SYSTEM OF DIVISION OF REVENUE IN ETHIOPIA

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Abstract

In addressing the issue of the allocation of revenue raising powers, the main question is the taxation power distributed between the tiers of government in a federal system. It is an issue of vital significance that federations usually specify in their constitutions the revenue raising powers of the two orders of government. This is quite clear due to the very rational for creating and maintaining federal system. Scholars are undivided in arguing that fiscal federalism may aggravate imbalances if mistakes are committed in tax assignments of major tax bases. However, there is no one best model for all societies, except for those broad guidelines such as local governments should be assigned taxes whose burdens are local. Note also that assignment of tax bases may have to consider the importance of other tax objectives other than raising revenue, such as income distribution and economic stabilization. Besides, informational and technical requirements as well as potential gains and losses (economies and diseconomies of scale) have to be evaluated in assigning of tax bases.

Keywords: Revenue, system of division

Introduction

The Ethiopian federal system follows the conventional model of separate provision for the division of revenue sources between the federal government and regional governments (Assefa, 2007: 353-359). The federal constitution has three lists in this regard: federal, concurrent and regional.

In Ethiopia, the federal constitution declares that the federal government shall levy taxes and collect duties on sources reserved to it, and the states likewise exercise the same power with respect to sources that fall under their jurisdiction. Thus, the two tiers of government exercise their legislative and administrative powers within their respective taxation competences. As a result, the revenue generated from respective sources belongs exclusively to each level of government. The FDRE Constitution does not explicitly limit the powers of the states to alter the taxes or influence the tax bases. However, it provides general 'directives on taxation' which they must consider exercising their taxation powers. Both levels of government have the obligation to ensure that any tax is related to the source of revenue taxed, and tax imposed by them should not adversely affect their relationship. If any tax imposed by a state affects interstate commerce, the central government intervenes. However, in practice tax legislation is uniform throughout the country.

Federal Taxation Power of Federal Government

The federal constitution provides exclusive revenue sources under the title 'federal power of taxation' and 'state power of taxation'. As in most federal countries, in Ethiopia central governments have, relatively speaking, bigger sources of revenue. Taxation powers of the federal government include: employment from the employees of the federal government and its public enterprises and international organizations, federal stamp duties, monopoly tax, value added tax, national lottery, fees from licenses issued and services provided by organs of the federal government. This is on top of the federal government's share on royalty and taxes on natural resources (mainly gold and natural gas). At federal level it is the federal parliament which is responsible for levying taxes assigned to the federal government (Art. 51).

Regional State Taxation Powers

Taxation power of the regional states within their jurisdiction include: taxation of employment income from employees of the state government; agricultural tax from farmers, tax on individual traders, houses and other property owned by private persons or regional government; employment, and sales tax from public enterprises owned by the state government; forest products, royalties and land lease fees from small mining undertakings. At state level, state councils (the legislative branches of state governments) are empowered to levy taxes on those tax bases (Art. 52(2)).

Concurrent powers of taxation

The Federal constitution provides that the federal government and states all collect taxes and shall share revenue taking the federal government in to account (Art.95). Article 98 lists concurrent powers of taxation as follows: profit, sales, exercise, and personal taxes on enterprises they jointly establish; taxes on the profits of companies and individuals to shareholders; taxes on the incomes of derived from large-scale mining and all petroleum and gas operations, and royalties on such operations (Art. 98). The federal government levy and collects taxes on those listed under concurrent powers of taxation, and the incomes are shared with the states, based on the decisions of the House of Federations, the upper chamber of the federal legislature. Regarding residual taxes they federal houses jointly decide by 2/3rds majority (Art.62).

In general, the division of revenue raising power in Ethiopia is mainly structured according to the categories of taxpayers or particular things as a source of revenue. The exclusive domain of each government is not the tax base but the tax source. Thus, it does not result in taxing the same income, transaction or thing by both levels of government. As a result, there is no limit to levy taxes for the federal government with the intention that subnational governments can raise enough money.

For those taxes which are not explicitly stated in the provisions of the constitutions of the constitution, it is to be determined by a 2/3rd majority vote of the joint session of two houses of the federal parliament.

We can classify the taxes in Ethiopia in to four:

1) Import and export taxes and dues: In line with the federal tradition, import and export taxes and other dues are exclusively levied and collected by the federal government. Tax on foreign trade is a major source of tax in Ethiopia. As a developing country, the nature and type of export items are few in number and originate from specific regions.
2) Income Tax: Experiences show some federations allocated personal income taxes to the central government while others have done so to the regions (Solomon, 2006: 126).

The Ethiopian constitution does not exclusively assign income tax to the federal government or to the states. The power to levy and collect taxes from income is assigned to both tier of government. Each of them is conferred power over specific sources. Federal government is given income of employees of federal government, of public enterprises owned by the federal government and international organisations. Incomes from employees of states and other private organisations are reserved to the states (ibid, 127).

3) <u>Sales and excise taxes</u>: The federal government assigns exclusive powers to the federal government to levy and collect sales and excise taxes from sale, production or services of public enterprises owned by the federal government. The same pattern is followed as the power of the states: they can levy these taxes against public

enterprises owned by them. In addition, the states can also levy and collect sales and excise taxes from individual traders within their jurisdiction (ibid, 130: Kibre, 1994: 26)

4) Property Taxes: The constitution gives the states a power to levy property taxes upon houses which are privately owned, land which is used by the *usufractuaries* and royalists from the use of forests. They can also levy and collect tax and royalties on small-scale mining activities (ibid, 132).
5) Fees and other charges: Both federal and states have power to collect fees and other charges. Each level has exclusive powers to collect fees and charges if the service lies under their exclusive jurisdiction (ibid, 134).

Imbalances: the Ethiopia federation is characterised by a high level of both vertical and horizontal fiscal imbalances. The vertical one is mostly due the limited economic space of the national economy which limited the tax base, and also because that the most lucrative tax bases are assigned to the federal government. When it comes to the horizontal one, the problems are much more complex. As regions are created based on ethnicity, we have huge asymmetries. Besides, some of the regions suffer from the historical legacy of marginalization from the centre, and thus more weak institutional capacity to collect tax (Kibre, 1994: Solomon, 2006: 213).

Regional borrowing: the major issues concerning borrowing are the adoption of appropriate criteria for acquiring loans, setting the upper limit to be borrowed, interstate obligations, the repayment period and debt servicing capacity. Unlike the centre, subnational borrowing is restricted to domestic borrowing and they may even be subject to direct control by the central government. The main reason for participation and federal control by the centre is that monetary and fiscal policies are centralised. In Ethiopia federal government determine the conditions and terms under which states can borrow from domestic sources. Accordingly, regional governments have to submit all necessary information to determine the amounts to be borrowed, together with revenue collection forecast, and with economic indicators.
Understandably, fiscal discipline is a concern of all federal governments including developed countries federations. Bailout of over-spending regional states could cause inflation. However in Ethiopian context, regions are criticized for not effectively spending the budget allocated to them. Hence problem of debt and bailout requests will not be serious problems for some time to come.

The constitution says that the federal government and the states 'shall respectively bear all financial expenditures necessary to carry out all responsibilities and functions assigned to them by law'. The crucial factor that determines the financial expenditure of the respective governments is the financial capacity which is primarily influenced by constitutional allocation of revenue sources and the method of redistribution. Therefore, there is limit the subnational government budget autonomy.

Conclusion

In sharing of revenue, taxes are grouped in to there: Federal, regional and joint. Fiscal federalism in Ethiopia has been adopted within a unique political landscape of ethnic federalism. This creates a gap between constitutional provision and practice. There is a huge imbalance and political centralism in practice.

Another issue is the link between the link between revenue and state creation and revenue and secession. In a multi-ethnic developing federation where ethnic politics is designed to govern every aspect of political aspect, several groups contend for governmental power as a means of access to the control of national resources. As a result, different groups at different layers strive towards state formation, regardless of the viability of those structures. This has raised issues relating to its fiscal implications. In Ethiopia the practice so far is that states with larger population and territorial size obtain smaller per capita revenue compared to states with smaller states. This encourages smaller ethnic groups to claim statehood, so that they can become direct participant in the federal law-making process and to get more resources.

Even the more serious potential problem is the link between revenue and secession: Every ethnic group has the unconditional right of secession. This could lead to constant fiscal conflict between the regions. It could affect fiscal equalisation from richer to poorer regions. The richer regions may want to use their resources independently, rather than sharing it with poorer regions.

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