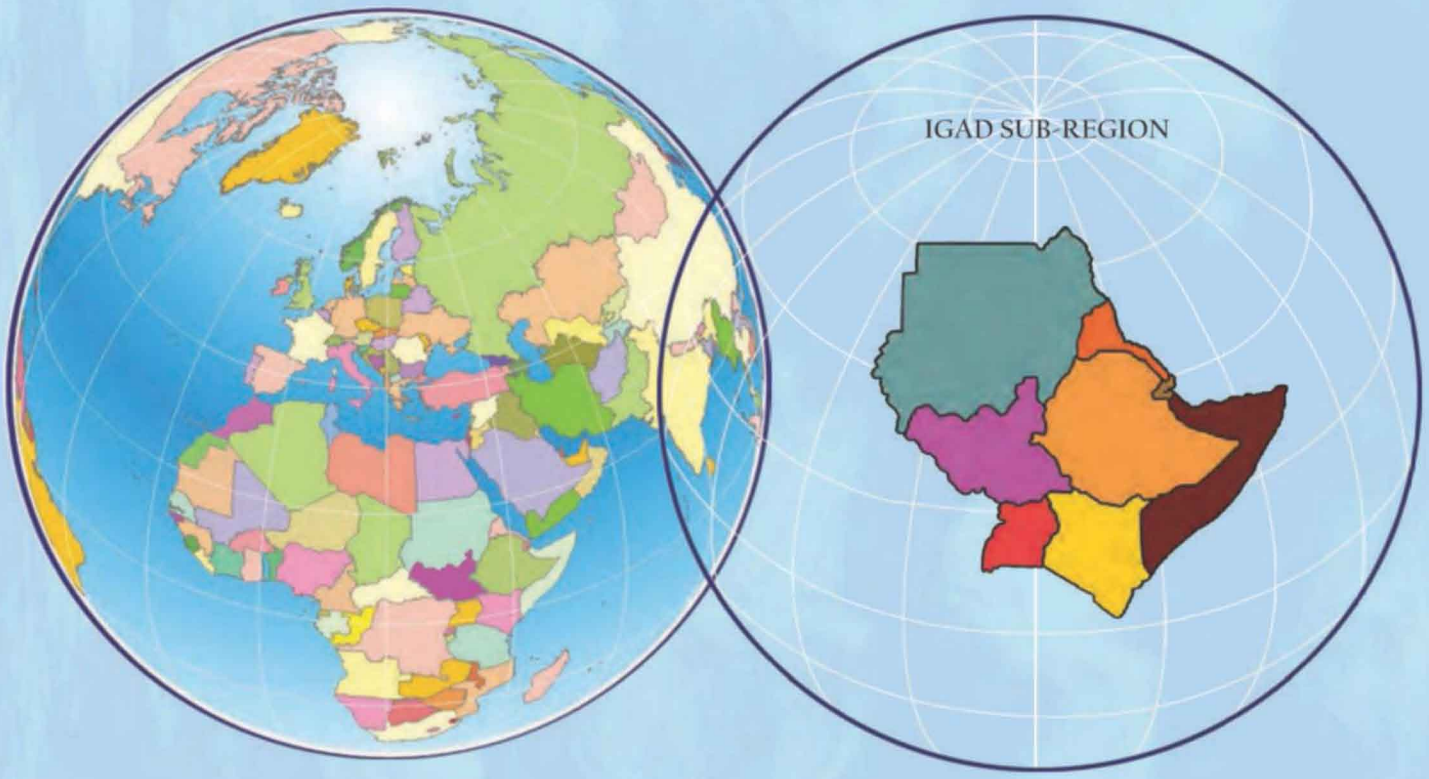
Fiscal Federalism and Decentralization in Selected IGAD Member Countries



The Horn Economic and Social Policy Institute (HESPI)
Working Paper 04/16

Solomon Negussie (PhD)
(Resident Research Fellow of HESPI)

August 2016

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Table of Contents

1. Introduction 1

2. The context of the Region 2
2.1. General background about the region 2
2.2. Constitutional political structure of federalism/devolution in the IGAD region 4

3. Brief Conceptual Framework and Rationales of Fiscal Federalism 10

4. A brief review of experiences in fiscal federalism 13
4.1. The practice in old and developed federations 13
4.2. The Practice in Africa 18

5. Building blocks of fiscal federalism assessed in the IGAD region 25
5.1. Institutional/constitutional frameworks 25
5.2. Distribution of expenditure responsibilities 29
5.3. Assignment of revenue raising powers 33
5.4. Natural resource revenue 38

6. Intergovernmental Transfers 42
6.1. Imbalances 42
6.2. Instruments of Intergovernmental Transfers 43
6.3. Functional and administrative capacity 50
6.4. Institutional arrangements for fiscal relations 53

7. General Conclusions 55

8. Lesson learned and policy recommendations 59
8.1. Lessons to be learned 59
8.2. Policy recommendations 61

References 64

Fiscal Federalism and Decentralization in Selected IGAD Member Countries[1]

1. Introduction

Fiscal federalism - the fiscal implications of a decentralized system of multi-level government – is an important component of governance in a federal or a decentralized system. Among the aspects of fiscal federalism to be assessed are the constitutional and political context, the allocation and the scope of federal, state and local revenues and expenditures, the nature and scope of intergovernmental transfers, equalization arrangements and institutional architecture for the participation of constituent units at the federal/national level. This study of fiscal federalism in the IGAD region focuses on the four member countries - Ethiopia, Kenya, South Sudan and Somalia. Although these countries have incorporated some or all principles of fiscal federalism in their federal or devolved constitution, obviously each country is unique in its own way.

There are significant differences in the constitutional and political context within which fiscal federalism operates or should operate in each of the four member countries. Ethiopia put in place a federal system and practiced fiscal federalism for more than two decades. Kenya, though not new to a decentralized system, introduced fundamental changes in its devolved system of government through a new Constitution adopted in August 2010, which also changes the fiscal structure. Somalia and South Sudan are fragile states struggling to maintain a stable government and a workable structure of fiscal federalism. This study pulls together the four countries to identify the opportunities and the challenges for successful fiscal arrangements. The available theoretical and empirical literature on fiscal federalism will be assessed to identify lessons that may be drawn. In considering the lessons that may be learned, attention will be given to the criteria of equity, autonomy, accountability, political stability and intergovernmental relations between the levels of government.

[1] HESPI commissioned study prepared by Dr. Solomon Negussie, College of Law and Governance Studies, Addis Ababa University.

2. The context of the Region

2.1. General background about the region

At present member countries of IGAD (Intergovernmental Authority for Development) are Djibouti, Eritrea, Ethiopia, Kenya, Somalia, South Sudan, Sudan, and Uganda. The region has an estimated population of 250 million, as of 2014, and it stretches over 5.2 million KM^2.[2] The six countries that formed the organization (which was then called IGADD-Intergovernmental Authority on Drought and Desertification) in 1986 were Djibouti, Ethiopia, Kenya, Somalia, Sudan, and Uganda. Eritrea and South Sudan were admitted to IGAD in 1993 and 2011 respectively, with the former currently suspended from active participation in the organization. Setting aside the motives for the establishment and the mandates of the organization and the inevitable unique history and socioeconomic realties of the member countries, the region has been plagued by intra and inter-state internecine conflicts and instability. Almost all member states have faced problems in maintaining democratic governance, in the challenges of the management of ethno-linguistic and religious diversity, and in grievances over the distribution of revenues and resources. Besides, the same ethno-linguistic communities are divided between different territories, as it is the case in many African countries, which may play a role in destabilizing the region. For instance, the Somalis exist in Somalia, Ethiopia, Djibouti and Kenya; the Afars exist in Djibouti, Ethiopia and Eritrea; the Nuer in Ethiopia and South Sudan; and the pastoralist Oromos live in both Kenya and Ethiopia. Some of the implications could be the threat of secession claiming

[2] Often population figures are contested but the estimation in 2011 put countries to have the following population size. Uganda 35 million, Kenya 39 million; Ethiopia 86 million; Somalia 10 million; the Sudan 30 million, South Sudan 10 million; Eritrea 5 million and Djibouti 700, 000.

territories from two or more countries, cross border conflicts for resources, and spillover effects of internal conflicts.

In spite of the bleak picture of the region and the real challenges that have been and are still witnessed in the region, IGAD member countries have embarked on different forms of devolved governance and/or federal structure that they think would address their problems. Many countries in the region and in Africa at large were skeptical about the relevance of federalism and devolution in resolving conflict partly because they think it is a colonial agenda of 'divide and rule' and partly because they are concerned on the risk of further fragmentation (Assefa 2013: 12). However, historically the region was not alien to federal or decentralized form of governance. Some of the cases are the Ethio-Eritrean federation (1952-1962), the Addis Ababa Agreement signed between the government of Sudan and the SPLM on federal or decentralized system (1972-1983).[3] They were adopted as mechanisms to resolve conflicts or to manage diversity, but mostly they failed due to central governments' approach to consolidate power by disregarding the arrangements for decentralization or self-rule. Sometimes such approaches led to devastating consequences not only in terms of human costs but also in terms instability, economic degradation and disintegration which probably led to the birth of Eritrea and South Sudan.

Of course, decentralization and federalism are not panacea for resolving all sorts of problems. It all depends on the political will to make it successful and the design and context of political institutions (Suberu 2013, 33). The institutional design should respond to the critical challenges that each country faces. In this regard, the perennial conflict that has been afflicting the region can be attributed to the failure of the respective governments to accommodate and manage diversity and institute a functioning power sharing mechanism. In this regard, federalism and decentralization are proved to be viable options when there is ethno-nationalist movement and there is a political agenda for recognition and accommodation, in contrast to assimilation and lack of democracy (Assefa 2007). There are also different power sharing and consociational arrangements to manage diversity.[4] But equally important are rule of law, democracy, accountability, equitable distribution of resources and economic development which should be given due recognition in either federal or unitary systems in the region.

Federal systems or decentralized systems are not 'one size fits all' type of institutional arrangements. They are neither essentially beneficial nor detrimental. Effective federal or decentralized systems proved to be useful for managing diversity, conflict or economic inequality when they are applied by taking into account the relevant local context. This is because diversity or conflict manifests itself in the form of regional economic imbalance, in the form of ethno-linguistic or religious based mobilization, or in the form of regionalism (Assefa 2013, 3). Member countries of IGAD have recently been engaged in adopting

[3] The federal idea was also discussed in the East African Community established in 1967 but ceased to exist in 1977. The Community revived in July 2000 which is considered as a precursor to the proposed East African Federation.

[4] For a detailed discussion on consociational and other power sharing arrangements, see Aren Lijphart, 2012. *Patters of Democracy*, 2nd ed., (Yale Univ. Press, New Haven)

federalism or decentralization with the objective of addressing the above mentioned problems. The design and implementation of fiscal federalism is one of the contributing factors for the successful implementation of federalism or decentralization in the region.

2.2. Constitutional political structure of federalism/devolution in the IGAD region

The IGAD region has suffered from many intractable conflicts caused by external forces, interstate conflicts, geopolitical factors, and terrorism (Assefa 2013: 12). However, intrastate crisis related to marginalization of various groups and diverse interests, lack of democracy and rule of law, discrimination and unfair distribution of resources can be attributed to primary causes of instability with significant spillover effects at the region at large. It is within this perspective that member countries adopted federalism, federal like or decentralized arrangement as a means for addressing the above stated problems.

Ethiopia

Ethiopia is very diverse with more than eighty language groups. Of these, four groups —the Oromos with 34.5%, the Amhara with 27%, Somali with 6.2%, and Tigrayans with 6.1% — constitute about 74% of the total population (CSA 2007). According to the Central Statistical Agency, the population size, as of July 1, 2015, is estimated to be 90.1 million, of which 50.2% is male and 49.8% female. Ethiopia is also a home for religious diversity with 44% of its population professing Orthodox Christianity, and 34% being Muslim and the rest belonging to Protestant, Catholic and indigenous religions. Ethiopia is a landlocked country with a territorial size of 1.2 million Km^2.

Ethiopia introduced a decentralized and federal system to address the problems attributed to a century old centralized unitary systems run by a monarchy and later followed by a military Derge/junta. The politics of nation building was entrenched in creating a strong centralist state which did not give regard to language, religion and cultural diversity. Similarly, political pluralism, respect for civil and political rights, and elections did not have place in the system of governance. Over the years, the state structural problem led to unorganized farmers revolt, ethno-national movement spearheaded by student movement, and a protracted civil war. Despite the fact that there were some attempts to institutionalize decentralization, it has remained a new phenomenon until the change in government in 1991. The change of government marked a departure from the then traditional roles of the central government in political, economic and legal establishments. Of course, the legacy of this inexperience in decentralized governance and political order has its own impact on instituting a working democratic federal structure.

The federal arrangement in Ethiopia was introduced *de facto* in 1992 and *de jure* in 1995 with the adoption of the federal Constitution[5]. This ethno-linguistic federal system was put in place to manage diversity by providing the right to self rule at regional state level and shared rule through different forms of representation at the federal level. The FDRE, as per the Constitution, comprises of nine states, also called regions or national regional self-

[5] The 1995 constitution is the fourth written Constitution of Ethiopia. The 1931, the 1955 revised Constitution, the 1987 PDRE Constitution and the 1995 Federal Constitution

governments[6] and two chartered cities, Addis Ababa the capital city and Dire Dawa. The Constitution embodies the characteristics commonly enshrined in federal systems such as written and supreme constitution and at the same not amendable unilaterally by one level of government, the existence of two level of government, the constitutional division of legislative, executive and tax power, umpiring procedures for constitutional disputes and institutions for intergovernmental relations. The Constitution further stipulates that residual powers are reserved to the states (Art 52/1), except tax powers to be decided by a joint meeting of the two federal Houses (Art 99). It also has its own distinct features. Some of them are the constitutional recognition of the right to secession, ethnic sovereignty, constitutional interpretation through the House of federation (hereafter HoF), absence of legislative role for the upper house, and lack of federal supremacy. Ethnic sovereignty is also another uniqueness where sovereignty resides in the ethnic groups (not explicitly on the people) mentioned in the Constitution as nations, nationalities and peoples.

Both the federal and regional states have legislative, executive and judicial functions. The Constitution emphatically recognizes nations, nationalities and peoples[7] as sovereign units with a view to ensuring their self-rule and for the workings of the federal system as a whole. Each regional government has a constitution, a flag, a regional working language, an elected regional council, an executive administration, and the power to prepare and approve its own budget. The regional state structure has four tiers of government, namely regional, zonal, wereda/municipality and kebele. Each of the regions has a directly elected Council, a President appointed by the Council and an Executive Committee appointed by the President, and Supreme and High Court judges appointed by the Council. The zones may have either an elected council (SNNPR) or a council appointed by the Regional Council (in Amhara and Oromiya). Zonal Councils appoint Zonal Administrators and executive committees. Woredas are guaranteed by regional constitutions and have directly elected councils and executive committees comprising mostly of administrative heads of bureaus. Kebeles have directly elected councils and appointed executive committees comprising elected officials, development agents, school director, and representatives from women and youth associations.

Kenya

Kenya, with a territorial size of 582,650 km^2, has an estimated (World Bank, 2014) population of 44.8milion with 42 ethnic groups, none of which constitutes a majority. The larger ethnic groups are the Kikuyu, which comprises 22 percent, followed by Luhuya (14%), Luo (13%), Kalenjin (12%), Kamba (11%). In terms of religion, the population is largely Christian and Muslims constitute second largest religions community (Cheng 2008, 127).

[6] Unless otherwise provided, hereafter state, region and regional or subnational government are used alternatively.

[7] One can observe its importance from the preamble to the Constitution which states 'we, the Nations, Nationalities and Peoples of Ethiopia…have adopted the Constitution'. The choice to build political community, community solidarity and administrative territories has to be determined from the perspective of the rights of the groups. Art. 39 (5) of the FDRE Constitution provides, 'Nation, Nationality or People' for the purpose of this Constitution, is a group of people who have or share a large measure of a common culture or similar customs, mutual intelligibility of language, belief in a common or related identities, a common psychological make-up and who inhabit an identifiable, predominantly contiguous territory.'

Kenya has the largest economy in the region and the prospect of good potential for growth is supported by the recent discovery of oil and minerals in the country.

Kenya experienced a highly decentralized or federal-like system - often referred to as 'Majimbo'[8], in the run up to independence from 1960-1963 (Rocaboy, et al, 2013: 161). It was a result of a compromise before the country became independent on December 12, 1963. The 1963 Independence Constitution established a classic parliamentary system replicating the British model, with a prime minister as head of government and a bicameral parliament (House of Representatives and Senate). The constitution did not make provision for the post of president but included a position—ceremonial in nature—of governor general representing the British monarchy and acting as head of state. It included (a) a federal-style *Majimbo* system, with seven regions having some autonomy; (b) an independent judiciary system; and (c) a charter of rights for minorities (Ibid).

This short lived arrangement aimed at ensuring significant role through establishing elected assembly, own financial resources and establishing public institutions. But the newly adopted Constitutional provision in 1964 established Kenya as a Unitary Republic and gave the first president[9] - Kenyatta – to implement a deconcentrated provincial system structured around provinces, districts, divisions, locations, and sub-locations. By removing the regional level which overshadowed the role of lower levels, the president took some measures to revitalize the economy and mobilize the grassroots (Ibid, 163-164). In this regard, Smoke and Whimp (2011, 109) claim, "elite capture and other governance problems common in post-colonial states existed, but Kenyan local governments were long more empowered and less fiscally dependent on the central government than those in most African countries." However, the office of the president directly appointed officers of the organization of the provincial administration and its various levels that ensured upward accountability. Consequently, over the years local responsibilities and resources become increasingly recentralized. (Rocaboy, et al, 2013: 164).

As many African countries experienced in the 1990s, the government of Kenya faced challenges demanding reforms alleging it as a centralized authoritarian regime. The reforms targeted, among other things, democratization of the political system, decentralization of power to the lower levels, and improvement of public sector efficiency (Cheng 2008). Although the challenges and protests were aimed at reforming the political and administrative aspects, they only resulted in a limited reform aimed at promoting budgetary and fiscal decentralization. As a result, the Kenya Local Government Reform Program (KLGRP) was devised in 1995 in an attempt to increase the local financial resources, foster citizens' participation in community life, and improve the reliability of budgetary and accounting information (Rocaboy 2013, 164). However, a superficial approach to the problem led to

[8] 'Majimbo' in Swahili means province and Majimboism sometimes refers to federal system

[9] Executive power was vested in a president who held all powers: head of state, head of government, and head of the armed forces. The *Majimbo* system was abolished, and power was thus centralized, along with a transition to a unicameral parliament, with the dissolution of the Senate in 1967.

recurring political conflict and it erupted dreadfully following the 2007 election (Cheng 2008).

After the 2007 riots, a new constitution[10] was proposed by a committee of experts in 2009 and put to a referendum in 2010. The new constitution passed by referendum, with a majority of 66.9 percent of voters in favor. Then it came into force on August 27, 2010, but is being implemented gradually, in line with the transitional timeline set out therein (Schedule five). With the coming into force of the new Constitution, Kenya has embarked on a new path with significant restructuring of government system. The Constitution provides a robust devolution and establishes 47 new lower level county governments that are directly accountable to local residents. The first county governments established following the 2013 election have elected county governors, deputy governors and representatives. The constitution establishes a presidential system, where both the national and county governments follow the principle with separation of executive and legislative power. It also establishes Parliament with two Houses: the National Assembly responsible for national concerns, and the Senate of 47 county representatives with special powers in relation to allocation of a fair share of resources to county governments. The constitution also outlines a framework for the establishment of many new institutions and requires further details in laws aimed at entrenching devolution. For this purpose, a constitutional commission established to oversee the process of preparing legislation required by the constitution. Although the Kenyan Constitution does not explicitly employ the word federal, argues Mutakha (2013: 15) 'what the constitution refers to as devolution is basically a federal system'.

Somalia

Somalia is located in the north-eastern region of Africa, which is known as the Horn of Africa. The country's land area is approximately 637,600 km^2 (Hassig and Abdul Latif 2008:7) with an approximate population size of 12milion ((UNPF 2014:21). In terms of language, Somalia is one of the most homogenous countries in Africa. However, clan plays a significant role in the socio-political aspects of the Somalis. As a result, the nature of diversity in Somalia is unique. In this regard, Assefa (2013) argues, "though Somalia is perceived as constituting as single ethnic group speaking same language and practicing Islam,[11] the clan structure remains a primary source of affiliation and basis for political action just like ethno-nationalist mobilization is in other parts of the region. It appears to [outweigh] class, religion or other forms of socio-political mobilization." The economic overview is dominated by lack of security and political stability. As a consequence of the prolonged conflict and devastation of public institutions, there is a dismally low level of provision of public services. Although pastoral and rain fed agriculture are the backbone of the economy, the flow of remittance by the Somali Diaspora and international assistance play a significant role in the economy.

[10] Before the 2010 constitution, there was an attempt to introduce a new constitution. A constitution (the Bomas draft followed by the Wako Bill) was proposed in 2005 by the attorney general and rejected by popular referendum in November of that year.

[11] In terms of language all Somali speak Somali language. Religion wise 99% follow Sunni sect.

Following the fall of General Mohammed Siyad Baree's regime in 1991 and the beginning of the civil war, Somalia descended into a prolonged conflict and insecurity. As a result the national state and its institutions collapsed within months, paving the way for warlords with armed clan militias taking claims of governance in various regions of the country. The control of Mogadishu, the capital, divided along clan and sub-clan lines. The armed conflicts resulted in the loss of lives, the destruction of property and human displacement on a magnitude and scale unheard of in Somali history.

As a result of the collapse of the Somali state, the former Somaliland declared secession (though not recognized by the international community), and the creation of Puntland was declared in 1998. The Isaq clan (through the Somali National Movement) and the Darood (through the Somali Salvation Democratic Front) controlled Somaliland and Puntland respectively. These two regions are relatively stable and have constitutions, elected parliaments, presidents, courts and others. The rest of the country remained volatile for long while sometimes controlled by warlords, UIC, Alshabab, or foreign militias. In between, various peace processes were brokered by international and regional communities with the aim of installing security, state reconstruction and nation building. Different forms of military interventions were mandated by regional (IGAD, AU) and international organizations (UN). These efforts led to multiple transitional arrangements, but the process culminated in the formation of the Somalia Federal Government (FGS) in 2012, which replaced the transitional governments.[12]

The present federal government was formed after the Somalis held the first post-civil war election held in September 2012. The government is mandated by Provisional Constitution approved in August 2012 by the 824 members of the Constitutional Assembly, which was established by a clan representation formula. With regard to governance, the Constitution put a blend of parliamentary and presidential systems in place. The president is to be directly elected by the voters and the president appoints a Prime Minister who in turn appoints cabinet members in consultation with the President. The executive power is divided between the president and the Prime Minister, which sometimes led to power feud between the President and the Prime minister. Finally, Parliament has the power either to approve or reject the cabinet and its program agenda.

The system of government put in place is constrained by various issues not fully addressed by the Constitution. Some of them are left for further negotiations (such as taxation and the basis for creating states) while others need the establishment of institutions and ensuring security. The 2012 Provisional Constitution of Somalia declares a federal system and establishes the Federal Government, which is yet to be seen as effective one.

[12] However, the federalization process in the country still remains strongly guarded by the deployment of African army under the African Mission to Somalia (AMISOM).

South Sudan

South Sudan, with an approximate territorial size of 650,000 km^2 and an estimated population of 11 million (World Bank), is the youngest member of the United Nations (UN). It gained its independence by a referendum in 2011 through a peace process brokered with the government in Khartoum. The country is one of the most diverse, and has more than 60 distinct ethnic groups. In terms of religion, the bulk of population follows some form of traditional belief, while Christianity appears to have the largest adherents and Islam is widely practiced in the urban areas. Economically, South Sudan started with a good record of GDP growth and per capita income (1081 USD) due to its small population size (World Bank 2013) and petroleum revenue. However, there is low level of provision of socioeconomic services due to lack of peace and security.

The Republic of South Sudan has adopted a 'federal like' system with a division of power between the national government and the ten states –the number of states was recently increased significantly to 28 by the President. Despite the absence of a *de jure* inclusion of a federal system before and after independence of South Sudan, federalism has been on the table following the 2013 conflict between factions led by the President and the Vice President, respectively (SPLA/M and SPLA/M/IO). The Transitional Constitution has widely incorporated elements of decentralization process which have at least some elements of federalism. Decentralization is envisaged as a means to bring power closer to the people, to empower marginalized groups and to ensure development at the local level.

3. Brief Conceptual Framework and Rationales of Fiscal Federalism

Fiscal federalism, as it is widely covered under 'fiscal decentralization,'[13] is generally concerned with the study of the distribution of expenditure responsibilities, the allocation of taxation power, intergovernmental transfers for adjusting fiscal imbalances, the management of regional borrowing and institutional mechanisms for fiscal relations between the levels of government. The traditional normative approach of fiscal federalism, as pointed by R. Musgrave (1959, 179), states that it is a system whose purpose 'is to permit different groups living in various states to express different preferences for public services; and this, inevitably, leads to differences in the levels of taxation and public services.' The analysis is based on the three major functions for the public sector: macroeconomic stabilization, income distribution and resource allocation. The theory is in favor of assigning macroeconomic stabilization function to the central government which is inherently considered to be national in nature. This is because sub-national levels of government are ineffective in dealing with the issues of unemployment and inflation/or lack the necessary instruments such as fiscal and monetary policies. Income distribution is also primarily the responsibility of a national government. Taxation policies aimed at bringing about desirable income distribution from the wealthy to the poor are better taken care of by the central/federal government and to address possible regional disparities. Even though it is sometimes argued that in some countries sub-national governments in practice have some redistribution functions by distributing benefits in kind. Allocation function is in principle the responsibility of all tiers of government.

The classic argument is that providing some of the goods and services (such as defense) by the national government bring about efficient level of output since it confers significant benefit to everyone in the country. On the other hand, local public goods can better be provided by local authorities who can easily identify local priorities. Thus, public goods and services can be provided nationally, regionally or locally. With regard to intergovernmental transfers, the assumption lies on federal responsibility as part of its redistributive function. R. Musgrave's seminal work was underpinned through the contributions of others, such as Tiebout (1956 'voting-with-feet'), Olson (1969, principles of equivalence), Oates (1972, decentralization theorem). The normative approach has been challenged due to its assumption of a 'benevolent government' (Ahmad and Brosio 2006: 1). The assumption fails to investigate the impact of individuals, political parties and corruption, which all have necessitated a political economy approach. The latter emphasizes the importance of institutional strengths, including the legal, political and administrative aspects, and intergovernmental collaboration and prudent fiscal measures to generate good governance.

[13] The generic meaning of the term 'federalism' in economics is decentralization. Therefore, fiscal federalism/decentralization literatures deal with the fiscal implications of a decentralized system of multi-level government irrespective of their constitutional status (federal, decentralized unitary, regional or supranational arrangements like EU).

The institutional approach (Litva 1998, Azfar 1999)[14] challenges the normative approach on the ground that the impact of the linkage between decentralization and political, administrative and financial institutions are not well established. It argues that the success of decentralized service delivery is dependent on institutional arrangement as it is widely exhibited in the difference between developed and developing countries. The Inter-Governmental Relations (IGR) approach (Zimmerman 1990) also emphasizes the importance of various, detailed and complex (horizontal and vertical) relationship between the levels of government. It questions the normative assumption on the distribution of the three economic roles of a government and distinct roles of the 'dual polity' (federal and local governments). It further argues that there are continuous changes with regard to the type and extent of relationship between levels of government due to local dynamics, information flow and the impact of globalization.

The New Public Management Theory– NPM (Lane 2000) challenges any assumption of distribution of responsibilities, revenue sources and intergovernmental transfers on the basis of the provision of public goods by the public sector. It advocates for a limited government role but for an increased market role aiming at curbing government transaction cost and improving political accountability. Despite all theoretical assumptions, arguments and propositions for the implementation of fiscal federalism, distinct socio-cultural, constitutional and economic challenges emanating from each country cannot be underestimated.

Based on the conceptual framework stated and the functional divisions among different levels of government, fiscal federalism literature focuses, in short on examining the following interrelated issues. First, it deals with the issue of 'who does what' – the distribution of *expenditure* responsibilities which in a federal system depends on the constitutional division of powers and responsibilities. The second issue is the division of *revenue* raising powers between the federal government and the regions. It is followed by the study of the causes and impact of fiscal *imbalances* between the tiers of government in executing their respective responsibilities. It also deals with the design and objectives of intergovernmental *transfers* towards establishing a meaningful relationship between the tiers of government. This is accompanied by analyzing the institutional arrangements for managing fiscal relations between the tiers of government, including regulating the issues of regional borrowing.

The rationale of fiscal federalism has to be seen within the broader objectives of federalism or decentralization. Ebel and Yilmaz (2002: 157) noted that addressing 'inefficient governance, macroeconomic instability, and inadequate economic growth' as the major objectives of decentralization. But federalism has been considered as a useful institutional arrangement for accommodating diversity, ensuring self rule at subnational level and fair representation at national level, managing regional economic disparities, and maintaining national unity. In a decentralized or federal system fiscal federalism provides important principles towards achieving the above stated objectives by promoting efficiency, improving service delivery, promoting equitable distribution of resources, managing conflicts emanating

[14] For further analysis, see Paulos Chanie, 2007. *What One Hand Giveth, the Other Hand Taketh Away: Ethiopia's post-1991 decentralization reform under neo-patrimonialism* (Shaker Publisher)

from resource claim, and enhancing transparency and accountability. Various studies on the subject suggest that federal financial arrangements support a particular system to be efficient, equitable, autonomous and at the same accountable. But the implementation of principles of fiscal federalism in each country is widely influenced by the individual political and economic system, financial resources, levels of economic development, and the constitutional and legal framework. However, Shah (2007: 30) argues that federal or decentralized systems have shown remarkable success when fiscal arrangements respect diversity in local identities and preferences, and 'pay special attention to regional economic divisions to ensure level playing field to strengthen the economic union.' Such an effective fiscal arrangement is described by Ahmad and Searle (2006: 390) as 'the glue that holds the nation together'.

4. A brief review of experiences in fiscal federalism

4.1. The practice in old and developed federations

All federations incorporate common characteristics of a federal system, but there are variations based on the concurrence of their history, politics and development patterns. The variations are dynamic as there are different challenges to be dealt with and the choices to be made. One of the approaches to address the challenges would be learning from the experiences of others. In considering the lesson that may be drawn from other federations, this section gives attention to basic constitutional features of the developed or mature federations, the approaches in terms of the division of expenditure and tax powers, in the instruments of transfers and institutional arrangements. In this section, first we present some general observations about constitutional features. It is followed by specific reference to country experiences. Finally, some general comparative observation is given.

i. Important constitutional features

In terms of the mode of division of power and interaction between the levels of government, federations are broadly divided into two models: dual federalism or integrated federalism[15]. Canada, USA and Switzerland resemble the coordinate authority model of dual federalism. Under the model of a coordinate dual federalism, states enjoy significant autonomy and local governments are simply creations of the states with limited or no direct relationship with the federal government. The German Constitution features an integrated model where the federal government reserves policy/law making power and the states primarily act as the implementing agent. The constitutional status of local government as a third tier of government has its own impact on fiscal arrangements affecting local governments. In Germany the self governing status of local/municipal governments is guaranteed (Art28), and specific financial arrangement is also provided (Art104). Local governments are constitutionally recognized as a third tier in Brazil, India, Nigeria and South Africa distinct from the federal and regional levels. But they are the creations of states/provinces in other federations.

Federations also vary in the implication on the process of regional influence on federal/national policies and the degree of federal influence on regional governments. According to the constitutional design, federal influence on state governments is strong in Australia and Germany, but weak in Canada, USA, and Switzerland. In the latter group, regional governments have considerable autonomy to determine their own tax base and tax rate, and to decide on their own expenditure pattern.

The nature of regional participation or influence on federal policy making process is another difference between federations. This is primarily related to the representation of constituent units in the second chamber. In Germany state governments have a direct voice in federal

[15] Under dual federalism, each level of government is separate having its own law making and administrative powers and functions. Whereas in integrated federalism, the federal government mostly sets laws and policies and states and local governments act as implementing agencies.

institutions as they are represented in the second chamber. In the USA senate members are not appointed by state legislatures, but are directly elected by the people. Therefore, senators may not support the position of state executives. In Canada, members of the second chamber are nominated by the Prime Minister; therefore the senate is considered to be more technocratic in its orientation as members are often appointed based on recognition of their service achievements in government, politics or businesses.

The other issue is constitutionality of laws and the role of Courts[16] in the federal systems. It does not mean that all fiscal arrangements have been laid out in detail in all constitutions. The constitutions of Canada and the USA set out major allocations for expenditure responsibilities and revenue sources, whereas various transfer arrangements have been developed through practices and political processes (Watts 2004, 3). For instance any legislation, including fiscal issues, in Canada can be reviewed by the Supreme Court to check for its conformity to the Canadian Charter of Rights. In the USA the federal role over the years expanded due to judicial interpretation on the federal interstate commerce power. In these countries, Supreme Court decisions played vital role in establishing effective fiscal framework between the federal government and states. Despite a detailed fiscal arrangement for the division of tax source and sharing tax proceeds between governments, the German constitutional court also plays a role in fiscal rules, transfer designs, and federal bailout issues.[17] In Switzerland, the Constitution favors direct democracy of citizens and empowers them to hold fiscal referendum[18] to veto on government program.

ii. Experiences of some federations

A. Canada

Canada is a federation of ten Provinces and two territories. The constitution clearly defines the assignment of tax and expenditure responsibilities. Most tax sources are concurrently assigned to the federal government and provinces. The Provinces have a broader power to levy personal income tax, corporate tax, payroll tax, sales tax (VAT in some places) and specific excise taxes on items like alcohol, tobacco and petroleum. The federal government levies most of same taxes, but property taxes are left to local governments. The income and sales tax systems are harmonized. Expenditure responsibilities are assigned in the form of exclusive federal and provincial powers, and shared responsibilities. Residual powers are reserved to the provinces and asymmetrical power relationship is developed with Quebec.

In **Canada,** according to Boadway (2007) **there are two major federal – provincial transfer instruments** and other smaller highly conditional transfers for specific purposes. The first is **'equalization payment'**. The second major social transfer consists of **"equal per capita transfers for health, post-secondary education and welfare".** Both equalization and

[16] Courts refer to the regular Supreme court or to special or constitutional court to review the constitutionality of laws

[17] For instance, in 2005 the constitutional court decided against Berlin's claim for federal bailout to settle its debt

[18] Popular referendum in Switzerland empowers citizens to call for referendum for constitutional amendment by the request of hundred thousand citizens, and to challenge the constitutionality of laws by fifty thousand.

social transfers comprise about one-quarter of the federal budget (Ibid, 118). According to the review by Boadway, equalization payments are unconditional transfers to provinces whose revenue-raising is below the national average. A representative tax system (all thirty three provincial revenue sources included) is used to determine the per capita tax capacity of each province. A province whose per capita tax base is below the standard receives an equalization payment equal to the difference between the province's tax capacity and the national average, multiplied by the province's population size. Those provinces above the average will not face any deduction. The social transfer system has two components –Canada Health Transfer (CHT) and Canada Social Transfer (CST). Both transfers are made on an equal per capita basis, but provinces must adhere to the minimal conditions and standards attached to them.

B. Germany

Germany is a federation with 16 Länder as its constituent units. The assignment of powers and functions under the Basic law provides exclusive responsibilities to the federal and Länder governments, and shared responsibilities in the form of *concurrent* and *framework* powers.[19] With regard to assignment of tax power, major tax sources are shared by the federal and state governments. These shared taxes include personal income tax, corporate income tax and VAT which account about two thirds of tax revenue in the country. Therefore, the states do not have the autonomy to decide on tax bases and rates individually. Their exclusive tax sources are inheritance tax, gift tax, car tax, but on the basis of the federal legislation. The autonomy to set tax rates belongs to local governments only on local small businesses tax and real estate tax. Significant exclusive federal taxes are mineral oil tax and tobacco tax.

In Germany, there are four equalization transfer systems (Feld and Hagen 2007). The transfer arrangement is a reflection of the tax assignment system which assigns all major taxes to be shared by the federal and state governments. According to Feld and Hagen (2007), **the first arrangement is VAT (75 percent of the state share) sharing on a per capita basis.** The distribution of personal (42.5% to states) and corporate (50%) income taxes is according to the derivative principle. **Second, 25 percent of state VAT** distributed to states below the national average to support their fiscal position. **The third approach is interstate equalization transfer** (horizontal equalization). In this approach, first, a national average fiscal capacity is measured by taking all revenue sources and determining the fiscal capacity of each state. The fiscal capacity of a state with a capacity below average will be increased up to 90% of the national average. The additional revenue comes from states with a capacity significantly above the average. **The fourth transfer is supplementary grant from the federal government.** General federal grants are given to all states which have weak fiscal capacity. This type of grant has been an important source after German unification, especially for eastern states. However, economists strongly criticize this kind of transfer due to its disincentive effect on local efficiency. The transfer system in Germany comes next to the revenue sharing mechanism set in the Constitution which covers a high proportion of

[19] Concurrent and framework powers are extensively used in Germany. Concurrent powers are shared by both federal government and states. Framework powers are set by the federal government but leaving substantial room for the states to issue their own legislation within the limits set by the federation.

Lander/state expenditure. In both revenue sharing and transfer mechanisms a horizontal equalization approach is an important component.

C. Australia

Australia has six states and two internal self-governing territories. Tax assignment in Australia primarily allocates exclusive power to each level of government in a more centralized approach compared to other federations discussed above. According to the review conducted by Alan Moris (2007), income tax on individuals and companies, excise duties and levies, and international trade taxes (which account more than 65% of general government revenue) are assigned to the federal government. Taxes on payroll, land, financial and capital transaction, gambling, insurance, motor vehicles and mining royalty account for 17% of public revenue are assigned to states and territorial governments. Goods and Services Tax (GST) which accounts for 13 % of public revenue are administered by the federal government but transferred to states based on established formula. Municipal dues (3% of public revenue) are collected by local governments.

The transfer system in Australia consists of unconditional and conditional transfers. But the major one is equalization transfer which is the unconditional transfer of federal Goods and Services Tax (GST). It is based on a horizontal fiscal equalization principle which states that 'state (and territory) governments should receive funding from the pool of GST revenue such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard" (Moris 2007: 57). This principle is implemented under the formula which makes a comprehensive assessment of both the fiscal capacities and expenditure needs of the states undertaken by the Grant Commission. In its role the Commission uses three important pillars (Moris 2007: 58): (i) Capacity equalization - the principle that the financial capacities of the states, not their performance or outcomes are equalized; (ii) Policy neutrality – average policy standards to be followed, but a state's own policies should not directly influence its grant share; (iii) Internal standards –states are equalized to standards that reflect the average of revenue raised along expenditures under various recurrent expenditures. The assessments are based on average expense incurred by states on the services they provide and on average revenues they collected from the taxes and charges they impose' (Tegegn, et al, 2009, 26). In assessing the expenses, the effects of disabilities[20] on each state are calculated. 'Disabilities are circumstances beyond the control of individual states that require a state to spend more per capacity that other states to provide the average level of services' (Ibid). The Australian system is considered ideally the best option but practically complex and disregards the output of grant utilization.

[20] Disabilities are circumstances beyond the control of individual states that require a state to spend more than other states to provide an average level of services.

D. Switzerland

Switzerland has 26 Cantons (20 full and 6 half cantons[21]) and 2,760 municipalities. The cantons have significant autonomy both in revenue raising and expenditure decisions. The cantons have the power to tax all income, wealth and property while the federal government levies mainly indirect taxes such as VAT and mineral and oil tax. The Cantons have the autonomy to decide on the base, rate and other matters such as rate progressivity, unless rejected by popular referenda. They are free to compete with each other. The taxing power of Cantons is strong and they have a higher percentage of expenditure autonomy. In 2006 the Cantons were able to raise 65% of the total national revenue covering close to 87% of their expenditure (Gerhard 2007, 331).

In Switzerland, tax competition and difference in resource potential have led to huge difference in the fiscal capacity of cantons. **The new fiscal equalization system introduced in 2008 has three components: revenue equalization, cost equalization, and cohesion fund.** Under revenue equalization scheme, cantons are ranked according to their fiscal capacity and the 'poor' cantons are supported to reach a minimum (at least 85%) of the national average. The sources of funding are both the federal government and the 'rich' cantons, where the former contributes 70% while the latter provide 30%. Under the cost equalization scheme, the federal government finances excessive costs of certain public services of cantons arising from geo-topographic/mountainous/ and socioeconomic conditions. The third one, 'cohesion fund', aims at compensating cantons which may suffer from a small grant share computed under the 2008 equalization schemes mentioned above. It is a kind of transitional scheme for 28 years (starting from 2008) where two-thirds of the funding comes from the federal government and the remaining one-third from cantons.

Summary

Federations distribute expenditure responsibility and public service delivery to sub-national levels of government, but each country's approach is influenced by historical, cultural, institutional factors, and legal-judicial interpretations. Consequently, there exists a wide variation in the nature and degree of decentralization. In some federations, public goods of regional nature could be assigned to a federal government. The above discussion also indicates the assignment of tax power to different levels of government and the level of decentralization that these countries follow. As it is clearly observed states and local governments have considerable taxing power. At the same time, the assignment of tax power raises the issue of horizontal and vertical tax competition or harmonization. Some federations put a de jure harmonization prerequisite, while others opt for harmonization through practice. In this regard, an equally important issue would be whether competition or harmonization serves better the fiscal system of a country. Some argued in favor while others against it.

[21] The difference between full and half cantons is that half cantons have only one representation in the Upper Chamber and have half weight in initiating referendum

Virtually, all federations exhibit vertical[22] as well as horizontal imbalances. The vertical imbalance is related to the fact that expenditures are decentralized more than revenue sources, whereas the difference in revenue capacity or expenditure need across the regions/states in a federation is attributed to horizontal imbalance. However, the causes and extent of the imbalances considerably vary. For instance, Germany is said to have minimal imbalances due to harmonized tax system and the revenue sharing mechanisms. But in Canada and Switzerland although there is a high degree of decentralization in revenue raising power, considerable difference in revenue capacity is observed between the states due to economic disparity.

The existence of fiscal imbalances implies the importance of intergovernmental - federal–state –local, transfers. Such transfers primarily serve the purpose of closing the fiscal gap and minimizing the horizontal fiscal disparity, but the federal government also implements transfers as a means of setting minimum national standards or influencing state expenditure priorities. But federations differ in their approaches of addressing the objectives, in the magnitude of transfer, and in the typology of grants they put in place. For instance, the German equalization transfer comes next to the revenue sharing mechanism, which covers a high portion of Länder expenditure. In both cases of revenue sharing and equalization transfer equalization approach is an important component.

4.2. The Practice in Africa

Nigeria

Nigeria, a home to more than 250 ethnic groups and over 100 languages, operates under a federal system with three levels of government (Ekpo 2007: 205). The country follows a presidential system with a bicameral legislature – a House of Representatives and a Senate – and three branches of government. In each state there is a House of Assembly and local governments have their councils. The federal system which started with three states in 1960, at present has 36 states and 774 local governments.

The assignment of expenditure responsibilities follows the division of legislative power in the constitution. The 1999 constitution provides exclusive list (Second Schedule) only for the federal government and concurrent list (where both the federal and state governments can act, but in case conflict the federal power prevails over the state. Residual powers are reserved to states (section 4, 7a). Local governments are established with their respective functions (fourth schedule). Functions that benefit the whole country or functions that can be efficiently performed at the national level have been assigned to the federal level. These functions include defense, international relations, banking, currency and legal tender, weighs and measures. The concurrent list covers those functions which can be considered more of local but with possibility of spillover benefits or charges. These are antiquities and archives; electric power; industrial, commercial or agricultural development; scientific and technological research; university, technological, and post-primary educations. Functions that are considered purely local are assigned to local government. Such functions include the

[22] Shah uses Vertical fiscal gap instead of vertical imbalance. According to him vertical imbalance arises when vertical fiscal gap is not adequately addressed by the reassignment of responsibilities.

establishment and maintenance of cemeteries, markets, motor parks, public convenience, refuse disposal, constructions and maintenance of local roads.

The allocation of taxation power in Nigeria is related to the objective of 'accommodating the conflicting centrist and decentralist claims to natural resource revenue by centralizing natural resource taxation, while promoting the massive decentralization of the centrally collected resource revenue' (Suberu 2015: 37). As a result all taxes levied and administered by the federal government are not exclusively reserved to the federal government. The division of tax power is associated with the vertical allocation of revenue to each tier of government. **Revenues are categorized in to four**: taxes that accrue to 'Federation Account,' 'Special Federal Fund', VAT, and taxes/fees internally generated by subnational governments. The federal government legislates and administers import duties; petroleum profit tax, rents and royalties; corporate profit tax; and excises from which revenues are not unilaterally allocated to the federal government but to a common intergovernmental pool under the 'Federation Account' (Suberu 2015: 38). Revenue from the Federal Account is shared as per the formula recommended by the Fiscal Commission and adopted by the federal government. The recent formula (Lukpata 2013: 34) allocates 48.5, 26.7, 20.6, 4.2 percent to the federal, state, local government and 'special federal fund', respectively. The federal government levies VAT but shared with states and local governments. Currently, the federal government retains 15% of VAT revenue to cover the cost of administration, 50% to the states and 35% to local governments (Suberu 2015: 39). According to the above arrangement, revenue that accrues to Federal Account and VAT constitute the total grant pool to be distributed to states and local governments according to agreed principles and formula. In addition to the above types of taxes, the federal government has the power to legislate on tax rates and bases including personal income tax, stamp duties, capital gains tax, and business profit tax on individuals. But these taxes are administered and revenues retained by state governments. Subnational governments have the power to legislate, collect and retain revenue from property taxes, vehicle license fee, gaming and betting taxes, right of occupancy fee, outdoor advertising, parking fee, and birth and death registrations.

Table 1: Division of Tax Power in Nigeria

No.	Source of revenue	Legislative power	Administration	Revenue	Category
	Import duties; Company profit tax; petroleum profit tax; Rents and royalties; and Excises	Federal	Federal	Shared with state and local gov't	Federal account
2	VAT	Federal	Federal	Shred with states & local gov't	Shared tax
3	Personal income tax; Stamp duties Capital gains; and Business profit tax on individuals	Federal	State government	Own revenue	State
4	Vehicle license fees; Gaming and betting tax; Property taxes; Motor park fees; Outdoor advertising; and Birth and death registration charges	State government	Local government		
5	Other benefit taxes (fees and charges)	Level of government that provides service			

Source: Constitution of Nigeria 1999; Selami, Adeleke, 2011. Suberu 2015.

The overall effect of the distribution of revenue sources is that the share of each government depends on the revenue sharing arrangement. According to Suberu (2015:38), state and local governments receive more than 80% of their total budget from the revenue transferred through the sharing process. For instance, in 2009 subnational governments derived 76.3%, 10.1%, and 13.6% from the Federal Account, VAT, and from own revenue sources (Suberu, Ibid). That is, revenue from Federal Account and VAT account up to 86.4 percent. The share of subnational governments covers about fifty percent of the total national expenditure. As the allocation of revenue does not have any conditionality subnational governments have the autonomy to prioritize and decide their expenditure needs.

The horizontal allocation of revenue determining the share of each constituent unit (state and local government) from the Federation Account and VAT is statutorily determined on the basis of the following share.

Table 2: Nigeria – Horizontal allocation of revenue basis

Sharing from Federation Account				**Sharing VAT revenue**	
	Criteria	percentage		Criteria	Percentage
1	Equality	40%		Derivation	50
2	Population	30%		Equality	40
3	Social development need	10%		Population	10
4	Land mass and terrain	10%			
5	Internal revenue generation effort	10%			

Source: Lukapata 2013; Suberu 2015

One of the important features of intergovernmental transfer in Nigeria is the autonomy of subnational governments to decide on their expenditure priorities as the system mainly relies on general-purpose grants. But at the same time it serves as disincentive to subnational governments from raising own revenue. The other feature relates to the constitutional and statutory provisions, which give the system a strong institutional base rather than ad-hoc arrangements. This is also related to the expected role of the constitutionally established Revenue Mobilization Allocation and Fiscal Commission to review and recommend the revenue allocation formula from time to time. Such institutional design may assist the effort to constrain any tendency by the politicians to manipulate the horizontal allocation system (Suberu Ibid: 39).

The allocation of revenue in Nigeria is characterized by the controversy around the derivation criteria which determines the share of oil producing states (13%), and VAT. The Nigerian system is also highly criticized for being prone to economic mismanagement and irresponsible fiscal behavior of the authorities. Suberu (Ibid) argues that the system is prone to manipulation by federal authorities as it is evidenced by the failure to transfer revenue to the Federation Account. In general, the durability of the Nigerian fiscal federalism related to the constitutional design arrangement sometimes credited as positive feature. However, the corruption in the oil revenue, the weak institutional design to ensure fiscal discipline at all levels of government, and the continuous fiscal conflict claiming for a better share of resources by subnational governments make the Nigerian experience less attractive for other countries.

South Africa

The 1994 constitution establishes South Africa as a republic with constitutional supremacy and limited government with three spheres of government. South Africa has a stable government with a separation of power between the three branches of government. Since the 1994 ANC is in control of government, except one province and one metropolitan council. The constitution entrenched devolution of power to nine provinces and to 278 local governments (large and small municipalities),[23] but avoids using the word 'federal'.

According to the Constitution (Schedule 4), expenditure functions which have a national dimension such as defense, foreign affairs, justice, tertiary education, correctional services are the responsibilities of the national government. These expenditures account on average up to 39% of the total budget of the country. Provincial governments, on the other hand, are responsible for primary and secondary education, health and welfare service, provincial roads, and local economic development (Schedule 4). These expenditures account for about 55% of the total national budget, but provinces collect only 6% of the total national revenue. Local government functions include electricity and water distribution, waste removal, public transport, and municipal health services which account about 6 percent of the total national budget. Despite the constitutional distribution of functions, many of these functions required several framework legislations to delineate a clear responsibility for each sphere of government.

With regard to the distribution of revenue raising powers, there is a significant difference between the three spheres of government. The major revenue sources such as taxes on trade of goods and services, corporate profit tax, personal income tax and consumption taxes are assigned to the national government. Local governments have strong revenue capacity compared to provinces which have a limited power to raise revenue from motor vehicle license fee, gambling taxes, hospital user fees. Municipalities are assigned with property taxes, turnover and utility user fees collected from electricity, water, sanitation and waste removal. Weak revenue capacity of provinces can be witnessed from the share of provincial revenue to expenditures where national grant subsidy covers up to 95%. The government budget also shows that, compared to provinces local governments cover most of their expenditure from own revenue, i.e. local revenue covers more than 20 percent of local expenditure.[24] The trend shows centralization on the revenue side but high decentralization in the expenditure side. Kuhmalo and Mokate (2007: 273) argue that the limited revenue capacity of provinces has also been exacerbated by the dependency of provincial governments on transfers. This dependency constrains the autonomy of provinces to prioritize their expenditures, and it can have strong impact on equity considerations in the revenue sharing formula.

[23] Republic of South Africa, National Treasury, 'Explanatory memorandum for to the division of revenue'http://www.treasury.gov.za/documents/national%20budget/2015/review/Annexure%20W1.pdf, p.2 (accessed on May 20, 2016)

[24] Government of the Republic of South Africa, National Treasury, Budget Review 2014, p. 93

The South African intergovernmental fiscal relation system implements two types of transfer: **unconditional grants and specific-purpose (conditional) grants.** The objective of the unconditional grants is to reduce both vertical and horizontal imbalances. The unconditional grants are transferred to subnational governments through two separate programs: the Provincial Equitable Shares (PES) and the Local Equitable Share (LES) where the former targets only provinces while the latter benefits local governments only. The horizontal distribution (determining the share of each provincial or local government) of the unconditional grants is implemented on a basis of grant formula which has to be prepared taking in to account the specific criteria listed in the Constitution (under Section 214, 2,a-j). But with regard to the vertical distribution (determining the grant pool) the Constitution requires to share the national revenue to the three spheres of government. The vertical division is not based on a preexisting formula. The absence of a formula is defended by the government that 'it is a political process' and therefore cannot be determined through a formula (Kuhmalo and Mokate (2007: 278). The process of determining both the vertical and horizontal divisions is conducted on the basis of recommendations forwarded by the Financial and Fiscal Commission established under Chapter 13 of the Constitution.[25]

The 2015 formula for the horizontal division of grants is provided with six broad expenditure needs as follows: (2015 Budget Review)[26]

- Education (48 %): based on the size of the school age population (aged 5-17) and the number of learners (Grades R to 12) enrolled in public schools
- Health (27 %): based on each provinces risk profile and health system case load
- Basic component (16%): share of the national population
- Institutions (5%): divided equally between the provinces for providing government services
- Poverty level (3%): on a redistributive basis taking population size living in poverty
- Economic activity (output) (1%): based on regional GDP

The share of each province is specified in the formula R=E+H+B+P+EA+I (where R-share of each province, and the weighted share of each province in E-education, H-Health, B-basic component, P-poverty level, EA-economic activity, I-institution) ((Khumalo and Mukate 2007: 279).

The structure of local government equitable share formula determines the share of each municipality on the basis of the following five components (2015 Budget Review: 34). First, the basic services criteria considers the cost of free basic services for poor household such as water, sanitation, electricity, and waste removal. Second, the institutional principle provides subsidy for basic municipal administrative costs. Third, community services which are included under basic services criteria above. Fourth, revenue adjustment factor enables to

[25] The FFC recommendations have been accepted by the government. This is because 'the recommendations have been based on thorough and sound research and analysis, taking into account best practices on IGFR matters' (Khumalo and Mukate 2007: 278)

[26] National Treasury, *2015 Budget Review*, ANNEXURE W1: Explanatory Memorandum to the Division of Revenue, p.19

support municipalities with limited revenue capacity. Fifth, the correction and stabilization factor provides municipalities with predictable and stable grant to those, which may be affected due to changes in demographic data.

Conditional grants are also additional source of financing subnational governments' expenditure. They are intended to correct interjurisdictional spillover effects, to meet national redistributive objectives, and to achieve specific national priorities and policies concerning services provided by subnational sphere of government. The 2015 Budget review[27] of South Africa indicates four types of provincial conditional grants: (i) a very limited conditionality to supplement various programs partly funded by provinces; (ii) specific responsibilities and programs implemented by provinces; (iii) provide in-kind allocations through which a national department implements projects in provinces; and (iv) provide for the swift allocation and transfer of funds to a province to help it deal with a disaster. The national government also allocates conditional grants to local governments for two purposes: infrastructure and capacity building. The government budget review indicates the relevance and growth of conditional grant's share to the total amount of transfer. It is important to support subnational expenditure needs in the areas of agriculture, forestry and fisheries, adult education and school nutrition, prevention of AIDS, public works, culture, transport, and so on. Despite the importance of conditional grants, some studies have highlighted lack of transparency and accountability in the utilization of conditional grants, the problem of design on an ad-hoc basis, overlapping with priorities of subnational governments, and shortage of skilled staff at local level (Khumalo and Mokate 2007: 277).

Concluding remarks

Both Nigeria and South Africa provide a functioning intergovernmental fiscal relations system based on relevant constitutional principles. Nigeria operates under a federal structure, whereas South Africa has a strongly devolved system without adopting the word federal. Both constitutions recognize three spheres of government but local governments in Nigeria are under the control of states while in South Africa their status is alongside the national and provincial governments.

In both countries, revenue sources are highly centralized so that all spheres or levels of government are dependent on national government revenues, especially oil and gas revenue playing a significant role in Nigeria. There is a similar trend in the distribution of expenditure responsibilities where most functions are concurrently shared so that it is subject to continuous devolution of power leading to unfunded mandates. But with regard to assignment of taxes and expenditure patterns to subnational governments there are variation between the two systems. States in Nigeria are assigned with a relatively better taxing power compared to provinces in South Africa, and local governments are subordinate to states. But local governments in South Africa have strong revenue capacity and expenditure responsibility compared to provinces.

[27] National Treasury, *2015 Budget Review*, ANNEXURE W1: Explanatory Memorandum to the Division of Revenue, P. 23

As a result of centralized tax systems, in both countries intergovernmental transfers are the major source of financing subnational expenditures. **In both countries independent Finance and Revenue Allocation Commissions play significant roles in submitting recommendations for the sharing of national revenue. Both systems do not have a formula for determining the vertical grant pool, but they provide constitutional guidelines to determine the share. The horizontal allocation of general-purpose grants is determined based on formula in both systems.** However, there are also differences between them. While in Nigeria a derivative principle for sharing revenue is considered, in South Africa equity and equal provision of public services are the major criteria under the formula. The South African formula addresses the needs of disadvantaged regions, corrects spillover effects, and targets the provision of social services. Furthermore, conditional grants are often employed to correct differences in service provisions and help poor households. The vertical fiscal gap is not quantified in the South African formula.

5. Building blocks of fiscal federalism in the IGAD region

This section does not pretend to be exhaustive but pinpoints the most important issues pertaining to fiscal federalism. It aims at analyzing the constitutional design and identifies the economic implication of the political and legal issues which need to be addressed. With this objective this section covers the following: (i) The institutional framework that can be related to the fiscal issues and the importance of the constitutional institutions designed to ensure participation of the constituent units in the federal power sharing arrangement; (ii) constitutional model for the distribution of expenditure responsibilities, and the case for constitutional clarity to define what type of federal system; (iii) the assignment of revenue sources in general and natural resources taxation in particular. On the basis of basic rules for tax assignment we observe the constitutional arrangement and identify the complexities in the raising and sharing of natural resource taxes. The other important building blocks are addressed in the next section. They are (i) the types and forms of transfers employed and their constitutional basis, and (ii) the importance of functional and administrative capacity not only in terms of understanding laws and policies but also institutional capacity for proper implementation of fiscal responsibilities at all levels of government. Also, institutional capacity towards promoting equitable development and ensuring fiscal accountability is addressed.

5.1. Institutional/constitutional frameworks

The main features of a fiscal arrangement in any federation must be anchored in the constitution and other laws. This reminds us that the fiscal arrangement functions within the broader objective of balancing self-rule with shared-rule. Whether a federation is formed by a 'coming-together' or a 'holding-together' approach, embracing diversity requires a balanced approach of 'building out' and 'building in' (Anderson 2008: 72). G. Anderson says 'building out involves accommodating the demand for regional government. Building in involves ensuring that key minorities are integrated into the symbols, institutions, and policies of the central government as well as through other constitutional provisions.'

Therefore, if federalism is a preferred form of government to promote non-centralized decision making process, to enhance democratic participation, and to efficiently address diverse interests or preferences, it is important to evaluate the institutional architecture concerning sub-national governments. From the viewpoint of fiscal federalism, at least three issues can be raised to analyze the institutional approaches (Dafflon 2014: 12). First, is the number and size of constituent units in order to express the needs and define the nature of provision of goods and services at local level. As Dafflon (Ibid) put it, 'fiscal federalism is about sharing power: one cannot decentralize responsibilities and revenues to sub-national government levels without institutionally organizing the effective participation of sub-national governments in the decision making process.' Representation of sub-national units at the federal level is to share power in the legislative process or to decide on matters of their concerns of expenditure and revenue sources. This is usually possible through the Upper House (or the second chamber).

Second, federalism brings government closer to the people so that public goods are delivered according to the various needs of local residents. The constitutional division of power between the federal and regional governments, and decentralization of power from the regional to local level are meant to enhance citizens' participation to express their preferences and influence public decisions. The third issue is related to institutional building and promotion of accountability at sub-national level. In order to determine the outcome of devolution of power to sub-national levels, to promote effective social participation and to ensure accountability appropriate institutions have to be built and strengthened. Although significant changes have been observed, administrative, financial and human resource capacity constraints have to be addressed and institutional accountability have to be strengthened. Almost all constitutions incorporate the importance of building institutions, promoting efficiency and accountability, but they crawl in fulfilling their commitments and abide by the constitutional obligations.

(a) Federal Democratic Republic of Ethiopia (FDRE)

Like other federations, the FDRE Constitution established two levels of government (Federal and states) which cannot unilaterally be altered by either level of government. Each government is autonomous with respect to the jurisdictions defined by the constitution and has direct electoral relationship with the citizens. The process of taking political decisions on local preferences is limited by political boundaries which refer to the number of sub-regional or local level of governments. The FDRE Constitution (Art 47/1) defines the number of member states of the federation where each one of them has the right to determine the number of administrative levels and local governments (Art 50/4). Currently the FDRE structure consists of the federal government, nine regional states and two chartered city administrations[28]. The administrative structure of the regional states is divided into zones, which in turn are divided in to *weredas* (districts). The country follows a parliamentary form of government and all the federal, regional and wereda governments have legislative, executive and judicial functions. Each regional government has a state council and likewise the weredas have councils with members directly elected by the people. The weredas are further sub-divided into smaller units called kebeles. The weredas can be considered as the basic unit of administration with their own elected councils to decide on the choice of the provision of basic services.

The Constitution establishes two federal chambers - the House of People Representatives (Lower House) and the House of the Federation (Upper House) – with their distinct features. Only the Lower House exercises legislative power, and the House of Federations (hereafter Hof) interprets the constitution, and designs the sharing of revenue and allocation of grants (Article 62). The second chamber is meant for the participation of the constituent units at the federal level but does not share laws and policy making power with the House of Representatives.

[28] The nine regional states and the Addis Ababa city administration are created by the Constitution; the second city Administration (Dire Dawa) is mentioned only in the City Charter (Proc. No. 416/2004) which indicates that it is part of and accountable to the federal government.

According to the Constitution (Article 62), the House of Federations is designed to play roles in non-legislative matters concerning allocation of grant subsidies, revenue sharing, dispute resolutions, and constitutional interpretations. Although, the House assumes significant political power, it does not participate on significant issues affecting the interests of sub-national governments such as legislative/policy aspects on their expenditure responsibilities, on the determination of grant (distributable) pool and related issues. During the last two decades, the absence of sub-national participation at the federal level seems effectively replaced by the party channel operating under one dominant party at the federal and regional levels, through intervention of federal agencies, and the policy making process and implementation at the center (Assefa 2013). Moreover, there is no substantive policy or legal framework which governs intergovernmental relations between and among all levels of government (Ibid). The constitutional and legal frameworks recognizing citizens participation in electing their representatives, in planning and resource management, in establishing institutions and in making authorities accountable to their acts are put in place in the FDRE Constitution (Article 12, 43, 89-92).

(b) Kenya

The new Constitution of Kenya adopted in August 2010, although does not mention the word federal, established two orders of government - a national government and 47 counties which are guaranteed by the constitution. "The Constitution provides for governments at each level that have political autonomy in the sense that each has democratically elected political structures and institutions that are directly accountable to their electorate. They also have administrative autonomy in the sense that at each level government has constitutional powers to establish and control its own administration and public service to execute and implement its own policy decisions. Thus, the county governments are relatively autonomous, which makes the Kenyan devolution distinct from a unitary form of decentralization. The county governments do not exercise mere decentralized power delegated to them by the national government. Instead, in terms of Article 1(3) and (4), they share with the national government the sovereign power of the people assigned to them by the people through the Constitution.

The devolution principle under the Kenyan constitution, on one hand ensures the autonomy of county governments, and on the other, promotes their participation in the national policy making processes. Each level of government has the constitutional power to establish and control its own administration and public service to execute and implement its own policy decisions. Furthermore, the Constitution (Art 6 (2) and 189) requires that the devolutionary process must be guided by the principles of consultation and cooperation. It goes on to state that "government at either level shall perform its functions, and exercise its powers, in a manner that respects the functional and institutional integrity of government at the other level." With regard to shared rule at national level, the Senate represents the counties, and serves to protect the interests of the counties and their governments (Art 96, 1). The Senate bestowed by the Constitution to participate in the law-making function of Parliament by considering, debating and approving Bills concerning counties, to determine the allocation of national revenue among counties, and to exercise oversight over national revenue allocated to

the county governments. The powers and functions allocated to the senate are presumed to represent the interests of the constituent units, but the Senate may not necessarily reflect the interests of the county governments since members of the senate are directly elected by the people they may reflect the party interest. The Kenyan approach follows the US senate model but not the German model where there is an ex officio membership representing regional/Lander government.

According the Kenyan Constitution, democracy and participation of the people are some of the principles of governance. It also affirms that the objectives of devolution of government are: to give powers of self-governance to the people and enhance the participation of the people in the exercise of the powers of the State and in making decisions affecting them, and to recognize the right of communities to manage their own affairs and to further their development.

(c) Somalia

The provisional constitution of Somalia provides for the establishment of two levels of government: the 'Federal Government' and the 'Federal Member States' which is composed of the state government and the local government (Art48). The constitution provides that boundaries of districts (local government) shall be determined by law enacted by parliament. But it is not clear whether the powers and functions of local governments are to be defined by the federal constitution or by the respective member states. With regard to the number of constituent units of the federation and their powers and functions, the constitution simply provides some guidelines which make the federation different from other full- fledged federations. According to the constitution, the number of member states and their boundaries are to be determined by the House of the People of Federal Parliament upon the recommendation of the Commission established by the House itself (Art 49). In order to determine the number and boundaries of the states, the constitution lays down important guidelines: 'the boundaries of member states shall be based on the boundaries of administrative regions as they existed before 1991', but 'two or more of these regions may voluntarily merge to form a state (Art 49).

The federal constitution is supposed to define the establishment of federal institutions and their powers and functions. But the establishment of state legislative and executive bodies of state government shall be defined by the respective state constitutions which are required to be harmonized with the federal constitution (Art 121). This implies that each level of government has the power to establish and control its own public institutions to ensure its autonomy. The constitution also provides the importance of collaborative relationship between the levels of government. It lays down principles governing the relationship and establishment of institutions to facilitate interaction between the levels of government. The constitution also establishes an Upper House to serve as a means to ensure the participation of the constituent units at the federal level. The Upper House represents the states and participates in the law making process. Members of the House are directly elected by the people in each state, but the constitution does not mention whether they can assume office in the state executive. Each state has equal number of representation and the total number is limited to no more than 54 members (Art 72). In addition to the legislative power, the Upper House assumes a shared role in the amendment of the constitution and the establishment of federal institutions.

(d) South Sudan

According to the Transitional Constitution of the Republic of South Sudan, a 'decentralized system of governance' is put in place consisting of three levels: national, State and local (Section 47, a,b,c). It is followed by important principles (Section 48) which demand the National Government: (i) to exercise its competencies in accordance with the constitution, and, (ii) to respect the powers devolved to the state and local governments. Furthermore, the Constitution includes detailed schedules that show the orders of government with the types of powers they enjoy in the form of delegated[29], concurrent, and residual. The approach followed by the constitution was considered by many as a de facto 'federal type arrangement' although there is no explicit mention of the term 'federal' throughout the text. However, there are non-federal features in the Constitution which rather resemble that of a decentralized unitary system. For instance, in a federal system, the existence of Constituent Units is constitutionally protected and cannot be unilaterally changed by a national government. The Transitional Constitution, like that of the Interim Constitution, recognizes ten states, but recently the number was increased to 28 by a presidential decree.[30] The Constitution also empowers the President to dismiss state parliaments and governors quite unusual to a federal system, although a federal system is widely expected to be adopted in the permanent constitution.

The South Sudan legislature is bicameral consisting of the legislative assembly with 332 seats and the Council of states with 50 seats. The Council of States was established by presidential decree in 2011.[31] Members of the council neither represent state governments, nor are they elected by the voters in the states. They represent the government of South Sudan. Twenty of them were elected in 2010 to represent Southern Sudan in the Sudan National Assembly before independence, and thirty of them represent different groups of the society.

Conclusion

The legal framework for bringing government closer to the people and for promoting local participation is one thing, but ensuring the democratic process and implementing the continuous participation of citizens is another. Although the stories are not uniform throughout the countries, there are strong claims for direct participation in local government planning, implementation and overseeing socio-economic activities. However, there are still concerns in ensuring downward accountability, continuous social participation and administrative efficiency (Solomon, 2014).

5.2. Distribution of expenditure responsibilities

Central to the issue of expenditure assignment is which authorities or functions have to be divided between the tiers of government. From the economics point of view, it is argued on the ground of efficiency, manageability, autonomy and accountability.[32] In federations, the

[29] The term delegated implies constitutional delegation but not power delegated by the national government

[30] The decree passed approved by the Council of Ministers (October 13, 2015) followed by legislative process which amounts to Constitutional Amendment according to the procedure laid in the Constitution.

[31] http://www.goss.org/index.php/legislative-assembly/council of states, last accessed on May 15, 2016

[32] For the economic theories on expenditure assignment, see the discussion in the preceding section

division of expenditure responsibilities is primarily determined by a federal constitution. In this regard, the actual division of expenditure responsibility deals mainly with the interrelated aspects of the constitutional division of legislative and executive powers. In the division of legislative power, there are great variations amongst federal systems with regard to the form and contents (or scope) of the functions assigned to each tier of government. In order to understand the mode of the division of expenditure responsibilities, we focus on the division of executive powers which leads to two observed models (Watts, 1999): the *dualist* and the *integrated* models.[33] It involves a strong relationship between the federal government and the states. In general, the above two models imply the constitutional approaches for the division of legislative and executive powers, but recent federations tend to design their constitutions to provide instances in between the two approaches (Saunders 1995).

As it can be seen in Table A-1, in the statistical annex, on the basis of normative economics theory, Anwar Shah proposed a framework to assign expenditure properly on the basis of the division of policy and standard making, production, supervision and regulation. However, the realty on the ground could be more complex than it appears in the proposal.

Table A-1 attempts to classify responsibilities by a level of government. But, we have noted in the preceding section that the criteria set under the traditional fiscal federalism do not by themselves make it possible to assign a function to a level of government. They also fail to indicate the question of collaboration between local governments (communes) that can take very diverse forms. However, Dafflon and Madies (2009: 35) said, 'This classification of functions is rudimentary but it has the merit of insisting on the distinction to be made between regulatory functions and public service supply functions.' Even when the economic criteria indicate the reasons for assigning a function to either level of government, the final decision remains a political matter. The difference in political decisions on the mode, nature and extent of assignment of responsibilities is envisaged in the IGAD region as indicated below.

(a) Federal Democratic Republic of Ethiopia (FDRE)

It is important to deal with the FDRE Constitution to determine the allocation of expenditure responsibilities to both tiers of government (summarized below in Table4). The FDRE Constitution follows a dual structure where each government has legislative and executive powers on matters that fall under the respective jurisdictions (Art 50/2). Regional governments are made responsible for executing economic and social development policies, strategies and plans of the region, and establishing and administering a regional police force and maintaining public order (Art52, 2). **They hold all the residual power in addition to those explicitly listed in the Constitution (Art 52, 1).** And both the federal government and the states have to cover their respective financial expenditures but if the federal government allocates grants, it has the power to audit and inspect the proper utilization of subsidies it

[33] Under the dualist or classical federalism (USA and Canada), each level of government retains the executive responsibility in those matters in which it exercises the legislative power. In integrated or functional model of federalism (often called the German model), the federal government is primarily concerned with policy initiation, formulation and legislation, while the states are mainly responsible for implementation and administration. For further details, see Anderson (2010: 11-18)

grants to the states (Article 94/1&2). In practice, the federal government establishes national standards concerning public health, education, science and technology leaving the bulk of administrative powers to the states (Article 51/3). And regional governments assume responsibility in primary and secondary education, health services, environmental protection, rural roads, provision of drinking water and sanitation, and other municipal services. Therefore, one can observe that constitutionally it appears a dualist approach, but in practice it tends to be functional federalism, albeit the absence of sub-national governments participation in the federal law making process.

The other important process in determining expenditure responsibility in Ethiopia is district level decentralization. The constitution provides that adequate power shall be granted to the lowest administrative units to enable people to directly participate in their own affairs (Art 50/4). However, sub-regional decentralization evolved through time and the process since 2003 (which is known as the second phase) brought about changes in the role of urban weredas and municipalities. They have become centers for the provision of many social services. The expectation is that decentralization strengthens participatory governance whereby public authorities will be responsive to local preferences and held accountable to the citizens. In most regions, if not all, local governments primarily function as extension of regional governments. Therefore, local governments assume many of their responsibilities in the form of delegation or deconcentration where devolution is limited to cultural or language related aspects.

Table 3: Ethiopia: Constitutional division of powers and functions

Federal powers and functions (Article 51)	**State/Regional powers and functions (Article 52)**	**Comment**
Foreign affairs, defense, federal police, public security	Ensuring self-government	
Overall economic and social policies and food security	Ensuring democratic order based on rule of law	
Fiscal, monetary and foreign investment policies, commerce	Socioeconomic development policies at the state level	Local planning and development
Natural resource management	Land conservation and Natural Resources management based on federal laws	
Air, rail and water transport	State police and public security	
Regulation and inter-state trade	Civil service at the state level	
National standards and basic criteria for public health, education, science and technology	Implementation of federal policies, laws and policies, but needs constitutional clarity in future	states: secondary schools, state colleges wereda (local):primary education
Interstate roads, railways and highways	Intrastate and rural roads	
Levy and collect federal taxes	Levy and collect state taxes	
Nationality and immigration issues		
	Residual powers	Local level: Water, Sewerage, fire protection

Source: FDRE Constitution (1995)

(b) Kenya

One important feature of the Kenyan Constitution is the constitutionally guaranteed distribution of powers and functions to the two levels of government. Article 186 in

conjunction with the forth schedule are the main constitutional basis for the distribution of powers and functions to each level of government. According to Article 186 (2) 'A function or power that is conferred on more than one level of government is a function or power within the concurrent jurisdiction of each of those levels of government.' This provision implies that powers and functions that are not concurrently vested in the national and county governments remain under the exclusive jurisdiction of one level of government. However, there is no listing of concurrent powers in the constitution and the fourth schedule does not specify which of them may fall in this category. The other important provision (186, 3) reserves the residual powers and functions to the national government.[34] The constitution also indicates (Article 186, 3 and 183, 1, d) the national government may assign some of its powers and functions listed under the fourth schedule or reserved through residual powers to county government when the center determines citizens and communities would better be served through this approach. This delegation or transfer of power can be done symmetrically to all 47 counties or asymmetrically to some of them. In either of these options, however, there can be a problem of 'unfunded mandate' where the counties may face problem of funding powers and functions assigned to them.

(c) Somalia

Although Somalia put a federal government and a provisional federal constitution, the assignment of powers and functions to the levels of government it remains to be a work in progress to date. According to the constitution, (Article 54) that "…the allocation of powers and resources shall be negotiated and agreed upon by the Federal Government and the Federal Member States (pending the formation of Federal Member States), except in matters concerning: (a) Foreign Affairs; (b) National Defense; (c) Citizenship and Immigration; (d) Monetary Policy, which shall be within the powers and responsibilities of the federal government."

(d) South Sudan

According to the Transitional Constitution of South Sudan (TCSS), the distribution of expenditure responsibilities is reflected in the allocation of powers and functions to the three tiers of government: national, state and local. The constitution delineates the exclusive legislative and executive powers of each level of government, concurrent powers and residual powers. Schedule A (Art 150-161) of the TCSS provides the exclusive powers and functions of the national government, schedule B (Art 162-165) allocates powers to the states, while those of local governments are found under Art 166-168. In so doing, the TCSS follows the approach of many federal systems. Similarly, (Further), it incorporates the principle followed to resolve the conflict in exercising aspects of concurrent power. The Constitution provides, "If there is a contradiction between the provisions of National law and a state law on the matters that are concurrent, the national law shall prevail to the extent of the contradiction." Unlike Ethiopia and Kenya, residual power is not exclusively assigned to either level of government. It all depends on the nature of residual power. It provides "If the power pertains to a national matter, requires a national standard, or is a matter which cannot be regulated by a single state, it shall be exercised by the National Government. If the power pertains to a

[34] Federations, except India and Canada, reserve residual powers to the states.

matter that is usually exercised by the state or local government, it shall be exercised by the state or local government (Schedule D)."

In general, the above mentioned powers have to be guided by the principle of devolution as mentioned under Art 48 of the TCSS. According to Lual Deng (2015, 23), the principle emphasizes unity in diversity, which is essentially the concept of ethnic-oriented decentralization/federalism embedded in the creation of 28 states. The other values are the promotion of the welfare of the people and protection of their human rights and fundamental freedoms, the recognition of the need for the involvement and participation of all people, and the ideals of democratic governance – rule of law, separation of powers (i.e. between legislature, executive, and judiciary), transparency and accountability. Lual Deng argues that the constitutional assignment responsibilities between the three levels of government shows beyond doubt that South Sudan is a *de facto* federal system, though the framers of TCSS were determined not to use the term federalism. However, the dismal performance of the national government in the production of public goods and services during the last ten years is a compelling economic argument for the adoption of a functioning fiscal federalism in South Sudan. (Ibid)

5.3. Assignment of revenue raising powers

Once expenditure responsibilities are defined, governments rely on a wide variety of tax and non-tax sources, as well as transfers, to cover the cost of their need. In this section we address the question of which tax sources are constitutionally assigned to which level of government. As Ronald Watts repeatedly contends, it is the allocation of financial sources that enables or constrains governments in the exercise of their constitutionally assigned expenditure responsibilities.[35] There is no ideal allocation of tax power between the federal government and states, but there are a number of considerations that call for centralizing or decentralizing revenue sources by considering criteria of economic efficiency, equity, need and administrative feasibility. As a general principle, there should be a framework in which each tier of government can levy or generate its own finance without there being a conflict between them. In practice, however, the degree of tax autonomy enjoyed by the state governments demonstrates wide variations.

Tax assignment often reflects centralization with significant decentralization of expenditure responsibilities. This can be attributed to the four general principles for assigning tax powers to different levels of government (Shah 2007: 19-20). The first principle – economic efficiency – dictates that taxes that contribute to macroeconomic stability should be allocated to national government. Similarly, taxes on mobile factors that have impact on economic efficiency should be assigned to the center. The other side of this argument is that sub-national tax sources should be stable. The next principle related to 'national equity' considerations dictates that tax bases that are unevenly distributed should be assigned to the central government. The third principle, administrative feasibility, aims at minimizing tax evasion and administrative cost but targets in increasing tax compliance. User fees and other

[35]Ronald Watts, *Comparing Federal Systems*, 2nd ed., Montreal, McGill-Queen's Univ. Press (1999) p. 43.

benefit taxes are better addressed by a level of government which renders the service. Finally, Anwar Shah (Ibid, 20) forwarded the 'fiscal need or revenue adequacy' principle which suggests that "to ensure accountability, revenue means should be matched as closely as possible with expenditure needs." But it is difficult to comply with this principle coherently with the previous three principles. In general, following the above principles we may observe three approaches in the assignment of tax power.

A constitution may assign several tax sources to the federal government and to the states separately, allowing each to have *exclusive* tax powers within its own sphere. A *concurrent* power of taxation may also exist where the federal government and the states have equal constitutional authority to levy the same kind of tax with respect to the same category of persons, business or particular thing. Besides the allocation of exclusive and concurrent powers of taxation, a constitution may provide *joint/shared* taxes where the power of legislation and levying taxes assigned to the federal level, while the states' reserve right to share some or all of the proceeds from specified taxes.

Like what we have seen for the guidelines of expenditure assignment above, Table 6, below provides a possible way of assignment of revenue raising power through taxes, fees and charges to levels of government.

(a) Ethiopia

The division of taxation powers is a principal aspect of the Constitution that provides the legal foundation of the Ethiopian federation. The tax power is divided into three categories, namely 'the federal power of taxation', 'the state power of taxation' and 'concurrent power of taxation.' It also prescribes the conditions under which the regional governments could acquire revenue through grant subsidies. The taxation power assigned to the federal government and to the stats resulted in exclusive revenue sources allocated to each level of government.

The exclusive revenue sources allocated to the federal government (Article 96) include:

- custom duties, taxes and other charges on imports and exports;
- personal income tax on employees of the federal government and international organizations;
- personal income tax, profit tax, sales and excise taxes on enterprises owned by the federal government;
- taxes on income from national lotteries and other chance winning games; taxes on the income of air, rail and sea transport services;
- tax on rental of houses and properties owned by the federal government;
- federal stamp duties and tax on monopolies; and collecting fees and charges related to licenses issued and services rendered by the federal government.

The revenue sources allocated to the states (Article 97) include:

- personal income tax collected from employees of the state and private enterprises;
- rural land use fee and tax on income of private farmers and cooperative associations;
- profit and sales tax on individual traders; tax on income from inland water transportation;

- taxes on income derived from rent of houses and other properties in the state individual owned or owned by state;
- personal income tax, profit, sales and excise taxes on enterprises owned by the states;
- income tax, royalties and rent of land levied on small and medium scale mining activities;
- royalties for use forest resources; and charges and fees on licenses and services issued by state government.

Types of taxes and sources listed under the 'concurrent power'[36] of taxation include:

- profit, sales, excise and personal income taxes levied on enterprises jointly established by the federal and state governments;
- profit, sales and excise taxes on companies, and tax on dividend due to shareholders;
- profit tax and royalties on large-scale mining and all petroleum and gas operations.

Although the title of the constitutional provision appears to give both levels of government access to the same tax base or apply a kind of *piggyback* taxation, in practice the regional states retain only the right to share revenue collected by the federal government. The practice indicates that concurrent taxes are levied and administered by the federal government whereas the states share the revenue on the basis of a formula designed by the HoF.

In general, the division of taxation power in Ethiopia is mainly structured according to the categories of taxpayers or particular things as a source of revenue. Except some types of taxes such as custom duties, the exclusive domain of each government is not the tax base but the tax source. Thus, it does not result in taxing the same income, transaction or thing by both levels of government. In the discussion of the exclusive power of taxation the most important question would be whether the states can individually determine the tax rate, or influence the tax bases through tax exemption or relief. To limit destructive tax competition and to promote equity, both levels of government harmonized their tax bases and tax rates. Tax harmonization likely succeeds if sub-national governments are committed to ensure comparable level efficiency in the respective tax administration system. However, it is still one of the challenging areas in tapping the full potential of sub-national governments. The other problem is that the constitution does not encourage both levels of government to introduce new tax basis or sources, but if there is a need to do so first it has to be determined by a two-thirds majority vote in a joint meeting of the House of Federation and the House of Peoples' Representatives (Article 99).[37] For instance, Capital gains tax, royalty from the use of patent and copy right, income from interest on deposits, surtax and VAT were undesignated tax sources and decided by a joint meeting of the two federal Houses.

[36] Several issues can be raised with regard to the application of 'the concurrent power' as provided under Article 98 of the Constitution. The main issue is whether both the federal government and the states can levy the same type of tax on the same source listed under concurrent power – for instance, can each impose corporate income tax on the same company, what roles do the states play in levying concurrent taxes, and on how the derivation criteria is put in to effect.

[37] A reading of Articles 52(1) and 99 implies that states have legislative power over residual matters except tax issues.

(b) Kenya

The 2010 Constitution of Kenya (Art 209) provides that both the national and county governments can raise revenue through imposition of taxes, imposition of charges for services, and borrowing. The constitution identifies the exclusive revenue sources of each tier of government as indicated in the Table 7 below. The own-source revenue bases assigned to county governments are very limited since the national government is assigned with major tax sources. The limited revenue raising power is augmented by the constitutional guarantee to 'not less than fifteen percent of all revenue raised by the national government. In this regard, the national revenue may be considered as joint revenue of the national and county governments. This approach may increase effectiveness in tax administration, but it can undermine competition/efficiency and downward accountability to local residents. Dependency on revenue sharing and transfers can trigger fiscal inefficiency.

Table 4: Assignment of taxing power in the 2010 Kenyan Constitution

National government (Art 209, 1,2) revenue sources	**County governments (Art 209, 3,4) revenue sources**
Income tax	Property rates
Value added tax	Entertainment taxes
Customs duties and other duties on import and export goods	Any other tax which county governments are authorized by an Act of parliament to impose
Excise tax	
Any other tax authorized by an Act of parliament other tthan property rates and entertainment taxes, which are taxes exclusive imposed by county governments	
Charges for services rendered by the national government	Charges for services rendered by county governments
Borrowing	county governments may borrow only if the national government guarantees the loan; and with the approval of the county government's assembly.

(c) Somalia

With respect to allocation of revenue raising power, the 2012 Provisional Constitution does not categorize sources for the federal government and the member states. Instead, the constitution laid down very general principles. It (under Art. 54) provides that "the allocation of powers and resources shall be negotiated and agreed upon by the Federal Government and the Federal Member States" (pending the formation of Federal Member States). And the other guiding principle (Art 50, f) says, 'revenue raising responsibilities should be given to the level of government that can exercise that responsibility most effectively." Accordingly, the details in the division of revenue raising power including, among others, the listing of revenue sources, tax bases and the revenue sharing arrangements between the different levels of government have to be negotiated in the process of the enactment of a permanent constitution. However, despite the absence of details in the division of tax sources, taxes are levied and collected on a geographical basis.

The current practices show that Puntland levies and collects taxes within its geographical boundaries, while the FGS collecting taxes from the Mogadishu region (and sharing a proportion with the Benadir capital region) (World Bank 2015: 54). The newly established

member states are also resorting to collecting their own taxes. For instance, the Interim Jubaland Administration started collecting customs and other port related taxes. However, such tendencies undermine the norm of sharing such types of taxes with other states which do not have access to control ports. Therefore, the federal government has to negotiate for designing a workable revenue sharing or equalization mechanisms so that states like that of the Interim South West Administration, the Galmudug Interim Administration, and the remaining central state would benefit from such arrangements.

Table 5: Distribution of tax bases in Somalia (in practice)

Types of taxes	Federal government of Somalia	Puntland
Customs duty	√	√
Sales tax		√
Telecoms charges	√	√
Corporate income tax	√	√
Turnover tax	√	√
Personal income tax (public sector)	√	√
Personal income tax (private sector)	√	√
Land/property taxes		√
Stamp duty	√	√
Vehicle taxes	√	√
Business taxes		
Departure/ visa fees	√	√
Airport/harbor fees and charges	√	√
Administrative fees	√	√

Source: (World Bank Group, 2015: 54).

(d) South Sudan

The South Sudan Constitution addressed the distribution of revenue sources to the national government and the states. It (Art 169) also provides guiding principles for the development and equitable sharing of national wealth. In addition, the guiding principles for petroleum and gas development and management are contained in the constitution. But, revenue decentralization in South Sudan derives its legality from three Articles 177, 178, and 179. The National Government shall legislate for raising revenue or collecting taxes from sources listed under Article 177. Similarly, the states taxing power and the sources are mentioned under Article 179. The details are given in the Table below. In addition to the sources of revenue assigned to the National Government the Constitution (Article 178) stipulates the formula for sharing of oil revenue. This sharing is only between National Government and oil producing states and communities. In addition to the revenue sources mentioned for the national government and the states, the constitution (Article 184) also lists domestic borrowing, foreign loans and financial grants with the approval of the respective legislatures. State loan will not be guaranteed unless approved by the national government.

The above constitutionally provided provisions for fiscal arrangement of South Sudan system would, if operationalized, be classified as having a full access to broad-based taxes, such as income, sales, payroll taxes, and so forth (Deng 2016, 33). However, custom duties, import taxes; airports, rail, road, and river transport revenue, value added tax, and nationality,

passports, immigration and visa fees are exclusive sources for the National Government. Revenue from tourism fees, stamp duties, and agricultural taxes is exclusively reserved for states.

Table 6: Distribution of tax sources in South Sudan

National Government Tax sources (Art177)	**State taxes (Art 179)**
petroleum, Gas/oil, mineral, and other natural resources;	
national personal income tax;	
corporate and business profit tax;	
customs duties and import taxes;	state land and property tax and royalties;
airports, rail, road, and river transport revenue;	service charges for state services;
service charges, fees and fines;	licenses issued by the state
national government enterprises and projects	state personal income tax;
value added tax or general sales tax on goods and services;	levies on tourism;
excise duties	stamp duties
loans and borrowing from the Bank of South Sudan and the public	agricultural production taxes;
grants-in-aid and foreign financial assistance	excise duties
fees from nationality, passports, immigration and visas;	at least two percent of net oil and other mineral revenues for each producing state;
royalties;	grants-in-aid and foreign aid
any other tax or revenue as may be determined by law	other state taxes, which are not within the exclusive jurisdiction of the National Government

5.4. Natural resource revenue

In the discussion of assignment of tax powers, raising revenue from natural resources is considered as one of the contentious issues. Natural resource revenues are different from others because they can be a significant source in a federation and often are unevenly distributed among the constituent units. The most important natural resources are oil and natural gas, but rare minerals are also significant in some federations. In this regard, the key issues relate to the control and administration, ownership and sharing of revenue between the federal government and the producing or non-producing constituent units, transparency and accountability in the sector (Anderson 2010, Brosio 2006). The issues imply the importance of not only equitable share of natural resource revenue, but also financial transparency and accountability. The implementation of equitable share of oil revenue can be undermined by the culture of corruption, lack of transparency, waste and inefficiency so that local needs for social services, infrastructure, and efforts to ameliorate environmental problems remain to be unaddressed (Suberu 2006).

Natural resource ownership is usually determined by a constitution[38], but people where the resource is located have emotional attachment to it. Issues of revenue sharing in many

[38] For instance, Article 40/3/ of the FDRE Constitution states that ownership of rural and urban land as well as natural resources ix exclusively vested in the state and the people of Ethiopia.

federations are normally separated from the question of control and management.[39] Revenue from oil and gas can be captured in different form, including royalties, license and fees, export taxes, excise taxes, environmental taxes, special corporate income taxes, payments from state-owned companies and so on. The sharing of revenue from oil and gas, and other rare minerals is usually a subset of the broader design of the sharing and transfer of grants. However, political negotiations are important to decide on how much to allocate to producing regions, and how much to be managed by the federal government on behalf of the citizens of the country as a whole. Equally important in major natural resource taxation are stabilization funds and savings, and transparency and accountability (Anderson 2010). In deciding the allocation of natural resource revenues, although there is no uniformity in the experiences of federations, the following considerations usually favor allocation to the federal government:

(i) the overall significance of the revenues for the economy and their corresponding macro-economic impact;
(ii) the volatile and non-renewable nature of natural resources revenues and the impact of those characteristics on sub-national governments fiscal management;
(iii) the potential to create significant inter-regional inequity if revenues are unevenly distributed.

Many countries in the IGAD region, such as South Sudan, Kenya and Uganda, have recently been engaged in producing and taxing the oil and gas sector, and countries like Ethiopia and Somalia are looking forward to succeed in their exploration efforts to boost their revenue capacity. Yet, they have to learn from the experiences of countries engaged in oil production and administration of revenue there from. In this regard, Brian and Forman (2007: 10) warned that 'prospects for successful management of natural resources significantly improve when democratic institutions are in place prior to the exploration of mineral wealth.' Suberu (2015: 35) further argues, 'such democratic institutions, including mechanisms of vertical and horizontal accountability like elections and parliaments, can be harnessed to foster rules and procedures that can restrain the ability of political leaders to misallocate natural resources resents to themselves and/or their cronies.' However, if the flow of natural resource revenue precedes the development of democratic institutions, establishing effective and meaningful institutions for the transparent and accountable allocation of resource revenues would become more difficult (Ibid: 35).

The stories from Nigeria and Ghana support the above argument. Despite a long experience of federalism and a constitutionally designed intergovernmental fiscal relations mechanism, Nigeria is described a classic case of 'resource curse'. Nigeria, in addition to poor socio-economic performance, still faces the challenges of oil revenue control, inter-group polarization and conflict, extraordinary financial and political corruption, and environmental damages to the oil producing areas. This is mainly because the struggle for petroleum

[39] George Anderson (2008) mentions that ownership, management and principal access to revenue go together in some federations, but there are also variations. For instance, in Brazil federal government owns and manages but states get most revenue; in India states own but the center manages and gets most revenue; in Russia federal government manages and gets all revenue. Ownership and share of resources sometimes vary depending on whether the resource is off-shore or on-shore.

revenue started long before putting in place appropriate democratic institutions and accountability mechanisms (Ibid: 36). On the other hand, Ghana has established important institutions for petroleum management under a vibrant, competitive, and democratic two-party system before generating natural resource revenue (Ibid). Nonetheless, the process of resource governance requires to effectively constraining the tendency to corrupt practices, to install meaningful decentralization process, to firmly entrench equitable sharing of oil revenue with accountability.

In Kenya, the announcement of the discovery of oil in 2012 came after the country adopted its new Constitution in 2010, which did not provide any separate and explicit details about the sharing of natural resource revenues either in the form of general or specific grants. The constitution provides general principles and mechanisms for sharing national revenue between the national and county governments. Unlike the Nigerian Constitution, the Kenyan constitution does not provide the sharing of revenue on a derivative basis to the oil producing subnational governments. It is left to the Commission on Revenue Allocation which is empowered to make recommendations to the intergovernmental revenue transfer programs.

In the case of South Sudan, the oil producing states receive 2 percent of the total oil revenue (Art 178 of the Constitution). In the absence of a working formula for equitable distribution of revenue between the national, state and local government, the constitutional allocation guarantees the share of those states which receive 2 percent of the oil revenue. Although the Transitional Constitution provides for the division of revenue between the national government and the states, the amount it generates from non-oil revenue sources is said to be very minimal. The government relies absolutely on oil revenue.[40] The problems associated with resource sharing in South Sudan is very serious mainly due to the arrival of oil revenue before the necessary legal, political, regulatory, administrative and democratic institutions are put in place. This has been clearly articulated in the government report which says:

> The fiscal decentralization mechanism in South Sudan was found to still be in its infancy stage with systems and procedures still being developed. The main problems identified in the fiscal decentralization revolve around inadequate legal and regulatory frameworks for financing; inadequate policy and strategic frameworks; inadequate financing and financial management mechanisms; inadequate institutional and human resource capacities; and political, social and economic factors' (Government).

In Somalia, "The allocation of powers and resources shall be negotiated and agreed upon by the Federal Government and the Federal Member States" (Art 54), and "The allocation of the natural resources of the Federal Republic of Somalia shall be negotiated by, and agreed upon, by the Federal Government and the Federal Member States in accordance with this Constitution" Art 44). According to the Provisional Constitution, the negotiation in both cases is pending until the formation of Federal Member States. Ones the state formation

[40] Many countries face the challenge to diversify the tax base so that dependency on oil revenue can be reduced, and protect the local economic stability from the potential impact of the volatility of global oil prices.

process is completed, the federal government and the states must enter into serious consultation, debate and negotiation to define the division of tax power and the mode of equitable share of natural resource revenue. The outcome of the negotiation process will have both political and technical implications. Political in the sense of defining the allocation of tax bases related to natural resources to each level of government, either leading to decentralizing, centralizing or concurring tax power. It also addresses establishing appropriate institutions to build democracy, to curb corrupt practices, and to ensure transparent, fair and equitable share of resources. In technical terms, designing effective economic policies, building administrative, regulatory and oversight capacity through skilled manpower, and putting in place mechanisms for checks and balances.

In Ethiopia, if natural resource (say oil & gas) exploited and becomes major revenue source for the country, the question would be whether the issue is sufficiently addressed by the Constitution and other substantive legislations. According to the existing arrangement, company profit tax, dividend tax, VAT, and royalties will be shared on the basis of the decision of the HoF. But new issues such as defining the sharing of revenue with the producing state or local government can emerge. That is, the challenges of balancing the objectives of equalization with the ownership claim by the producing region or local government. The details of pursuing equitable share of revenue with non-producing regions, and addressing the political claim of ownership of resources have to be defined. It is recommended that a decision on sharing major natural resource revenues should be taken before revenues begin to flow.

As we have seen above, it is important to put in place all the necessary legal, financial and democratic institutions in place before major resource revenue accrues to government treasury. Furthermore, an effective revenue allocation formula that generates broad support from oil producing and the rest of the states could prevent a painful conflict as experienced in the Niger Delta of Nigeria. If well administered, oil can become a key instrument of empowering state and local politics. If not, it could prompt corrupt practices, extreme polarization and ethnic conflict, and the young state could easily become another example of the 'resource curse' (African Report 2011, 21)[41]. The effective functioning of fiscal federalism in any system is associated with meaningful devolution of function, equitable distribution of revenues, efficient fiscal management and effective socioeconomic services by subnational governments. But, in natural resource dependent countries in particular, it is important to revisit the mechanisms for intergovernmental fiscal relations within the broader issues of local development concerns, political stability and ethnic relations.

[41] Politics and Transition in the New South Sudan, Africa Report No.172 – 4 April 2011

6. Intergovernmental Transfers

6.1. Imbalances

Intergovernmental transfers play various roles but they primarily address the two kinds of fiscal imbalances: vertical[42] and horizontal. The former refers to the mismatch between the revenue means and the constitutionally assigned expenditure responsibilities of sub-national governments. The latter refers to the financial disparity between constituent units and their inability to provide comparable level of services to their citizens. Vertical imbalance is implicit in the Constitutions of Kenya, Somalia, South Sudan and Ethiopia when the major lucrative revenue sources are assigned to the national or federal government while subnational governments are mainly limited to inelastic tax sources. As a result, the volume of own-source revenue of subnational governments is limited, but each differs in the magnitude of imbalances it faces and the impacts of imbalances on the mode of intergovernmental fiscal relations. It is also common to observe not only the gap between expenditure responsibilities and revenue means, but also the differences in the fiscal capacity among subnational governments. The horizontal fiscal disparity thereby necessitated equalization transfers in order for them to be able to provide comparable level of public services to their residents.

For instance, in Ethiopia the Constitution initially anticipates the imbalances and provides for the sharing of federally levied revenue with the states (Article 62/7), as well as allocation of federal grant subsidy to the states (Article 94) as measures to correct the imbalances. The practice for the last two decades shows that the extent of vertical fiscal imbalance is considerably high (Solomon 2014; HoF 2007 and 2012). On average, states were able to generate on average 19% of their total expenditure while the rest was covered through federal transfers. Though there are slight variations between fiscal years, the vertical imbalance in Ethiopia still remains high. Such kind of imbalance occurs for the reason that the major sources of revenue are reserved to the federal government, while the states assume the bulk of expenditure responsibilities such as health, education and social services. The states also have limited administrative and technical capacity to levy tax and collect their revenue.

Furthermore, all the regions have fiscal deficits and they also have widely divergent revenue-raising capacities. During the same fiscal year stated above, the fiscal disparity between the states is high ranging from barely 9% expenditure to more than 29%. This disparity can primarily be attributed to the fact that regional governments vary considerably in their financial sources, in as much as population and territorial size. They also have variations with regard to the management and administrative capacities as a result of relative variations in infrastructure, skilled manpower and the characteristics of urbanization. They also vary in their economic environment for attracting investment. This asymmetry causes problems in measuring the imbalances between the jurisdictions. Also the impact of corruption, absence of supervision, control and local accountability cannot be underestimated.

[42] Sometimes 'vertical fiscal gap' is used instead of 'vertical imbalance' to explain the mismatch between expenditure need and the revenue means.

Similarly, considering the possible manifestation of fiscal imbalances, the Kenyan Constitution guarantees county governments a share from the national revenue (Art 203, 2) and allocation of equalization fund (Art 204). Although it is too early to analyze the nature and extent of imbalances in Kenya after the establishment of county governments in 2013, the available data for 2013/14 fiscal years shows that only 14 percent of the total county expenditures came from own-source revenue and the remaining 86% was covered through national sources (Kimenyi 2013).

6.2. Instruments of Intergovernmental Transfers

To overcome the imbalances, federal constitutions envisage intergovernmental transfers in the form of sharing tax bases, joint tax revenue and allocation of grants. However, the processes, extent and nature of transfer to reach the desired level of equalization vary widely across federations (Shah 2007). While in many federations the types, extent and power of transfers entrenched through specific interpretations of the constitution or a wider transfer authority is mandated by the constitution, in some cases the power is left to the discretion of the federal government. In some cases regional disparities are huge and therefore equity concerns and political stability are given emphasis, or regional dependency on grants become economically counterproductive. In other cases economic and political issues attached to transfers may not be significant.

The major instrument for intergovernmental transfer (or grants) can be broadly classified into general or unconditional grant and specific-purpose, conditional or categorical grants. Sometimes a separate revenue sharing mechanism can also exist. General-purpose or unconditional grants are general budget support to strengthen the capacity to spend on priorities of the recipient government. Since no conditions are attached to spending the grants, they are considered as effective tool to preserve autonomy and to enhance equitable share of resources. In principle, designing a mechanism for allocating revenue for general purpose grants has to address two major questions: how should the total volume of revenue transferred from the centre (to the states as a whole) be determined ? And, how should this gross amount (total pool) be distributed amongst the states?[43]

Specific-purpose, conditional, earmarked or categorical grants are specifically intended to finance a particular program or project. Such type of grants explicitly specifies the desired output or the type of expenditure - usually large capital projects - that can be financed. As the conditions become more specific, the recipient government will in effect be left with no option but of spending the money in the area specifically required by the centre. Conditional grants may also be further classified as *matching* (cost-sharing) and *non-matching* – where the states are not required to spend a portion of their income to match the funding by the central government. Ahmad and Craig (1997: 87) claim that the objective of specific purpose grants is to impose conditions on the use of grants in order to maintain nationwide standards for the provision of services such as health and education. But its objective may go further to address the problems associated with the provision of public goods in the less developed by

[43] Similar issues could be raised in the process of intra-state transfer of revenue, and similarly the solutions adopted at the federal level could also be used at the state level.

allocating funds to scarcely endowed areas. It can also play a role in curbing financial embezzlement, inefficiency and corruption, as the federal government retains the power to set conditions, to control and audit the spending.

In most decentralized or federal systems several objectives are set for fiscal transfer to sub-national levels of government. These are: to address vertical imbalance (improve revenue adequacy); to equalize fiscal capacity horizontally (inter-jurisdictional redistribution); to correct inter-jurisdictional spillover effect; to correct for major administrative weaknesses and streamline bureaucracy (Schroeder & Smoke 2003). A number of approaches can be used to allocate transfer to sub-national government to fulfill the above objectives. Of course, the use of grant formula to objectively define the transfer has been widely supported. There are different types of formula for equalization transfers: formula on the basis of expenditure equalization formula only; on the basis of revenue raising capacity equalization only; equal per capita equalization formula; or on the basis of expenditure need and revenue raising capacity equalization formula only.

I. Ethiopia

In Ethiopia, there are three different forms of transfers: allocation of general-purpose or unconditional grants, allocation of conditional grants, and sharing of joint revenues collected by the federal government.

1. Allocation of general-purpose or unconditional grants.

In the process of allocation of general grants, there are two important issues: who determines the total grant pool, and how the share of each constituent unit is determined. Concerning the first question, in Ethiopia the total grant pool is determined by the federal government (the executive proposal approved by the legislature), and concerning the second question, the horizontal allocation is determined by a formula adopted by the House of Federation.

With regard to the process of determining the total federal grant pool, there is no explicit constitutional or legislative regulatory guideline which requires the participation of the regional states. The only ambiguous guideline is Article 95 of the FDRE Constitution which states that the federal government and the states shall share revenue taking the federal arrangement into account. The total pool is determined as part the federal budget approved by the House of Peoples' Representatives. The trend in the available data (Table below) shows that there is a non-declining approach in the total pool in nominal terms. But when it is expressed in terms of share of the total federal budget, there are inconsistencies in some fiscal years. For instance, there is a declining trend since 2011 but it is due to a separate grant set aside for MDGs programs. The experience indicates that there is a need for a clear guideline to show its predictability and the basis for determining by how much percentage it increases every fiscal year.

Table 7: The percentage share of grant subsidy to the total federal budget: 2005/6 – 2013/14 as published in the Negarit Gazette

Fiscal Year	Total federal budget (millions)	Grant to regions	% of grant to total Federal budget	
2005/06	30,044.4	78,32.81	26.07	
2006/07	35,444.7	9,879.7	27.87	
2007/08	43,947.7	14,261.22	32.45	
2008/09	54,277.9	17,438.3	32.13	
2009/10	64,508.4	20,932.96	32.45	
2010/11	77,228	24,000.2	31.33	
2011/12	11,781.3	31,393.4	26.65	12.3%
2012/13	13,700. 8	36,000.5	26.50	MDG 20Billion (14.51% of the total
2013/14	154,903.3	430,515.6	27.80	MDG 15billion (9.7% of the total)

Source: (Solomon 2014) computed from the federal budget laws

Federal general purpose grants in Ethiopia allocated to the states on a formula basis represent close to one-third of the federal budget and cover 80 to 85 % of regional expenditures. Since 1995, the HoF revised the grant formula in 2000, 2003, 2007, 2009 and 2012 with several minor revisions in between those years (Solomon, 2014). Formulas were subject to revision due to regional asymmetries in terms of population size and lack of reliable data. The current formula was adopted in 2012 for a five year period. The formula aims at filling the fiscal gap, bridging the horizontal inequality and compensating spillover effects (such as compensating additional expenses incurred due to security and defense related activities) guided by the constitutional principles mentioned below.

The formula used Representative Tax System (RTS) and Representative Expenditure System (RES) in order to calculate the fiscal gap between revenue potential and expenditure need (HoF 2012). The expenditure needs of the regions estimated on the basis of selected regional expenditures which make up more that 90% of their budget, and the revenue potential on the basis of tax sources which contribute more than 90% of states total revenue. This approach aims at equalizing the fiscal capacity of the states. But the assessment process can not in any way be exempted from critics mainly because of the unavailability of reliable and up-to-date data which is a crucial element in designing a grant formula.

- RTS is used to estimate potential regional revenue based on: payroll tax, agricultural income tax, land use fee, livestock tax, profit tax, Turn over tax, Value added tax (VAT). They constituted around 90% off the regions' total revenue in the last five years (2006-2011) before the formula was adopted.
- RES is used in estimating expenditure needs of regional states determined by taking the biggest sectors that cover for more than 95% of the regions' total public expenditure. These are: general administration (organs of the state, justice and security, and general service), primary and secondary education, public health, agriculture and rural development, environmental protection, drinking water development, rural road construction and maintenance, urban development, and micro and small scale enterprise development.

The effort to fill the gap between expenditure needs and revenue capacity has to be guided by the principles set out under the FDRE Constitution. The relevant principles are:

(i) Every Ethiopian national has the right to equal access to publicly funded special services - Article 41(3);
(ii) Government has the duty to ensure that all Ethiopians get equal opportunity to improve their economic conditions and to promote equitable distribution of wealth among them- Article 89(2);
(iii) Government shall provide special assistance to nations, nationalities and peoples least developed economically and socially - Article 89(4);
(iv) The federal government and the states shall respectively bear all the financial expenditure necessary to carry out all responsibilities and functions assigned to them by law. Unless otherwise agreed upon , the financial expenditures required for the carrying out of any delegated function by a state shall be borne by the delegating party- Article 94 (1);
(v) The federal government may grant the states emergency, rehabilitation, and development assistance and loans, due care being taken that such assistance and loans do not hinder the appropriate development of states. The federal government shall have the power to audit and inspect the proper utilization of subsidies it grants to the states – Article 94(2);
(vi) Building one economic community (preamble)

In general, it is not only the details in the formula that ensures equitable distribution of public services. Besides the provision of grant subsidies, other policy measures such as promoting balanced growth of regional economies, controlling disincentive effects of grants, ensuring fiscal discipline, creating the link between budget, transparency and participation are all essential (Solomon 2014). This implies the need to m*ake* sense of the link between the constitutional principle and the type and objective of grant.

2. Special Purpose Grants (SPG)

The need for Special Purpose Grants (SPG) in Ethiopia has also become clear. For instance, in the 2011/12 fiscal year 12.73 % of the total federal budget (or 32.33% of the total grant) was allocated in the form of MDG grant and in 2012/13 14.51% was allocated to meet the Millennium Development Goals. MDGs grants can be spent on priority areas selected by the federal government but projects designed by a regional government. The federal ministry (MoFED) reserved the power to approve and supervise the projects.

Most local development projects are dependent on Specific-Purpose Grants (SPG) or local contributions in the form of cash or labor – which is a kind of *matching* grant (Yilmaz and Venugopal 2008). Recently, SPG covers the bulk of local projects in urban areas mainly allocated in the areas of cobblestone road and microfinance projects. There are also specific allocations by federal ministries and donor agencies for promoting basic services and capacity building in the areas of education, health and safety-net (which are now transformed

into House Asset Building Program-HABP) programs.[44] For instance, General Education Quality Improvement Program (GEQIP) is one of the areas which support regional and local education bureaus in their efforts to increase the quality of education service delivery. So, a new trend has been observed towards an inclusion of specific grants, such as safety net programs, to specific allocation of funds for MDG and Urban Local Development Programs. The overall outcome of such grant depends upon how it is spent for the intended purposes and how adequately administered.

3. Revenue sharing

Revenue sharing in this context refers to the sharing of revenue generated mostly through the federal administration of taxes but shared with the regional states on a certain principle. According to the Constitution (Article 67/2), the mandate to determine the revenue sharing arrangement is bestowed upon the HoF. Since 2003 sharing applies to revenue generated under Article 98 of the federal Constitution. The current arrangement is set to divide revenue generated from concurrent taxes as follows: direct taxes from companies in the proportion of 50:50 and indirect taxes in the proportion of 70:30 between the federal and the regional governments respectively. Similarly, direct taxes from large-scale mining and petroleum operations are divided in proportion of 50:50, whereas royalties are divided in proportion to 60:40.[45] This approach follows a 'derivative' principle which is understood as transferring revenue to the regional jurisdiction where the taxpaying or collecting company is registered (Solomon 2008). In a revenue sharing arrangement, the advantage is to minimize administrative and compliance cost, while the states from where revenue is generated may claim benefit much more than other states. If it is properly implemented, it will be the major source of revenue for the states. But the current arrangement has to be scrutinized on how it is implemented and whether it is feasible in future.

II. Kenya

The Kenyan constitution provides that intergovernmental relations shall be guided by the principle of equality and trust, cooperation, consultation and support (Art 189). In particular, it obliges the national government 'to ensure that county governments have adequate support to enable them to perform their functions' (Art 190, 1). The principles address various aspects of relations ranging from executive to legislative and fiscal relations. They can be applied with respect to intergovernmental fiscal relations between the national and county governments to enable county governments perform functions allocated to them, to reduce economic disparities among counties, and to enhance fiscal capacity and efficiency of county governments (Art 203). Guided by the above principles, the Constitution specifically provides for different instruments of fiscal transfers.

[44] The World Bank supports the Safety net program for more than ten years and recently (in October 2014) signed an agreement with the government to support the House Asset Building Program which is expected to uplift millions of Ethiopians from the poverty line.

[45] The HoF decided on the formula in 2003. See 'HoF minutes, 2nd ordinary meeting March 13, 2003' which is applicable for more than ten years.

There are at least three forms of transfer:

i. The first form is county governments' entitlement to an equitable share of revenue raised by the national government. As a result of this constitutional dispensation, the revenue raised by the national government cannot be considered as exclusive revenue. It is considered as an 'equitable share' to counties. According to Art 202(2), 'the equitable share of the revenue raised nationally that is allocated to county governments shall be not less than 15% of all revenue collected by the national government.' And it goes on to prescribe that the pool shall be "calculated on the basis of the most recent audited accounts of revenue received, as approved by the National Assembly" (Art 202,3).

   Revenue sharing process on a 'derivative principle' or allocation of 'unconditional grants' requires two important steps: first, determining the 'vertical or distributable pool', and second, determining the 'horizontal share' or the share of each constituent unit or county. In determining the vertical share, economic theories dictate that it is the division of functional responsibilities which guides the process of limiting the share of subnational governments. In the present case, the constitution has already set the minimum unconditional 'vertical pool' to be allotted to the counties, but it does not prohibit increasing to a higher share for the counties. Currently, the allocation formula introduced by the Commission on Revenue Allocation determines how much each county receives from the 15 percent of the revenue collected by the national government. The variables included in the formula and the corresponding weights are: population 45 %; poverty index 20%; land area 8%; basic equal share 25%, and fiscal responsibility 2% - (Kimeayi 2013).

ii. The second is 'equalization fund'. Equalization fund is to be paid from one half per cent of all the total national revenue for the purpose of financing basic services in counties where marginalized communities exist (Art 204). The fund targets not all counties, but only those which have a very limited fiscal capacity and fail to provide basic services in comparison to other developed counties. The constitution (Art 204,2,3b) explicitly requires the fund to be used in the form of conditional grant for the provisions of water, roads, health facilities and electricity to bring the quality of these services to 'the level generally enjoyed by the rest of the nation'.

iii. The third allocation is additional to the minimum equitable unconditional allocation granted to county governments. It can be given in the form of either conditional or unconditional allocation (Art 202, 2). In this category the allocation of conditional grants would be crucial since the unconditional one can be seen together with the first equitable share of national revenue. Conditional allocation plays significant role in financing specific programs or activities of county government. But one of the major issues would be who decides on the mode and extent of conditional grants; should it be the grantor (the executive branch of national government) or should it be the legislature or an independent commission. In many federations, it is the federal cabinet that decides to allocate conditional grants and at the same time determines the purpose, program and volume of grant. In the case of Kenya, all forms of transfers are to pass the test of the two House of the national Parliament and an independent Commission on Revenue Allocation. However, the relationship between these institutions and the outcome of their decision on

the allocation of conditional grants is yet to be seen. Nonetheless, Kenya is not strange to the allocation of earmarked grants. Before the coming into effect of the new constitution, there were at least three programs and if maintained to continue they would fall under the category of conditional grants. These programs, which constituted about 8 percent of the national revenue, are the Road Maintenance Levy, the Constituency Development Fund, and the Local Authorities Transfer Fund (World Bank 2013).

In all the above three forms of transfers, there are two important aspects: (a) determining the share of the county governments (vertical division to determine the grant pool), and, (b) determining the share of each county (horizontal allocation of revenue). With regard to both aspects of allocation of revenue, the Constitution established an independent commission called Commission on Revenue Allocation (CAR). According to the Constitution (Art 205,1) the Commission has the power to consider any bill that includes provisions dealing with the sharing of revenue, or any financial matter concerning county governments and make recommendations to the National Assembly and the Senate. In fact, the Commission is required to make recommendations on both the vertical division between the national and county governments, and the horizontal allocation to determine the share of each county government. These recommendations have to be submitted to the Senate, the National Assembly, the national executive, county assemblies and county executives (Art 216, 5). The final recommendations prepared by the CAR are the basis for the five year formula prepared by the Senate. The Senate has to consider the CAR's recommendations, and engage in a consultative process involving county governors, cabinet secretary, any county organization, relevant professional bodies, and the public. The Senate has to be guided by the criteria set under the Constitution.

The Constitutional provision (Art 203,1) requires the senate to take into account the following criteria: (*a*) the national interest; (*b*) any provision that must be made in respect of the public debt and other national obligations;(*c*) the needs of the national government, determined by objective criteria; (*d*) the need to ensure that county governments are able to perform the functions allocated to them; (*e*) the fiscal capacity and efficiency of county governments; (*f*) developmental and other needs of counties; (*g*) economic disparities within and among counties and the need to remedy them; (*h*) the need for affirmative action in respect of disadvantaged areas and groups; (*i*) the need for economic optimization of each county and to provide incentives for each county to optimize its capacity to raise revenue; (*j*) the desirability of stable and predictable allocations of revenue; and (*k*) the need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria.

III. South Sudan

Intergovernmental transfers in South Sudan result in the allocation of grants from national revenue to state and local government levels. Revenue is transferred from the national revenue fund consolidated from domestic revenue sources, foreign assistance and loans. But oil revenue remains as the major source of national revenue which is subject to national expenditure, subnational grants and 'Future Generation Fund' (Art 1778, 3). The constitution

(Art 180, 4) requires the criteria and conditions for allocation of revenue to the states and local government to be determined by law. For this purpose, the Constitution (Art 181) established an independent[46] body called Finance Allocation and Monitoring Commission. The commission is mandated to ensure transparency and fairness in the allocation of funds to states and local governments from the total revenue collected by the national government.

Some of the important mandates of the Commission are 'to ensure and monitor that grants are promptly transferred to the respective levels of government from the National Revenue Fund, to guarantee appropriate sharing and utilization of financial resources at subnational levels, to safeguard transparency and fairness in the allocation of funds, and monitor allocation and utilization of grants to and by the subnational governments' (Art 181, 2). However, whether the Commission has a role on the allocation of conditional grants is yet to be clarified. Some preliminary studies indicated that the Commission is struggling to put in place an equitable distribution of resources at state and local levels. This is partly related to the problem related to lack of accountability, lack of capacity to assess subnational governments' performance, conflict and weak governance capacity.

6.3. Functional and administrative capacity

The political rationale of self-rule in a federal system took the vey assumption that sub-national governments have legislative and administrative autonomy to set priorities in light of local preferences and to allocate revenues accordingly. The essence of administrative autonomy is to enable each level of government to establish and control its own administration and public service to execute and implement its own policy decisions. At the same time, it entails the strengthening of regional and local institutions' capacity to accommodate the devolution of powers and functions. It is therefore essential to define the governance structure at the regional level, as well as to strengthen the capacity of sub-national governments in formulating and implementing strategies, laws and regulations (Tegegn, 20014).

In a federal system, government institutions are necessitated to improve the performance of governance in general and the delivery of services through improved planning and participatory evaluation in particular. Therefore, it is imperative to improve the technical and professional implementation capacity of the public sector. This is with a view to improve the planning, budgeting, executing and accounting practices. No less important component of administrative capacity is 'political capacity'. As Dafflon (2014: 18-19) puts it:

> *Political capacity* is the ability of elected members of the local government to understand the residents' preferences and demand, to apprehend the policy issues, and to behave appropriately in political assembly. It is also the ability to distinguish between private, pressure group and general local interests. 'Policy capacity' belongs to the same category: identify the demand and clarify the issues in order to define the objectives, fix the supply and delivery of local public services and find the appropriate means and tools.

[46] The Independence of the Commission appears to be compromised since the heads of the Commission are appointed by and accountable to the President

As already mentioned, the Constitution of Kenya established a devolved system of government with two - national and county - levels of government, with a possibility of creating local governments below counties. With regard to empowering county and local administrations, the Constitution incorporates important principles. To begin with, according to Art 176(2) of the constitution county governments can decentralize the provision of functions by creating local governments based on the legislative framework to determine criteria for classification of cities and urban areas enacted by the national government (Art 184). Therefore, administrative functions can be provided by the national, county and local governments. The constitution also empowers both the national and county governments to establish relevant offices for public services, to appoint, recruit and dismiss officers, and to ensure accountability. According to Art 235, a county government is responsible, within a framework of uniform norms and standards prescribed by an Act of Parliament. The capacity of county and local governments is relevant not only for discharging subnational functions but also for national functions. According to Article 183, a county executive would be in charge of executing any functions conferred on it by the Constitution or national legislation in addition to executing county function. This implies the possibility of an integrated approach to perform national public services through county administrative agencies. Such performances are governed through intergovernmental relations (Art 189). The constitution also provides the importance of establishing various commissions and institutions[47] and direct public participation to improve governance at all levels of government. One of those important institutions is the Salaries and Remuneration Commission (Art 230). It is expected to harmonize pay and remunerations across the public sector, and to advise both national and county governments on remuneration and other benefits. In general, the devolution process is in progress and it is difficult to provide an overall assessment. But ensuring accountability, attracting qualified and competent staff, and increasing capacity for planning and implementation will lead to a better implementation of the devolution process in Kenya.

The transitional constitution of South Sudan recognizes that the decentralization process would provide delivery of services by bringing government closer to the people. However, the national government is constrained by serious shortage of skilled, committed and accountable civil service, let alone building capacity at the state and local government levels. The legal framework to maintain subnational administrative autonomy is also staggering partly due lack of clarity in the legal framework and partly due to national government interference in the states. This constitution (Art 101 as amended) also gives this mandate to the national executive branch and the president. The president has the power to remove any state governor and to dissolve any state legislature although they have to be replaced by election within sixty days.

When we come to Somalia, the key challenges are political stability, peace and security and bringing some level of consensus to the form and structure of the federal system. This requires completing the process of establishing member states, the division of power and resources between the levels of government and designing appropriate institutions. The

[47] See Art 10, 248, 249. The relevance of laws and institutions is clear, but by no means guarantee the success of the system

provisional Constitution provides important guidelines for the formation of a professional civil service in which different Somali communities will have to be represented in a competitive manner and excluded from party leadership.[48] The guideline under Art 119 provides:

- The Federal Government and the Federal Member States may recruit their employees;
- There shall be a civil service both at the Federal level and at the level of the Federal Member States;
- The Federal Government and the Federal Member States may cooperate in the deployment of staff, in order to ensure that expertise and experience are available where needed and in order to promote national unity;
- The Civil Service of the Federal Government and Federal Member States shall be formed on the basis of proportional representation of the resident population.

Therefore, a lot has to be done in clarifying the administrative autonomy of each level of government and putting skilled, committed and accountable civil service especially at subnational level.

Building administrative capacity at subnational levels is still a continuous process in Ethiopia. The first step taken to address the human resource demand of the newly established sub-national governments was to deploy and redeploy human resource from the center. This was followed by a serious of steps and programs taken by the government to address the overcome the human resource problem at the sub-national levels. It can be related to the establishment of training and education institutions (like Ethiopian Civil Service College - now University) to different components of the civil service reform programs. Especially after 2000, the government together with its development partners introduced various programs aimed at improving capacity not only at the public sector at the federal, regional and local levels, but also at the private sector and the civil society. The various components of the public sector governance program include: The Public Sector Capacity building Program (PSCAP), the Protection of Basic Services (PBS), Capacity Building for Decentralized Service delivery (CBDSD), Democratic Institutions Program (DIP), and the recent programs of Urban Local Development Program (ULDP) and Urban Management Program (UMP) (Tegegn, 2014, 153). Progress has been made in terms of civil service employment, in local planning and implementation capacity. However, Tegegn (2014, 153) concludes, 'various studies have shown that there is a clear capacity gap of local governments in running and managing different responsibilities under the decentralized system. Weredas in particular face shortages of manpower and as a result suffer from poor administrative, oversight and planning functions.' The problems of lack of accountability and good governance, resource mismanagement, and inefficiency at all levels of government are widely acknowledged as crippling governance in Ethiopia.

In general, some of the overall objectives of devolution and decentralization of powers and functions are to bring government closer to the people to promote efficient delivery of public services, and to promote public participation. In order to achieve these objectives, at least a dual administration and civil service structures have to be put in place. The fundamental of

[48] For details governing the Civil Service, see chapter 11 (Articles 115-119) of the Provisional constitution

establishing dual structure is to enhance administrative autonomy of each level of government with the power to appoint authorities and hire administrative staff capable of efficient delivery of services. The underlined principle behind this is that political (local elected officials should be accountable to local residents), administrative and fiscal autonomy have to be exercised. By implementing these principles enshrined in the Constitutions of the IGAD member countries sub-national governments should be autonomous and citizens should be able to constrain the behavior of public authorities which are the major challenges throughout the region.

6.4. Institutional arrangements for fiscal relations

In any intergovernmental transfer system, one of the issues is determining the responsible organ for designing the system of federal –state- local transfers. Shah (2007: 46) says the most commonly used approach is for the federal government to design the system on its own. This is because the federal government is responsible for spending of the revenue transferred by subnational governments to achieve the objectives of national programs. But this approach has a potential problem of limiting subnational autonomy. This problem can be minimized when the task is constitutionally conferred on a specific institution which may be well received by the constituent units of the federation. Federal experiences have demonstrated several options. Some have opted for independent commissions mandated with advisory roles, while others use the federal legislature/through the upper house or some form of intergovernmental councils. R. Watts (1999, 53) identifies four distinct patterns of institutional processes for intergovernmental fiscal relations. The first pattern exists in Australia, India, and South Africa where independent commissions have been entrusted with the power to determine appropriate transfer formulas. Second, a constitutionally established intergovernmental council composed of federal and state representatives. Third pattern is the experience in Germany, Swiss, USA, Belgium where federal grants are determined by the legislature but with a strong states participation through the second chambers. Fourth is, the constitutional design where all forms of federal transfer mechanisms are under the unilateral control of the federal government, although in practice it involves several discussions between representatives of the federal and provincial governments.

In Ethiopia, the power to deal with intergovernmental fiscal transfers is vested in the House of Federation. The functions of the HoF, as prescribed by Article 62(7) of the Constitution, are ‘determining the division of revenues derived from joint federal and state tax sources and the subsidies that the federal government may provide to the states.’ The House has the power to determine the horizontal share of the states and the mode of division of joint/shared taxes. The reason for this kind of approach is political. The constitutional development process has shown that all major political issues should be dealt with an institution composed of representatives of nations, nationalities and peoples. Accordingly, constitutional adjudication, self-determination and secession issues and the transfer of revenue are considered as the major political issues which have to be decided by the HoF (Minutes of the Constitutional Assembly, 1995).

In Kenya the Constitution established an Independent Advisory Commission on Allocation of Revenue whose mandate is well designed compared to other countries in the region. The Commission has the mandate to submit recommendation on the vertical as well as horizontal division of revenue to the Senate, the National assembly and the Executive. Based on the Commission's recommendation, the Senate prepares and decides on a formula and refers it to the National Assembly for approval.[49] The approach followed by the Constitution gives the best option by involving the role of experts in the Commission, and the political process at the Senate and the National Assembly. The South Sudan Constitution also established an independent commission known as Fiscal and Financial Allocation and Monitoring Commission. Its role includes recommending criteria for proper allocation of grants to states and local governments, and ensuring and monitoring for the timely transfer of grants to subnational governments. With regard to the role of the independent commission in Kenya and South Sudan, whether the recommendations of the commissions have been accepted or rejected by the national governments is yet to be seen.

[49] See Article 217 (3-9) of the Constitution for the relationship between the Senate and the National Assembly on voting procedure, amendment and final decisions.

7. General Conclusions

The present study compares the design and implementation of fiscal federalism in four member countries of IGAD. All the constitutions of the four countries incorporated the major constitutional features of a federation. There are, however, differences in the constitutional, political and fiscal contexts within which each system operates. Some of the conclusions that can be drawn from the above discussions are summarized below.

In terms of constitutional and political context. As noted above, broadly speaking all countries have similarities in adopting federalism or 'a federal-like' system to address the perennial conflicts lingering in these countries. Ethiopia and Somalia have explicitly adopted a federal system in their constitutions while Kenya and South Sudan have included devolution in their constitutions which also reflected significant federal features. Ethiopia functions under a parliamentary system, while the rest established a presidential or semi-presidential (Somalia) system. The constitutions established two levels of government with the respective powers and functions determined through the constitutional division of power. But they also exhibited significant differences.

These countries vary in terms of relative duration of adopting a federal or devolution constitution, and in the details provided in the constitutions. Ethiopia adopted a federal constitution de jure in 1995 which is in place for more than two decades. Although Kenya has been practicing some sort of decentralization for long, strong devolutionary process is included in the 2010 constitution which came into practice in 2012. Somalia and South Sudan are by and large considered as fragile states, but they opted for a federal or devolution constitution to stabilize the political processes. South Sudan and Somalia are struggling with a state making process while Ethiopia and Kenya are facing the challenges of lack of good governance and inefficiency in order to internalize the benefits of decentralization. The Kenyan constitution provides detailed fiscal arrangements in addition to important principles of devolution while the provisional constitution of Somalia postponed the issues of fiscal arrangement for future negotiations.

Constitutional distribution of expenditure and revenue raising powers and functions. The importance of constitutionally defined distribution of expenditure responsibilities and revenue-raising powers is recognized in all countries included in this study. But there is considerable difference in defining the jurisdiction of each level of government. In Somalia the assignment of both expenditure and tax powers is yet to be defined although in principle the constitution stresses that powers and functions have to be decentralized. In all the other three countries the constitutions established legislative and executive authorities to define the nature of expenditure responsibilities and revenue sources to two levels of government.

As is the case in virtually all federal or devolved systems, IGAD member countries have recognized the importance of decentralizing various public goods and services to subnational levels of government. The assignment of certain functions may appear uncontroversial due to their nature when seen from economic and administrative perspectives. These include

sanitation and water, sewage, parks, libraries and registration of births and death to be delivered at local or regional level, and defense, foreign affairs and international trade at national level. But the provision of major public services in the areas of health, education, social and economic services are subject to different views considering redistributive equity, equality and efficiency perspectives. There is no uniform approach but the distribution of these functions sometimes led to national, subnational or shared responsibility. This is one of the areas which can lead to significant variation in defining the mode and scope expenditure responsibilities assigned to each level of government. For instance, provision and regulation of pre-primary schools and child cares are responsibilities of counties in Kenya, but they are responsibilities of local (third tier) governments in Ethiopia.

In all countries, there is a common issue of clarifying the exclusive responsibilities of subnational governments. In Kenya, despite the constitutional recognition of exclusive and concurrent powers, the constitution does not specify which ones are exclusive and which ones are concurrent. Rather, the national government assumes the power to determine functions which have to be implemented by counties. Similarly, in Ethiopia there are broad constitutional phrases which empower the federal government to determine national policy for setting standards and regulatory mechanisms. So that the experience in both countries show that the state council and county assemblies have a limited role in enacting their own laws and policies but assume significant responsibility to implement federal laws. This approach leaves the practice to be similar with that of Germany where subnational governments primarily assume administrative responsibilities for delivering programs initiated by the federal government. However, this has two important limitations. First, the constitutions are not clear whether the 'integrated' approach is to be followed; second, subnational governments are not compensated for by participating[50] at the national law making process like that of the Länder in Germany.

On the expenditure side of the budget, all countries have shown considerable dependence on the national government where more than eighty percent of subnational expenditures depend on transfers. It has to be noted that this is an indicative of the trend of decentralization of expenditure responsibilities. But the scope, actual discretion and the manner of discharging responsibilities of subnational governments have to be investigated. For instance, states in South Sudan barely deliver public goods and services, while states and local governments in Ethiopia play a significant role. The variation in the scope of expenditure responsibilities is also related to the mode of allocation of residual power. Residual power is assigned to the states in Ethiopia which is common to most of the federations, while it is assigned to the national government in Kenya and concurrently to the national government and states in South Sudan. Despite the variations in the mode and scope of expenditure responsibilities, the general picture is that expenditure responsibilities are decentralized more than the revenue raising power as indicated below.

[50] The Ethiopian HoF does not have a law/policy making power at the federal level, while in Kenya the Senate has the law making power and the composition does not reflect representation of county governments.

Difference in the distribution of revenue raising power is more pronounced than in the case of expenditures. Subnational tax power in Kenya and South Sudan is limited to fees and charges, and property taxes, while in Ethiopia States also have exclusive power on business tax, and concurrent power on VAT, company profit tax, dividend tax, royalties, and excises. Countries also vary in their capacity to raise revenue from the available tax sources in general and in the capacity of subnational governments in particular, which gives rise to different consequences in the transfer mechanisms. In Kenya, counties have a constitutional right for 'equitable share' of national revenue, in addition to the exclusive revenue sources reserved to them. There is a constitutionally guaranteed share of a minimum 15% for all counties in Kenya, 2% for oil producing states in South Sudan, and no constitutionally determined share for subnational governments in Ethiopia. The overall result is that subnational governments in all countries are hugely dependent on national revenue transfers. This in turn should lead to adopting various instruments for financing subnational governments with own source tax so that local autonomy will be strengthened, accountability will be enhanced and efficiency and effectiveness will be promoted.

Intergovernmental fiscal transfers. In all countries vertical fiscal gap visibly exists due to the assignment of major revenue sources to the national government. Similarly, wide horizontal imbalances exist due to significant variation in the revenue capacity of the constituent units. Consequently, intergovernmental transfers are designed to transfer revenue from the national to subnational governments to correct the vertical and horizontal imbalances. While extensive intergovernmental transfers are found in all countries, the constitutional basis for these transfers and the institutions involved show some basic differences. In Ethiopia there are no constitutionally specified portions for federal taxes to be transferred to states. Transfers in the form of unconditional grants to states are implemented on the basis of formula designed by the upper chamber which does not assume a law making power with the lower house. In additional to the general one, conditional grants can be designated by federal laws. Kenya and South Sudan on the contrary provide a constitutionally determined minimum share to be transferred to counties and states in the form of unconditional grants. Guided by the constitutional provisions different institutions are involved in the design of transfer instruments. Both Kenya and South Sudan have independent fiscal commissions for designing and submitting recommendations to the law making bodies. While the role of the South Sudan Fiscal Commission is yet to be investigated, the young Commission on Revenue Allocation of Kenya has already shown some commendable efforts in its recommendation for the vertical and horizontal division of revenue. Although the constitutions of Kenya and South Sudan provide detailed guidelines for 'equitable share', the existing formulas and the variables included in it are far from ensuring equalization among subnational governments to provide services at comparable levels of revenue capacity.

Interdependence and participation of constituent units at the national level. Despite the division of power between the levels of governments, common to all countries is the inevitable existence of some degree of interdependence at least in the area of shared jurisdiction. But the degree of interdependence varies from country to country. In addition to

the revenue transfer processes and mechanisms, this interdependence arises in various fiscal and administrative aspects. Fiscally, the tax harmonization can be one of the cases. Interdependence can also exist through the constitutionally designed institutions as well as through practically arranged institutions and processes involving different forms of vertical as well as horizontal intergovernmental relations. In this regard, the most important institutions in Kenya and South Sudan are the independent Fiscal Commissions and the Senate. Despite the fact that there is no direct representation of states or counties in the Senate, the constitutional guidelines require to take the interests of constituent units and various forms of minorities into consideration. The role of Supreme Court in fiscal matters has also become significant in Kenya.

Administratively, the implementation of federal laws through regional administrative agencies can involve strong interaction between governments. But the dynamism in the nature of interactions depends on the form of political pluralism exhibited in the power sharing arrangement. The existence of different parties at the national and regional levels may affect the nature of interactions between the levels of government. The political pressure from the constituent units for maintaining their autonomy on one hand, and the tendency to maintain uniform standard and decentralization of unfunded responsibilities by the national government on the other can become strong limitation to the discretion of the national government. In case of absolute control of both federal and regional governments by a single dominant party as is the case in Ethiopia, decisions are simply taken unilaterally by the federal government. The other area of interaction is the role and participation of constituent units at the national law and policy making processes. In Ethiopia it is the HoF which serves as an institution to represent subnational interests on fiscal matters but it has no role in law making processes. The problem in the regions however is weak administrative agencies

8. Lesson learned and policy recommendations

8.1. Lessons to be learned

To draw lessons from the experiences of member countries of IGAD, assessment is made taking the following aspects into consideration; autonomy, efficiency, equity, transparency, accountability and political stability.

- **Autonomy:** Autonomy refers to the power to decide on certain aspects of public life by a level of government without external control by the other levels of government. This is important in a genuinely federal or devolved system, as self-rule for certain specified purposes is exercised by the government of the constituent units. In such a context, the constitutional division of powers and functions exclusively reserved to the constituent units are an indication of the degree of autonomy in the decision making authority. But this depends on the extent to which the taxing power is exercised and the type of grant instruments is used. In this respect, there are some level of similarities and also variations among the IGAD countries. In terms of reliance upon own revenue sources, all countries have limited revenue capacity. Significant amount of revenue comes through transfers from the federal/national governments. Generally speaking this dependency on grant transfers affects and limits the autonomy of subnational governments. However, the actual limitation depends on whether conditional grants take the lion share of the transfer system and whether transfer instruments are not predictable or stable. In this regard, the lower proportions of conditional transfers, and the constitutionally mandated transfer of unconditional grants from federal to subnational governments, will have less impact on regional autonomy. A typical example is where counties in Kenya are entitled to a constitutionally determined share from the national revenue. Although there is no fixed share from federal taxes in Ethiopia, the transfer of unconditional grants to states constitutes up to 35 percent of the federal budget. Such approaches provide some degree of autonomy for subnational governments.

- **Efficiency:** a devolved fiscal arrangement is put in place with the expectation that it can contribute to the improvement of economic efficiency, but if it is not properly managed it can also compromise the economic functions. The conflicting views imply that it is not easy to assess the effects of fiscal federalism on efficiency. Efficiency cannot be assessed only in terms of market output or cost management. It has to be assessed in terms of other values of introducing a federal or devolution system such as conflict management, accommodation of different forms of diversity, and self rule. The efficiency advantages of the federal system in the IGAD region have also to be assessed in terms of managing conflicts and institutional designs aimed at economic development.

- **Equity:** Equity in a federal or devolved system is a difficult concept as there are various value judgments and the distribution of expenditure responsibilities may not

bring about the intended equity. Equality of subnational government, non-discrimination, equal opportunity, providing comparable level of public services, equalizing the revenue capacity of subnational governments, and so on are some indicators used in the objectives of government. However, the ability of governments to address equity, the extent to which equity should be pursued and the indicators to achieve equitable distribution of resources are subject to debate. But to the extent possible countries have to strive to achieve equity. More so relevant in countries where equitable share of resources has been one of the sources of conflicts. In countries under consideration, the issue of equitable distribution of resources has been given a constitutional recognition, institutions mandated with this issue have been established and guidelines and policies on equity objectives are included in the constitutions. The explicit constitutional requirement for revenue sharing or grant formulas to equalize the fiscal capacity of constituent units can be considered as one of the standards. None the less, one must be cautious about the successes since there are several historical, regional and economic factors which may determine the outcome of the effort.

- **Transparency:** Transparency in this context is understood in the process of making intergovernmental fiscal relations open to all levels of government and the citizens. In particular how decisions involve the participation of different levels of government and the establishment of independent institutions to pave the way for better public access. The establishment of institutions such as Fiscal Commissions or second chambers to design and recommend revenue sharing or grant formulas and to oversee the implementations can be considered as a step towards ensuring transparency in the process of transfers. However, there are concerns due to lack of proper participation of constituent units in the federal decision making processes. The constituent units in Kenya and South Sudan are not represented at the national government level since the composition of the Senates does not give representation to them. In Ethiopia, though constituent units are represented through the HoF, their role is limited to some aspects (such as grant formulas) and they do not have a role in all federal policy/law making processes. Furthermore, the constitutional requirement for a continuous public participation in governance is not translated into public scrutiny to control the behavior of public authorities.

- **Accountability:** Accountability is closely related to transparency. The very basic assumption is that elected and appointed officials should be accountable to the citizens for their actions. With regard to fiscal arrangements, this assumption implies that decision making bodies have to be legally and publicly accountable for their decisions. This requires that the relationship between the executive and the legislature at all levels of government should ultimately bring about accountability to the public. In this regard, further investigation has to be done as to whether a parliamentary system ensures better accountability to the legislature or the power fusion between the executive and the legislature undermines accountability. Similarly whether a presidential system undermines collaboration between the executive and the

legislature or strengthens executive accountability to the representatives of the people have to be investigated. Whatever the choice may be, accountability for the utilization of resources at all levels of government has implication to the provision of public service, equitable distribution of resources and economic development.

- **Political stability:** It refers to at least to two issues: first, the degree to which the federal or devolution system is accepted by the people to address the long term conflict or development problems, and second, the process of intergovernmental fiscal relations conducted through minimum problems. The first issue reminds that the proper functioning of a fiscal arrangement depends on the political decision to adopt a federal or devolved system to address problems associated with centralization of power and conflicts. It functions better in Ethiopia and Kenya where there exists a relative political stability. Ethiopia opted for a federal system as a useful institutional arrangement for accommodating diversity. Kenya identified devolution for a better participation and meaningful community participation in the political decision making process. The second issue is also the reflection of the first one. Details in the proper design of assignment of functions, taxes and transfer mechanisms in the legal and constitutional frameworks contribute for a relative political stability. Especially designing an effective transfer mechanism can serve as 'glue that holds the nation'. Independent institutions that facilitate the transfer of grants, principles enshrined in the constitution and the participation of constituent units are important for building solidarity and ensuring accountability. We have examined how the existing mechanisms for equitable sharing of national and local resources contribute to political stability, empowerment and inclusion.

8.2. Policy recommendations

The policy recommendations emanate from the analyses outlined; they should not be taken as final guides but each observation need to be considered to improve the situation or to be seriously negotiated in finalizing the constitution making process as it is the case in Somalia, and others.

1. Rationale for a federal or federal-like arrangement and the will to implement it.

Ethiopia and Kenya are defined in their constitutions as a federal system and a devolved government. Kenya opted for devolution at the county level without expressly allocating territorial recognition of ethno-linguistic groups. Ethiopia on the other adopted a federal system with the right to self-rule and including up to secession. Ethiopia follows a parliamentary system while Kenya has a presidential system. The variations in their institutional arrangements are foremost a political choice within their political situation. But both cases of federalism and devolution are envisaged as means of bringing power closer to the people, to ensure local development, to accommodate different choices, to improve efficiency of the provision of public goods and services, and install a functioning democracy. These objectives can be meaningfully achieved if all political actors are

committed to upholding the constitutional values and building the fundamentals of fiscal federalism.

2. **Assignment of expenditure responsibilities.** The literature on fiscal federalism has developed various principles for assigning expenditure responsibilities among the levels of government. The issue however is how best to assign responsibilities which must lead to the assignment of specific responsibilities to each level of government. This is because a high degree of overlapping of responsibilities between levels of government undermines the process of devolution of power. Further, if responsibilities are not clearly defined, one level of government (usually the national) assumes to much discretionary power to the detriment of subnational government autonomy. Moreover, lack of clarity undermines accountability, and distorts the distribution of resources. Therefore, to the extent possible the constitutional division of legislative and executive power guided by the principles of decentralization has to be defined. None the less, constitutions cannot address all issues as distribution of expenditure responsibilities in some aspects is an evolving process which requires collaboration between levels of government. Deciding on the question of 'who does what' often requires disaggregating the different components of a certain public function in terms of policy making, regulation, service delivery and financing. Thus, in order to find a balance in defining the responsibilities of each tier of government, the participation of constituent units at the federal/national policy making process has to be defined and implemented.

3. **Assignment of tax power.** The assignment of taxation power is one of the controversial issues in designing a federal or decentralized system. Theoretically, tax assignment should come after a clear assignment of expenditure responsibilities. And there are various principles to define the tax jurisdiction off the national and subnational governments. But in almost all federations there is 'revenue centralization and expenditure decentralization' because of economic justifications which give broader taxing power to the federal government. The implication is that it is not always easy to reconcile the economic reasons embedded in fiscal federalism with that of the political values of federalism such as self-rule, conflict management and solidarity. This could be one of the practical challenges that define the fate of a federal system in Somalia.

   There are several rules that guide the allocation of tax power. The most important ones deal with taxes with strong impact on economic efficiency and macroeconomic stability, taxes with strong redistributive effects, benefit taxes, the mobility or immobility of tax sources, the unevenly distribution of tax sources, and the need to allocate adequate revenues to subnational levels of governments. The issues of tax competition, tax harmonization, double taxation and tax administrative efficiency are also important. Considering these criteria, it is important to define the tax powers available to the federal government, to the states and local governments in the form of exclusive taxes, shared taxes and concurrent taxes. In cases where the available tax sources to subnational governments are limited, it is important to assign federally administered taxes jointly to the federal government and states where the latter are guaranteed for a minimum

constitutionally defined share of the federal taxes. Local fiscal autonomy can be increased through a constitutionally guaranteed revenue sharing mechanism.

4. **Natural resource taxation.** Revenue from natural resources can be considered together with the principles for the assignment of taxes. But natural resource taxation is different from other sources of revenue because of its significance to the economy as a whole and its impact on disparity among the constituent units. There are also key issues associated with control of natural resources and sharing of revenue with producing or non-producing constituent units. Revenue from natural resources are mostly administered by the federal government and shared with the constituent units although there is no uniformity in the experiences of federations. In this regard, it is important to consider a wide-ranging recommendation given by Suberu (2015: 33-34): 'Incorporating judicious arrangements for the equitable [vertical and] horizontal distribution of revenues from natural resources; Addressing the environmental and socio-economic impacts upon natural resource producing regions, jurisdictions, or communities; Establishing legitimate institutions (including revenue sharing commissions and judicial tribunals) for the neutral administration, arbitration, adjudication, or brokerage of competing inter-governmental and/or inter-regional resource claims; Ensuring opportunities for subnational political participation and accountability; Creating appropriate processes for the reform or adjustment of inter-governmental resource revenue sharing arrangements in response to changing political and economic dynamics.'

5. **Intergovernmental transfers.** Intergovernmental transfers are the major sources of finance in most of the federations. They can be transferred in the form of general-purpose (unconditional) grants and conditional grants with matching or non-matching requirements. The volumes of revenue in each type of grants and the purpose to be achieved have to be clearly laid down in the grant instruments. Some of the objectives are aimed at ensuring equitable share of resources; enabling subnational governments provide comparable level of public services, correcting fiscal imbalances and spillover effects, and setting minimum national standard. Therefore, it is important to define as to which type of grant instrument help achieve the intended objective. A related issue is how to design a grant framework for ensuring accountable and equitable governance, at the same time respecting subnational autonomy. This requires extensive constitutional principles guiding the process of intergovernmental transfers, and establishing institutions which may guarantee transparency either through the participation of constituent units or through a constitutional independent commission mandated with technical recommendations.

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Statistical Annexes

Annex A-1: A representative assignment of expenditure responsibilities

Function	Policy, standards and oversight	Provision and administration	Production and supervision	Comments
Interregional & international conflict resolution	U	U		Benefits and costs international conflicts resolution in scope
External trade	U	U,N,S		Benefits and costs international in scope
Telecommunications	U, N	P		Has national and global dimensions
Financial transactions	U,N	P		Has national and global dimensions
Environment	U,N,S,L	U,N,S,L		Externalities of global, national, state, and local scope
Foreign direct investment	N, L	L	P	Local infrastructure critical
Defense	N	N	N,P	Benefits and costs national in scope
Foreign affairs	N	N	N	Benefits and costs national in scope
Monetary policy, currency, banking	U,ICB	ICB	ICB, P	Independence from all levels and banking essential; some international role for common discipline
Interstate commerce	Constitution, N	N	P	Constitutional safeguards important for factors and goods mobility
Immigration	U, N	N	N	U due to forced exit
Transfer payments	N	N	N	Redistribution
Criminal and civil law	N	N	N	Rule of law, a national concern
Industrial policy	N	N	P	To avoid beggar-tie neigbour policies
Regulation	N	N,S,L	N,S,L,P	Internal common market
Fiscal policy	N	N,S,L	N,S,L,P	Coordination is possible
Natural resources	N	N,S,L	N,S,L,P	Promotes regional equity and internal common market
Education, health & social welfare	N,S,L	S,L	S,L,P	Transfers in kind
Highways	N,S,L	N,S,L	N,S,L,P	Benefits and costs of various roads vary in scope
Parks &recreation	N,S,L	N,S,L	N,S,L,P	Benefits and costs of various roads vary in scope
Police	S,L	S,L	S,L	Primarily local benefits
Water, sewer, refuse, fire protection	L	L	L,P	Primarily local benefits

Note: U – supranational responsibility; ICB – independent national bank; N- national government; S – state/provincial government; L – local government; P – non-government sector/civil society
Source: Anwar Shah 2007: 8-9

Annex A-2: Kenya: Divisions of powers and functions

National Government	**County Government**
Foreign affairs, foreign policy and international trade.	Agriculture, including crop and animal husbandry; livestock sale yards; county abattoirs; plant and animal disease control; and fisheries.
The use of international waters and water resources.	County health services, including county health facilities and pharmacies; ambulance services; promotion of primary health care; licensing and control of undertakings that sell food to the public; veterinary services (excluding regulation of the profession); cemeteries, funeral parlours and crematoria; and refuse removal, refuse dumps and solid waste disposal.
Immigration and citizenship	
National defense and the use of the national defense services.	
Police services, including the setting of standards of recruitment, training of police and use of police services; criminal law; and correctional services.	Control of air pollution, noise pollution, other public nuisances and outdoor advertising.
Monetary policy, banking, the incorporation and regulation of banking, insurance and financial corporations.	Cultural activities, public entertainment and public amenities, including—betting, casinos and other forms of gambling; racing; liquor licensing; cinemas; video shows and hiring; libraries; museums; sports and cultural activities and facilities; and county parks, beaches and recreation facilities.
National economic policy and planning	County planning and development, including—statistics; land survey and mapping; boundaries and fencing; housing; and electricity and gas reticulation and energy regulation.
Labor standards.	Animal control and welfare, including—licensing of dogs; and facilities for the accommodation, care and burial of animals.
National statistics and data on population, the economy and society generally.	Trade development and regulation, including—markets; trade licenses (excluding regulation of professions); fair trading practices; local tourism; and cooperative societies.
Education policy, standards, curricula, examinations and the granting of university charters.	Pre-primary education, village polytechnics, home-craft centers and childcare facilities.
Universities, tertiary educational institutions and other institutions of research and higher learning and primary schools, special education, secondary schools and special education institutions.	Implementation of specific national government policies on natural resources and environmental conservation, including—soil and water conservation; and forestry.
Transport and communications, including road traffic, the construction and operation of national trunk roads; standards of construction and maintenance of other roads by counties; railways; pipelines; marine navigation; civil aviation; space travel; postal services; telecommunications; and radio and television broadcasting.	County transport, including—county roads; street lighting; traffic and parking; public road transport; and ferries and harbors, excluding the regulation of international and national shipping and matters related thereto.
National public works.	Control of drugs and pornography.
Housing policy.	Fire fighting services and disaster management.
General principles of land planning and the coordination of planning by the counties.	Ensuring and coordinating the participation of communities and locations in governance at the local level and assisting communities and locations to develop the administrative capacity for the effective exercise of the functions and powers and participation in governance at the local level.
Protection of the environment and natural	

resources with a view to establishing a durable and sustainable system of development, including fishing, hunting and gathering; protection of animals and wildlife; water protection, securing sufficient residual water, hydraulic engineering and the safety of dams; and energy policy.	
Energy policy including electricity and gas reticulation and energy regulation.	
Agricultural policy and veterinary policy.	
Ancient and historical monuments of national importance.	
National betting, casinos and other forms of gambling.	
Tourism policy and development.	
Disaster management.	
Health policy and national referral health facilities.	

Source: Schedule four of the Constitution of Kenya

Annex A-3: Representative assignment of taxing powers

Type of tax	Determination of base	Collection and rate	administration	Comments
Customs	F	F	F	International trade taxes
Corporate income	F, U	F, U	F , U	Mobility factor, stabilization tool
Resource taxes -resource rent, profit tax, royalties, fees, charges, severance taxes, production, - output and property tax; conservation charge	F SL	F S, L	F S, L	-Highly unequally distributed tax bases -benefit charges for state-local services; to preserve local environment
Personal income tax	F	F, S, L	F	Redistributive, mobile factor, stabilization tool
Wealth taxes (taxes on capital, wealth, inheritance, bequests)	F	F, S	F	Redistributive
Payroll	F, S	F, S	F, S	Benefit charge e.g. social security coverage
VAT	F	F	F	Border tax adjustment possible under federal assignment; potential stabilization tool
Single stage sales tax - Option A - Option B	 S F	 S, L S	 S ,L F	 -Higher compliance cost; -harmonized, lower compliance cost
'Sin' taxes - Excise on alcohol, tobacco - Betting and gambling - Lotteries	 F, S S, L S, L	 F, S S, L S, L	 F, S S, L S, L	-Health care a shared responsibility; -state and local responsibility; -state and local responsibility
Taxation of 'bads' - Carbon - BTU taxes - Motor fuels - Congestion tolls - Parking fees	 F F,S,L F,S,L F,S,L L	 F, F, S, L F, S, L F,S,L L	 F F,S,L F,S,L F,S,L L	-to combat global pollution -pollution impact may be national, regional or local -tolls on federal/provincial/local roads
Motor vehicles - Registration, transfer taxes, annual fees - Driving license and fee	 S	 S	 S	State responsibility
Business taxes	S	S	S	Benefit tax
Excises	S,L	S, L	S, L	Residence-based taxes
Property	S	L	L	Immobile factor
Land	S	L	L	Immobile factor, benefit tax
Frontage, betterment	S, L	L	L	Cost recovery
Poll	F,S,L	F, S, L	F, S, L	Payment for local services
User charges	F,S,L	F, S, L	F, S, L	For services received

U - Supranational agency; F – federal; S – state or province; L- municipal or local
Source: Shah (2007: 12-1

Annex A-4: Comparative Inter-governmental Relations

Criteria	Ethiopia	Kenya	Somalia	South Sudan	Additional Remarks
1. Institutional Arrangement					
Form of government	Parliamentary	Presidential	Semi-presidential	Presidential	-Nigeria, South Africa, USA, Brazil have presidential system -Many other federations have parliamentary system
Constitution	Federal constitution	Devolved Constitution, with strong federal features	Transitional federal constitution; work in progress	Transitional constitution; the permanent one is expected to be federal	
No. of tiers of government (Gov't)	Two levels of gov't: federal gov't and 9 states; with two chartered cities	Two levels: national government and 47 counties	-two tiers –federal and state gov'ts; but the number of states and their boundaries yet to be finalized	Recognizes three levels – national, state and local gov'ts, but lists power only for the national and states;	Local gov'ts in Nigeria, South Africa, India, Brazil have three tiers
Status of local gov'ts	-close to1000 urban and rural local gov'ts -local gov'ts established by State constitutions with local council, executive, and judicial powers	-Local gov'ts are not established by the 2010 constitution; - local gov'ts below Counties can be established	-local gov'ts to be established by states guided by the constitution	-local gov'ts exercise power within states	Local gov'ts in Nigeria, South Africa, India, Brazil and Switzerland have constitutional status
Intergovernmental relations	-Weak constitutional principles and no specific institution established; -In practice, strong relations sometimes leading to centralization	-some important principles laid by the Constitution	-important principle -Relations to be guided by the meetings of presidents of federal gov't and states	Relevant constitutional principles are laid down but their implementation is yet to be seen	-South Africa, Germany and Canada have strong IGR mechanisms; -it boosts states' influence on federal policies
Upper House	-uniquely designed HoF with the power to determine constitutionality and grant formula, but no legislative power; -members represent 'nations, nationalities and peoples', not state govt's -direct or indirect election possible, but the latter is put in practice	-the Senate, with 47 members, participates in law and decision making processes; -the Senate represents and protects the interests of counties; - Members directly elected (but how county gov'ts represented?); -each county has one representative	-Upper House with max 54 members; each state has equal representation; Members directly elected; -the House has legislative and decision making powers; - represents the interest of sates, but requires further investigation for its implementation		Upper Houses mostly serve to protect states' interests, but Germany's Bundesrat strongly influences federal policies
2. Expenditure Assignments					
Constitutional design	-Dual, but interdependent form of	-cooperative with devolution	Dual but yet to be clearly	Cooperative with strong	Nigeria, South Africa and

	cooperation; -constitutional division of power with significant shared powers	process and strong interdependence;	defined	interdependence	Germany have strong cooperative and interdependent feature; the rest follow dual structre
Exclusive powers	-The constitution provides federal and state exclusive powers;	Exclusive powers provided for two levels; -But further details of division of power to be laid by national laws	Few federal exclusive powers listed, but further details to be negotiated	Provided to the two levels of gov't	Exclusive powers are mainly provided for federal government
Shared powers	-the constitution provides shared powers; -But, in practice, several functions are shared in the form of federal laws and state administration	Provided by the constitution	Mostly Implied	Most powers assumed to be shared, but need further clarification	Shared powers are extensively used; sometimes used to broaden the federal power
Residual powers	Reserved to states, except taxes to be determined by the two Houses	To the national government	Not clear (power is given to where most effectively exercised)	To be dealt with according to the nature of power	Residual powers assigned to states except in India, Canada
3. Assignment of Revenue					
Exclusive sources	-Provided for two levels of gov't; -strong fiscal power to federal -land related taxes reserved to states;	Only property and entertainment taxes are exclusive to counties	To be negotiated; Tax negotiation probably determines the viability the federation	Exclusive sources provided for each level (Art 78 and 79)	
Shared taxes	Article 98 of the Constitution	All taxes except the above; To be shared according allocation formula	Sharing taxes can be an option	Oil revenue with producing states	
Autonomy (base and rate determination)	Both harmonized except agricultural income tax, land use fee	Shared taxes harmonized			No harmonization in Swiss, US, India; Many others prefer harmonization
Tax administration	Dual	Rely on national tax admin	Weak tax administration; Federal gov't limited to Mogadishu		Some state taxes can be federally administered
Natural resource taxation	-good prospect but yet not significant; -currently taxes related to natural resource are shared; -the mode of sharing needs further inquiry; -new tax bases on natural resources have to be developed	-taxes shared; -soon expected to be the major national revenue source;	-subject to negotiation; -the outcome will determine the nature of the federation	Highly significant source of revenue; Source of conflict?	-Mostly assigned to federal government, but Canada decentralizes; -lessons from the challenges of Nigeria;

Annex A-5: Comparative Conclusions of Intergovernmental Transfers

CRITERA	ETHIOPIA	KENYA	SOMALIA	SOUTH SUDAN	REMARKS
Guiding constitutional principles	Principles set the importance of narrowing development gaps	Constitutional Principles for Revenue allocation	To be developed	Revenue allocation to states	Constitutional or statutory guidelines are important; Nigeria, Germany, Switzerland have important principles
States tax performance (imbalances)	Weak performance, therefore huge imbalance, 80% gap	90% of counties' expenditure come from revenue allocation	Currently some states have strong fiscal power	Significantly low	Weak in Nigeria and South Africa too; Butt strong in Canada, Germany, USA, India and Brazil
Unconditional (general) grants	-major source for states; -based on equalization formula;	Used in the form of revenue sharing or revenue allocation	Depends on the outcome of tax negotiation	Formula based process introduced	South Africa, Nigeria, Australia, Germany, Canada use full or partial unconditional grants or revenue sharing
Conditional grants	-formula based (such as MDG grants) -line ministries and other forms are used	Constitutionally provided	>>	Not systematically developed	-It is the major source in USA; -it is also widely used in all federations
Revenue sharing	-formula based sharing; -It is used for the sharing of concurrent taxes	Formula based (sharing of all national revenue)	>>	Sharing of oil revenue	A formula based revenue sharing used in Nigeria
Institutional Arrangement	The HoF (Upper House) determines	Commission on Revenue Allocation and the Senate	>>	Finance Allocation and Monitoring Commission	'Independent' commissions are widely used in Nigeria, South Africa, Australia, India
State – local transfer	-formula based general grants; -but specific purpose grants are also used	No process observed below county level	>>	No formal process developed	-formula based transfer used in South Africa; to some extent in Nigeria

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