Measuring and explaining fiscal de/centralization

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Measuring and explaining fiscal de/centralization: Empirical evidence from Ethiopia, 1995–2020

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Abstract

This article provides an in-depth analysis of fiscal decentralization in Ethiopia from 1994/95 to 2019/20, focusing on five fiscal categories: regional own-source revenues, regional tax autonomy, regional borrowing, federal grants, and conditional grants. To measure fiscal de/centralization, the study constructs original data sets based on reports from various organizations over multiple years. The analysis results demonstrate that fiscal de/centralization varies temporally and spatially. While improved capacity is associated with enhanced own-source revenue, the desire to improve regional fiscal management often results in fiscal centralization. Further, although Ethiopian regions have constitutional powers to determine the bases and rates of regional taxes, the central government has significant influence in such matters, often manipulating regional affairs in disregard of the constitution. The article reveals substantial variations of own-source revenues across regions attributed to regional differences in capacity, development, location, and investment distribution. The article highlights the importance of a systematic understanding of region-specific challenges to accurately assess the effectiveness of decentralization policies in the global South. Insights from Ethiopia are of great importance to policymakers looking to embrace fiscal decentralization in developing countries.

KEYWORDS
Ethiopia, fiscal decentralization, grants, region, revenues

1 | INTRODUCTION

Since the 1990s, countries in the global South have adopted fiscal decentralization, supported and promoted by global actors such as the IMF and the World Bank (Stegarescu, 2005, pp. 301–302; Smoke, 2015a, 2015b). Besides the theoretical argument regarding the benefits of fiscal decentralization in ensuring subnational spending matches citizens' demands and improves effectiveness (Gomes, 2010, p. 124; Oates, 1999, 2005), political pressures, such as the demand for regional autonomy, have triggered fiscal decentralization (Hobdari et al., 2018, p. 6). In federations, fiscal decentralization is crucial as formal jurisdictional autonomy can be meaningless without fiscal autonomy, which would lead to regional political decisions facing a financial veto from the center.

Growing attention has been given to cross-country comparative assessment of decentralization (e.g., Dardanelli et al., 2019; Hooghe et al., 2016). Even existing inter-state studies are dominated by developed countries, and low-income countries that adopted decentralization in response to pressures such as decades-long centralized rule, ethnic-based secessionist insurgency, and ethnic contention received insufficient attention (Hobdari et al., 2018, p. 6). Liu (2011) encompassed both developed and developing countries and clustered countries into different categories based on six types of fiscal decentralization systems, yet the study focuses on cross-country comparison. Exiting studies note that though most developing states are often legally decentralized, subnational units tend to lack fiscal autonomy (Martell, 2008; J. I. Lewis, 2014; Edwards et al., 2015), and implementation of fiscal decentralization has been affected by national and local factors (J. I. Lewis, 2014). A recent study by Yimenu (2022a) found that policy autonomy varies over time and across regions due to different factors, although subnational units have the same powers under the constitution.

Similarly, Wu et al. (2017) note the variation of decentralization performance across local governments due to capacity differences. Beyond such district-level studies, little is known about whether fiscal decentralization also varies over time and across regions within the same state and what factors contribute to such variations, if any. As existing studies tend to implicitly assume a uniform fiscal de/centralization within a state, hiding within-country fiscal disparities, further research is needed to systematically understand the dynamics of fiscal de/centralization in developing countries.

This article contributes by systematically assessing fiscal de/centralization using Ethiopia, which introduced federalism in 1991, as a case. Ethiopia's 3 decades of federalism experience is reasonably long enough to be used as a case to reveal the implementation of fiscal de/centralization in third-world developing countries. The article's contribution is triple: (1) It develops a comprehensive fiscal de/centralization operationalization. (2) It presents an original data set showing temporal and spatial de/centralization variation in five fiscal categories from 1994/5 to 2019/20, which can be employed by other researchers seeking to include cases from the global South. (3) It analyzes how best we can explain the factors deriving temporal and spatial fiscal de/centralization variations based on insights from Ethiopia.

The analysis of fiscal de/centralization in Ethiopia reveals temporal and regional variation. Improved capacity results in higher own-source revenue, but the drive to improve regional fiscal management often leads to fiscal centralization. Additionally, regional differences in capacity, development, location, and investment distribution result in substantial variations in own-source revenue. The remainder of this article is structured as follows. It first presents a theoretical framework followed by conceptualization, operationalization, and methods. After discussing Ethiopia's fiscal federalism design, it presents the measurement of de/centralization in five fiscal categories: own-source revenue, tax autonomy, federal grants, conditional grants, and borrowing. Later, the main factors driving temporal and spatial fiscal centralization are explained. Finally, a discussion of the findings against theoretical expectations and conclusions are made.

2 | THEORETICAL FRAMEWORK

Fiscal decentralization reforms got impetus in Sub-saharan Africa in the early 1990s, with Ethiopia, Nigeria, and South Africa leading the way in implementing them. In these countries, subnational spending constitutes around half of the government's total spending (IMF, 2006). However, in Kenya, Rwanda, Tanzania, and Uganda, subnational spending is only about 15–20% of the general government spending, a proportion similar to other emerging economies but substantially lower than a typical OECD country (Hobdari et al., 2018, p. 1).

Federations vary in the degree of subnational fiscal decentralization they offer. For example, constituent units in Australia, Canada, Switzerland, and the USA have significant control over their tax revenues, while subnational units in Austria and Germany have limited tax autonomy (Stegarescu, 2005, p. 312). However, fiscal decentralization varies across states and over time within the same federation. For instance, classic federations such as the US and Switzerland retained considerable fiscal autonomy over time (Dardanelli et al., 2019, p. 210), whereas Indian states experienced temporal centralization (Singh, 2019, p. 122). Further, the degree of decentralization or regional autonomy may vary within a federation due to the constitutional status of the unit and differences in subnational institutional capacity and resources (Loughlin, 2000, p. 12). The former is de jure regional autonomy asymmetry due to the constitutional status of the regions, while the latter is de facto regional autonomy variation caused by extra-constitutional factors like disparities in capacity. While de jure asymmetry is easy to analyze by relying on what the law says, de facto decentralization variation, which this article seeks to assess, is challenging as it requires a critical examination of factors beyond the constitution generating variation.

It is important to note that there can be gaps between formal authority, which refers to what the law says, and real power, which refers to the practice of formal authority (Aghion & Tirole, 1997, pp. 2–3). Therefore, regions may have formal authority, de jure, within their jurisdiction but could be, de facto, constrained to exercise their authority due to different factors, as is the case in hybrid regimes that tend to decentralize formally and recentralize informally (Boone, 2003; Dickovick, 2011). Such tendencies necessitate analyses that shift focus from the constitutionally declared fiscal decentralization to its practice. In some cases, the federal government or vice-versa can practically exercise competencies constitutionally assigned to the other government, as in Russia in the 1990s (Libman, 2016, p. 22). Moreover, the federal government may encroach on the competencies of subnational units in violation of the constitution (Bednar, 2009).

Consequently, dynamic de/centralization can occur over time and across regions due to different factors beyond the constitution. One factor that has been theorized to contribute to these dynamics is the party system. According to Riker (1964, pp. 130–131), regional autonomy depends on whether the same party rules the federation and the regions and whether the federal party controls regional parties. Two-level party non-congruence generates decentralization, as seen in South Africa, where only provinces led by opposition parties challenged central encroachment on provincial tax competence (Fessha & Kirkby, 2008, p. 263). However, the opposite can also happen as some regimes politicize federal grants to punish states ruled by opposition parties, as occurred during the second half of the 20th century in Mexico under the Institutional Revolutionary Party (PRI) (Diaz-Cayeros et al., 2003).

In non-democratic dominant party federations, manipulating fiscal policies to weaken the fiscal position of opposition-ruled states is a common tactic. This includes terminating federal grants, increasing grants in states controlled by the federal ruling party, and providing special grants to swing constituencies (Loh, 1996, 2010). A good illustration of such a case is Nigeria during its Second Republic (1979–1983), where the ruling National Party of Nigeria used its power to allocate funds in a way that favored states under its control while weakening those ruled by the opposition (Suberu, 2009, p. 78). This not only had negative implications for the fiscal autonomy of these states but also challenged the principles of democracy and fair governance. Malaysia's ruling party's encroachment on the opposition-ruled states of Kelantan and Sabah in the 1990s is another typical example. These actions demonstrate that the center's approach to fiscal transfers can lead to significant fiscal autonomy differences across regions within the same state. This manipulation of fiscal policies is problematic because it undermines the principles of federalism and democratic governance by giving the ruling party an unfair advantage over opposition parties in state-level politics.

However, beyond national-level factors such as regime type, region-specific factors, such as capacity, determine regional fiscal autonomy in the same state though the regions might have equal constitutional powers. Subnational units that lack the necessary administrative capacity to carry out their new responsibilities end up relying heavily on the central government for support, both in terms of administration and finances. This dependency on the center ultimately results in a loss of autonomy for these subnational units, making them more vulnerable to further erosion of their autonomy compared to other units that possess the necessary administrative capabilities (Erk, 2014; Edwards et al., 2015; B. D. Lewis, 2015; Wu et al., 2017). This means developed governance structures and infrastructure, which determine regional tax administration and economic diversity, which defines regional tax revenues are crucial for effectively implementing decentralization because they provide regional governments with the capacity needed to do their jobs (Ziblatt, 2004; World Bank, 2016a, pp. 8–9; Dasgupta & Kapur, 2020).

Therefore, even if regions have equal constitutional powers, developed and wealthy regions can have more income than poor regions, which produces regional fiscal disparities. This situation highlights the importance of investing in the administrative capacity of subnational units, as failure to do so can result in a centralized and highly unequal system that undermines the principles of decentralization and local governance. Furthermore, ensuring that subnational units are equipped with the necessary tools and resources to perform their duties autonomously is crucial, as this is the cornerstone of a functional and equitable decentralized system. Any failure to address these issues risks perpetuating an unequal and centralized system that undermines the principles of decentralization and local governance.

In conclusion, the degree of regional fiscal autonomy in decentralized states is influenced by a combination of national and region-specific factors. National-level factors, including regime type and fiscal transfers from the central government, significantly impact regional fiscal autonomy. However, region-specific factors such as administrative and organizational capacity, infrastructure development, and regional economic diversity also play a crucial role in generating variation in fiscal decentralization across regions within the same state. For instance, regions with weaker administrative and organizational capacity may become more dependent on the central government for support and funding, which can limit their fiscal autonomy. In contrast, regions with stronger capacity and diverse economies may be better equipped to generate revenue and manage their finances, allowing them to have higher levels of fiscal autonomy. Therefore, this article builds on previous works to systematically understand both national and region-specific factors to explain the effectiveness of decentralization fully.

3 | CONCEPTUALIZATION AND OPERATIONALIZATION

Fiscal autonomy is the regional government's power over its fiscal sources and the degree to which the federal grants are conditional. Fiscal decentralization should be operationalized because a country might be decentralized on some dimensions but not on others. Gomes (2010, p. 124) highlights the importance of regional tax autonomy and regular, unconditional grants as key indicators of fiscal decentralization.

Most studies, for example, OECD (1999) and Ebel and Yilmaz (2003), on fiscal decentralization, have focused on subnational own-source revenues, as they are considered to provide greater subnational fiscal autonomy compared to federal transfers (O'dwyer & Ziblatt, 2006; Stegarescu, 2005). Because federal grants are often tied to conditions, while own-source revenues give subnational units more fiscal freedom (OECD, 1999). Assessing changes in the allocation of decision-making competencies for each tax is essential in measuring fiscal de/centralization as changes can occur over time. According to Stegarescu (2005, p. 307), fiscal autonomy is safeguarded only for taxes that subnational governments independently have legislative and administrative control over. Therefore, instead of analyzing regional tax autonomy based on the constitution, examining the de jure and de facto regional competence in determining their tax bases and rates is more appropriate.

In addition, federal grants are another source of revenue for regional governments, which can be either unconditional or conditional. Unconditional grants offer subnational units the freedom of spending as they come with no constraints, while conditional grants are earmarked for specific purposes and offer limited spending freedom (Ebel & Yilmaz, 2003; Stegarescu, 2005, p. 309). Conditional grants are often used by central governments to coordinate national policies and prioritize spending in certain areas, binding regions to these priorities (Gomes, 2012, pp. 388–389). Therefore, it is important to differentiate between conditional and general-purpose grants and analyze the conditions attached to conditional grants in order to accurately assess regional fiscal autonomy.

Considering the preceding discussion, I disaggregate fiscal autonomy into five categories. (1) *regional own-source revenues*: the proportion of individual regions' own-source revenues out of total revenues. (2) *Federal grants*: shows the extent of regional dependence on federal transfers. (3) *Conditional grants*: the proportion of conditional grants from federal transfers to the regions. (4) *Tax autonomy*: the degree to which regional governments have the power to determine the base and rates of regional taxes. (5) *Borrowing autonomy* encompasses the regions' legal and practical freedoms regarding public sector borrowing. Regional expenditure is deliberately excluded from analysis because expenditure is an inadequate guide in measuring fiscal autonomy as it neither shows the source of the spending nor spending freedom (Rodden, 2004; Hooghe et al., 2008, p. 157).

4 | METHODS

I generated data out of fieldwork from January to September 2019. When the fieldwork was conducted in 2019, Ethiopia had nine regions, all included in the study. The number of regions has increased to 11 since then. The study assessed regional fiscal decentralization using quantitative and qualitative data. Quantitative data from several years of revenues, expenditures, and federal grant reports from the Ministry of Finance and Economic Cooperation, the Ministry of Revenues, and their equivalent bodies at the regional level and the World Bank were generated and constructed to measure regional fiscal autonomy on five fiscal categories from 1994/95–2019/20. Qualitative data, which includes laws related to taxation, federal transfers, and regional borrowing, as well as the constitution, policy documents, proclamations, published articles, news reports, and gray literature related to fiscal decentralization, were generated through qualitative content analyses. Further, thirteen semi-structured interviews were conducted with federal and regional government officials to gather detailed information on the motives driving the federal government's pursuit of de/centralization and why some regions have small own-source revenues and fiscal autonomy. The interviews targeted officials with first-hand knowledge of the topic. The data enabled me to identify fiscal de/centralization drivers and factors contributing to regional variation in own source revenues. However, obtaining quantitative data was difficult as most relevant documents were unavailable online, requiring physical visits to relevant federal and regional during a 9-month fieldwork.

After that, fiscal autonomy coding was made based on objective quantitative data. Coding enables comparison because it helps in designating regions into categories. I coded *regional own-source revenue* by calculating the proportion of regional own-source revenues from the total regional revenues. The coding (1–10) is as follows: 1 = [0%–10%]; 2 = (10%–20%]; 3 = 20%–30%]; 4 = (30%–40%]; 5 = (40%–50%]; 6 = (50%–60%]; 7 = (60–70]; 8 = (70–80]; 9 = (80–90] and 10 = (90% = 100%]. A higher score indicates higher regional autonomy. *Dependence on federal grants* is measured by computing the percentage of federal grants out of regional revenue. The coding (10-1) is as follows: 10 = [0%–10%]; 9 = (10%–20%]; 8 = (20%–30%]; 7 = (30%–40%]; 6 = (40%–50%]; 5 = (50%–60%]; 4 = (60–70]; 3 = (70–80]; 2 = (80–90] and 1= (90% = 100%]. A higher score means that the region is less dependent on federal transfers. *Conditional grants* were measured by calculating conditional grants as a percentage of the total grant. The scores (1–10) are as follows: 1 = [0%–10%]; 2 = (10%–20%]; 3 = (20%–30%]; 4 = (30%–40%]; 5 = (40%–50%]; 6 = (50%–60%]; 7 = (60–70]; 8 = (70–80]; 9 = (80–90] and 10 = (90% = 100%]. A higher score indicates relative regional spending freedom.

Tax autonomy coding (1–10), 1 indicates the lowest autonomy while 10 indicates the highest autonomy. 1 = the base and rates of taxes contributing [90%–100%) of regional tax revenues are determined by the center. 10 = the base and rates of taxes contributing (1–10] of regional tax revenues are determined by the federal government. *Borrowing autonomy* coding (1–5) indicates the following: 1 = exclusively federal; 2 = largely federal; 3 = equally federal and regional; 4 = largely regional, and 5 = exclusively regional. The higher the score, the higher the borrowing autonomy, and vice-versa.

5 | OVERVIEW OF ETHIOPIA'S FEDERAL DESIGN

One of the consequences of adopting federalism in Ethiopia is a constitutionally affirmed fiscal decentralization. Based on the dual federal principle, the constitution of Ethiopia declares that the two tiers of government bear all financial expenditures needed to discharge their respective responsibilities. When functions are delegated, a delegating party covers any costs required to conduct any delegated function. To that effect, it distributes taxation powers between the federation and the regions. It provides some exclusively federal, solely regional, and shared taxation powers (Articles 96–98, FDRE Constitution 1995).

The center has exclusive taxation powers on subjects such as foreign trades, national lotteries, monopolies, licenses it issues, and federal stamp duties. In come from air, rail, and sea transport services and employment income tax of the federal and international organizations are also federal mandates (Art. 96). The regions have constitutional tax powers on their employees, private enterprises, land use tax, and cooperative and private farmers. Regional sole proprietors, transport services, private houses rental, firms they own, mining, royalties, land rentals, and regional license are also regional subjects (Art. 97).

The assignment of taxing powers in Ethiopia is broadly in line with the conventional fiscal federalism theory that prescribes the assignment of redistributive, stabilizing, and uneven taxes to the center and relatively immobile tax bases, such as local real estate, water, and sewerage services, to subnational governments

(Oates, 1972, 1999) Nonetheless, Ethiopia's tax power division is slightly strange as it is based on taxpayers' category rather than types of business. Besides, the regional exclusive tax domain is taxes with small proceeds (World Bank, 2000, pp. 16, 2010, p. 19).

The federal constitution has no list of concurrent functional competencies. Concerning taxation, however, it contains a list of concurrent powers on three tax bases: (1) jointly owned enterprises; (2) enterprises and dividends payable to shareholders; (3) large-scale mining, petroleum, and gas operations and their royalties (Art. 98). The constitution envisions the emergence of new revenue sources not enumerated in the federal pact. Consequently, it dictates that the House of Federation (HoF) and the House of Peoples Representatives shall, in a joint session, determine by a two-thirds majority vote on the exercise of powers of taxation that have not been expressly provided for in the constitution (Art 99). This means an undesignated tax may become exclusively federal, exclusively regional, or concurrent upon the outcome of a joint session of the two houses. Further, the center may give financial support, assistance, and loans to the regions (Art. 94). Article 62(7) dictates that the HoF shall determine the division of proceeds derived from joint sources and the federal grants flowing to the regions.

A close examination of Ethiopia's fiscal federalism design implies that the country's fiscal power distribution hugely favors the center. The constitution designers apparently sought to put certain traps on regions to make them fiscally dependent on the center. For example, the constitutional assignment of lucrative tax sources to the center and regions' lack of residual fiscal powers means regions should depend on the federal transfers to discharge their mandates implying that the dominant force that framed the constitution wanted a strong federal government. Ethiopian federation is unique in that ethnonationalities, embedded in regions, have the right to self-rule, including secession. The regions have the constitutional power to make region-specific development and social policies. However, the center's competence on generic economic and development matters broadens the scope of the federal government to act on any issues, enabling centralization (Yimenu, 2022a, p. 254).

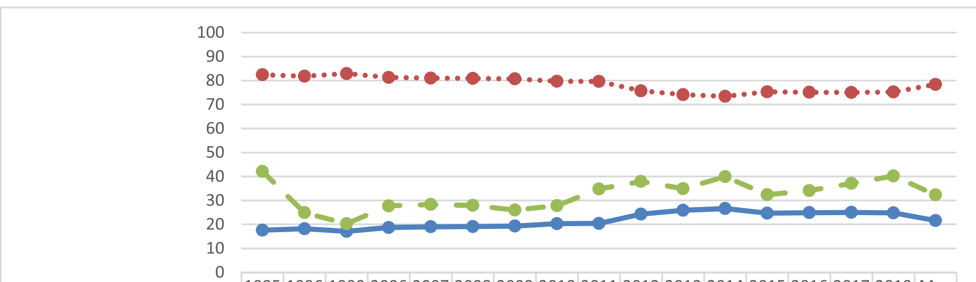
At birth, the federation constituted nine states, commonly called regions. Post-2019, the number of regions increased to 11 following referendums for regional status. The regions are highly different. While Oromia and Amhara combined constitute about 65% of the federation's population, regions such as Afar, Benishangul-Gumuz, Harari, and Gambella each host less than one percent of the country's population (Yimenu, 2022b, p. 8). While some regions' economic structure is relatively urbanized and industrializing, the economic structure of regions such as Afar and Somali are dominated by pastoralism. Irrespective of such striking variation, all regions have equal rights and powers under the constitution.

The Ethiopian Peoples Revolutionary Democratic Front (EPRDF), a coalition of four parties from the regions of Amhara, Oromia, Tigray, and Southern Nations Nationalities and Peoples (SNNP), dominated the federation. The coalition members ruled their respective regions until they were dissolved in 2019 when Abiy Ahamed formed Prosperity Party (PP) by merging all regional parties except the Tigray Peoples Liberation Front (TPLF)-Tigray ruling party. The TPLF was the creator of all regional parties and the dominant core in the dominant coalition, EPRDF. The remaining regions, known as 'developing,' were ruled by their regional parties affiliated with the EPRDF.

6 | MEASURING FISCAL DECENTRALIZATION IN ETHIOPIA

6.1 | Regional own-source revenue

The regions have a formal competence to impose and collect taxes from their revenue sources and get their shares from joint revenue sources. Practically, the federal government collects the lion's share of revenues. Regional revenue share gradually increased to about 25% in 2019/20 from 17.6% in 1994/95. The mean revenue share of the regions from 1995/96 to 2019/20 was 21.6%, respectively (Figure 1). In contrast, regional expenditure share has risen from



	1995/96	1996/97	1999/00	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2019/20	Mean
Regional R share	17.6	18.2	17.1	18.7	19	19.1	19.3	20.3	20.4	24.3	25.9	26.6	24.7	24.9	25	24.8	21.6
Federal R share	82.4	81.8	82.9	81.3	81	80.9	80.7	79.7	79.6	75.7	74.1	73.4	75.3	75.1	75	75.2	78.4
Grants	42.1	24.9	20.3	27.7	28.3	27.9	26	27.8	34.8	37.9	34.9	39.9	32.4	34.1	37.1	40.2	32.3

FIGURE 1 Revenue share and grants. *Sources:* Own compilation from various years' of budget data, UNICEF (2017, 2018a, 2018b); and World Bank (2000, 2020a, 2020b). R, Regional R share, regional revenue share; Federal R share, federal revenue share, and Grants, grants as a proportion of the federal government budget.

39.7% in 2000/01% to 58.3% in 2016/17, which means regions rely on federal transfer to fill the deficit (MoFEC, 2018, p. 70). The trend is decentralization of expenditure without corresponding tax revenues.

The proportion of own-source revenue was 28.8% in 2019/20, about 10% increase from 1995/95 (Table 1). Regional own-source revenue in Ethiopia is greater than that of subnational units in Uganda (5%), Kenya (10%), Nigeria (15%), and South Africa (20%) (Hobdari et al., 2018, p. 23).

The analysis of regional own-source revenue highlights a clear variation across regions, with Oromia and Tigray showing the highest rates at 40.8% and 36.6%, respectively. On the other hand, the regions of Benishangul-Gumuz, Somali, Afar, and Gambella have consistently recorded below-average own-source revenue, falling short of the regional mean (as shown in Table 1). This disparity is further emphasized by a large standard deviation of 9, indicating a significant divergence in the proportion of own-source revenue across regions. This finding suggests that there may be underlying factors influencing these regions' ability to generate revenue from their own sources, which could potentially limit their capacity to fund and sustain development initiatives independently. This suggests further investigation, which this article does in the later section by identifying and explaining the factors contributing to the variation in own-source revenue among regions to enable the development of targeted policy interventions to address this disparity.

6.2 | Tax autonomy

Another category of fiscal decentralization is regional tax autonomy, which is the regions' control over decisions regarding their tax bases and tax rate (Blöchliger & King, 2006). The constitution empowers the regions to determine the base and rates of taxes within their jurisdiction. However, in practice, the regions used federal tax laws to levy and collect regional taxes (Chanie, 2007, p. 179; Lencho, 2010, p. 43). Consequently, tax rates and bases are similar across the regions, though differences across regions require heterogeneous taxation. Until 2008/09, the determination of the bases and rates of major regional taxes was exclusively federal in defiance of the constitutional clause that grants tax autonomy. Post-2008/09, however, regional control over their taxes slightly improved as regions started deciding the base and rates of taxes, such as agricultural income tax and land-use taxes (Lencho, 2010, p. 43). Thus, the regional tax autonomy score increased from 1 to 3 in 2010 (See online Supplemental file S1).

As regions started exercising their formal prerogatives regarding agricultural income tax and land-use taxes, the rates and bases of

TABLE 1 Regional own-source revenues.

	Own-source revenues										
Year	B-G	Afar	Somali	Gambella	Amhara	Oromia	SNNP	Tigray	Harari	Mean	STD.
1995/96	5.9	9.7	24.6	5.8	18.6	29.7	21.5	28.9	18.8	18.2	8.7
1996/97	6.8	22	23	8.7	19.1	30.1	23.1	26.6	19.6	19.9	7.2
1999/00	10.6	4.2	12.3	7.4	20.7	35	23.3	28.2	17.4	17.7	9.5
2006/07	9.5	15.4	9.2	9.4	18.9	21.2	16.1	29.3	26.8	17.3	7
2007/08	15.4	8.5	8.1	11.7	14.2	15.8	15.7	26.7	21.2	15.3	5.6
2008/09	15.7	15	4	13.6	20.6	44.3	11.8	38.4	24	20.8	12.2
2009/10	15.8	14	13	13.2	18.6	45.5	13	41.4	20.3	21.6	11.9
2010/11	17.3	16	11	14.9	23.4	48.8	19.8	39.8	25.4	24	11.8
2011/12	17.8	14	10	13.5	23.4	40.4	11.5	41.1	19.1	21.2	11.1
2012/13	19.2	16	16	15.7	23.8	42.4	19.2	40.3	23.7	24	9.7
2013/14	23	19	20	19.5	23.3	53.4	24.7	38.7	26.3	27.5	10.7
2014/15	24.2	17	22	19	28	49	27.2	37.4	26.3	27.8	9.3
2015/16	24.1	17	22	19.5	27.4	50.3	27	40.6	27.5	28.4	10
2016/17	19.6	17.9	20.5	19.8	25.9	48.9	27.5	38.2	26.7	27.2	9.6
2017/18	23.2	17.5	17.4	19.7	28.3	48	26.6	44.2	27.2	28	10.4
2019/20	23.4	18.2	17.8	19.6	29.1	49.8	28.2	45	28	28.8	10.8
Mean	17	15.1	15.7	14.4	22.7	40.8	21	36.6	23.6	23	9

Abbreviations: B-G, Benishangul-Gumuz.

Sources: Own compilation from various years' of budget data, UNICEF (2017, 2018a, 2018b); World Bank (2000, 2020a, 2020b).

these taxes started to vary across the regions post-2008/09 (HoF, 2017, pp. 16–19). Except for these taxes, the center decides the bases and rates of main regional taxes constituting about 70% of the regional own-source revenues, although these taxes are de jure regional subjects (Table 2). Regions translate federal tax laws into their respective working languages, and no region ventured to adopt tax laws to its need. Consequently, there is no variation across regions regarding tax autonomy.

TABLE 2 De jure and de facto powers over major regional taxes.

Major taxes	Contribution to own-source revenue (OSR) in percent	Tax base & tax rate determination	
		De jure	De facto
Payroll tax	36.5	Regional	Federal
Value-added tax	17.2	Regional	Federal
Business income tax	12.7	Regional	Federal
Turnover tax	5.4	Regional	Federal
Agricultural income tax	1.7	Regional	Regional
Rural land-use tax	1.5	Regional	Regional

Source: HoF, 2017.

6.3 | Federal grants

Federal grants, known as regional subsidies in Ethiopia, represented about 32.3% of the federal budget (Figure 1). The territorial distribution of federal grants is based on a formula prepared by the House of Federation. Population, level of development, and revenue-raising effort are the main variables used to construct the formula. The number of variables used to frame the formula varied from 3 to 6, and the weights given to the variables also altered significantly. For instance, the importance of "population size" fluctuated from 30% in 1995 to 65% in 2004 (Yimenu, 2021, p. 144). The analysis of federal grants reveals a significant reliance on grants, which accounted for approximately 77% of the total regional revenues. However, the extent of this dependence varied considerably across regions. For instance, Oromia and Tigray appear relatively better, with grants constituting 60% and 64% of their respective revenues. In contrast, Afar, Benishangul-Gumuz, Gambella, and Somali are heavily reliant on grants, accounting for as much as 85% of their regional revenues (as shown in Table 3). This finding underscores the potential vulnerability of some regions to changes in the availability of federal grants, which could have significant implications for their ability to finance essential development programs and initiatives. The regional governments could explore alternative revenue sources and strategies to mitigate this risk and ensure sustainable own-source revenues.

TABLE 3 Federal grants.

	Federal grants											CG
Year	B-G	Afar	Somali	Gam	Amhara	Oro	SNNP	Tigray	Harari	Mean	STD.	All regions
1995/96	94.1	90.3	75.4	94.2	81.4	70.3	78.5	71.1	81.2	81.8	8.7	0
1996/97	93.2	78	77	91.3	80.9	69.9	76.9	73.4	80.4	80.1	7.2	0
1999/00	89.4	95.8	87.7	92.6	79.3	65	76.7	71.8	82.6	82.3	9.5	0
2006/07	90.5	84.6	90.8	90.6	81.1	79.8	83.9	70.7	73.2	82.8	7	0
2007/08	84.6	91.5	91.9	88.3	85.8	84.2	84.3	73.3	78.8	84.7	5.6	0
2008/09	84.3	85	96	86.4	79.4	55.7	88.2	61.6	76	79.2	12.2	0
2009/10	84.2	86	87	86.8	81.4	54.5	87	59.6	79.7	78.5	11.8	0
2010/11	82.7	84	89	85.1	76.6	51.2	80.2	61.2	74.6	76.1	11.6	0
2011/12	82.2	86	90	86.5	76.6	59.6	88.5	58.9	80.9	78.8	11.1	34.1
2012/13	80.8	84	84	84.3	76.2	57.6	80.2	59.7	76.3	75.9	9.7	37.3
2013/14	77	81	80	80.5	76.7	46.6	75.3	61.3	73.7	72.5	10.7	23.6
2014/15	75.8	83	78	81	72	51	72.8	62.6	73.7	72.2	9.3	20.6
2015/16	75.9	83	78	80.5	72.6	49.7	73	59.4	72.5	71.6	10	13.3
2016/17	80.4	86.1	77.5	80.2	74.1	49.1	72.5	61.8	72.3	72.7	10.5	11.2
2017/18	76.8	86.5	76.6	80.3	71.7	52	73.4	55.8	72.8	71.8	10.5	5.7
2019/20	76.5	86.1	75	80.1	70.2	50	73	55	71.8	71.3	10.8	6.2
Mean	83	85.7	83.4	85.5	77.3	59.1	79	63.6	76.3	77	9	9.5

Abbreviations: B, Benishangul-Gumuz; CG, Conditional Grants; Gam, Gambella.

Sources: Own compilation from various years' of budget data, UNICEF (2017, 2018a, 2018b); World Bank (2000, 2020a, 2020b).

6.4 | Conditional grants

Like most federations, the monies flowing from the federal government of Ethiopia to the regions are in two forms: conditional and unconditional grants. Ethiopia introduced conditional grants attached to specific sectors in 2011/12. Its regional allocation is based on the same formula used to allocate unconditional grants. The main sectors covered by the fund were education, health, roads, and agriculture (UNICEF, 2017). Conditional grants in Ethiopia unveil three main restrictive features: (1) their disbursement is earmarked; (2) they are monitored by the center on a project-by-project basis; and (3) they are accompanied by rigorous reporting (World Bank, 2016b, p. 13). Conditional grants accounted for approximately one-third of the total federal grants during the first 3 years. However, the proportion of conditional grants has declined steadily since 2014/15 and reached a low of 6.2% in 2019/20 (as shown in Table 3). This trend suggests that the regional governments have gained greater spending freedom in recent years and may have more autonomy in deciding how to allocate their resources towards development initiatives that best reflect their unique needs and priorities.

It is important to note that each region's proportion of conditional grants out of the total grants corresponds to the mean, as the same formula is used for block grants and conditional grants allocation. This means that there is no variation in regional autonomy in this fiscal category. The decline in the proportion of conditional grants over time is a positive sign for regional autonomy, as it implies that the federal government is gradually shifting towards providing more block grants, which can be used more flexibly by regional governments to meet their specific development needs. This trend also highlights the importance of strengthening local institutions and building the capacity of regional governments to manage their own finances effectively and efficiently.

6.5 | Regional borrowing

Regions have no authority, both de jure and de facto, to borrow from external sources because foreign currency decisions are exclusively federal (Art. 51(7) Constitution of the Federal Democratic Republic of Ethiopia, 1995). The constitution stipulates that regions can borrow from domestic sources under the conditions and terms issued by the federal government. Hence, the regions score 3 (means equally federal and regional) on domestic borrowing and 1 (means exclusively federal) on foreign borrowing (See online supplemental file). Regions can borrow only against future grants, that is, the Ministry of Finance deducts the loan amount from the grants the regions would receive in the future. Besides, the center decides the repayment and duration of the loan. Some regions made public sector borrowings to provide credits for farmers with the Federal Ministry of Finance consensus. For instance, out of the total agricultural credit scheme provided by the Commercial Bank of Ethiopia and the Development Bank of Ethiopia in 1996/97, the borrowing share of Oromia was the highest (56%), followed by Amhara (23%) and SNNP (18%) (World Bank, 2000, pp. 33–34).

While a quantitative analysis of regional borrowing is challenging due to a lack of statistical data, some insights can be gleaned from a review of relevant laws and regulations. First, it appears that the technical and political constraints imposed by the central government limit regional governments' ability to borrow from domestic sources. This could be due to concerns over regional debt sustainability and the potential impact on macroeconomic stability. Second, financially better-off regions, such as Oromia, do not have a strong incentive to borrow from domestic sources except for specific purposes, such as funding agricultural inputs or employment creation. This is because these regions may have other sources of revenue that allow them to finance their development programs without resorting to borrowing.

Third, in less developed regions such as Benishangul-Gumuz and Gambella, a lack of technical capacity to design projects, limited access to lenders, cumbersome procedures, and the risk of default pose significant challenges to regional borrowing. These factors could discourage potential lenders from providing loans to these regions, thereby limiting their ability to finance their development needs. Overall, the limited borrowing capacity of regional governments suggests that there is a need for the central government to provide greater support to less developed regions to build their capacity for project design and implementation, streamline borrowing procedures, and mitigate the risk of default. Such support could be in the form of technical assistance, capacity-building programs, and targeted policy interventions that promote access to credit and improve the investment climate in these regions.

7 | WHY CHANGES OVERTIME

The constitutional centralization of lucrative taxes such as foreign trade taxes, corporate taxes, and stumps indicate Ethiopia's centralized fiscal federalism design at the outset (World Bank, 2000, p. v). Nevertheless, some extra-constitutional factors generated changes over time.

First, regional tax administration capacity explains the temporal increase in regional own-source revenues. A report by World Bank (2016b, pp. 8–9) notes that from 2005/06 to 2014/15, while federal taxation increased less than GDP, regional taxation increased nearly twice as fast as GDP. This article also demonstrated that regional own-source revenues increased from 18.2% in 1995/96 to 28.8% in 2019/20 (Table 2). The World Bank (2016b, p. 9) identifies four possible causes for the growth of regional tax revenues: introduction of new tax bases, growth in tax bases, increased tax rates, and enhanced tax collection efforts. The regions did not introduce new taxes, tax rates were not increased, and no evidence suggesting growth in tax bases. Post-2010, regional own-source revenues improved due to enhanced revenue collection through the introduction of new tools and strengthening public tax education. The regional governments had every incentive to collect taxes more effectively because they could spend the revenues collected, and the initial efficiency was relatively low (MoFEC, 2018, p. 63; World Bank, 2016b, pp. 8–9).

Second, harmonization and standardization aimed at state-building have played centralizing roles. The federal government instructed the regions to harmonize and standardize their tax bases according to the center and consult the center on all new or changed taxes (Proclamation No. 57/1997 and Regulation No. 17/1997). Hence, the regions adopted centrally enacted uniform tax rates for regional taxes constituting more than 70% of own-source revenues. The center asserts that 'pursuing a harmonized tax policy across the country ensures macroeconomic stability' (MoFEC, 2018, p. 5). Tax harmonization violates regional autonomy enshrined in the constitution. However, it did not generate opposition from the regions (Lencho, 2010, p. 43).

The third factor is the economic objectives of improving regional fiscal management. For this purpose, the center enacted a law compelling the regions to provide regular reports on federal grant usage (Art. 56 Regulation No 190/2010). Later, in 2011/12, the center introduced conditional grants aimed at meeting the Millennium Development Goals (MDGs) and the Sustainable Development Goals (SDGs) (UNICEF, 2017). The aims of the grants were: 1) to enhance investments in vital sectors such as education, health, roads, and water and 2) to redirect regional spending from recurrent to capital expenditures (World Bank, 2016b, pp. 11–13). Consequently, conditional grants increased regional capital expenditures from 25 to 40%. However, this was not okay for regions because a completed capital project requires a recurrent budget to provide services. As today's capital expenditures generate tomorrow's recurrent expenses, maintaining a balance between the two is essential. The grants were practical tools to achieve the two purposes mentioned above. One may argue that money with more duties can be more attractive than no money and conditions. However, conditional grants were not additional money. Instead, the funds were tied grants accompanied by a drop in block grants (World Bank, 2016b, 27–33).

Regarding borrowing, though the constitution allows domestic borrowing, federal law, which empowers the Ministry of Finance to determine the amounts borrowed by a region, restricts regional borrowing (Proclamation No. 648/2009). The federal leaders' conviction of not risking economic stability by allowing regional borrowing was the main reason for passing such a deterring law. Since 2016, the federal government has adopted a more stringent government borrowing policy (IMF, 2018).

8 | EXPLAINING OWN-SOURCE REVENUE VARIATION ACROSS REGIONS

Now let us discuss the factors explaining variation among regions in the proportion of own-source revenues presented in the previous section. Ethiopian regions are divided into developing and developed. Developing regions, consisting of Afar, Benishangul-Gumuz, Gambella, and Somali regions, lack capacity and infrastructure, while others are better off. Developing regions face several challenges. *First*, the regions have severe weather conditions (high temperature, low rainfall, and desert), leading to a lack of water affecting agriculture and pastoralism, high living costs, and administrative expenses to pay for higher salaries and hardship allowances for civil servants. *Second*, the regions occupy peripheral areas far from the federal capital bordering neighboring countries, which limits their access to market, technology, and infrastructure.

Third, sparse population settlement that leads to high public service delivery costs. While the national average density is (121.5 persons/km2), the Gambella, Afar, Benishangul-Gumuz, and Somali regions' density is 13.6, 23.9, 19.8, and 21.8, respectively (CSA, 2014). Such a low density implies that these regions incur a high cost of public service delivery. *Fourth*, the regions faced marginalization during the imperial and the *Derg* regimes, which limited their participation in national politics, and led to low socio-economic development (Gebre-Egziabhere, 2018, pp. 6–9). *Fifth*, the regions are affected by internal ethnic/clan-based conflict and international conflicts with rebels and insurgencies operating in neighboring countries. Due to these challenges, the regions lacked administrative capacity, infrastructure, investment, and an educated workforce compared to other regions.

Developing regions are not very unequal in per capita income with developed regions, but they are very different and do not have access to similar infrastructure and public services (World Bank, 2016a, p. 11). Such differences resulted in de facto fiscal capacity variation despite de jure symmetric federalism. For example, in 2019/20, the average own-source revenue of all regions was 28%. The mean of developing regions was 15.3%, while developed regions' own-source revenue was 22.6% (Table 1). Similarly, about 85% of developing regions' income was federal grants, while the proportion is 76% in developed regions (Table 3).

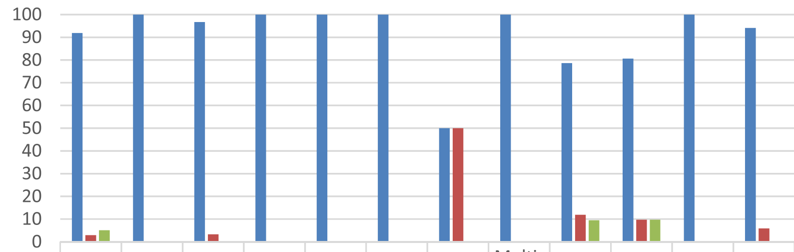
Administrative and infrastructural capacity differences generate fiscal capacity variation because tax administration requires institutional and human capacities, which the developing regions lack (Fiseha & Ayele, 2017, p. 250; Young, 1999, p. 344). For instance, a shortage of trained staff and staff turnover hindered developing regions' revenue administration (World Bank, 2016a, pp. 4–5). Besides its impact on own-source revenues, the impact of lack of capacity is also noted in project implementation and expenditure management. Developing regions themselves recognize their capacity gap. For instance, the Somali region admitted it did not have the capacity to implement some of its programs, such as water projects, and temporarily delegated it to the federal Ministry of Agriculture. The ministry helped the region by transferring enough expertise, and the region was enabled to take things back into its own hands (World Bank, 2016b, p. 20).

While regularly visiting investments in developing regions was challenging, investors in relatively developed regions of Amhara, Oromia, SNNP, and Tigray were more likely to be supervised because of better regional capacity (Keeley et al., 2014, p. 20). Most investors who received licenses to invest in developing regions could not start operations because the regions lacked qualified personnel to conduct follow-ups and supervision (MoFEC, 2018, p. 55). Hence, developing regions perform poorly in converting licensed projects into operations (Figure 2). A low conversion rate means the regions could not generate tax revenues from such investments, widening the fiscal gap (MoFEC, 2018, p. 55). Regarding borrowing, while developed regions, such as Oromia and Amhara, could borrow from domestic sources, developing regions struggle as they lack the expertise to design feasible projects and financial institutions' reluctance to lend money because of the risk of default loans.

Another difference between developed and developing regions generating fiscal capacity variation is socio-economic development inequality. Though data are scanty, I highlight differences among developed and developing regions using selected socio-economic indicators. Regions with many urban centers have better tax revenue potential, which is a disadvantage for developing regions as they have very few urban centers (World Bank, 2000, pp. 40,70). Developing regions have higher recurrent expenditure than the national average and lower capital expenditure than the national average (Gebre-Egziabhere, 2018, pp. 16–17). The higher recurrent spending is due to these regions' harsh environment, sparse population, and fragile security situation because they allocate a lot of money for hardship allowance, logistics, and service provision in sparsely populated areas. As budgets are channeled to recurrent spending, capital expenditures are lower than the national average. Lower capital disbursement means lower public investment in development projects, which affects the flow of private investment, sustains existing development variation and leads to lower own-source revenues.

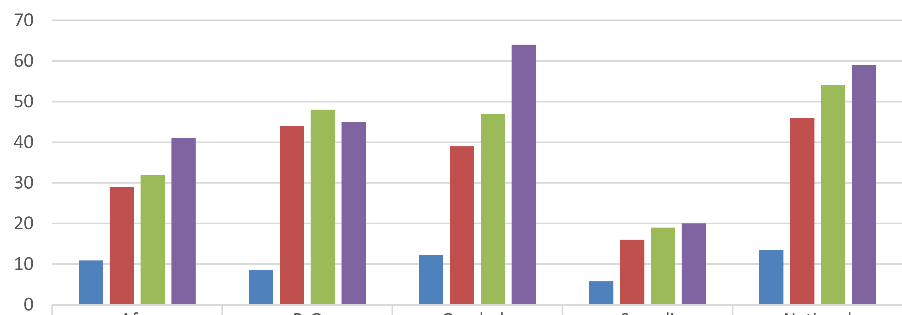
Regarding infrastructure, for instance, developing regions' road density is lower than the national average for all selected years (Figure 3). An inadequate infrastructure limits private investment, leading to small tax revenues. The public and private investments are highly concentrated in Addis Ababa and a few developed regions such as Oromia, Amhara, and Tigray.

When we take public investment distribution, from 1992 to 2012, only 3% of public investments were made in developing regions. During the same period, emerging regions' combined share of



	Addis Ababa	Afar	Amhar a	B-G	Dire Dawa	Gamb ela	Harari	Multir egiona l	Oromi a	SNNPR	Somali	Tigray
Preemplimentation	91.9	100	96.7	100	100	100	50	100	78.6	80.6	100	94.1
Implementation	2.9	0	3.3	0	0	0	50	0	11.9	9.7	0	5.9
Operational	5.1	0	0	0	0	0	0	0	9.5	9.7	0	0

FIGURE 2 Licensed Investment Conversion Rate in 2016/17. *Source*: MoFEC (2018, p. 56). B-G, Benishangul-Gumuz.



	Afar	B-G	Gambela	Somali	National
1998	10.9	8.6	12.3	5.8	13.5
2009	29	44	39	16	46
2012	32	48	47	19	54
2014	41	45	64	20	59

FIGURE 3 Road network (density in '000 km^2). *Source*: Ethiopian Road Authority (2015).

TABLE 4 Distribution of investment (1992–2018).

Region	Public investment			Private investment		
	Project (%)	Capital (%)	Employment (%)	Project (%)	Capital (%)	Employment (%)
Addis Ababa	24.0	26.1	38.5	41.2	24.6	32.3
Afar	1.6	0.2	0.1	0.5	1.5	0.9
Amhara	10.6	10.4	11.8	11.0	9.6	13.2
B-G	1.2	27.0	0.6	1.8	1.2	0.9
Dire dawa	3.3	0.3	3.3	2.9	3.4	2.0
Gambella	0.8	0.1	0.2	1.1	2.1	0.9
Harar	0.5	0.2	0.1	1.0	0.2	0.5
Multi-regional	19.3	9.2	7.3	1.8	8.1	10.6
Oromia	21.2	5.0	5.2	24.6	30.5	25.5
SNNP	13.0	16.3	28.6	8.6	4.5	7.5
Somali	0.4	0.1	0.2	0.6	0.6	0.7
Tigray	4.1	5.1	4.1	4.9	4.0	4.9
Total	100	100	100	100	100	100

Note: Addis Ababa and Dire Dawa are chartered cities accountable to the federal government. Constitutionally, they have a status different from the regions. Hence, they are excluded from the analysis.
Source: Ethiopian Investment Commission (2019).

private projects was less than 5%, while their share of private-sector employment opportunities was less than 4% (Table 4). Considering that about 80% of subnational tax revenues and 67% of own-source revenues are from taxes that constitute personal income tax, business income tax, and VAT (World Bank, 2016b, p. 53), low private investment in developing regions is troubling.

Regional imbalances in the distribution of infrastructure, public projects, and private investments have contributed to lower own-source revenues recorded in less developed regions such as Afar, Benishangul-Gumuz, Gambella, and Somali. While these regions have seen some improvement in their development situation over the past 2 decades, there remains a significant gap between developed and developing regions in terms of access to investment and development opportunities. For instance, data from 2016/17 shows that the shares of Oromia, Tigray, and Amhara out of the total private investment projects licensed were significantly higher than those of the less developed regions. In contrast, the combined share of Afar, Gambella, and Benishangul-Gumuz was only around 3%. Furthermore, these less developed regions had no investment projects that were successfully converted into operations during that period, whereas Oromia and SNNPR saw over 20% of their investment projects successfully transformed into operations (MoFEC, 2018, pp. 53–55).

Given the historical marginalization these regions face and their potential for development, it is crucial to address the persistent inequality through targeted efforts to build infrastructure and human resource capacity. This could involve policies and interventions to attract private investment, improve access to credit, and provide technical assistance to support regional governments in project design and implementation. Additionally, the central government could provide targeted support to these regions to bridge the development gap and promote more balanced regional development across the country. By doing so, Ethiopia could unlock the untapped potential of these regions and achieve more inclusive and sustainable development outcomes.

9 | DISCUSSIONS

Fiscal federalism in Ethiopia was a reaction to demands of ethno-nationalities for self-rule, like low-income countries, such as Indonesia and Peru, that adopted fiscal decentralization to respond to pressures of prolonged centralized rule. Indeed, addressing ethnic conflict is the primary driver of decentralization in Sub-saharan African states such as Kenya, Nigeria, South Africa, and Uganda (Hobdari et al., 2018). Nevertheless, the states are different in that while Ethiopia, Nigeria, and South Africa implemented decentralization by adopting federal systems, Kenya and Uganda are devolved unitary states. Ethiopian federalism decentralizes expenditure mandates without a commensurate revenue source, as in Eastern Europe in the early 1990s and in Sub-saharan states such as Nigeria and South Africa. Though Ethiopian regions remarkably vary to merit the asymmetric allocation of competencies, like Belgium, Italy, and Span (Ahmad & Tanzi, 2002), its constitution is symmetrical.

Beyond the constitutional division of tax sources, other factors, such as the desire to boost national economic unification, and the need to bridge horizontal inequalities and redirect regional expenditure from recurrent to capital, have triggered the center to pursue fiscal centralization. Overall, regions in Ethiopia have limited fiscal competence as lucrative revenue sources are allocated to the center. Hence, regional own-source revenue form about one-fourth of subnational expenditures, as is the case in Kenya, Nigeria, South Africa, and Uganda. Ethiopia kept subnational borrowing under tight control by centralizing such decision-making. Most Sub-saharan states follow a similar approach, including fixing subnational governments' debt stock ceilings and imposing sanctions on subnational units if they ignore good fiscal practices set at the national level.

Regarding fiscal autonomy variation across regions, I expected regions ruled by parties not in the federal ruling coalition would have relative fiscal autonomy vis-à-vis other regions. However, this is not the case because regional parties lack the independence to assert regional autonomy, for instance, to determine their tax bases and rates. In this regard, Ethiopia corroborates Riker's (1964) theory regarding the impact of a centralized party system in creating a centralized federation. The country's formally decentralized party system neither enabled the regions to assert autonomy nor defy encroachment because the party system is decentralized only on paper, tendencies noted in Malaysia, Mexico, Nigeria, Russia, and South Africa (Dickovick, 2014; Ostwald, 2017; Sakwa, 2010; Wuhs, 2013), where the federal ruling party maneuver regional affairs regardless of party non-congruence and constitutionally affirmed subnational autonomy.

Similar to Sub-saharan African countries like Nigeria and South Africa, federal grants in Ethiopia are mainly unconditional. As no opposition has ever ruled a region, fiscally punishing opposition-ruled subnational units, as noted in Malaysia, Mexico and Nigeria, has not been observed in Ethiopia. Since the federal grant allocation is based on a complex formula, it might be difficult for the center to manipulate the system to benefit a specific region. However, region-specific issues such as capacity, infrastructure, and economic structure are vital forces shaping regional fiscal situations.

As theoretically anticipated, there is an association between regional capacity and regional own source revenue. In general, improved own-source revenue was caused by improved regional tax administration capacity. Regions with better infrastructure, educated staffing, and capacity have higher fiscal autonomy. In contrast, regions with low socio-economic development, which eventually means small own-source revenue and high dependence on federal grants, ultimately have less fiscal autonomy because grants are often attached to conditions that restrict spending freedom. Like Ethiopia, countries such as Kenya and South Africa faced subnational capacity issues during the initial phase of decentralization because of the mismatch between fiscal decentralization and subnational capacity. It was addressed gradually (Hobdari et al., 2018). Such practices suggest the relevance of step-by-step decentralization rather than suddenly shifting responsibilities to subnational units lacking tax administration and public finance management capacity.

Ethiopia is a good case illustrating the impact of geographic peripherality, harsh environment, and fragile security on subnational fiscal capacity. Peripheral regions are fiscally disadvantageous because they lack access to markets and infrastructure compared to core regions. Besides, conflict-hit regions suffer from a lack of private investment because of investment risks and high regional security expenditures that limit investment in public infrastructure. Environmental factors such as severe weather conditions mean high recurrent regional spending to cope with the weather condition, and hardship allowance would be high, lowering the subnational capital budget. Moreover, sparsely populated regions are disadvantageous because the cost of providing public services such as education, health, and water is high compared to densely populated regions, limiting public investment in other sectors.

Insights from Ethiopia reveal that regional differences in the distribution of public projects and private investments are vital factors determining regional own-source revenue. When private companies, investments, and public projects are concentrated in a few regions, it contributes to horizontal fiscal imbalance. For instance, in Ethiopia, investments are concentrated in Addis Ababa, Oromia, and Amhara, whereas Afar, Benishangul-Gumuz, Gambella, and Somali have neither industries nor high tax-paying companies (MoFEC, 2018). These differences are crucial as they reflect the extent of economic activity that determines the revenue base. Other things being equal, a broad revenue base is associated with higher own-source revenues.

Ethiopia reveals that federalism requires constituent units with a capacity sufficient to discharge their constitutional mandates. Lack of capacity can be the problem of all regions or more severe in some units than others. Though federalism can improve subnational capacity, this seems not straightforward as regions require several decades to catch up. When regions are patently divergent in socio-economic development and distribution of private and public projects, their fiscal capacity also varies. The gap between developed and developing regions could persist even after federalism to the extent that the latters' fiscal survival depends on federal grants.

Such outstanding regional development and capacity differences demand asymmetric constitutional design or phased decentralization. The implication is beyond fiscal issues. It affects weak regions' relations with the center because fiscal coercion can incentivize poor regions to comply with federal policies more than wealthy units, ultimately leading to informal autonomy variation among regions. In contrast, richer and developed regions may feel they are contributing excessively to the federation by funding weak and poor units without a proportionate representation in federal institutions or getting differential constitutional treatment, such as more autonomy. They may develop resentment that they would be better off without poor regions, affecting the implementation of federalism. Such phenomena can also be seen in states embracing federalism, such as Nepal, Somalia, and South Sudan.

10 | CONCLUSIONS

In conclusion, this article offers significant insights into fiscal decentralization in Ethiopia, contributing to both theoretical and empirical discussions on fiscal federalism and decentralization in developing states. By examining the variations in fiscal decentralization across regions and over time and identifying the factors that drive such differences, this study reveals the complexities of implementing fiscal decentralization in a young federation. A key finding is a significant variation in own-source revenue distribution across regions, which highlights the challenges facing developing states in effectively implementing fiscal decentralization. It also underscores the need to address regional disparities in infrastructure and private investment to promote regionally balanced economic growth.

Moreover, the insights from Ethiopia's experience have implications beyond its borders. Decentralization is often implemented in developing countries to address ethnic conflict arising from unfair resource distribution, and this study reveals that formal decentralization alone cannot address regional inequality unless region-specific situations are considered. Thus, targeted capacity building and policy interventions are needed to redirect investment in less developed subnational units, enabling them to benefit from decentralization initiatives and catch up with peer regions. The study emphasizes the need for careful analysis of regional dynamics and region-specific policy approaches to ensure a successful implementation of fiscal decentralization. The article reveals the importance of a nuanced assessment of fiscal decentralization beyond a mere constitutional framework. In the context of federalism studies, cross-regional variations offer ideal conditions for testing and refining existing theories or developing new ones. Hence, the article highlights the need for further research on the factors that contribute to successful decentralization in young federations, such as the role of regional governments, regional socio-economic contexts, and the impact of dominant parties on regional autonomy. Overall, Ethiopia's 25 years of fiscal decentralization experience provide valuable lessons for policymakers and scholars interested in promoting decentralization and sustainable economic growth in developing states.

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CONFLICT OF INTEREST STATEMENT

No conflict of interest.

DATA AVAILABILITY STATEMENT

The data that support the findings of this study are available on request from the corresponding author. The data are not publicly available due to privacy or ethical restrictions.

STATEMENT OF POLICY RELEVANCE

This study offers valuable insights into the challenges of implementing fiscal decentralization in developing countries. It highlights the importance of region-specific interventions to address regional disparities to implement decentralization effectively. The study emphasizes the need for a nuanced assessment of factors contributing to successful decentralization that policymakers should consider to inform the design of effective decentralization initiatives.

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Additional supporting information can be found online in the Supporting Information section at the end of this article.

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