

# The political economy of fiscal transfers

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## RESEARCH ARTICLE

# The political economy of fiscal transfers: The case of Ethiopia

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## Abstract

This article examines the political economy of fiscal transfers in Ethiopia. Utilising an original data set spanning 1995–2020, as well as interviews and document analyses, the article illustrates how different factors interact to shape the distribution of grants. Statistical analysis indicates that population size is critical in determining regional grant shares. However, the analyses reveal a pattern of ethno-regional favouritism in grant distributions during the early stages of Ethiopian federalism. During that period, opaque and centralised decision-making processes, coupled with the dominant influence of the Tigray People's Liberation Front in the federal government, resulted in grant distribution deviating from principles of fiscal equity. Over time, this evolved into more fluid forms of negotiation influenced by intra-party competition, dynamics of bargaining between the central and regional authorities, and regional assertiveness, collectively shaping the allocation of grants alongside the grant formula. The analysis highlights how economically and politically marginalised regions are disadvantaged, especially when their population is small. The absence of an independent grant agency means that political considerations continue to affect seemingly formula-driven allocations. The Ethiopian case underscores how intra-party bargaining and alignment along ethnic and regional lines undermine the effectiveness of formula-based grant allocations in the absence of an independent and empowered grant agency.

## KEYWORDS

decentralisation, Ethiopia, federalism, grant, region, transfer

## 1 | INTRODUCTION

Decentralisation has emerged as a prevailing strategy for public sector reform worldwide (Smoke, 2015). Among the various decentralisation models, fiscal decentralisation stands out as a pervasive approach. Integral to federal systems, fiscal decentralisation involves devolving spending responsibilities and revenue-raising powers to subnational governments. However, while transferring revenue authority to these sub-national units, federations often encounter vertical fiscal

imbalances wherein constituent states face budget deficits as their expenditure obligations exceed their revenue capacities (Boadway et al., 2011; McLure, 1999; Oates, 1972, 1999). Therefore, fiscal transfers from the central government to subnational units are crucial for addressing these vertical fiscal gaps. These transfers also play a critical role in addressing horizontal imbalances, the differences in revenue capacity among subnational units (Bird & Smart, 2002, p. 900).

A growing body of research suggests that the allocation of such intergovernmental grants is frequently shaped by institutional

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dynamics and political considerations beyond just objective economic criteria (Acosta & Tillin, 2019; Calvo & Murillo, 2004; Evans, 2005; Gervasoni, 2010; Gordin, 2006; Oates, 2005; Weingast, 2009). However, most existing studies focus on established, higher-income federations with sound fiscal frameworks. In contrast, this study investigates the political economy of federal grants in a multiethnic African state. In this regional context, subnational fiscal capacities are generally limited (Hobdari et al., 2018; Masaki, 2018), necessitating heavy reliance on transfers from central governments to fulfil expenditure responsibilities. This vertical fiscal imbalance creates distinct political economy dynamics shaping grant allocation processes.

This study contributes to the evolving discourse on the political economy of fiscal transfers by examining the case of Ethiopia, a vital nation from the Global South that embraced a multinational federal system in 1995. The 1995 Constitution transformed Ethiopia into a federation of nine regions primarily organised along ethnic lines. Per the Constitution, the federal government is mandated to provide fiscal grants to the regions to address both vertical imbalances and horizontal socioeconomic inequalities across regions. Until 2019, this Ethiopian federal system operated such that each region was governed by its own ethnic-based regional party, while at the national level, the federal government consisted of a coalition of four regional parties known as the Ethiopian Peoples' Revolutionary Democratic Front (EPRDF). This tight ethno-regional alignment of ruling elites in the federal ruling coalition suggests that the distribution of fiscal transfers may have been influenced by political considerations tied to ethno-regional favouritism and power dynamics.

Crucially, Ethiopian regions rely heavily on federal grants, which account for over 75% of their expenditure funding (Yimenu, 2023b). Given this high fiscal dependence, the interplay between politics and the grant allocation system was virtually inevitable. This article posits that regions likely competed for larger shares of the transfer pool, while the central government could strategically disburse grants to pursue specific political interests aligned with its ethnic power base across regions. Ethiopia's complex case of institutionalised multinational federalism, coupled with an intricate dominant party system built on identity-based regional parties, amplifies the possibility of politics influencing fiscal transfers. This makes it a critical case study for understanding how fiscal transfers unfold in younger, multiethnic federations across the Global South.

While existing studies on Ethiopia have delved into various aspects of fiscal transfer arrangements (e.g., Chanie, 2007a; Ishiyama, 2012; Keller, 2002; Moges, 2003), this article addresses a literature gap by assessing the evolution of Ethiopia's grant systems since the country became a federation in 1995. The analysis is enabled by an original dataset computed from official federal and regional government sources and other reliable sources like the World Bank. This novel dataset encompasses detailed information on grant allocation formulas, formula variables and their respective weightings, annual regional grant disbursements, the proportion of conditional grants, and regional own-source revenue trends spanning 1995–2020. Qualitative evidence generated through document

analyses and key informant interviews supplements and reinforces the quantitative data.

Utilising this longitudinal dataset and the qualitative evidence, the analyses reveal that demographic and political factors and dynamics have shaped Ethiopia's federal grant system evolution, often superseding objective economic criteria. The study fills a vital gap in the literature by providing a comprehensive assessment across 25 years. It sheds light on the complex power dynamics and ethnically-driven political re/alignments inherent in centre-regional fiscal relations in Ethiopia. The detailed empirical investigation unravels how the economic, institutional, and political forces interacted to shape federal grant flows over time. The findings demonstrate that the formal allocation principles have frequently been subverted by political incentives and interests, yielding varying implications across the regions.

The article unfolds in a structured manner. Section two conducts a literature review. Section three outlines the data and methods. Section four provides background on Ethiopia's federal model, party system, and legal framework for fiscal transfers. Section five analyses the political economy dynamics shaping federal grant allocation across regions. Section six analyses conditional grants in Ethiopia. Section seven discusses insights from the Ethiopian case within the broader literature. The final section provides conclusions.

## 2 | THEORETICAL FRAMEWORK

Countries have pursued decentralisation reforms over recent decades. This trend has been driven by initiatives aimed at better responding to diverse local needs by bringing government closer to citizens (Rodden & Wibbels, 2010). In regions with historically centralised governance models, such as Africa and the post-communist states, decentralisation was further advocated by donor agencies (Dickovick, 2014). Among the array of decentralisation policies adopted globally, fiscal decentralisation reforms are widespread (Hanif et al., 2020). In the final quarter of the 20th century alone, more than 75 countries decentralised fiscal responsibilities (Ahmad & Devarajan, 2005, p. 1). This embrace of fiscal decentralisation across the global North and South states reflects its recognised potential benefits (Boex & Simatupang, 2008, p. 436). Fiscal decentralisation encompasses the devolution of revenue-raising powers, expenditure responsibilities, and borrowing authority to subnational governments (Rodden & Wibbels, 2010; Yimenu, 2023b). Crucially, it also necessitates fiscal transfers from higher to lower government tiers, as the revenue capacities of constituent units in federations are typically insufficient to fully cover their expenditure obligations (Boadway et al., 2011; Rodden, 2004).

Fundamentally, realising the potential benefits of fiscal decentralisation hinges on well-designed and coordinated intergovernmental fiscal relations frameworks. These mechanisms govern the process of grant distributions and regulatory oversight of its usages (Boex & Martinez-Vazquez, 2005). In federations, in particular, establishing sustainable and equitable fiscal transfer arrangements is

crucial for achieving decentralisation objectives like equitable development and public service delivery across constituent units (Bahl & Bird, 2018; Boadway & Shah, 2011; Weingast, 2009).

Conventional theories of fiscal federalism consider fiscal transfers as tools to rectify economic imperfections. These theories posit that public decision-makers are benevolent agents seeking to maximise overall social welfare (Oates, 1972, 1999). However, more recent theoretical perspectives challenge this assumption. Instead, they suggest that political institutions create incentives that lead public officials to pursue goals that often diverge from pure welfare maximisation (Oates, 2005; Weingast, 2009). Consequently, contemporary literature portrays fiscal transfers not only as economic decisions aimed at addressing vertical and horizontal fiscal imbalances but also political ones to achieve political objectives. That said, there is no universal approach to designing transfer systems to bridge vertical and horizontal fiscal gaps. As Yilmaz and Zahir (2020) assert, the absence of a universal model reflects contextual differences across countries in specific policy objectives their transfers want to achieve. For instance, Germany's system prioritises compensating states with below-average tax revenues (Spahn, 2020), while US federal grants aim to support low-income populations (Chernick, 2020). In Switzerland, the primary goals are reducing cantonal financial disparities and ensuring minimum fiscal capacities (Burret et al., 2022).

Transfers can be either block grants (unconditional) or specific-purpose (conditional) grants (Boadway et al., 2011; Sham, 2007). Block grants provide regional governments relative autonomy in their spending decisions, while conditional grants come with specific conditions and usage restrictions imposed by the central government (Boadway & Shah, 2011; Oates, 1999, 2005). For instance, South Africa utilises an unconditional provincial transfer system to allow provinces more spending autonomy, though it requires central monitoring as a counterbalance (Savage, 2020). This means the type of grant itself has implications for regional autonomy. Given this autonomy implication, assessing the type of grants in Ethiopia is crucial. This necessitates evaluating the relative balance between unconditional versus conditional transfers, as well as examining the nature and stringency of the conditions attached to earmarked grants.

Like the objectives and types of grants, the approaches to determining the transfer pool vary across countries. Broadly, these approaches can be classified into three categories (Bird & Smart, 2002; Yilmaz & Zahir, 2020). The first approach is the *fixed proportion* method, wherein transfers are established as a pre-determined percentage of the central government's revenues. This method offers a level of stability and predictability, as funds are allocated consistently over time. However, it may lack the necessary flexibility to address evolving fiscal needs or regional disparities effectively. The second approach, the *ad hoc basis*, involves determining grants like other federal government budgetary expenditures. In this approach, the central government sets aside a specific amount of money to distribute as grants. Typically, these grants target specific sectors aligning with the central government's priorities

(Pasachoff, 2020). This approach offers flexibility but also introduces instability. Political factors or short-term budget concerns may influence grant amounts, risking long-term planning. This approach might be problematic in federations like Ethiopia, Nigeria, and South Africa, where subnational units heavily rely on federal transfers (Hobdari et al., 2018; Yimenu, 2023a, 2023b).

The third approach is the *formula-driven* method, in which transfers are determined through a formula that ties grants to specific subnational contexts, such as expenditures and population. This approach seeks to balance stability and flexibility by providing formula-based predictable transfers while allowing adjustments to accommodate varying needs. However, its effectiveness hinges on the availability of updated data, a challenge particularly prevalent in many developing countries. For example, Wetzel and Vinuela (2020) critique Brazil's grant system, citing its reliance on outdated indicators. Similarly, India's Finance Commission has faced criticism for its grants approach due to arbitrary criteria and economic assumptions (Zahir, 2020). Given the substantial reliance of Ethiopian regions on federal grants (Chanie, 2007a; Yimenu, 2023b), the stability and flexibility of the grant system are crucial for regional planning and fiscal viability. Thus, exploring Ethiopia's approach to determining the transfer pool is imperative to analyse the fiscal transfer trends, predictability, and stability.

Following the determination of overall transfer pool sizes, the allocation of funds presents significant challenges. As Bahl (1999) notes, a crucial issue lies in determining not only the overall funding amount but also the method of allocation across subnational jurisdictions. While conventional fiscal federalism theory often advocates for formula-based distributions to ensure objectivity (Oates, 1972), in practice, allocation methods vary across countries (Boadway & Shah, 2011). This heterogeneity stems from competing policy objectives, including balancing equity concerns with efficiency incentives, as well as the central government's transfer-related political incentives (Rodden, 2002).

The amount of grants allocated to each subnational unit typically hinges on needs assessments the central government conducts. Factors such as population size, economic conditions, and the distinct challenges faced by each state are considered during this evaluation process. Sometimes, fiscal transfers are awarded through competition, where subnational units compete for funding. Allocation depends on the quality and feasibility of their proposals. In other cases, grants are allocated considering the past performance of states in adhering to grant requirements and utilising funds. Consequently, states with a proven track record may receive larger grants (Pasachoff, 2020).

Various factors influence the allocation of grants in federal states. One crucial factor is the alignment between the central and subnational government officials. For instance, research in Brazil indicates that subnational governments with leaders aligned with federal officials tend to receive more grants (Bugarin & Marciniuk, 2017; Ferreira et al., 2021). Historical analyses in the United States reveal the evolving dynamics of political and economic factors in grant allocation. During the 1930s, presidential priorities

significantly influenced grant allocation among US states. However, the influence of presidential factors waned over time, with Congressional influences and state government expenditures assuming greater importance between 1932 and 1982 (Wallis, 2018).

Electorate considerations, encompassing targeting swing constituencies, appeasing opposition strongholds, and rewarding supportive jurisdictions, influence grant allocation across jurisdictions (Grossman, 1994; Rangarajan & Srivastava, 2004). In Ghana, for instance, each district's share of grants generally increased by 8.4% during election years. However, the distribution favoured swing districts (Fumey, 2018). Similarly, research notes that subnational units with swing voters tend to receive larger grants in Sweden (Johansson, 2003). These observations align with Lindbeck and Weibull's (1993) "swing theory," which posits that transfers are strategically directed towards securing swing votes during elections. However, the applicability of this theory may vary depending on the political context. In settings where hegemonic parties dominate elections, as seen in Ethiopia (Yimenu, 2024), the incentives for allocating funds to swing constituencies may differ. Incumbents in such contexts may lack the motivation to allocate funds strategically, especially since opposition parties have minimal prospects of gaining power through elections.

Central parties may strategically allocate transfers as rewards for supportive constituencies (Boex & Martinez-Vazquez, 2005). This political favouritism results in larger grants for regions backing the ruling party. Gordin (2006) and Gervasoni (2010) further stress the influence of political factors in distributing transfers among Argentine provinces, highlighting the role of intergovernmental bargaining. Gervasoni (2010) suggests that fiscal transfers can be seen as rent paid by the central government to subnational units. Larizza and Folgar (2020) note how this exchange distorts equity principles in Argentina's transfer system, with rentier governments using grants for political patronage. Consequently, a bias favouring supportive and core regions perpetuates political dominance (Ardanaz et al., 2014; Gervasoni, 2010). From 1995 to 2019, when the Tigray People's Liberation Front (TPLF) dominated the EPRDF and controlled all regions through its members and affiliates, the Tigray region became the core region for the TPLF due to its constituency. This suggests that the TPLF may have disproportionately directed funds to its core region, which aligns with reward theory.

The "fiscal appeasement" approach offers an alternative perspective, positing that transfers are utilised to pacify non-supportive districts or appease separatist regions, as evidenced by the Nigerian central government's attempts to use grants to mitigate conflict in the Niger Delta (Omeje, 2006). Similarly, Treisman (1996) highlights Russia's fiscal appeasement policy in the 1990s, which aimed to mollify ethnically non-Russian republics. These cases illustrate the potential use of transfers to uphold political stability and territorial integrity. Conversely, federal ruling parties may also politicise grants to penalise opposition-ruled states, as observed in Mexico under the Institutional Revolutionary Party (PRI) (Diaz-Cayeros et al., 2003). Such instances include terminating grants to opposition-ruled states and increasing subsidies to federal party-governed states (Loh, 1996).

Similar practices of favouring core states while weakening opposition-ruled ones were observed during Nigeria's Second Republic (1979–1983) (Suberu, 2009, p. 78).

In the context of Ethiopia, Ishiyama (2012) observed that transfers from regions to districts in 2006 were intended to appease non-supportive districts. This observation holds merit because regions can easily identify non-supportive districts within boundaries. However, at the federal level, such a division is less straightforward, primarily due to the overwhelming dominance of the EPRDF, which consistently secured over 90% of federal and regional seats (Yimenu, 2024). This level of political hegemony renders the selective appeasement of regions challenging. What can be more important is the intra-party politics within the federal ruling coalition, the EPRDF. Within the EPRDF, the TPLF held the core position (Vaughan, 2011; Yimenu, 2022), potentially leading to a bias in transfer allocation towards its region. However, this situation also fosters contention among other coalition members for larger grant shares.

However, it is crucial to acknowledge that non-political factors such as population size, level of development, and subnational expenditure needs are also vital in determining grant amounts (Boex & Martinez-Vazquez, 2005). However, even when a country uses an objective formula, the actual distribution may not always align precisely with the formula because other factors, including negotiation and bargaining, play roles (Acosta & Tillin, 2019; Boex & Martinez-Vazquez, 2005). As Sham (2007, 35–37) highlights, constitutional safeguards can provide some protection against political interference and protect regional interests. However, regional interest will still be affected if grant decision-making power is centralised. One alternative to address this issue is establishing a *joint grant body* comprising representatives from federal and subnational governments. Parker (2014) suggests that this approach fosters more inclusive decision-making, allowing for the consideration of both national and subnational interests. However, it may bring administrative complications and data coordination challenges.

In some federations, such as Australia, a *quasi-independent body* like the Grant Commission is entrusted with this task. A quasi-independent body can provide expertise and impartiality in transfer systems. Federations like Germany utilise *intergovernmental forums* to negotiate fiscal transfers, thereby promoting transparency and cooperation. The practice of intergovernmental agreements (IGAs) is particularly prevalent in Canadian federalism. IGAs result from political negotiations and can create legally binding obligations between the centre and provinces (Robson & Laurin, 2015). Intergovernmental forums aim to ensure that grant allocation decisions are based on the broader interests of national and subnational governments. However, the effectiveness of this mechanism relies on all parties' willingness to engage in constructive dialogue and compromise. Analysing these approaches underscores the importance of balancing data requirements, regional autonomy and participation, national government priorities and devotion to constitutional provisions to develop effective fiscal transfer systems. Ethiopia's arrangement empowers the House of Federation (HoF), the second chamber, regarding grants. Hence, investigating the impact of this arrangement and

grant-related legal frameworks on regional participation and grant decision-making is relevant.

### 3 | METHODS

I employed mixed methods, combining quantitative panel data with qualitative data generated through interviews and document analysis.

#### 3.1 | Quantitative methods

Quantitative data were generated from the reports of the Ministry of Finance and Economic Cooperation (MoFEC), Regional Bureaus of Finance and Economic Cooperation (BoFEC), the World Bank (2000, 2020a, 2020b), UNICEF (2017, 2018a, 2018b), and HoF (2007, 2017). I relied on academic sources to fill some data gaps. I collected the following four types of *grant regime quantitative data* from the HoF's reports (HoF, 2007, 2017). (a) *Grant formula changes*. The article highlights multiple changes in grant formulas over time. Analysing these revisions reveals the underlying principles, priorities, potential biases, and the impact on regional grant shares. (b) *Variables of the formula*. By analysing the specific variables used in the formulas, I identify the factors considered important in determining grant allocations. This analysis offers insights into how the formulas address regional disparities, promote equitable development, and account for the unique needs of the regions. (c) *Weights of the variables*. Analysing the weights assigned to variables illuminates the relative priorities and policy considerations driving the grant allocation process. Furthermore, shifts in variable weights may indicate evolving power dynamics, bargaining processes, and political influences. (d) *Regional grant shares*. This data offers direct quantitative evidence of the outcomes of grant allocation. Analysing the evolution of these shares helps identify patterns, trends, and anomalies that may reflect factors beyond the official grant formulas.

Additionally, I computed the following four categories of data. (a) *The proportion of grants out of the total federal budget*. This data is essential to understand the significance of fiscal transfers within the broader federal budgetary context and assess the stability and predictability of grants. (b) *The proportion of conditional grants out of the total grants*. This data allows for examining to what extent the federal government has employed conditional transfers over time to influence regional expenditures and promote national objectives. (c) *Regional own-source revenues (OSR)*. This data is critical for assessing the degree of regional fiscal independence and analysing whether grant allocation compensates regions with limited revenues. (d) *Grants as a percentage of regional revenues*. This data quantifies the extent to which regions rely on transfers and highlights the potential implications of fluctuations in transfer allocations on overall regional fiscal sustainability.

Statistical techniques, such as correlation analysis and cross-tabulation, are employed to evaluate the relationships between

regional grant share and the following four '*grant-related regional variables*'. (a) *Regional Population*. Population size is a critical variable in determining regional grant shares. The study assesses the relationship between regional population and grant allocations to examine whether grant distributions have followed a demographic logic. (b) *OSR*. Regional revenue is a crucial factor in the grant system, as fiscal transfers are often aimed at helping the regions with limited revenues. Analysing the correlation between regional OSR and grant shares provides insights into the extent to which the grant system has compensated for horizontal fiscal imbalances. (c) *Access to potable water*. Access to water is one indicator of the level of development. By examining the relationship between regional access to potable water and grant shares, the article assesses whether more deprived regions have received transfers commensurate to their development needs, per constitutional intentions of ensuring equitable regional development. (d) *Road network density*. Road network density is also a proxy measure for development. Hence, analysing the correlation between road network density and grant allocations provides insights into whether regions with weaker infrastructure have received higher transfers to support their development needs.

#### 3.2 | Qualitative methods

I conducted 16 semi-structured interviews with key informants during the fieldwork from January to September 2019 as a part of a bigger project. Key informants include officials from the MoFEC, members of parliaments, and officials from the Afar, Benishangul-Gumuz, Oromia, Southern Nations Nationalities and Peoples (SNNP), and Somali Regional Bureaus of Finance and Economic Cooperation. Data from the interviews are primarily presented in direct quotes. The interviews were essential in gathering qualitative data regarding the following three dimensions of the politics of grants. (a) *Federal motives and rationales*. The interviews yielded qualitative data regarding the motives behind enacting grant laws, the introduction of conditional grants, and their impacts on regions. (b) *Center-region bargaining dynamics*. The interviews helped get data regarding centre-regional bargaining dynamics. By capturing perspectives from federal and regional officials, the study gained insights into power dynamics, negotiation strategies, and regional participation levels. (c) *Intra-party bargaining dynamics*. The interviews offered insights into intra-party bargaining dynamics in the context of ethno-regional alignments with EPRDF.

In addition to interviews, qualitative content analysis of documents, including the Constitution and federal grant-related laws and policies, is made. The aims are two. (a) By examining these legal documents, the article traces the evolution of formal grant institutions, shedding light on how the legal frameworks have shaped the fiscal transfer system over time. (b) By analysing constitutional provisions and principles, the article assesses the extent to which the grant allocation process has adhered to the goals of promoting equitable regional development.



#### 4 | OVERVIEW OF ETHIOPIA'S PARTY SYSTEM, FEDERALISM, AND GRANT LAWS

Upon overthrowing the *Derg* in 1991, the EPRDF ushered in a *de jure* federal system in 1995 by adopting a Constitution that established a federation of nine regions demarcated mainly along ethnic lines (Aalen, 2006; Yimenu, 2022). The Constitution granted these regions considerable rights, including secession (Art. 39, FDRE Constitution, 1995). The EPRDF itself was a coalition of four ethnically-based regional parties: Amhara National Democratic Movement, Oromo People's Democratic Organization (OPDO), Southern Ethiopian People's Democratic Movement and TPLF. This ruling coalition dominated Ethiopian politics until its dissolution in 2019. Operating as a unified front, the four members controlled the relatively developed regions of Amhara, Oromia, SNNP, and Tigray, respectively. However, the balance of power within the EPRDF was not equal. The TPLF, drawing from its historical prominence in leading the struggle against the *Derg* regime and its military strength, emerged as the dominant force within the coalition (Young, 1999, p. 321; Aalen, 2006, p. 250). As the originator of the EPRDF and chief architect of Ethiopian federalism, the TPLF positioned itself atop the federal power structure despite jointly governing as a coalition with the three parties.

In contrast to the four major EPRDF members, the regions considered "developing" or "peripheral" - Afar, Benishangul-Gumuz, Gambella, and Somali - were governed by their own respective regional parties that held only affiliate status within the EPRDF. The EPRDF designated these regions' ruling parties as mere "affiliates" rather than full members, claiming they did not meet the criteria for full EPRDF membership (Aalen, 2002, p. 83). As a result, these affiliate parties were excluded from key EPRDF decision-making bodies where national policies and priorities were formulated. Yimenu (2021, 2022) notes that the relegation of peripheral regions to affiliate status systematically excluded them from national politics, manifesting the continuity of the regions' historical marginalisation despite Ethiopian regions' constitutionally declared equal status. The EPRDF members are highly different in the size of the population they represent and the parliament seats they control. However, the TPLF, with only 8% of federal parliament seats (compared to Oromia 37.4%, Amhara 28.8%, and SNNP 25.6%), held key leadership posts, such as the EPRDF chairman, Premiership, Foreign Minister, National Intelligence, and Chief of Staff of the National army (Yimenu, 2021, p. 53).

The TPLF's dominant position within the EPRDF began facing challenges after the passing of Meles Zenawi in 2012. As the former prime minister and chairman of both the EPRDF and TPLF, Meles had been a unifying force managing internal party dynamics. After his death, internal conflicts and power struggles within the EPRDF escalated, presenting formidable obstacles for the coalition to maintain its firm political control nationwide. Ultimately, these internal rifts - exacerbated by widespread protests - led to the resignation of Prime Minister Hailemariam Desalegn in 2018 and the subsequent appointment of Abiy Ahmed, a member of the OPDO, as the new EPRDF chairman and prime minister. Given the TPLF's

historical dominance, there is a likelihood that it had leveraged its control over fiscal resources like intergovernmental grants to favour its home region of Tigray during its period of preeminence. More broadly, the ethno-regional makeup of the EPRDF raises the possibility that the allocation of federal grants had been shaped by the alignment of ruling elites across the coalition's constituent parties, each pursuing ways to direct fiscal flows towards their respective ethnic regional bases.

Ethiopia's decentralisation aimed to enhance governance and foster balanced regional development by devolving fiscal and administrative powers from central to subnational governments. The goal is to empower the regions with greater decision-making autonomy, resource access, and accountability to their respective communities (Gebre-Egziabhere, 2018; Negussie, 2015; World Bank, 2013). Under Ethiopia's Constitution, regional governments have broad responsibilities, such as agriculture, education, health-care, road construction, regional police, regional civil service, security, and culture. However, despite these constitutional mandates, regional funding has not adequately matched the expanding responsibilities (Chanie, 2007a; Mesfin & Teka, 2023; Yimenu, 2023b).

The Ethiopian Constitution lays out a framework for fiscal federalism and expenditure responsibilities. While it does not explicitly delineate these expenditure assignments, Article 94(1) stipulates that both levels of government are responsible for financing their designated functions. Furthermore, the same article specifies that the delegating party will bear the financial costs of delegated functions unless agreed upon. While this arrangement highlights the importance of financial autonomy and accountability, the absence of provisions for expenditure assignments underscores the need for both tiers of government to bear their financial burden arising from assigned functions. This implies that the delegating body should fund delegated functions, and if the services provided are inadequate, the regional government will not bear sole responsibility.

The Constitution also enshrines the rights of Ethiopian citizens to access public services and economic opportunities, which provides the rationale for fiscal transfers. Article 41(3) declares that every Ethiopian has the right to equal access to publicly funded social services. Moreover, Article 90(1) states that policies shall aim to provide all Ethiopians access to public health, education, clean water, housing, food, and social security to the extent the country's resources permit. Similarly, Article 89(2) declares that the government has the duty to ensure equal economic opportunities and promote equitable wealth distribution among Ethiopians. Furthermore, Articles 89(4) and 92(2) highlight additional objectives of fiscal transfers. Article 89(4) stipulates that the government shall provide special assistance to regions least advantaged in development, while Article 92(2) requires the centre to provide emergency, rehabilitation, and development assistance. These provisions underscore that fiscal transfers aim to correct historical development injustices, reduce horizontal fiscal disparities, ensure a standardised service across regions, and bridge vertical fiscal gaps.

The Ethiopian federal Constitution, in Article 62, bestowed upon the HoF the power to determine regional subsidies. However, this

constitutional mandate was disrupted just 2 years after the adoption of the Constitution. In 1997, a law enacted by the Council of Ministers (CM) transferred this power to the Ministry of Finance and Economic Cooperation (MoFEC) (Regulation No. 17/, 1997).<sup>1</sup> It was not until 2001 that the House of Peoples' Representatives (HPR) passed a law to restore the HoF's authority over subsidies (Proclamation No. 251/, 2001).<sup>2</sup> This notable act of taking away the constitutional power of the HoF through an executive act raises several critical points.

Firstly, it highlights the considerable power the federal government's executive branch wielded, enabling it to disrupt constitutional power distribution unilaterally. Secondly, the legitimacy of such a change is questionable, as it was made without following the proper constitutional amendment process set under Article 105 of the Constitution. Moreover, the lack of objection from the HoF or the regions is noteworthy. It shows the regions' and the House's lack of autonomy and independence, as their silence or acquiescence indicates a compromise of their constitutional power. The change contradicts the provision of the Constitution regarding the autonomy of different branches of government within the federal system.

The legal framework surrounding grants in Ethiopia encompassed various aspects of grant administration, such as notification, reporting, and audit procedures. The CM Regulation No. 17/, 1997 mandated that the federal government prepare and notify the regions of their subsidies within specified timeframes. Furthermore, Article 94(2) of the Constitution explicitly states that the federal government has the power to audit and inspect the equitable development of the regions. In line with the Constitutional provision, Proclamation No. 648/, 2009 reasserted the federal government's authority to audit the utilisation of grants by the regions, reinforcing the oversight mechanisms in place. These legal provisions outlined a clear procedure, emphasising the importance of timely notification, transparency, and accountability. However, the centre's audit and inspection powers can create tensions between central control and regional autonomy. While these mechanisms aim to ensure proper resource utilisation, they may also enable undue influence in regional decision-making processes.

The discussion of the legal framework reveals important issues. Firstly, laws governing subsidies imply that regions should provide information about subsidy needs and utilisation to the centre, with the federal government holding grant decision-making power. Secondly, during the early stages of the federation, the executive assumed a dominant role in the grant process, limiting meaningful regional participation. Lastly, the powers of the HoF regarding subsidies were enhanced post-2000 due to a proclamation that clarified and restored the House's powers, likely aiming to strengthen its role in ensuring fair and balanced grant distributions.

## 5 | CRITICAL ANALYSES OF THE POLITICAL ECONOMY OF FISCAL TRANSFERS IN ETHIOPIA

### 5.1 | Determination of the transfer pool and administration of grants

Article 62 of the Constitution, as discussed in the preceding section, stipulates that the HoF is authorised to determine the regional distribution of grants. However, it does not specify any formula for the proportion of federal revenue that should be allocated for subsidies. During the first decade of federalism, the process for drafting the distribution pool proposal was centralised and non-transparent. The Ministry of Finance and Economic Development collaborated with the Economic Affairs Department of the Prime Minister's Office to prepare the initial proposal (Chanie, 2007b, p. 215). Final approval was then granted by a special committee in the CM, chaired by the Prime Minister (Moges, 2003, pp. 130–33). The proposal would subsequently be endorsed by the full CM session before receiving ultimate authorisation from the HPR during its annual budget approval. This centralised process concentrated power at the federal level and precluded meaningful input from the regions. As a result, the allocation of grants was exposed to political considerations rather than being guided by an objective, transparent formula.

The process for determining the transfer pool after 2001 further centralised fiscal control. Rather than utilising a predetermined formula or negotiating with regional governments, each year's total transfer was determined at the MoFEC's discretion. This discretionary approach provided significant fiscal leverage to the federal government in its dealings with regions. While regional finance officials were brought into the process through meetings steered by MoFEC, their involvement was largely symbolic. As one regional finance director stated: "After MoFEC prepares the subsidy proposal, regional finance representatives attend meetings to discuss it. However, regional participation is merely informative, with no ability to modify the federal proposal".<sup>3</sup> Rather than actively shaping subsidy sizes, regional states were relegated to providing information about their respective budget deficits to inform the federal calculations. This institutional framework governing fiscal transfers enabled the central government to strategically wield its fiscal power over regions.

Once the MoFEC determines the transfer pool, the allocation among regions occurs in two main steps. First, the HoF distributes the subsidies to each region utilising a predetermined formula (discussed below). However, the total amount and regional shares still require final approval from the parliament. This parliamentary endorsement of the grant allocations coincides with the annual federal budget process, deliberately tying fiscal transfer decisions to overarching budgetary and central fiscal considerations rather than being primarily based on regional needs and circumstances. The federal budgeting process that shapes the grant allocations is guided by the Macro-Economic and Fiscal Framework (MEFF) prepared by MoFEC. As the regional

<sup>1</sup>Article 4(4) of Regulation No. 17/, 1997 states that the MoFEC is responsible for the "preparation of estimates of regional subsidies".

<sup>2</sup>Article 35 (1) of the proclamation states that "the house shall set a reliable and an ongoing improvement in the formula of subsidies which the federal government may provide to the states, based on the information it secures from relevant executive organs"

<sup>3</sup>A Director of Finance and Administration in the Oromia Region Bureau of Finance and Economic Cooperation, April 2019, Addis Ababa.



subsidies are legally considered a component of the federal budget (Art. 18, Proclamation No. 648/, 2009), their formulation and approval integrate directly with the MEFF and broader budgetary planning. Utilising the HoF's grant distribution formula and the MEFF projection, MoFEC provides regions with a 3-year estimate of their anticipated subsidies by February each year (MoFEC, 2018), allowing for some predictability in transfer amounts. The draft subsidies are then presented to the CM before receiving ultimate parliamentary approval. However, the actual disbursement of the grants to regional governments occurs annually in early July (UNICEF, 2017) based on the specific cash requirements the regions submit.<sup>4</sup>

Regarding the utilisation of fiscal transfers from the federal government, regional administrations faced centralised oversight and control mechanisms. Once disbursed, regional governments were required to adhere to the federal government's specific financial management and reporting rules when using the grants (Art. 68, Proclamation No. 648/, 2009). The federal authorities could audit and inspect how the regions spent the subsidies. Furthermore, a 2010 law allowed the Ministry of Finance and Economic Cooperation (MoFEC) to enter into contractual agreements with regional states. Under these agreements, regions were obligated to provide MoFEC with timely information about their overall financial operations and the specific usage of federal subsidies (Art. 56, Regulation No. 190/ 2010). From the federal government's perspective, as one official noted, "the contractual relationship is necessary to enhance effective and efficient fiscal management and improve fiscal accountability".<sup>5</sup> However, regional officials viewed these contractual arrangements as a way for the central authorities to control regions. One regional finance official stated that "since the federal body prepares the contracts and the regions have no influence over the conditions and content of the agreements, the contractual arrangement is used to control the regions tightly".<sup>6</sup> Thus, while intended to promote accountability, the laws enabling these federal contracts over subsidy usage limited regional autonomy. It is noteworthy that, before 2011, all grants were unconditional. The introduction of contractual arrangements and conditional grant requirements marked a shift towards greater federal oversight and control over regional fiscal affairs.

## 5.2 | Review of subsidies formulas: 1995–2007

While the federal government maintained discretionary control over determining the overall transfer pool, regions had more ability to influence the formula used to distribute grants among themselves. This allocation formula, designed by the HoF, considers various variables as outlined in Table 1. Compared to the centralised process for the transfer pool itself, regional participation was more meaningful in relation to the subsidy allocation formula, especially in recent years. As

one regional official stated: "Regions are consulted in the transfer formula approval through their members in the HoF. Besides, as regional presidents are members of the HoF, they can let their concerns regarding the subsidy distribution formula be heard during the House's sessions. The sessions sometimes entertain debates as some members raise issues regarding the weights of the variables employed in determining regional subsidies".<sup>7</sup> So, while regions had little substantive input in determining the total amount of funds available for disbursement each year, they had a better opportunity to shape how that pool would be divided among themselves through the HoF's deliberations on the allocation formula variables and weightings.

There was no fixed schedule for revising the regional allocation formula itself. However, the formula has undergone eight revisions since the establishment of the federation in 1995. According to the World Bank (2010, p. 43), the irregularity in timing for these formula updates stemmed from issues like lack of quality data, shortage of skilled personnel, and absence of an independent body dedicated to this task. During the federation's formative years, the Federal Ministry of Finance was in charge of designing and executing the allocation formula (World Bank, 2000, p. 30; 2010, 43). Over time, however, the HoF's role in this process improved and became more substantive (World Bank, 2010, p. 43). The specific variables incorporated into the subsidy formulas varied until 2007. However, after that point, regions' revenue-raising capacity and expenditure needs emerged as the two main factors determining each region's grant share. This post-2007 formula approach is discussed in more detail in the following section.

The variables incorporated into the subsidy allocation formulas included some straightforward metrics like population, territorial size, and poverty levels, for which data could be obtained from government statistical reports. However, other variables aimed at gauging regional development levels and revenue-raising efforts proved more complex and subjective in measuring reliably. The level of development was assessed through indicators including the regional road network, access to potable water, and health facilities. Revenue-raising efforts were measured using metrics such as revenue per capita, revenue growth rate, and the tax revenue ratio. The estimations of these indicators were controversial and subjective due to a lack of reliable data (HoF, 2007). As shown in Table 1, the number of variables used to frame the subsidy formula varied from 3 to 6. Moreover, each variable's specific weightings were significantly altered (Table 1). Generally, population size received the highest weight, followed by the development and revenue-raising effort.

## 5.3 | Post-2007 subsidies allocation approach

In response to criticisms about the subjectivity of variables and weightings used previously, the approach to the distribution of grants among regions underwent a major reform in 2007. This new methodology shifted away from emphasising specific demographic and

<sup>4</sup>An Official in the Ministry of Finance and Economic Cooperation, April 2019, Addis Ababa.

<sup>5</sup>An Official in the Ministry of Finance and Economic Cooperation, April 2019, Addis Ababa.

<sup>6</sup>An official in the Benishangul-Gumuz Region Bureau of Finance and Economic Development, July 2019, Asosa.

<sup>7</sup>A Director of Finance and Administration in the Oromia Region Bureau of Finance and Economic Cooperation, April 2019, Addis Ababa.

**TABLE 1** Variables and weights in the subsidies formulas (1995–2007).

Variable	Weight in percent					Average
	1995	1997	1998	2000	2004–2007	
Population size	30.0	33.3	60.0	55.0	65.0	48.7
Level of development	25.0	33.3	15.0	20.0	25.0	23.7
Revenue raising effort	20.0	33.3	15.0	15.0	10.0	18.7
Preceding year capital budget	15.0	0.0	0.0	0.0	0.0	3.0
Territorial size	10.0	0.0	10.0	0.0	0.0	4.0
Poverty index	0.0	0.0	0.0	10.0	0.0	2.0

Source: HoF (2007).

development variables. Instead, the calculation aimed to determine each region's budget deficit and subsidy needs more objectively based on estimations of their potential revenue capacities versus expected expenditure responsibilities (HoF, 2007). On the revenue side, the formula incorporated major regional revenues like agricultural income tax, land use fees, payroll tax, business income tax, turnover tax, livestock tax, and value-added tax. Collectively, these tax types accounted for 85%–90% of total regional revenues in the five years preceding the estimation. For expenditures, the key sectors factored into the calculations included general administration, primary/secondary education, technical and vocational training, public health, agriculture/rural development, water infrastructure, rural road construction/maintenance, urban development, and micro/small enterprise support. These expenditure categories constituted over 95% of total regional public spending (HoF, 2007). This technocratic reform aimed to minimise political lobbying and discretion that could distort the allocation. The World Bank (2010, 23–24) endorsed the changes as reducing partisan interference. Based on this post-2007 approach, the regional grant shares were revised again in 2012, with the portion for Amhara decreasing while the shares for less developed regions like Afar, Benishangul-Gumuz, Gambella and Somali increased notably (Table 2).

The current regional grant allocation formula, introduced in 2017, maintained the broader approach of estimating representative revenues and expenditures to determine each region's grant shares (HoF, 2017). However, a notable adjustment was made by omitting the livestock tax component that had initially been incorporated to assess regional revenue capacities in the 2007 and 2012 formula versions (HoF, 2017). This adjustment was prompted by concerns raised by developing regions with substantial pastoralist communities, such as Afar and Somali. These regions pointed out that despite their abundance of livestock, they faced challenges in collecting sufficient taxes due to capacity limitations and the nature of pastoralist livelihoods, making tax administration costs too expensive.<sup>8</sup> Moreover, there was apprehension that attempts to impose taxes on pastoralists could escalate hostilities between the government and armed pastoralist communities.<sup>9</sup>

The 2017 formula introduced a provision allocating 1% of the total subsidies to developing regions (Afar, Benishangul-Gumuz, Gambella, and Somali). This 1% set-aside aimed to provide additional support to address regional developmental disparities. However, under this new formula, the overall proportional shares for Afar, Benishangul-Gumuz, and Gambella decreased compared to their 2012 levels (Table 2). Counterintuitively, the formula unintendedly reduced the developing regions' absolute grant amounts from what they had previously received. To offset this, deductions of 0.92%, 0.3%, and 0.3% were made from the total allocations to Oromia, Somali, and SNNP regions, respectively and reallocated to the developing regions. Though officially framed as a voluntary redistribution (HoF, 2017, p. 83), evidence suggests these adjustments were driven by political pressure. As one regional official put it, “the adjustment was driven by pressure from federal leaders on members of the HoF through the party structure, following directives from the EPRDF central committee”.<sup>10</sup>

The unintended impacts of the new formula and the need for behind-the-scenes political bargaining to reconcile the outcomes underscores the challenges in depoliticising fiscal transfer systems. Ultimately, while adjusting the formula's parameters, the deeper political logic of centralised discretion and the predominance of intra-party politics over formal fiscal institutions remained intact in shaping Ethiopia's intergovernmental grant system. This reality demonstrates the inherent difficulties of insulating fiscal arrangements from politics where state institutions lack independence from the ruling party apparatus.

Despite improvements, the revised formula retains flaws. A study by the Forum of Federation (2020) indicates that the formula's calculations are overly complex for policymakers to comprehend, and it rewards regions with higher populations and land sizes rather than supporting developing regions as constitutionally intended. The evolution of regional grant shares across different formula periods reveals the complex dynamics of intra-party bargaining and federal-regional negotiations. As emerging regional governing elites grew bolder in asserting their interests, this prompted adjustments to the allocation formula and a gradual redistribution of shares away from the long-dominant Tigray region towards others, like Somali. The

<sup>8</sup>Former member of parliament from Somali region, May 2019, Addis Ababa.

<sup>9</sup>Former member of House of Federation from Afar region, June 2019, Semera.

<sup>10</sup>An official in the Oromia Region Office of the President, March 2019, Addis Ababa, and a member of HoF from SNNPR, April 2019, Hawassa.

TABLE 2 Regional share of federal subsidies.

Region	Regional share under different formula regimes								Mean	STD	CV	RR	P (%)
	1995–1996	1997	1998–1999	2000–2003	2004–2006	2007–2011	2012–2016	2017–					
Tigray	10.5	11.4	9.5	7.6	7.7	6.4	7.2	6.0	8.3	2.0	23.6	36.6	5.8
Afar	4.9	3.3	4.9	6.9	4.7	2.5	3.2	3.0	4.2	1.4	34.5	15.1	2.0
Amhara	20.1	24.6	24.0	21.8	21.6	26.5	23.2	21.6	22.9	2.1	9.0	22.7	23.5
Oromia	32.3	28.1	29.0	27.3	30.1	33.7	32.5	34.5	30.9	2.7	8.6	40.8	38.9
Somali	3.1	2.8	5.0	9.0	7.3	6.7	8.1	10.0	6.5	2.7	40.8	15.7	6.3
B-G	3.4	1.5	3.9	4.8	3.7	1.4	2.1	1.8	2.8	1.3	44.9	17.0	1.2
SNNPR	15.9	20.5	18.6	16.1	18.0	20.7	20.1	20.1	18.7	2.0	10.5	21.0	21.1
Gambella	2.8	2.5	2.5	4.0	2.8	0.9	1.5	1.3	2.3	1.0	43.2	14.4	0.5
Harari	0.8	1.3	1.7	1.8	1.5	0.5	1.0	0.8	1.2	0.5	39.7	23.6	0.3
Correlation between population and grant share = 0.99													
Correlation between own-source revenues (OSR) = 0.61													

Note: B-G = Benishangul-Gumuz; P = population (2015); CV = Coefficient of Variation, STD = Standard Deviation, and RR = regional own-source revenue of regional budget.

Source: computed from various years' formula

revision of the formulas produced significant fluctuations in the allocation of subsidy shares among most regions. Apart from Tigray, the share of developed regions, including Amhara, Oromia and SNNP, increased over time. Conversely, the share of developing regions, except Somali, has declined (Table 2). The decline of developing regions' share significantly affects them as they are already disadvantaged because of a lack of basic infrastructure, educated human resources, and OSR.

The analysis of standard deviation in grant shares reveals a notable contrast between developing and developed regions. Developing regions show moderate variability in grant shares over time, while developed regions exhibit very high variability (Table 2). This divergence suggests grant allocation follows an incremental, path-dependent approach rather than adjusting swiftly to changes in population, revenue, or other formula factors. Further, analysis reveals a robust positive correlation of 0.99 between population size and grant shares, indicating population is a primary determinant (Table 3). The most populated regions received the largest transfers, while less populated regions like Afar and Gambella got the smallest. However, Tigray emerged as an outlier, receiving a disproportionately high share in the 1990s compared to the Somali region, which had almost the same or higher population as Tigray (Table 3).

While population strongly predicts overall grant allocation, analysis of individual regions uncovers notable deviations from this national correlation. Regions like Amhara, Benishangul-Gumuz, Gambella and Somali exhibit negative relationships between population and grant share changes. For instance, when we compare 1995 with 2007, Amhara's share grew by 6.4% despite an almost 3% population decline (Table 3). Amhara's increased share demonstrates an incremental, negotiation-based logic aimed at sustaining its position relative to other major regions. This implies that objective formula factors alone did not influence grants. The weights given to the

population increased from 33% to 60% in 1998 (Table 2). However, Table 3 illustrates that the share of some regions declined even though their population increased (Table 3). For instance, Gambella's and Benishangul-Gumuz's share declined amidst population growth. This divergence suggests political factors impacting allocation decisions, overriding the population-based formula.

Another formula variable is regional revenues. Yimenu (2023b, 250) shows that the average percentage of regional OSR as a part of the regional budget from 1995 to 2020 was 17% (B-G), 15.1% (Afar), 15.7% (Somali), 14.4% (Gambella), 22.7% (Amhara), 40.8% (Oromia), 21% (SNNP), 36.6% (Tigray) and 23.6% (Harari). Logically, one might expect regions with smaller revenue to receive higher grant shares as a compensatory measure. However, the correlation analysis between own-source revenue and grant shares shows a paradoxical positive relationship of 0.61 with grant shares (Table 2). Unlike compensatory expectations, regions with higher internal revenue receive larger transfers (Figure 1). However, this perplexing finding stems from the intersection of revenue and population. Regions with higher own-source revenue tend to have a larger population, resulting in a higher grant share. For instance, Tigray receives the fourth-largest grant share despite generating the second-largest own-source revenue. Compared to Amhara and SNNP, its smaller population led to this outcome for Tigray. The two regions have larger populations, though their proportion of OSR is smaller than Tigray's. This highlights the primacy of demographic size overbalancing fiscal capacity in the grant formula.

The allocation of fiscal transfers in Ethiopia during the 1990s was significantly influenced by political factors, particularly ethno-regional alignments, rather than purely economic considerations. Tigray's disproportionate share of grants during this period stemmed from the political dominance of the TPLF. A key informant reported that TPLF officials justified this imbalance by citing Tigray's history of suffering

TABLE 3 Regional level correlation between population and grant.

Year	Tigray		Afar		Amhara		Oromia		Somali		B-G		SNNP		Gambella		Harari	
	P	G	P	G	P	G	P	G	P	G	P	G	P	G	P	G	P	G
1995	5.9	10.5	2.1	4.9	25.9	20.1	35.0	32.3	6.4	3.1	0.3	3.4	19.4	15.9	0.3	2.8	0.2	0.8
1999	5.8	9.5	1.9	4.9	25.6	24.0	35.5	29.0	5.8	5.0	0.8	3.9	19.8	18.6	0.3	2.5	0.3	1.7
2007	5.6	6.4	1.9	2.5	23.4	26.5	36.7	33.7	6.0	6.7	1.1	1.4	20.2	20.7	0.4	0.9	0.2	0.5
2015	5.6	6.0	1.9	3.0	22.6	21.6	37.4	34.5	6.1	10.0	1.1	1.8	20.3	20.1	0.5	1.3	0.3	0.8
2022	5.5	6.0	1.9	3.0	21.8	21.6	38.1	34.5	6.2	10.0	1.2	1.8	20.5	20.1	0.5	1.3	0.3	0.8
Corr	0.95		0.51		-0.07		0.76		-0.19		-0.72		0.94		-0.82		0.28	

Note: P = Population, G = Grant; Corr = Correlation between P and G; the data do not include Addis Ababa and Dire Dawa as they are chartered cities, not regions.

Source: Grant share computed from various years' formula; Population computed from Ethiopian Statistical Services <https://www.statsethiopia.gov.et/>

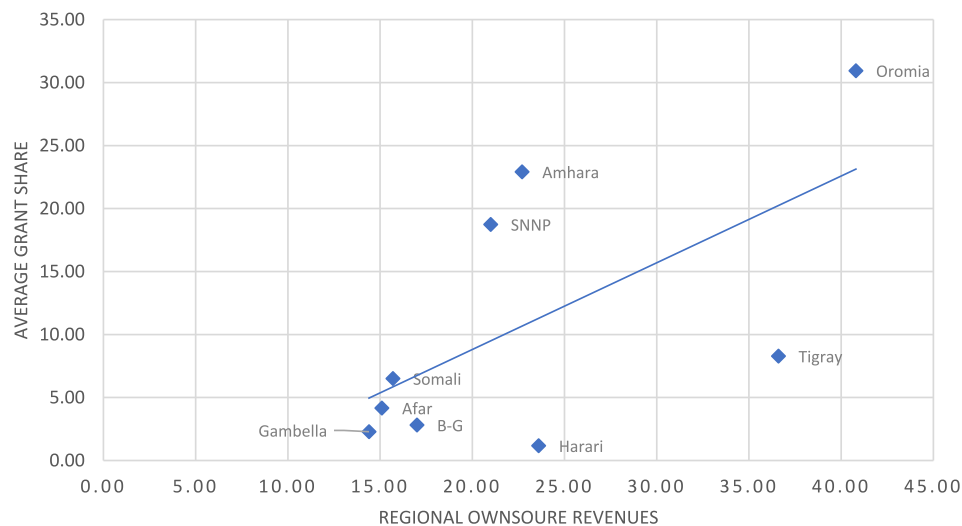


FIGURE 1 Regional own-source revenues (OSR) Versus average grant share. Source: For grant data, Table 2; for revenue data, Yimenu (2023b, 250).

during the 17-year war with the *Derg* regime, including human and infrastructural losses, as well as the sacrifices the region made to overthrow the *Derg*.<sup>11</sup> This reveals how ethno-regional political alignments drove grants to reward TPLF's home region. Consequently, this diverted grants away from lagging areas like Somali region despite their larger populations and greater developmental needs.

Somali and other developing regions in the lowland part of Ethiopia, like Afar and Benishangul-Gumuz, have sparse settlements requiring more grants. According to CSA (2014), while the national average population density is 121.5 persons/km<sup>2</sup>, the lowland regions of Gambella, Afar, Benishangul-Gumuz, and Somali have densities of 13.6, 23.9, 19.8, and 21.8, respectively. Expressing his discontent in 2009, Yaregal Ayishehum, then president of the Benishangul-Gumuz Region, stated, "Our region is wide and its population scattered. The arid weather exposes our people to various diseases. As we share a border with Sudan, we also have security matters to take care. Thus,

the budget subsidy formula should be revised to give us the special consideration we deserve".<sup>12</sup> These lowland regions face elevated costs due to challenging geography, higher recurrent expenditures and costly service provision for their sparse populations (Gebre-Egziabhere, 2018, pp. 16–17; Yimenu, 2023b, p. 253). Given these circumstances, these regions are expected to receive higher grants than their developed highland counterparts. However, grant allocation during the 1990s did not align with this expectation, making the realisation of constitutional intentions of rectifying regional inequalities challenging.

The improvement in Somali's grant share over time highlights extra-formulaic political factors shaping allocation. Dynamics such as centre-periphery renegotiation and regional political changes partially explain the improved status of the Somali region. According to a former member of the HoF, the Somali region's increased security importance in fighting frontier insurgent Ogaden National

<sup>11</sup> A former member of the federal parliament, June 2019, Addis Ababa.

<sup>12</sup> Yaregal Ayishehum, president of Benishangul-Gumuz region, Ezega. <https://www.ezega.com/News/NewsDetails?NewsID=458>, 2009.

Liberation Front and fanatic militant *Alshabab* increased the region's bargaining power.<sup>13</sup> This security consideration likely played a role in the centre's decision to allocate a larger share of grants to the Somali region. Furthermore, the death of Prime Minister Meles Zenawi, who was EPRDF and TPLF's leader, altered the power dynamics within the federal system. With Hailemariam Desalegn, an SNNP official, succeeding Meles as the Prime Minister and EPRDF leader in 2012, the power locus shifted away from Tigray, creating an opportunity for other regions to increase their influence and bargaining power.

The death of Meles Zenawi had significant repercussions for the internal dynamics and power balance within the EPRDF. According to Tronvoll (2021), Meles Zenawi's leadership style and authority played a crucial role in managing internal differences and dissent within the coalition, and his absence contributed to the emergence of internal disputes. The data presented in Table 2 show that a few years after Meles Zenawi's demise, regional grant shares were revised in 2017. This adjustment decreased Tigray's share by 1.6%, while Oromia and Somali experienced an increase of 2%. These changes in regional grant allocations often reflect shifts in political influence and power dynamics. The post-Meles political developments indicate the continuity of the complex evolution of centre-region bargaining and the relevance of the ethno-regional base in the internal power struggle to dominate the coalition. Such dynamics ultimately led to the fracture of the EPRDF following protests in Oromia, paving the way for Abiy Ahmed, an official from Oromia, to become the Prime Minister in 2018.

Abiy Ahmed's dissolution of the EPRDF and the formation of Prosperity Party (PP) by merging all regional parties except the TPLF in 2019 marked a shift. This development had implications for grant allocation dynamics, even though the 2017 formula remained unchanged. In 2022, recognising the need for reform, the HoF conducted a study that recommended the establishment of an independent Grant Commission. Waktole Dadi, the director of the grant department at the HoF, explained, "The study suggested a Grant Commission must be established to oversee resource distribution management and fiscal transfer reform independently. Currently, there is a directorate in HoF, but it cannot be free of politics. The Commission will be a think-tank equipped with high professionals".<sup>14</sup> The proposed Commission aimed to insulate the grant allocation process from undue political influences and promote more objective and equitable fiscal transfers.

The dissolution of the EPRDF and the subsequent integration of regional parties into the federal ruling PP led to an increased role for officials from developing regions within the federal government. Somali politician Aden Farah's appointment as PP deputy president exemplifies emerging peripheral region influence. The Somali region president, Mustafa Omer, celebrated this achievement as follows:

*"The Somali people in Ethiopia have today lived to see their son elected as the deputy president of the ruling Prosperity Party. Unthinkable just years back when Somalis were branded unfit to comprehend "revolutionary democracy"! Congratulations, brother Adan Farah. We are at the center!"* (SD News, 2022).

This remark expresses historical grievances, referring to the TPLF-dominated EPRDF's past refusal to integrate Somali and other peripheral parties into the federal ruling coalition. Incorporating emerging regional elites may reshape fiscal transfers. As the 2017 formula has not been changed, analysing the impact of EPRDF's dissolution on regional grant shares merits future research. But, early signs point to increasing peripheral regions' bargaining power.

Analysis of proxy development measures uncovers perplexing relationships with grant allocation. Road density exhibits a slight positive correlation, while water access negatively correlates with regional grant share (Table 4). This contradictory evidence underscores the lack of a clear association between key indicators of the level of development and grants. Developing regions did not consistently receive greater funding based on deprivation levels. The lack of clear connections between development proxies and grants highlights the significance of demographic and political factors over the equity principles outlined in Articles 41(3), 89(2), and 90(1) of the Constitution. These articles emphasise the vision of providing equal access and opportunities for all Ethiopians.

Figure 2 and Table 4 show that developing regions received the smallest transfers despite infrastructure deficits and a lack of access to potable water. This deviation from compensatory, needs-based principles reveals a gap between constitutional intents and the practice. This demonstrates political motivations and path-dependent historical logic played important roles. This affected certain regions and made redressing regional development disparities daunting.

## 6 | CONDITIONAL GRANTS IN ETHIOPIA

Analysis shows grants comprise a significant portion of federal expenditures, averaging 33% of the budget (Figure 3). Despite upward trends, regions contend transfers remain inadequate due to the centralisation of revenues and the decentralisation of expenditures.<sup>15</sup> This reveals a disjuncture between subnational expectations and federal calculations. Grants comprise over 75% of regional budgets, making them crucial for filling budget deficits. The degree of dependence varies, with grants constituting 85% of revenues for developing regions (Yimenu, 2023b, p. 251). While important for all regions, grants are vital for the fiscal viability of developing regions, whose budgets heavily rely on federal subsidies.

<sup>13</sup> Former member of House of Federation from Somali region, May 2019, Addis Ababa.

<sup>14</sup> Waktole Dadi, director of Regional States Fiscal Equalization department at the HoF. The Reporter. <https://www.thereporterethiopia.com/22595/>, April 9, 2022.

<sup>15</sup> An official in the SNNPR Bureau of Finance and Economic Cooperation, May 2019, Hawassa, and An official in the Oromia Region Bureau of Finance and Economic Development, March 2019, Addis Ababa.

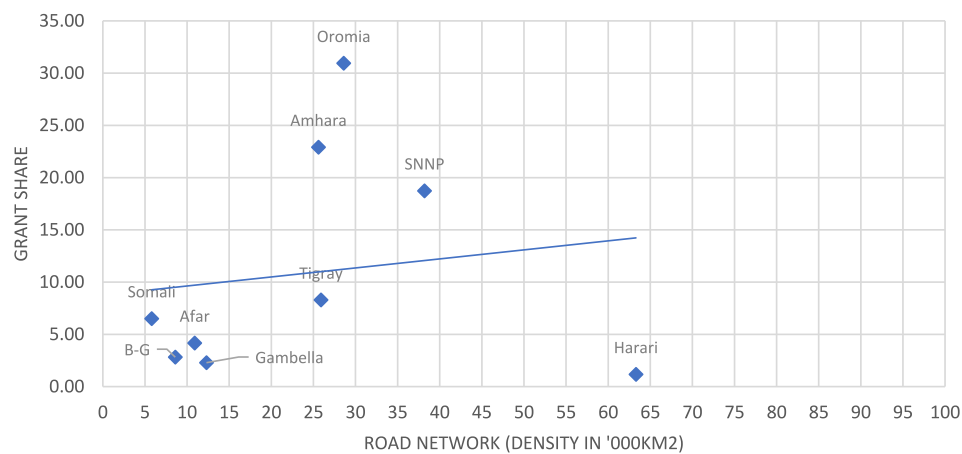
**TABLE 4** Access to potable water, Road network, and Grant share.

Region	% Of the population with potable water	Road network	Average grant share
Tigray	21.4	25.9	8.29
Afar	13	10.9	4.17
Amhara	21	25.6	22.91
Oromia	22.5	28.6	30.94
Somali	10.6	5.8	6.51
B-G	18.2	8.6	2.81
SNNPR	19.3	38.2	18.74
Gambella	26.7	12.3	2.29
Harari	63.6	63.3	1.17

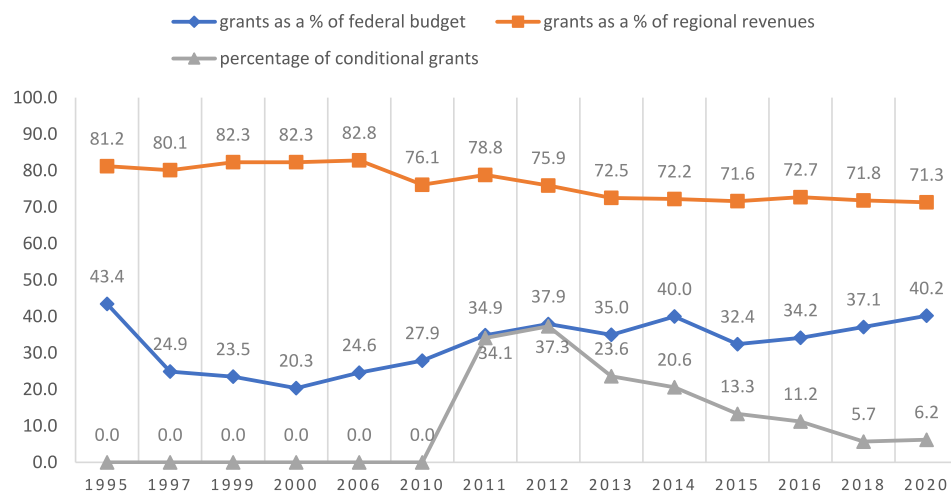
Correlation b/n water access and grant = 0.14

Correlation b/n road network and grant = -0.24

Source: Computed from World Bank (2000) and various years' grant formula



**FIGURE 2** Road density Versus grant share. Source: Table 4.



**FIGURE 3** Subsidies data (1995–2020). Source: Own compilation from various years of budget data, UNICEF (2017, 2018a, 2018b) and the World Bank (2000, 2020a, 2020b).



Initially, subsidies were provided as unconditional block grants until conditional grants were introduced in 2011. According to UNICEF (2017), conditional transfers are intended to fund regional capital expenditures in specific sectors aligned with the MDGs and SDGs. This alteration reflects a strategic move by the central government to leverage grants to direct regional spending towards national priorities. Notably, the distribution of conditional grants among regions closely mirrors the allocation of unconditional grants, as the same formula is used for both types of grants. As depicted in Figure 3, conditional grants comprised approximately one-third during the initial two years, reduced to one-fifth in the fiscal years 2013 and 2014, and have consistently declined since 2014. Officials attribute this to “the conclusion of the MDGs, which held priority for both the federal government and donor agencies”.<sup>16</sup>

Conditional grants in Ethiopia are characterised by common features, including earmarking, strict monitoring, and burdensome reporting, which significantly influence regional flexibility (World Bank, 2016, p. 13). As analysed below, these conditions enable federal steering of regional spending.

**Ear-marked Grants:** the grants in Ethiopia can only be utilised for capital expenditures within six sectors: rural roads, drinking water and irrigation, health, education, agriculture, and small and medium enterprise development. However, regions retain discretion in allocating funds within these sectors. Before introducing specific-purpose grants, regional government expenditures heavily accentuated recurrent expenses, jeopardising investments in capital projects.<sup>17</sup> According to the World Bank report, after the introduction of conditional grants in 2011, regional capital expenditure increased from 25% to 40%. However, it is noteworthy that conditional grants were not additional money. Instead, they were conditional grants accompanied by a drop in block grants (World Bank, 2016, pp. 27–33).

**Monitoring Project by Project:** The centre conducts project-by-project monitoring. Regions must compile a project list within the six sectors for conditional grant financing and secure approval from the MoFEC. Once sanctioned, projects in a sector cannot be substituted with projects from another sector (World Bank, 2016, p. 14). Furthermore, the grant requires regions to plan expenditures yearly as if projects were initiated and completed within a fiscal year. Hence, multi-year projects faced unrealistic annual budgeting rules.

**Rigorous Reporting:** Regions must provide the centre with quarterly, semi-annual, and annual financial reports (Art. 51, Regulation No. 190/ 2010). The World Bank described the reporting requirements, stating, “No report, no money. In that sense, the grant is often described as “performance-based”: funding is not released before the performance but after. The disbursement is an effective transfer, conditional upon producing timely and satisfactory quarterly reports” (World Bank, 2016, p. 14). The reporting process caused delays in the release of money. An SNNP informant highlights that “conditional grants, coupled with limited OSR, have become a

major challenge”. The informant adds that “since policies funded by federal grants are centrally designed with little or no input from the regions, the regions are reduced to executing the federal government's priorities rather than pursuing their own”.<sup>18</sup>

Another concern was the predictability of funds. A regional official states, “The region planned several projects based on the first 2 years' grants and the federal priorities. However, the federal government terminated the MDGs' funding and told the region to finish the ongoing projects from its sources. Thus, we had to shift the budget from other projects to finish the MDGs' projects initiated based on priorities set by the centre”.<sup>19</sup> To sum up, conditional grants briefly allowed the federal government to assert control over regional spending, primarily associated with pursuing MDGs.

## 7 | DISCUSSION

The preceding sections delved into the analyses of the political economy of grants in Ethiopia, which constitutes the central focus of this article. The study addressed how political and economic factors interplay and shape the federal grant system through comprehensive data analyses. The article traced the evolution of the grant system through quantitative and qualitative data. The evidence suggests that institutional inertia shapes grants, not only formula-based needs. This underscores a decision-making process characterised by an ad hoc approach shaped by political considerations alongside the employed formula. This article corroborates previous studies, for instance, Moges (2003, p. 131) and Chanie (2007a, p. 377), that the federal government focussed on ensuring administrative continuity by stabilising developing regions' grant share while developed regions' share was renegotiated alongside the grant formula. Although population size typically aligns with overall grant allocation trends, there are some deviations from this pattern at the individual region level. Notably, regions such as Amhara, Benishangul-Gumuz, Gambella, and Somali demonstrate inverse relationships between population size and changes in grant share. This suggests the influence of non-formulaic factors, potentially past manipulation of formulas by the TPLF to favour the Tigray region, as well as subnational political dynamics. While overt political influence has waned over time, covert intra-party negotiations persist, exerting an ongoing impact on regional grant allocations.

The findings underscore that Ethiopia's fiscal transfer model exhibits various characteristics outlined in the theoretical section. Notably, the determination of the transfer pool appears to rely on an ad hoc basis, guided by the discretionary decisions of the central authority. Ethiopia is not unusual, as this approach is common in most federations (Sham, 2007, pp. 34–37). In line with Bird and Smart's (2002) theorisation, Ethiopia's ad hoc grant pool

<sup>16</sup> An Official in the Ministry of Finance and Economic Cooperation, April 2019, Addis Ababa.

<sup>17</sup> An Official in the Ministry of Finance and Economic Cooperation, April 2019, Addis Ababa.

<sup>18</sup> A Director of Budget Administration in the SNNPR Region Bureau of Finance and Economic Development, May 2019, Hawassa.

<sup>19</sup> A Director of Budget Administration in the Oromia Region Bureau of Finance and Economic Cooperation, April 2019, Addis Ababa.

determination enabled the centre to adjust based on changing circumstances and leverage grants to influence regional spending. Ethiopia's experience shows that a centrally determined ad hoc transfer pool makes regional planning and fiscal autonomy precarious. Further, conditional grants introduced in 2011 enabled the centre to briefly influence regional spending patterns. The primary aim of conditional grants is to allocate federal funds more efficiently towards targeted policy interventions. This objective aims to address the "swimming pool problem," illustrated by a historical case in the USA during the 1960s. In this instance, a school district diverted federal education grants towards constructing a new town swimming pool instead of improving educational opportunities for underprivileged children (Pasachoff, 2020, p. 583).

This study offers insights into the political determinants of fiscal transfers in federations. The analyses show that the allocation of grants was strategically employed to selectively favour a specific region that was home to federal ruling elites and government strongholds. The findings align with and expand on the existing literature, for example, Boex and Martinez-Vazquez (2005), Gervasoni (2010), and Ardanaz et al. (2014), highlighting the importance of political factors in shaping grants. Similar scenarios were observed in federations such as Mexico, Malaysia, Nigeria, and Russia (Diaz-Cayeros et al., 2003; Loh, 1996; Suberu, 2009; Treisman, 1996). The study brings to light a notable incongruity within the fiscal transfer process. Despite the HoF ostensibly utilising a predefined formula for fund allocation, the article uncovers that intra-party negotiations influence the determination of the grant pool and the eventual allocation among regions. This appears to circumvent constitutionally empowered institutions and the intended formulaic approach. Corroborating Boex and Martinez-Vazquez (2005), this evidence challenges technocratic viewpoints that overlook political motivations. Ethiopia's case illustrates that fiscal transfers entail complex bargaining between national and subnational officials. Importantly, the final grant allocation may not consistently align with the official grant formula.

As anticipated theoretically, the case of Ethiopia provides insights suggesting that concepts such as appeasement, swing, reward, and rentier theories may not fully elucidate grant allocation dynamics in a multiethnic dominant party federation like Ethiopia. In a context where election outcomes are often predetermined for the incumbent, grant allocation dynamics seem primarily influenced by ethno-regional alliances, intra-party contests, and regional assertiveness rather than electoral considerations or patronage politics.

Federal officials' allegiance to ethno-regional affiliations often leads to the manipulation of grant formulas in favour of their respective home regions. However, the extent of this manipulation is contingent upon the officials' rank within the federal ruling party and the assertiveness of governors from other regions. As anticipated, the dominance of Tigray elites within the federal government and the ruling party appears to have resulted in the disproportionate allocation of grants to Tigray during the early years of Ethiopian federalism. Ethiopia's experience is not unique in this regard. Similar scenarios have been observed in federations such as Nigeria and

Malaysia, where the federal ruling party tends to favour core regions in grant allocation (Loh, 1996; Suberu, 2009). Ethiopia's case reinforces existing findings from countries like Argentina, Mexico, and Russia, highlighting the influence of political considerations on the allocation of federal grants. Such patterns may emerge in ethnically diverse federations where ethnicity and regional boundaries overlap, particularly when the grant agency lacks independence. The findings suggest that ethno-regionalised political logic influences grant allocation in a setting where ethnicity serves as the primary tool of political mobilisation.

While early allocation demonstrated ethno-regional favouritism, the analysis unveils a more intricate evolution of grant distributions through intra-party negotiation. This led to a gradual moderation of political manipulation over time. This is evident in the decline of Tigray's share and the concurrent rise of other regions' shares. This shift appears to be driven by the dynamics of intra-party negotiations and contests and the growing assertiveness of other regions. Ethiopia's experience further illustrates that historical political legacy plays a pivotal role in shaping the grant system, as marginalisation tends to be perpetuated even after the formal adoption of a rules-based grant system. This affects historically disadvantaged ethnic regions' grant share despite the needs-based approach granting otherwise.

Ethiopia's experience offers lessons for structuring grant systems to balance national cohesion, equitable grant allocation, and minimise unhealthy competition among regions. The findings suggest that relying solely on technical grant formulas may not suffice to depoliticise fiscal transfers in ethnically diverse federations. Ethiopia's case underscores the imperative of incorporating institutional checks and balances to ensure adherence to the principles of fiscal federalism. Integrating robust data analysis with recent fiscal federalism theories offers a multidimensional explanation of the intricate challenges inherent in multiethnic federations' intergovernmental fiscal relations.

## 8 | CONCLUSIONS

The article analysed the political economy of fiscal transfers in Ethiopia. It offered empirical evidence and theoretical insights through a mixed-methods approach, combining quantitative data spanning 25 years with insights derived from interviews and documents. The study elucidates the discretionary and opaque nature of the transfer pool determination process, coupled with the short-lived conditioning of grants, which has briefly enabled the central government to influence regional spending priorities. Moreover, the frequent changes in grant formula variables and weights have impacted the stability and predictability of regional subsidies, further exacerbating the fiscal precariousness of already vulnerable regions.

The article challenges mainstream theories that anticipate strategies, such as vote-buying and swing targeting, which are found to have limited applicability in dominant party states where elections offer restricted choices. Instead, the analyses uncovered a pattern of overt ethno-regional favouritism in grant distributions during the

early stages, which evolved into more fluid forms of negotiation tied to intra-party contestation and regional assertiveness. Furthermore, the article reveals some disconnect between formal grant formulas and regional grant shares due to the influence of intra-party negotiations. The study argues that fiscal redistribution efforts did not effectively address the historical inequalities experienced by Ethiopia's developing regions. Instead, path-dependent institutional inertia and demographic size emerged as more predictive of regional grant shares. Ethiopia's case emphasises the significance of ongoing structural reforms and bargaining processes to reconcile diverse interests and address underlying drivers.

Insights from Ethiopia have implications for states embracing fiscal decentralisation. Ethiopia's case implies that the discretionary nature of fiscal transfer, limited regional involvement, and centralisation of grant decisions could be obstacles to achieving equitable grant distribution and effective regional development planning. This highlights the imperative of transparent and inclusive decision-making processes considering regional needs and national priorities. Balancing regional autonomy and national oversight is pivotal in the fiscal transfer system. Decentralisation engenders intricate trade-offs encompassing local discretion, efficiency, and national imperatives. While subnational fiscal autonomy fosters the reasonable allocation of funds to local priorities, conditional transfers become imperative to safeguard the provision of indispensable public services and achieve national objectives.

The optimal role of the central government in transfer arrangements should be tailored to the contextual exigencies to address sectoral requirements while concurrently upholding local autonomy. For example, the conditions mandated by the federal government, stipulating that the regions allocate some of the grants solely to six priority sectors, played a crucial role in forcing the regions to redirect their expenditure from recurring expenses towards capital investments. This shift contributed to enhancing regional infrastructure and the realisation of national objectives. This shows that regional autonomy and national priority are not necessarily mutually exclusive. However, since transfer systems evolve through iterative consultations, there is a pressing need for institutional mechanisms facilitating dialogues between the regions and the federal government. The absence of an independent entity configured to manage grants and facilitate intergovernmental dialogue in Ethiopia resulted in the centre's dominance over the transfer system. Formal and regular intergovernmental forums play a vital role in navigating the establishment of oversight structures that foster a balance between national priorities and subnational autonomy.

#### 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.

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