

# **Fiscal Federalism in Ethiopia**

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# Major issues of Fiscal Federalism

- allocation of expenditure responsibilities: which power of spending carried by which level of government;
- allocation of revenue raising power: taxes and non tax revenue sources by which level
- fiscal imbalance between tiers of governments: vertical and horizontal imbalances
- intergovernmental financial transfer: financial flows in order to adjust the imbalances

# Allocation of powers & responsibilities in Ethiopia

- Constitution Article 51 powers and functions of the federal gov
- Constitution Article 52 powers and functions of regional gov
- Constitution reserves residual powers to the **states**
- **If new Residual power of taxation** however, the constitution has not given to the states, rather it set to be decided by **the two federal houses** (article 99)

# Powers and responsibilities of Federal G

- national defense, public security, foreign relations
- interstate trade, telecommunication, postal, monetary and fiscal policy, patent right, rail, air and water transport, major roads...
- legislation on matters of electoral law, enforcement of political right, press law, registration of political parties
- Enactment of penal code is federal matter (civil law left to states)
- major policy and national standards governing education, health, environment, science and technology and development strategies

# Powers & responsibilities of Regional G

- legislative, judicial and executive powers on regional matters
- Have power over education, health and agriculture etc (federal government has power set national standards)
- state police power, the maintenance of public peace
- levying and collecting **taxes and duties on revenue sources reserved to states,**
- the administration of **land and other natural resources** based on federal laws,
- employment and working conditions of civil servants.

# Allocation of revenue raising power (Structure of Taxation Power)

FDRE Constitution divides the taxation power into three categories:

1. Federal power of taxation,
  2. Regional power of taxation and
  3. **Concurrent** power of taxation
- revenue generated from the respective sources belongs **exclusively** to each level of the government

# 1. Federal power of taxation

- Article 96 enumerates the exclusive revenue sources of the federal gov't
- revenue sources such as **customs duties including import /export tax and other duties**
- the income tax of employees of the federal gov't, public enterprises owned by the federal gov't and of international organizations
- Income or profits tax from federal public enterprises
- income arising from rail, air and sea transport and income from lotteries (Art.96 (4) and (5)).

# Federal power of taxation cont'd

- Tax income from leasing own property and houses
- **fees and charges** relating to licenses issued by organs of the federal government
- levy and collect **stamp duties**
- of income from the **National Bank**, residual surpluses from various **public enterprises** (banks, insurance, Telecom, Electric Power, Post Office, Petroleum Corporation, Sugar industries etc)



# 2. Regions Power of Taxation

- listed under Article 97 of FDRE constitution
- **except custom duties**, all tax bases are also the source of state revenue
- income from employees of the regions and from employees of private enterprises
- The income or profits of the public enterprises owned by the states
- Profit or income from small business activities and sole proprietorships
- Income from individual farmers or cooperative association,

# Regions Power of Taxation cont'd

- income from water transport service provided within the boundary of the region
- rental income from properties owned by the state
- property taxes on houses which are privately owned and royalties from the use of forests
- taxes and royalties on small-scale mining activities
- revenue from land lease (land owned by the public)
- collection of fees and charges on license issued and services rendered by different organs of the region

# 3. Concurrent Power of Taxation

- different from its application in other systems
- ...federal government and the states shall jointly levy and collect...(Article 98)
- the provision has been interpreted in such a way that those tax sources listed under the concurrent power have to be levied and collected by the federal government and the proceeds are compulsorily shared with the regions (parliaments joint decision)

# Fiscal Imbalances in FDRE

- mismatch between the expenditure responsibility and revenue sources (vertical imbalance)

# Fiscal Imbalances in FDRE cont'd

## Vertical Imbalance

For example

- For instance, the revenue generated by the regions accounts for only a maximum of 9.7% of the total national revenue in 2007/08 fiscal year
- An other example, in the 2016 fiscal year the states own revenues (excluding Addis Ababa) covered only 20 per cent of their total expenditure.

# Fiscal Imbalances in FDRE cont'd

## Horizontal Imbalance

- the fiscal disparity between the regions
- all the regions have fiscal deficits and they also have widely diverse revenue-raising capacities
- They vary considerably in their skilled manpower, financial capacity, resource endowment etc
- This imbalance is not limited b/n regions, but also reflected with in regions (intra regional among local governments)
- **Special support program**

# Inter-governmental Revenue Transfer system in Ethiopia

- greater fiscal imbalances requires transfer system as in the case of many federations.
- main objective of addressing the regions financial constraints in executing their expenditure responsibilities
- necessitates an equitable revenue transfer system and collaboration b/n the constituent units
- Ethiopia has developed interesting mechanism of subsidy transfer systems and formulas (revised formulas in 1997, 1998, 2000, 2003, 2007, 2009, 2012)
- Working on a new formula for 2017/18

- The resource envelope (pool) is determined by the federal government (cabinet)
- The allocation formula is determined by the HoF
- It considers capital and recurrent expenditure as well as revenue potential of regions
- Participatory and wide political consensus
- Has brought significant contribution to Ethiopia's fast and sustained development
- It has some weaknesses as well (such as its complexity)