most of the elements of the formula. Thus, even if Addis Ababa is incorporated within the system of IGFTs, its share of transfer would be quite minimal.

It is usually stated that sub-national government should be encouraged to rely on their own revenue and exhaustively utilize their revenue potential than to rely on transfer. High reliance on transfer reduces fiscal autonomy of local governments as most transfers come with conditionality imposing political and policy wills on Regions. It is in this vein, Addis Ababa should work hard to promote its revenue collection capacities rather than complaining about the insignificance of the transfer. Head of Finance and Economic Development of the City forwarded her view about the transfers of the City. She had reservation on the better revenue potential of the City to be taken as the main justification for insignificant amount Government fiscal support to the City. She explained that the “potential revenue” of the City had not been clearly assessed due to technical and financial incapacity. According to her, the “revenue potential” of the city was more of imaginary than evidence-based claim.

For this study, the major problem of City’s transfer is associated with lack of predictability and consistence of the transfers. There is significant variation in the amount and composition of the transfers. During the period, it was only the road fund provided consistently. The Federal Government does not inform the City about the size and types of transfers to be given to the City prior to budget year of the City so that it becomes unpredictable to the City Government. For instance, the data obtained from BoFED indicates that the City planned to receive 63.49 Million Birr from transfer for 2008/09 fiscal year while it received only 27.03 Million Birr at the end of the year.

3.7. Borrowing power of Addis Ababa City Administration

Allowing sub-national borrowing can contribute improvements in resource allocation and in accountability of public service provision. This is particularly true for large municipalities including Addis Ababa where there is high demand for socio-economic infrastructures. In terms of autonomy, transparency, objectivity and consistence of the regulatory framework for borrowing is the central point. Addis Ababa city has statutory mandate to borrow money from both domestic and external sources under conditional based control by the Federal Government. Article 52 of the Revised Charter empowers the City government to borrow from domestic sources directly or by way of selling bonds, on short and long repayment terms.

But, this borrowing power requires the authorization by the Federal Government. The loan is required to consider the non-endangerment of the country's macroeconomic stability as well as of the City's financial capability to discharge its functions and obligations. The same Article in sub section two further gives the City the power to identify international credit sources and solicit the Federal Government to take loans there from on its behalf. This power of the City would have contributed much in its financing capital projects if the City has been exercising this power properly. But, the financial report of the city witnessed the poor borrowing practice of the city.

The interviewees, Senior Advisor for the Head of BoFED and Treasury Directorate Director in MoFED, affirmed the poor records of the City in exercising its borrowing power. From 2003/04-2007/08 it is only in 2004/05 fiscal year the City's financial report indicates the existence of borrowing when it received 900,000 Birr as a 'subsidized loan'. But, in 2008/09 fiscal year the City borrowed one billion Birr from Ethiopian Telecommunication Corporation (ETC) to finance the road construction as a short-term liability to be paid from land-lease revenue. Though the borrowing arrangement is to be encouraged, there are some critical problems associated with the loan. First, the loan arrangement failed to meet the required procedures and related financial analysis through MoFED; the loan was simply made through the agreements between the City and the Corporation. For instance, there is no evidence whether the credit worthies of the city was critically analyzed. The interest rate was not determined. It was simply an agreement that allowed the City to use the deposited money of the Corporation assuming the City would pay it from its income from lease.

Such an informal borrowing practices may produce fiscal stress in the City. Secondly, experiences in transitional countries indicate reliance on borrowing from state-controlled financial institutions may pose significant macroeconomic risks, reduce accountability and transparency. Third, road construction should be financed through long term loan agreement since these long life projects should be paid for as they are used up. The recent borrowing practice of the City has related to the extensive housing construction activities. In order to finance the integrated housing development program, the City Government, through the MoFED, has arranged borrowing mechanism with Commercial Bank of Ethiopia (CBE). Accordingly, in

2007/08 fiscal year the City borrowed one billion Birr by issuing coupon bond with an annual interest of five percent having three years maturity period. But, the City failed to repay the loan as per the agreement due to inability to raise sufficient revenue. The related problem in this arrangement was that the City covered full costs of the houses and received 20 percent down payment leaving the remaining to be received in annuity terms. Thus, the City faced financial problems to precede the program as well as to pay its loan. Learning from this experience, according to the interviewees from BoFED and MoFED, new arrangement was established to transfer the loan from the City to the house owners so that the Bank took the houses as collateral and made loan agreement with the house owners regarding the 80 percent cost of the houses. Under this arrangement City of Addis Ababa borrowed additional one billion Birr in 2008/09 fiscal year from Commercial Bank of Ethiopia (CBE) under similar loan agreement of the previous borrowing. And, in 2009/10 fiscal year the city also borrowed 1.2 billion Birr from the state-owned Bank. But, the housing agency has been re-established as a semi-autonomous entity primarily responsible for the project and loan repayment since 2009/10. This has made expenditures of Integrated Housing Development Program (IHDP) out of the City's regular budget and outlined clear mechanism for responsibility. Till last fiscal year, the City was able to repay 1.3 billion birr from the total of 3.2 billion Birr in 2010/11 fiscal year.

The recent efforts of Addis Ababa City to rely on borrowing in order to finance basic infrastructures (such as road and housing) are substantially important due to two compelling factors. First, as it is stated earlier Addis Ababa has received very small fiscal support from the Federal Government and hence the only potential external financing source is borrowing. Secondly, due to the serious deterioration of the existing infrastructure of the City as well as the highly increasing population growth of the city, the demand for more and better infrastructural services will be inevitable. Thus, using borrowing to finance infrastructures will be found the necessarily condition to the well-being of the city and its residents. This should also require that such infrastructural development projects will be carried out with out harming the fiscal viability of the City in the future. The borrowing arrangement with the two public enterprises needs some adjustments. The informal loan arrangements with the state-owned financial institutions may produce problems in accountability and long –term viability of the City. For instance, such

arrangements usually failed to consider the credit worthiness and fiscal capacity of the city to repay the loan. There is found no evidence of financial and economic analysis made when ETC and ECB borrowed to the city so as to determine the credit worthiness and fiscal capacity of the city. This may endanger the long-term fiscal status of the City.

Furthermore, feasibility study of the projects for which the City borrowed is not found. The only thing the lending institutions have in order to ensure the repayment of the loan is that the federal government, through MoFED, has become the guarantor for the city. Sub national borrowing is usually advised to be undertaken through financial markets. Though it is well understood the existence of undeveloped financial market in the country, effort should be done to utilize the existing one optimally. From the interviewees, Treasury Directorate Director in MoFED and Head of BoFED, the effort to utilize the financial market to get potential lenders is so insignificant. In countries where the financial market is not well-developed, like Ethiopia, creating specialized municipal credit institutions is one of the most important alternatives to provide municipalities' better access to borrowing with better mechanism for greater financial accountability and better project selection.

3.8. Intra-City decentralization

As an attempt to find balance between integration and local differentiation, urban municipalities usually create sub-local political bodies. In our case, the Revised Charter of 2003 has reorganized structure of Addis Ababa within three tiers: the City Government, the Sub-City and the Kebele. This section deals with the fiscal relations between the City as a whole (as a local self-government unit) and the Sub-City (as City districts). This section is important as the basic rationale of decentralization is to bring the government to the local residents in such away that enables them to involve in local decision-making processes and easily identify the needs and preferences of the residents. For instance, the constitutional devolutions of power to Regional governments was not sufficient to realize the benefits of decentralization in Ethiopia and hence, the government undertook broad decentralization measures (including Constitutional amendments in the four Regions) to empower Woredas and Kebeles by transferring resources,

and powers. If this is the case in the national framework, it would be important to view the extent of fiscal autonomy of Sub-Cities in Addis Ababa.

Sub-Cities are the second tier of City Administration. Currently, the City is divided into ten Sub-Cities. The Revised Charter of the City directs the City Government to create favorable conditions of living and work as well as to facilitate conditions in which residents determine the overall operations of the City and become beneficiaries of its development (Article 9(3)). Empowering the residents to determine the City's overall operations explicitly implies the need to arrange a decentralized way of administration.

The Proclamation also prescribes the obligation of the City Government to establish Sub-Cities and Kebeles, and it also assigns the power, duties, responsibilities and structure for the three tiers. Kebeles are presumed to be the center of socio-economic development where residents directly participate in the activities of the government. The City Government re-organizes the administrative structure of Kebeles and their status has been changed into "Woredas". Sub-City organs of power include Sub-City Council, Sub-City Chief, Executive and Sub-City Standing Committee. According to Article 30(1) of the Revised Charter, a Sub-City functions as a Municipality in accordance with the central leadership of the City Government. Thus, the status of Sub-Cities could be taken as an extension of the City-Government under the subordination of the latter. In addition, though a Sub-City is granted to have an elected Council, Article 32(1) subscribes that a Sub-City Council is accountable to the City Council.

Sub-article 2 further empowers the City Council to dissolve a Sub-City Council under pre-described conditions. The matrix structure and double accountability of officials at a Sub-City level might produce problems of coordination. For instance, the chief executive, head of the respective Sub-City, is made accountable to the Sub-City Council as well as the Mayor; the Sub-City Manager, an executive of municipal services, is also accountable to City Manager and the Chief Executive; and the same dual accountability applies to heads of sectoral offices. This problem of matrix structure is aggravated by lack of comprehensive monitoring and reporting mechanism, according to the study of UN-Habitat (2006).

Regarding functional responsibilities and service provision mandate of Sub-Cities, most municipal services have been arranged to be rendered at Sub-City and Kebele levels. But, the prime benefit from decentralized service provision will be realized if lower-tiers are able to prioritize the level and type of public services to be rendered. In this framework, Sub-Cities lack the power to approve their budget so that they are not in a position to determine the service provision. The optimum mandate Article 32(e) gives Sub-Cities is to allocate the budget set aside to it by the City-Council. The distribution of actual expenditure of the City between the City Government and Sub-Cities (including Kebeles) for five fiscal years (2004/05-2008/09) indicates that 71.2 percent of the city expenditure was spent by the city government. Moreover, the City Government dominates capital expenditures by having more than 85 percent. This is mainly due to the fact that financing the city's socio-economic infrastructures such as housing, roads and water supply is the responsibility of the City Government.

In terms of revenue autonomy of Sub-Cities, Article 57 proposes the revenue-sharing system for Sub-Cities to be effected according to a formula which enhances competitiveness and effectiveness as well as rests on equity. It further states that such revenues of the City Government are to be collected and directly utilized by Sub-Cities will be specified by the City Council. In spite of such provisions, the financial reports and the interviewees reveal that Sub-Cities do not yet have retaining and using autonomy of any portion of the revenue they collected. But, Sub-City revenue collection and supervision core processes are taken the main operational centers of the city's revenue agency. Furthermore, they deliver revenue-related services such as taxpayers' registration; issuance of taxpayers' identification number; issuance of VAT certificate; and tax assessment and collection. Nearly, 87 percent of the City's total revenue has been assessed and collected at Sub-City and Kebele levels. Hence, lower tiers with no retaining power might not have the incentive to collect as high revenue as possible since there is no rewarding mechanism for better collection performance.

Sub-Cities with no power of preparing and approving their budget and with absence of retaining power of their revenue are entirely dependent on budgetary subsidy allocated from the City Government. Head of the BoFED argues that Sub-Cities should not be allowed to retain their revenues. According to her, there is a high difference in the distribution of revenue base and

revenue potential among Sub-Cities. Thus, this horizontal imbalance is the rationale for the dependence of Sub-Cities on the budgetary transfer from the City Government. The budgetary allocation to Sub-Cities incorporates the revenue collection efforts into the “distribution formula” so that though they are not allowed to retain their revenues Sub-Cities that collected more revenue would receive higher amount of grants. Hence, Sub-Cities would try to collect as high amount of revenue as possible in order to receive more revenue. The City Government has undertaken significant measures in order to develop the institutional and administrative capacity of Sub-Cities and Kebeles. The institutional framework and structure of the City Government is almost symmetrically applicable to the sub-cities. Sub-Cities have been also delegated to carryout human resource management function within their jurisdictions. Data obtained from the City’s Civil Service Commission indicated that from the total public employees in the city i.e. 41,088, 30,683 (74.7 percent) were serving in institutions at Sub-Cities and Kebeles.

Finally, Sub-Cities are not allowed to borrow money from any sources. Sub-cities therefore can be better perceived as bodies with de-concentrated administrative organs the central City Government; rather than a viable local government with potential mandate to provide local services as per the unique needs and preferences of their residents.

Chapter four

Conclusions and Recommendations

This is last chapter of the thesis dealing with the conclusion drawn from the data analysis, findings and interpretation in the earlier chapters and the recommendations forwarded to government officials at the City and Federal levels to take corrective actions and to prospective researchers to conduct further studies on the indicated areas in the study.

4.1. Conclusions

- I.** Addis Ababa City Government is the statutory sub-national entity established by the Revised Charter of Proclamation No. 361/2003. The fiscal powers and functions of the City Government are defined by the Revised Charter within the general framework of Article 49 of the Federal Constitution, having “full measures” of self government. It has wholly-elected City Council with broad area of powers to make local laws, policies and strategies. The executive-body of the City, that is locally appointed, has also functions and powers on matters that fall under its jurisdictions, excluding those assigned to the Federal Government. The Constitutional and Statutory foundations for the existence of viable local government of Addis Ababa provide sufficient framework.

- II.** Addis Ababa City Government has substantial powers and functions to provide state and municipal services as well as relatively higher spending autonomy. Having locally-elected Council with the mandate to make final decision on budgetary choices, the City is found autonomous to prioritize the provision of public goods and services. The spending autonomy of the City is further strengthened by the minimal contribution of transfers so that the conditional ties associated with such transfers as to how, when and how much to spend them did not exist. This makes unique the City from State Governments that received about 64 percent of their budget from the Federal Government. Moreover, the power of the City to determine its internal administration, working conditions and service provision mechanisms would strengthen its spending autonomy and local capacity.

- III.** Actual expenditure of the City between 1993/94-2008/09 fiscal years demonstrated the significant fiscal importance of Addis Ababa. Although Addis Ababa has 4.02 and 0.04 percent population and area share of the Country respectively, it spent more than 17 percent of sub national expenditure. Additionally, the recent extensive socio-economic infrastructure development highly increased the actual expenditure of the City. Projects on road and housing development backed with the borrowing arrangement with Commercial Bank of Ethiopia and Telecommunication Corporation also made the expenditure of the City huge. One of the positive indication of the City's spending autonomy is the prime emphasis given to the capital accounts. Unlike any of the Regions, the City allocated more than 63 percent of its budget to capital expenditure. Moreover, the priority given to economic sector could be also a good trend.
- IV.** Regarding revenue sources and autonomy of the City, the unevenly concentration of economic activities at the City as well as better capacity to mobilize the existing revenue sources make Addis Ababa fiscally viable sub national unit of the country with better revenue collection having more than 50 percent of revenue collected by Regions in the country. Revised Charter Proclamation No. 361/2003 defines revenue sources and revenue power of the City. Accordingly, the City earns its revenue from taxes, non-taxes and municipal revenues. During 1993/94-2008/09, Addis Ababa was able to collect 20.28 billion Birr from these sources, of which 61.74 percent was earned from taxes, and 38.3 percent from non-taxes and municipal sources.
- V.** In terms of the degree of its control over these revenue sources, the City has almost full autonomy to determine the rates or/and bases of revenues from non-taxes and municipal sources. However, the state taxes, almost all direct and indirect taxes are assessed and administered as per Proclamations and Regulations of the Federal Government. Thus, the City has no fiscal power to fix their rates or/and determine their bases. It has therefore, limited control over these state tax revenues and they can not constitute "own revenue" of the City since Addis Ababa directly uses the Federal Legislations for administering the tax revenues. But, from the perspective of fiscal autonomy of the City, taxes contribute the highest revenue yield and it has full power to assess, collect, administer and retain its taxes as per the guidelines of the Federal Government. Thus, the City has full administering

autonomy and spending autonomy of tax revenues. Statically, Addis Ababa has full fiscal autonomy over 48 percent of its total revenues; 16 percent of its tax revenues; and 100 percent of its non-tax and municipal revenues.

VI. As to the intergovernmental fiscal transfers of the City from the Federal Government, it is found that Addis Ababa has insignificant, inconsistent and irregular transfers from the government. And, the City is excluded from the regular block grant transfers arrangement of the City due to the imaginary reason of high revenue potential of the City and the equity based system. Therefore, Addis Ababa has no transfers from the IGFT system of the county. This is extremely opposite to the experience of Regions that received about 64 percent of financing from the transfers. The insignificance of the transfers would have positive as well as negative impacts on its fiscal autonomy. Positively, absence of transfers provides better spending autonomy and put pressure on the City Government to mobilize its local revenue sources exhaustively. But, unless the City is not able to provide local services effectively and efficiently, the absence of transfers would have its own adverse impact on its fiscal autonomy.

VII. The City has borrowing power from domestic sources as per authorization of the Federal Government and foreign sources via the Federal Government. But, there is found no comprehensively established guidelines as per the conditions required from the City so as to exercise its borrowing power. Absence of this regulatory framework would reduce fiscal autonomy of the City in its endeavours to finance socio-economic infrastructures through borrowing. No evidence is found of the exercise of its foreign borrowing. Domestically, the City had poor borrowing practice. The recent three fiscal years, however, indicated the fact that it borrowed money from CBE and ETC to finance its housing and road projects. But, the borrowing process lacked clarity and formality. It can be rather described as a politically-induced informal decisions.

VIII. Although the City has three tier of administrative levels, intra-city decentralization is found lagging behind the intension of the Charter to have fiscally capable and viable lower tiers at the City. Accordingly, Sub-Cities though perform most of state and municipal functions, lack the power of approving their budget. With out having budgetary choices, Sub-Cities could

not provide public goods and services based on the needs and preferences of their localities. Moreover, though they assess and collect more than 80 percent of the City's revenue, sub-cities are not empowered to retain any portion of it. This may in turn reduce their efforts to raise more revenues. Sub-Cities, therefore, are better to be perceived as administrative branch of the City government with deconcentrated power; rather than viable local governments that would be instruments to realize the intended benefits of fiscal decentralization.

4.2. Recommendations

Based on the data analysis, findings and conclusions of the study, the following recommendations are forwarded so that appropriate measurement can be taken by the City Government, and further studies could be made by prospective researchers.

4.2.1. Recommendations for corrective measurement

- I.** The national framework for sub-national borrowing should be clearly stated so that Regions including Addis Ababa would get financing options to develop their socio-economic infrastructures. Clearly and explicitly defined conditions for borrowing would reduce subjective and politically-induced decisions by the Federal Government.

- II.** With minimal amount of transfers and under-developed capital market as well as absence of comprehensive framework for borrowing, Addis Ababa City Government has probably only one possible option to raise sufficient revenue that will enable it finance the ever-increasing demand for public goods and services, i.e. optimum utilization of its existing revenue sources. Revenue enhancement plan is usually an appropriate action to utilize existing revenue potential of the City exhaustively, that requires comprehensive survey of the actual revenue potential of the City. Modern mechanisms of property valuation will also help the City to raise more revenues from property taxation. For instance, Cadaster has substantial use in this case. More efforts need to be given to relatively more productive revenue sources. Systems should be established to incorporate the informal sector into the tax system. Political, legal and administrative actions should

be also taken to reduce the existing corruption in land management that caused the City to lose million of Birr every year.

- III.** Fiscal autonomy of Addis Ababa City Government would not be realized unless transparent and proper system is established to involve the residents in the provision of services. In this case, cost-sharing mechanisms are required to allow the residents to contribute their own part. Monetary material and labor contribution of the residents would increase its resource as well as provide them the opportunity to participate in the administration of the City.

- IV.** Fiscal power and autonomy of the lower tiers should be also strengthened so that assumed benefits of fiscal decentralization will be realized. Some degree of spending autonomy in terms of their power to influence their needs to be promoted so that local officials will be locally accountable and their budget reflects the real preference of their residents. Moreover, allowing them to retain and use some of revenue collected by them will increase their efforts to collect as much revenue as they could. The accountability structure of lower-tiers with in a matrix-model creates complexities and makes coordination problematic. This should be simplified so that unity of direction will be enhanced.

- V.** Mechanisms should be established to provide the City some fiscal supports so that it would provide local services more efficiently and consistently. The unemployment, poor housing, and poverty of residents of the City should be considered seriously. Furthermore, even the transfers should be made at least predictable to the City Government.

4.2.2. Recommendations for further studies

The following are found potential areas for further studies so that the full picture of the City's fiscal autonomy will be addressed adequately.

- I.** Important macro (national) frameworks may influence the degree of fiscal autonomy of Addis Ababa. These include how the national election rules, party-structure, freedom of press and rule of law and so on would affect the degree of fiscally autonomous local government.
- II.** Fiscal autonomy of a SNG is not the end goal of fiscal decentralization. In this direction, further studies are required to relate fiscal autonomy of the City with its impacts on service delivery, accountability, good governance and efficiency.

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ANNEXES

Annex - I

Addis Ababa University
School of Graduate Studies
Department of Public Administration and Management

Title of Thesis: A Critical Examination of Fiscal Autonomy of Addis Ababa City Administration.

Interviews Questions

In order to answer the research questions and to meet objectives, primary data was collected through in-depth interview from six interviewees in Ministry of Finance and Economic Development (MoFED) and Bureau of Finance and Economic Development (BoFED). The revenue – related questions were forwarded to the two interviewees at Revenue Agency of the City; most of the questions on transfers and borrowing of the City were asked to the two interviewees at MoFED and to make things clear and get cross- checked data almost all questions were asked to all interviewees. The Head of Revenue Agency was asked questions that required more general and analytical data and the view of senior official of the city government. The questions forwarded to all of the interviewees are summarized as follow.

1. Could you explain the legislations that define the fiscal powers of Addis Ababa?
2. What are the major constitutional and legislative differences regarding the fiscal status of Addis Ababa and State Governments?
3. What are the major revenue sources of the city?
4. Over which revenue sources does Addis Ababa have fiscal power to fix their rate or/and base?
5. How has Value Added Taxes been managed in the city?
6. Why does the city lack access to corporate taxes?

7. Why has the city failed to collect the planned size of revenue in the past three fiscal years?
8. What corrective actions are proposed to improve the revenue collection performance of the city?
9. Does the city fix the rate of its municipal revenues?
10. Can you explain the fiscal status of sub-cities? Could they approve their budget? Retain some portion of their collected revenue?
11. How does the Federal Government treat Addis Ababa in its inter governmental fiscal transfer system?
12. What are the reasons for the absence of Federal block grant transfers to Addis Ababa City?
13. What are the preconditions set by the Federal Government for borrowing of Addis Ababa?
14. What are reasons for low records of borrowing practice by the city?
15. Is there a revenue-sharing arrangement with the Federal Government?
16. Comparing with Regional Governments, how do you see fiscal autonomy of Addis Ababa?
17. Do you have any further important information on fiscal autonomy of Addis Ababa city?
18. Who are the main creditors for Addis Ababa City?
19. could you give me explanation on the increasing expenditure trends?
20. what are the reasons for higher capital expenditure of the City?

Declarations

I, the undersigned, do hereby declare that this Thesis is my original work and it has not been submitted partially or in full by any other person for an award of a degree in any other university/institution and that all sources of materials used for the Thesis duly acknowledged.

Declared by:

Name: _____

Signature: _____

Date: _____

Confirmed by Advisor:

Name: _____

Signature: _____

Date: _____

Place and date of submission: _____