

**Intergovernmental Revenue Assignment and  
Mobilization  
Principles and Applications for Somalia**

**Robert D. Ebel**



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## **Intergovernmental Revenue Assignment and Mobilization**

### **Principles and Applications for Somalia**

#### **Introduction: Purpose and Scope**

The World Bank's report on *Somalia Economic Update/Special Focus on Intergovernmental Relations* concludes that although Somalis face a daunting and long term development challenge to overcome two decades of conflict and fragility, with a commitment of a new government substantial progress is being made to support a potentially vibrant private sector economy, improve human and economic development outcomes, and prioritize the establishment of intergovernmental (central and member government) institutions for effective macro-fiscal management (World Bank, 2015).

A dimension of importance to achievement of these broad reform objectives is to now "focus on (and to) ... facilitate on-going negotiations(s)... for a way forward rather than finding a final fiscal arrangement" (World Bank, 2015). This perspective a setting a knowledge base for "a way forward" is the same advice that Janos Kornai made during the 1990s transition of Central and Eastern European countries from a demonstrably poor and slow growth command-and-control economy to one liberalized markets and public sector reform — that "a change of government is not a change of system, merely one of the pre-conditions for it" ...and that, the "change of system is an historical process that seems likely to require a long period of time". (Kornai, 1992). The World Bank 2015 report notes that the reform of public institutions take 20 years even in the fastest-of reforming economies.

Such a timeframe for setting the pre-conditions for a sustainable public sector is not a counsel for delay. Indeed today's Somalia faces a set of circumstances that have similarities other now well-established and effective federal states. There are four such similarities. The first is these countries had features of "bottom-up" federalism whereby the member states had to learn to collaborate --a collaboration often characterized by a high degree of tension—to create a functioning central state (e.g., Australia, Canada,

Switzerland, and United States).<sup>1</sup> An important aspect of a “bottom up” system is that from the start of the reform process the subnational governments that come together to create a federal system bring with them a revenue culture of decentralized fiscal autonomy and capacity that pays-off over the decades in terms of fiscal sustainability and economic development. In contrast, many historically centralized states find “top down” fiscal culture that becomes an obstacle to achieving public sector reform—an obstacle that is becoming more evident in an era of the globalization, (World Bank, WDR, 1999-2000, pg. 31-33; Congleton, 2006.). For the Somalia, the fact that its once and potentially future federal member states (FMS) of Somaliland and Puntland are, at present, more public administration capable than the federal government of Somalia (FGS) can be seen as nation-building advantage.<sup>2</sup>

Second, societies that have been and remain fragmented in the sense of having a “territorial based groups of people who are or who consider themselves to be, distinct in one or more features such as ethnicity, religion, language, and, or history, ancient or recent”, the sorting out of power and wealth sharing arrangements has become a “glue” for creating a nation state (e.g., Belgium, Canada, Germany, India, Indonesia, People’s Republic of China, Philippines, Spain).<sup>3</sup>

Third, after an era of conflict warring parties have been able to settle on a set of principles that allow for an “effective” state in terms not only to how efficiently and equitably provide public services, but also how the various aspects of a country’s public finances are structured (e.g., Indonesia, Northern Ireland, Switzerland).<sup>4</sup>

A fourth similarity for today’s Somalia is that it is far from alone in now making an effort to overcome a history of conflict and colonialism in order to become an “own functioning” society.<sup>5</sup> Federalism is always a work in progress. (Watts, 2008).

### *From Fragility to a Functional Federalism: The Case for Being Intergovernmental*

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<sup>1</sup> And, all four now federally mature countries have experienced periods of conflict. As Linder discusses, it would be “fundamentally wrong” to think of Switzerland as a country without historical conflicts. Switzerland is a country created by different ethnic groups speaking different languages and following different religions and thus having to deal with processes of nation-building that in many ways are comparable with processes in developing countries today (Linder, 1994). For the US, the 1861-65 Civil War (War Between the Confederate and Federal States) was a “defining event” that far more than the war for independence (1775-1783) from Great Britain consolidated a nation politically, economically, and ideologically (Hummel, 2007). Canada, which was founded in 1867 as a centralized federation (but since then has become highly decentralized), had its conflicts (notably the Rebellions of 1837-1838 of Upper vs. Lower Canada). During 1922-1926 an Australian Civil War (1922-1926) was a war fought between the Republic of Australia and the self-declared Queensland Republic (for an overview of Australian federalism see Saunders, 2005 and World Bank, 2015)

<sup>2</sup> FGS: federal government of Somalia. FMS: federal member state.

<sup>3</sup> Bird and Vaillancourt, xxxx; Zahar ccc

<sup>4</sup> For a review of the role played as a strategy for nation/peace building in conflict affected states see Bird and Ebel (2007) Bird, Vaillancourt, and Roy-Cesar (2010), Zahar (2013) and, specifically for Somalia, Ross (September 2014).

<sup>5</sup> Watts (2008); UNECA (2010); Ross (2014)

The working premise of this Briefing Note is that there is a ready willingness of Somalis to explore the transition from a “fragile state” to that of a functioning federal nation-state; that is, a system of governance whereby an agreed upon Constitution provides for a “coming together” in an alliance of constituent (member) governments, each of which recognize the legitimacy of a central government on some matters once exclusively the responsibility of the individual member states.<sup>6</sup> (Provisional Constitution, Article 50). *Federalism* is a system of voluntary agreement upon (i) a set of shared rules as well as (ii) areas for self-rule whereby each constituent unit recognizes the merits of the of a system of intergovernmental cooperation but at the same time remains politically accountable to its own electorate (Provisional Constitution, Article 50).<sup>7, 8</sup>

To accomplish this coming-together objective, a task for today’s Somali task is to engage in a dialogue of the principles and practices of the sorting out of the fiscal roles among the Federal Government of Somalia its member states, sub-state governments, and, likely at some point in the process, creating regional governments and multi-state compacts.<sup>9, 10</sup>

And, there is a good case for getting this set of intergovernmental arrangement right. As the public finance literature attests, a well- designed, well implemented system of intergovernmental fiscal arrangements can lead to improved efficiency in the utilization of a society’s limited resources of land, labor, capital and entrepreneurship; increases in the level and effectiveness of the delivery of public services, and, as a result of the convergence of these two factors, enhanced macro-stabilization and economic growth (Ebel and Yilmaz, 2004; Boadway and Shah, 2015)

To be clear, however, for a society to realize these potential payoffs much—a great deal—depends on the design and capacity of the intergovernmental institutions, a design that what may work for one

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<sup>6</sup> In some federations constitutions are explicit that there is no fiscal hierarchy among certain types of governments (e.g., Australia, Canada, India, Pakistan, Switzerland, and the United states). Others are constitutionally federal but in which there is a hierarchical (unitary) element whereby the central government is, as Shah describes, “at the apex” of the intergovernmental arrangement. Bird (Cuba Notes, 2005) makes the distinction between “loose” (Canada, Switzerland, United States, and “tight” Ethiopia, Germany, Malaysia, Mexico, Russia) federal systems. Present day Somalia is difficult to categorize. It is a nascent system of “bottom up” federalism, thus, “loose”, and likely to remain so for some time.

<sup>7</sup> Federalism is typically presented as in the middle of a continuum between that of a unitary and con-federate arrangement (Bird, 2005; Watts, 2008; World Bank, 2015). A unitary system is one in which the central government as the constitutionally bestowed authority to determine what political powers are assigned to “their” sub-central units, but also whether or create, abolish, or change the boundaries of the sub-central jurisdiction. Examples abound (Muwonge and Ebel, 2014). A confederation is a system in which a politically and fiscally weak central government serves and an agent of the member units which have significant spending or taxing lowers (Shah, 2007; Fox and Wallich, 2007).

<sup>8</sup> Bird, 2005

<sup>9</sup> At present, a political map of Somalis will show eighteen (18) administrative divisions, which the World Bank report presents as regions (World Bank, 2015, Table 8.4). The Provisional constitution (2012 ,Article 48) states that no single region can stand alone as a government, as until such time as a region merges with another region(s) to form a new Federal Member State (FMS), a region shall be directly administered by the Federal government for a maximum of two years. It is not clear what a regions formal fiscal role is if its residents do not join a member state.

<sup>10</sup> The topic creating joint service delivery districts will not be addressed in this report; but the principles laid out herein can be applied in a subsequent report the pros and cons of general vs. special purpose governments.

intergovernmental system may not be right for another.<sup>11</sup> And, to add to the discussion, there is also research that concludes that within a nation-state, the sorting out of intergovernmental roles and responsibilities among governments may be asymmetric. Thus, some countries with a federal form of governance have come to a cooperative agreement that for purposes of overall efficiency enhancing and political solidarity there is merit in giving some constituent units flexibility in accommodating different needs. These differences may be spatial (e.g., in terms of natural resource endowment, geography, size of the unit), economic (e.g., rural vs, urban), and/or social and cultural (language, ethnicity, religion).<sup>12</sup>

For purposes of this discussion, two key points emerge. The first is that for intergovernmental system to be capable—to function in a sustainable way—there is a set of fundamental principles that apply to all intergovernmental (and in Somali's case, a federal) society that are then adapted locally. As Bird (2005) puts it: universal principles with local applications.

The second is that for federalism to “work” both the central governments and the fiscally sovereign member states must become develop the intergovernmental capacity generate revenues in order to pay for public goods.<sup>13</sup>

#### *Four Fundamental Questions*

There are four fundamental questions facing any intergovernmental society (Bird, 1996).

- *Expenditure Assignment.* Which type of government, central and local, delivers which set of public sector services?
- *Revenue Assignment.* Which revenues are most appropriate for use by which type of government?
- *Intergovernmental Financial Transfers.* How can fiscal imbalances among the federation's constituent units be resolved when one learns that the amount Somali shillings (dollar, birr, franc, pound, rand, renminbi, rand...) required to satisfy the expenditure and revenue assignment amounts do not add up to the same number. And,
- *Borrowing and Debt Management.* How shall the timing of receipts for financing the public's capital be structured and monitored?

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<sup>11</sup>Bird, Ebel, Wallich, 1995; Brinkerhoff and Johnson, 2009; Yilmaz, Vaillancourt and Dafflon, 2012; A recent and thorough review of the literature is provided by Martinez-Vazquez, Lago-Penas, and Sacchi, 2015).

<sup>12</sup> Congleton, 2006; Bird, Vaillancourt, and Roy-Cesar (2010)

<sup>13</sup> There are three aspects to capacity building: (i) addressing the four fundamental questions listed below (organizational capacity); (ii) developing a set of governmental agencies and instrumentalities accompanied by a clear and transparent set of enabling rules and regulations for their operation (institutional capacity), and (iii) developing a knowledge base and system of learning so that individuals can make the first two forms of capacity effective (individual capacity).

To list these four core questions is the starting point for organizing the pre-conditions for Somali public sector reform. The next task is to work through them in a manner that reflects Somalia's special social, geographical, historical and political circumstances (World Bank, 2015, p37). And, although no single set of rules of how and in what form its federal system will evolve, as time passes a set policy options, and the tradeoffs among them, will emerge that require Somali policymakers and practitioners to continually research and evaluate how specific revenue arrangements in one era may need to be adjusted in another era in order to "fit" Somalia's changing economic, demographic, institutional and technological trends—that is, fits its "fiscal architecture". (Wallace, 2003; World Bank, 2015) But, even with such changes overtime, the principles of federalism, and with that, the four fundamental questions will not change. Indeed, one of the most important merits of a well-designed and well-implemented federal system is that it is a system that accommodates a nation's changing fiscal architecture. (Martinez-Vazquez and Vaillancourt, 2014)

### *Organization of the Remainder of This Briefing Note*

The focus of this *Briefing Note* is on second of the four core questions of intergovernmental finance-- the process of *sorting out* revenue authority and responsibility between the central government (the Federal Government of Somalia, FGS) and its and subnational (state, regional, district, municipal/SNG ) partners.<sup>14, 15</sup> As will be discussed below, some revenues assigned may be exclusive to the FSG, while others will be reserved for the member states and their local governments; and still other types of revenue will be concurrent in their application.. The purpose of this *Note* is to lay out the framework—a way of thinking- of how this all gets worked out. The payoff to getting the assignment question right will go a long way to allowing Somalia to seize upon what many view as a present turning point from that of a fragile to a functioning state. (World Bank, 2015, p 38-39; ICG, February 2017).

This *Briefing Note* is organized in what can be labeled a "stylized sequence". The reference here to "stylized" is made because the reality is that rather than be a smooth step-by-step sequence, the practice of the intergovernmental reform process and its outcome will be framed and, in some cases constrained, by the pace at which Somalia's different types of governments develop their organizational, institutional, and bureaucratic capacity (Thomas, 2006; OECD DAC, 2016); World Bank, 2015). The uneven nature how this sequence flows is reinforced in the case of Somalia due to what the World Bank (2015) refers to as the "state of state formation" —that is how overtime the nascent Federal government of

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<sup>14</sup> Throughout this Briefing Note the state/local/regional/local... types of government may be referred to subnational governments, or SNGs.

<sup>15</sup> The first of the four questions, that of Expenditure Assignment has been adequately addressed by elsewhere (for Somalia, by Peteri, 2017), as have the topics on Intergovernmental Transfers and Borrowing and Debt. Indeed, there is a large, yet due to data limitations, still more developing than robust, literature on all these topics. For reviews with an African focus see Yatta and Vaillancourt (2010), Yilmaz and Tosun (xxxx), and Negussie/.HESPI (2016)

Somalia (FGS) and its Federal Member States (FMSs) work together to create an era of cooperative-federalism (World Bank, 2015, Sec 7.4).<sup>16</sup>

Schematically, the organization of the remainder of this paper is as follows:

<Fundamentals of Revenue Assignment>  
the policy asymmetry of closed vs. open economies →  
finance follows function: establish a willingness to pay taxes and fees →  
from broad principles to local applications →  
theory of the public budget →  
the normative of “who should pay” taxes and fees? →  
how this normative is further shaped by spatial considerations →  
the revenue assignment matrix of which type of government  
is best positioned to utilize different types of revenues →  
which type of government administers own revenues?

### **Universal Principles: The Preliminaries**

To set the stage for sequencing revenue reform, the following two “preliminaries” must be considered: (i) revenue classification terminology; and (ii) the rationale for why the two assignment questions are taken in sequence whereby “finance (revenue authority) follows function (expenditure responsibility).”

#### *Terminology*

Getting “revenue assignment” right requires getting clarity on some terminology. There are three terminology topics to be highlighted in addressing the revenue assignment question: (i) different types of revenues and the distinction between a revenue and receipt; (ii) being explicit as to the definition of a local revenue; and (iii) why the Somali task is one of *sorting* out as distinct from *assigning* revenue authority among governments.

#### Tax vs. Non-Tax Revenue.

As an abstract economic matter, the distinction between “tax” and “non-tax: revenue is not much of a concern. Both refer to the setting of a revenue “price” (also referred to as a “tax cost”) for the delivery of a set of public services.

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<sup>16</sup> The World Bank identifies seven geographical groupings that might serve as part of an informal process of minimizing conflicts over state boundaries and the composition of interim FMS administrations. World Bank (2015), Sec 7.4. The seven are Somaliland, Puntland, Interim Juba Administration (the regions of Gedo, Lower Jubba, Middle Juba); Interim South West Administration (Bay, Bakool, Lower Shabelle), Interim Galmudug Administration (South Mudug and Galgaduud), Hiiran and Middle Shebelle, and, the Benadir Region.

However, in matters of accounting—for example, in developing a *Somalia Census of Government Finances*—one must be careful to not use terms “tax” and “revenue” interchangeably.

Here, there are two considerations. First, mixing up the terms may have implications for whether the amounts collected from certain types of revenue are subject to legally imposed limitations. Thus, in some countries and/or member states there is a constitutional or statutory limit on the amount of a tax that can be collected and/or on the tax rate that a government can impose. For example, in Benin, local governments may determine property tax rates subject to a minimum and maximum range that has been determined by the Parliament. (Vaillancourt and Yatta, 2010, p.36).

One response by a government that is so constrained, is to replace a tax with a non-tax revenue. For example, consider the local government that faces a limitation on the amount of property taxes it can generate; and at the same time still needs to provide road maintenance services. If the funds for paying for this service are paid out of property *tax* revenues that are subject to a levy limit, the funds may be insufficient to pay for the required repairs. If, however, the funding is derived from a nontax revenue such as a “right-of-way fee” assessed on land and building that front on the streets, then the tax limitation is circumvented.

Second, getting the terminology right at the outset will permit a meaningful comparison of Somali’s intergovernmental finances to that of other nation states. What is a “tax revenue” in one country may be classified as a “non-tax revenue” in another. The payments for the use of heating and lighting utilities provide a good example. Some governments classify the payments as a “utility tax”; others may classify the very same payment as a “utility charge”.<sup>17</sup>

A *tax* is a required -by-law compulsory payment to a government in order to finance the provision of government services. (Bird, 1976; Thuronyi, 2005). Names for taxes are excise, impost, cess, levy, and, in the case of international trade flows, customs duties and tariffs.

A tax may be “general” or “specific”. A general tax it is a payment made without reference to any specific benefits derived from government spending. The most common examples are the levies on personal income, retail sales, and general business activities measured by the gross sales (receipts), profits (“company tax”), and/or value added of a business enterprise.

Then there are “specific” levies, again compulsory, on a person or group of people assumed to be the primary beneficiaries of certain public services. Examples include levies the use of utility services, the purchase of motor vehicle fuels and “selective sales/excise” taxes sales on “things” such as food purchased in restaurants, luxury goods, amusements, and hotel accommodations. Too, a specific tax may levied on a products or activity that, though legal, society wishes discourage such as the use of alcohol. And as in Kenya, specific taxes products such as tobacco or khat that exhibit a price inelasticity of demand whereby the quantity of the product used is not much reduced by the imposition of special tax with the result that it becomes a reliable revenue producer.<sup>18</sup>

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<sup>17</sup> The classification of government imposed charges for the flow of utility services tax in South Africa and as a fee in the United States.

<sup>18</sup> Technically: the increase in the percentage change in the specific tax is less than the percentage change in the reduced quantity demanded of the product. Thus, total revenue increases even though the quantity demanded of the taxed product decreases.

A *non-tax revenue*—that is, a payment structured as a *user fee or charge*— is a payment to a government for which there is an explicit *quid-pro-quo* for a service received. Some user fees and charges are clearly voluntary payments—e.g., such as a sum of money paid by an individual who chooses to access a public museum, recreational facility, or game park or motor vehicle parking space; but, many fees and charges are compulsory.

With respect to the set of compulsory non-tax revenues, there are two categories: *regulatory charges* and *infrastructure charges and fees* levied for the purpose of financing the capital construction, and, once that infrastructure stock is in place, financing the maintenance and operations to pay for the continuing flow of infrastructure services (Bird and Slack, 2017).

- *Regulatory fees*, which may be central or state/ local tend are typically place-of- service specific. In nearly all these cases those who pay for the service and be readily matched to those who use a service being supplied. Examples include: payments for documentary services such as land registration, marriage and birth registration, and passport issuance along with charges for market stall rental, slaughterhouse/abattoir use, livestock grazing rights, food inspection, and advertising on public properties.
- In contrast to such regulatory fees, charges and in support of paying for cost of the *public infrastructure services* often have “polycentric” character since infrastructure (e.g., roads, bridges, ferries, sewer and sanitation systems, solid waste disposal facilities, water and ports, inland waterways, hospitals and health clinics, schools, on-street parking spaces and parking garages, facilities, game parks, publicly assisted housing) will be shared by/flow across the boundaries of government jurisdictions.

Financing the Capital Stock. In this case of paying for infrastructure, charges and fees may be earmarked either for financing new or improvements to the capital stock, or for funding the current flow of infrastructure services. Although as countries become more developed most of the capital financing of infrastructure is secured through the use of debt finance (e.g., Johannesburg, 2004-2010; Lagos, 2008-2010; Ouagadougou, 2006), there is also role for some user charge financing such as that of a (i) special assessment fees for publicly provides services charged to the property owners who live on-site along the infrastructure service (e.g., betterment levies for a city sidewalk) and (ii) and “exactions” and “impact fees” levied on developers of an infrastructure project in order to help defray the cost of nearby, but off-the-development site, infrastructure that the public would otherwise have to finance (e.g., a “feeder road” that provides access to a privately develop power plant or charge for using the public right-of-way to install a private telecommunications cable network).<sup>19</sup>

Funding the Service Flow. The primary role of user charges in developed and developing economies alike is that of funding current flow of infrastructure services—e.g. for roads and highways (e.g., tolls, fees or taxes on motor fuel, and in some cases, motor vehicle licensing for both the vehicle and the driver); utilities (amount of the utility output used, and, the aforementioned use of a public right-of way), hospitals (e.g., fees for services at government

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<sup>19</sup> Paulais (2012). Chapters

provided health clinic); sea and port facilities (e.g., wharfage and harbor fees), and permits to use and/or extract natural resources (royalties).<sup>20</sup>

### Central vs. Local Revenue.

For a system of federalism for which an intended high degree of autonomy is to be accorded to the FMS and its local governments, having clarity between what constitutes a central vs. a state/local “own” revenue is of considerable importance. A failure to have such clarity will undermine the very essence of fiscal federalism, which is to recognize that because of spatial considerations different types of government are positioned differently to deliver different types of public services in order to best deliver a total bundle of public services that most efficiently reflects citizen preferences and community needs. In this regard, a potentially problematic matter for revenue assignment is to fail to distinguish between the government that makes the payment for a public service from the government that made the decision to structure the taxes that fund that payment.

What constitutes a central revenue is generally straightforward: it is money that is generated through a central government legislatively levied tax or non-tax fee/charge that is initially deposited in a central government treasury account.<sup>21</sup> This is true even if for administrative (or political) convenience, revenue collection is administered by state government (German *länders*, in Canada the asymmetric case of Quebec province and the oblasts of the former Soviet Union.)

### Local Own Source Revenue.

A topic that merits further explanation is what constitutes a “local” (FMS) revenue—a topic that goes to the heart of the case for a multi-tiered national revenue system of the form envisaged in the Provisional Constitution.<sup>22</sup>

Taxes for local (FMS) may be divided into categories of decreasing local autonomy (Table 1). For a tax or fee to be considered a “local own source tax” the FMS or its sub-state governments (municipalities, villages, districts) must, at a minimum, have the authority to determine rate of the tax or the level of the fee or charge. If this basic requirement of the ability to set its “own” tax rate or level of the fee at the margin—that is, a rate/fee that generates the extra shilling (Sh. So.) for local own use—is not met, then the revenue cannot be classified as a “local” tax or non-tax revenue. One will note from Table 1 that this basic requirement allows for federal-member/state-local governments tax base conformity (harmonization) of tax bases.

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<sup>20</sup> The classification of government imposed charges for the flow of utility services is sometimes classified as a tax (S. Africa) or as a fee (United States).

<sup>21</sup> For Somalia: Provisional Constitution of 2012, Article 125.

<sup>22</sup> This lack of clarity is not limited to country policy deliberations. Thus, the *Government Finance Statistics* (GFS) of the International Monetary Fund are reported in a manner that lumps together as a subnational or local revenue both subnational receipts from tax sharing of central collections and “own” taxes and non-tax revenues (Ebel and Yilmaz. 2004).

**Table 1. Classification of Subnational Government (SNG) Revenues**

	Principle/Criterion	Illustrations
High Revenue Autonomy	SNG chooses the tax base and sets the rate. The only revenue bases sources “off limit” are those for which the Center is guaranteed exclusive rights (e.g., customs taxes, passport issuance, patents).	Highest degree of own – source revenues. Most often pertains to fees and charges. E.g., in Rwanda the property tax and a wide variety of fees, business licenses and permits (Yilmaz, 2010). Kenya, S. Africa, Tanzania, and Zimbabwe also generally provide for tax base autonomy. However in these five cases the central government has the legal authority to override local decisions (Vaillancourt and Yatta, 2008).
	SNG sets tax rate only	Necessary and sufficient condition for categorization as “own revenue”. Under this arrangement the SNG conforms to the central tax base but retains the authority to set its own tax rate without limit (including the option to apply a zero tax rate). South African local governments have discretion over property tax rates (Bird and Slack, 2014). Tax rate autonomy for some local taxes without a central veto occurs in Benin, Niger, Malawi, and Mali (Vaillancourt and Yatta, 2010)
	SNG sets tax rate, but only within centrally permissible ranges	A typical practice is to cap the top rate a local government may impose. Under this circumstance efficiency gains from being federal are greatly diminished (Hungary turnover taxes and property taxes in Benin, Japan, Poland, South Africa, and Russia).
Constrained Local Autonomy	Tax sharing whereby central/local revenue split can be only changed with consent of its SNG	Can result when a local authority collects the tax and remits to the center. Denmark’s Municipal Councils have non-legally binding but well established formal arrangement with the central government “Tax Denmark” autonomously levy income tax surcharge.
	Revenue sharing with share determined unilaterally by central authority.	100% control by center. E.g., Australia (VAT), Democratic Republic of the Congo (total national revenues); Gabon (personal income tax); Senegal (motor vehicle taxes and other specific taxes); Nigeria. VAT and mineral revenues; common in Central and South East Europe.
No Autonomy	Central government sets rate and base of “SNG revenue”	May accompany political decentralization

Source: Adapted from (OECD/Jensen , 2001) and OECD/Blochliher and Rabesona, 2009. Also see Table 2.

The 35 member OECD countries generally accord SNGs a high degree of revenue autonomy, but there is a mixed record in Latin America (other than in the OECD member federations of Argentina and Mexico), Central and Eastern Europe, and East Asia, and South Asia (although India local authorities set property tax rates subject to state discretion).

In Saharan Africa there are several examples of local autonomy, Kenya, South Africa, and Tanzania allow local discretion over the setting of property tax rates (Bird and Slack, 2004). Rwanda local governments have full authority over their property tax rate and base (and collection) as well as a high degree of own-revenue authority to levy fees (e.g., sale of animals, market fees, licenses and permits, and the setting of tolls on locally owned roads and bridges). Yilmaz (2010).

### Shared Revenue

An important implication of the definition of an “own” revenue is that revenues that accrue to one government, typically a central government, that are then “shared” in some manner (some percent of the total collections or by a formula) with other governments in an intergovernmental system are not to be recorded as “revenue” to the recipient government that has no independent powers to affect those revenues (Martinez -Vazquez and Timofeev, 2005; Muwonge and Ebel, 2014). In this case of *revenue sharing*, the monies received are properly classified as an intergovernmental grant, which is a matter to be addressed when examining the third of the four fundamental questions listed above.

Similarly, monies received by a government derived from grants and loans are *receipts*, not *revenues*. Thus, for example, in the case monies generated through of a loan (e.g., from the World Bank or other International Financial Institution) are receipts, which in the case of a loan or bond must be repaid and, thus (i) recorded in the government’s financial records as a receipt when deposited in the local treasury, and (ii) as an expenditure when debt service payments are made. This is why in listing of the fourth of the four fundamental questions facing any intergovernmental society, the language refers to the “the timing of *receipts* for financing the public’s capital”.

### Revenue “Assignment”

The use of the phrase revenue “assignment” became widely used in the public finance literature in the 1990s when the policy focus was on that of the fiscal decentralization of financial roles from historically strong central authorities to “their” local governments.<sup>23</sup> It was a trend and a term that was (in still is) in appropriate use in Eastern and Central Europe, Eastern Asia, South Asia, and Latin America. It is also a term that has crept into—indeed, still typifies-- much of the public finance literature. (e.g., Tosun and Yilmaz, 2010; UNECA, 2010; Vaillancourt and Yatta 2010; Muwonge and Ebel, 2014, and Negussie, 2016).

The problem with the term is that it may imply to some that the decision of “which revenues are most appropriate for use by which type of government” is a centrally determined “top-down” process. In the case of a unitary governmental structure, this is just fine—indeed, just the right way to think about second

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<sup>23</sup> As Peteri (2017) details, “fiscal decentralization” encompasses three distinct arrangements or variants: Deconcentration or administrative decentralization whereby regional offices of central ministries are established in local jurisdictions for the purpose of the composition of local goods and services to be provided; delegation, which can be characterized as an principal—agent relationship among different type of governments and devolution whereby by independent local self-governments are established. Elements of all three variants will occur with federalism

of the four fundamental questions for an intergovernmental society. But this is not the case for a federal constitution that accords a high degree of fiscal sovereignty to the member states

And, on this score, Somalia has a chance to get it right. Rather than declaring that the question that the determination of “which revenues are most appropriate for use by which type of government” is a matter for central government legislation, the Provisional Constitution adopts language that allows for a cooperative federalism: “the responsibility for the raising of revenue shall be given to the level of government where it is likely to be the most effectively exercised” (Provisional Constitution, Article 50, para f).

Thus, other than with respect to four areas revenue roles appropriately reserved for the FGS powers (foreign affairs, national defense, immigration, and citizenship) the Provisional Constitution avoids specifying a checklist of rules of how financial resources will be assigned among types of governments, but rather lays out a set of principles that envisage a process that opens up the opportunity for a knowledge-based dialogue for developing robust intergovernmental institutions to facilitate ongoing negotiation ...” (World Bank, 2015. vi; 36-40; Peteri, 2017). The Provisional Constitution further allows pre-existing states (of which now Puntland is the only practical example) to exercise powers given by their state constitutions<sup>24, 25</sup>.

Recognizing these caveats, the phrases “allocation of revenue authority” and “revenue mobilization” may be interchangeably used to refer to the process of “revenue assignment” throughout the remainder of this *Note*.

#### *Finance Follows Function.*

The four fundamental questions are sequential as well as intertwined. Thus, the decision about the design of only one of the four questions may distort, or support, the design of the other three questions (World Bank, 2015, 38). With respect to the first two of the four—the “assignment questions”, the rule is that the decision of which type of government will be responsible for providing which set of public goods and services (the *function* of government) should precede the determination of the question of which revenues to assign (*finance*). That is, “finance follows function”.<sup>26</sup>

There are two good reasons for the principle of finance-follows-function... along with a very important caveat. The first goes to the matter of question of a citizen willingness to pay taxes—that policymakers cannot knowledgeably establish the required level of subnational revenues independent of having a reasonably clear sense of the bundle of services that citizens expect their governments to deliver. As phrased below, governments tax to spend.

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<sup>24</sup> World Bank (2015). p.36.

<sup>25</sup> There is a further FGS/FMS sorting out dialogue needed with respect to granting FGS the role for carrying out traditionally accepted powers of a central state (e.g., maintaining an army, issuing visas, establishing customs barriers). Peteri, 2017.

<sup>26</sup> Mclure, 1993; Balh and Martinez-Vazquez, 2005; Peteri, 2017 and others.

The second is that ignoring the interplay between the finance follows function rule runs the risk of undermining one of the most basic responsibilities of government, which is to properly macro-manage the national economy.

### Governments Tax to Spend.

The first, and perhaps such an obvious reason, that finance-follows-function probably does not need be mentioned—but then again, it obvious enough that it must said: government’s tax to spend.

Unless citizens see the benefits that accrue to them from paying taxes and fees, a critical element of the social contract that allows a government to count on a willingness to pay for these services will collapse—and, thus, undermine the public finance system as a whole.

And, on this matter, Somalia has some work to do. A review at the most recent data reveals a matter of concern for the FGS, which shows that 84 percent of recurrent expenditures are being spent on the FGS itself, either in form compensation of the central (federal) government employees or its “use of goods and services”.<sup>27</sup> To date the FGS has been able to finesse the need to make the link between spending and a citizen willingness to pay taxes by financing itself through a combination of a (i) trade taxes and fees that are largely paid by –exported to—non- residents and (ii) and donor grants.<sup>28</sup>

But this arrangement may about to change. There is some recent survey evidence that citizens are looking to the new government to do more than pay for its employees and office supplies. In January of this year the Mogadishu-based Heritage Institute for Policy Studies conducted a public opinion poll that found that there is a citizen demand for public services. The need for improved public safety (security) led the list, followed by fixing “a broken education system” (nearly 70 percent of children of school age are not in school), putting a national healthcare program in place (e.g., disease control, community health education and awareness programs, monitoring and regulatory capabilities), and job development (two thirds of the 14-29 year old cohort is unemployed).<sup>29</sup> A related concern (not reported in the HIPS survey) is that the FGS capital expenditures account for less than a half percent of GDP, a policy that if continued will probably guarantee it status as a fragile state.<sup>30</sup>

The FGS current use of nearly all external funds to pay for itself combined with the rising expectations of its citizens and it’s remarkably low investment in providing an infrastructure for future consumption is a clear argument for quickly sorting out the expenditure and revenue assignment questions and moving just as quickly at establishing an intergovernmental revenue system.

### Macroeconomic Management.

The second reason for the finance follows function rule -to-follow-function rule is that getting the rule wrong can lead to a significant macroeconomic mess. Take, for example, the case of the Colombian Constitution of 1991 that incorporated a provision for a rapid increase in the sharing of central revenues with local authorities to demonstrate the nation’s commitment to becoming functionally intergovernmental.

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<sup>27</sup> FGS MoF (2015) cited in World Bank (2015) Table 3.2. Total Recurrent expenditures (\$US 184.5 m in 2015) accounts for 4.5% of GDP (excluding Somaliland).

<sup>28</sup> On average for 2012-14, 91 percent for of total tax revenue for 2012-14) World Bank (2015), p. 16

<sup>29</sup> Heritage Institute for Policy Studies (2017); World Bank (2015). Table 21.

<sup>30</sup> The link between allocating current revenues for the purpose of paying for the public’s capital (infrastructure) and future economic growth is well established. In the economist’s jargon, society reduces its current consumption (saving) in order to ensure future consumption (investing). For a review see Paulais (2012); Ebel and Prasad (2017)

Despite the well-intended nature of “top down” revenue assignment, that the policy failed to re-assign spending responsibilities from the center to the localities culminated in excessive public debt, which then precipitated a private debt crisis.<sup>31</sup>

### Simultaneity in Assignment.

The principle that that finance follows function is not contested here. However, there is a corollary: to the extent possible, make expenditure and revenue assignment decisions simultaneously. Empirical results of cross-sectional analysis suggest that: (i) the simultaneous decentralization of a national government’s taxing and spending powers exerts a negative and significant influence on overall public sector size; and (ii) there is a payoff in terms of improving a nation’s macroeconomic performance.<sup>32</sup>

## **Universal Principles... From Theory to Practice**

### *The Theory of the Public Budget in an Intergovernmental Society*

The traditional analysis of public finance lays out a way of looking at the role of governments by examining three public sector competencies, each of which stems from the economics of private market failure.<sup>33, 34</sup>

- The maintenance of full employment and price level stability (stabilization).
- The determination and attainment of an equitable distribution of income among its citizenry.<sup>35</sup> (distribution of income and wealth, which in an intergovernmental context refers to redistribution policies with respect to both people and places )
- The avoidance of a misallocation of the use of society’s scarce economic resources that results from certain inefficiencies due to the operation of the private market system (allocation).

Clearly, these functions may overlap. For example, tax and fee financing of a highway road project will re-direct resources from private to public sector uses (allocation) and, in the process, redistribute income

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<sup>31</sup> Ebel and Prasad, 2017.

<sup>32</sup> Ehadie, 1994; Ebel and Yilmaz, 2004; Boadway and Shah, 2013.

<sup>33</sup> Musgrave (1959 ); Others have argued for a broader model depending on the special circumstances of a system under change Bird, Ebel, Wallich (1995) note that in the Central European “post-socialist” transition the functions of privatization of the state-owned-enterprise regime and the maintenance of the social and health safety net became key local functions.

<sup>34</sup> The sources of “market failure” whereby the private market-price system fails to efficiently allocate resources include e (i) good and services for which there is a demand but for which the exclusion principle does not apply (pure public goods); (ii) concentration of n of monopoly power; (iii) positive or negative externalities (incomplete markets (spillover effects));(iv) incomplete markets (under supply of some goods for which there is a willingness to pay); (v) incomplete information, and (vi) macroeconomic disturbances. This topic is addressed Musgrave (1983); Stiglitz and Rosengard (2015), and others.

<sup>35</sup> The function of/responsibility for equalizing incomes by place—in the case of Somalia—across its geographic member states and regions—is the topic of the third of the four fundamental questions, which is how to structure a system of intergovernmental grants.

in favor of residents living along and at the end of the transportation path (distribution). If the project is very large it may be a component of a centrally funded job-generation effort (stabilization). In addition, the method of financing infrastructure (likely a mix of bonds, special tax and revenue assessments, asset sales and external grants) may have another set of allocation, distribution, and stabilization effects.

This stabilization-distribution-allocation breakdown provides a the basic framework for addressing the fundamental questions of public budget policy to be addressed in this *Briefing Note*—which type of government, central or local—should be charged with the performance of each these three tasks? And, given that answer, what type of revenues should be assigned in order to carry out the three roles of a public sector?

Underlying the answer to both questions is that of the degree of “economic openness” of the governmental jurisdiction. In a “closed economy” whereby the central government has the legal authority and access to the regulatory rules that enables it to isolate (or, at least, buffer or control) parts of its economy from the rest of the world, impacts of fiscal policy can be largely limited to the residents of the jurisdiction. That is, the “spillovers” to neighboring nations of the benefits of public budget policy can be minimized. Although no economy is fully closed, especially in this era of globalization, a well-functioning national (in Somali’s case, federal/FGS) government with the authority to restrict the flow of goods and services and the factors of production (e.g., labor, capital) across its borders approximates this structure. As a result, the interjurisdictional factor and goods mobility *within* the nation-state need not become a major consideration in key aspects of national budget policy

However, a crucial asymmetry exists for the making of budget policy in the member states of a federation due to the more “open” nature of their economies. Unlike the well-functioning central government of a nation state, the member states in a federal society will not have the authority to legislate tariffs, quotas, or license barriers to restrict the flow of goods and services across their borders. Nor, will member states and their localities have the authority to constrain the interstate movement of the factors of production through migration controls, capital controls, foreign exchange rate policy and the like.

Given this asymmetry, the character of central vs. member state budget policy changes. One implication is that the stabilization and distribution goals are primarily the concern of the central government. A second is that this assignment of competencies leads to an important first step in the sorting out of revenue authority among different types of government.

## Why Central (FGS) Tax Policy Matters

Stabilization. There are reasons why in a well- functioning federal system, the center rather than its constituent subnational units, can best carry out stabilization policies. The first follows from the open-economy reality that subnational governments will be unable to effectively induce changes in their output, employment, and price levels through fiscal policy—the discretionary manipulation of own-revenues and expenditures. Although subnational tax and spending policy may be directed toward local residents (e.g., a large scale public employment program, or an attempt to change the rate of control the rate of change of the price level), the stabilization effect within the jurisdiction will be greatly dampened because markets (factor and product) are so interrelated that spending leakages result.

For example, if a single FMS were to take on the task of a “full employment” program that reduces its rate of joblessness well below its neighboring state, one can not only expect an in-migration of new residents making the job search, but also, to see the spending of residents leak across state borders. This is particularly true for Somalia which is both highly consumption intensive (in 2014 household consumption was equal to 134 percent of GDP) and import reliant (2014 net exports are a negative 47 percent). Thus, for a given level of state output, the unemployment rate problem will re-emerge. In the economist’s terminology, the spending multiplier will be low (World Bank, 2015, Fig 3.3).<sup>36</sup>

The same fiscal policy frustration will occur if a member state attempts to control price level (which is not the same as controlling the cost of living). Such a subnational attempt at fiscal policy would likely require the FMS will to either (i) raise taxes to a such a level that it would lead to unemployment and/ or (ii) engage in deficit spending, which, if the debt is not well managed, will pose a threat to the sought-after price stability for FMS and FGS alike (World Bank, DMPED, 2017).

In contrast, central government has a critically important stabilization partner—an independent central bank that is designed to regulate the nation’s banking system control the supply of money and credit. This, in turn, can facilitate the center the ability to engage in deficit (or surplus) financing of its current

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<sup>36</sup> Recognizing this open economy reality does not rule out the merits of a member state or its sub-state governments instituting a local economic development strategy (e.g., infrastructure spending to enable private sector growth, making the distinction between the public sector provision vs. of a public service production of a public service); nor does it suggest that the member state should not become the agent of the central government for funding and implementing a national employment policy through a central-member state grant program. Indeed, there is good case for just such intergovernmental cooperation.

operating budget and thus, more effectively address than can subnational governments cyclical shocks which are typically national in scope (symmetric across regions).<sup>37,38</sup>

But, to be able to do carry out such countercyclical budget policy, the center must be in a fiscal position to do so, which, in turn, means it must have access to broad based revenue tools such as a broad based tax on consumption (value added) and income (personal income, including capital income and levies on business profits).<sup>39</sup>

The second reason that stabilization policy is a central function is that managing stabilization policy is similar to an insurance contract whereby the central authority agrees to the task of evening out income variations that result from regional or exogenous shocks. It follows that the center is best suited to assume the risks of volatile revenue sources; in particular, taxes on natural resource exploration and exploitation (petroleum, minerals, fishing, forestry) and the notoriously capricious company tax on corporate net income (profits).

And third, there is the practical matter it is the center's and the central bank's job to coordinate on foreign exchange policy.<sup>40</sup> It follows that the center must have control over international trade taxes. Thus, the authority to collect customs duties and clear imports into the country becomes a central responsibility.

Distribution. As noted above, there is both a "people" and a "place" aspect to a policy of the distribution of income and wealth among a nation's citizens.

*People.* When it comes to securing an equitable distribution of income among citizens who have different degrees an ability-to-pay taxes, the central vs. subnational division becomes less clear-cut than that for carrying out the stabilization function. However, for the same reason of the open nature of subnational economies, securing a broad degree of fairness equity in the overall distribution of income among a nation's population largely becomes central responsibility. This is not to say that a member state or its local governments will not have a role in poverty reduction. Indeed, the proximity of a state/local government local to the poor, and familiarity with and understanding of the institutional situations and

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<sup>37</sup> An independent central bank will not directly lend to the federal government (it's up to that government do borrow and then manage that debt) nor does the presence of a central bank guarantee good coordination of monetary and fiscal policy (Boadway and Shah, 2009).

<sup>38</sup> This argument as well as the counter-argument made by some question a central role in controlling the money supply is addressed by Boadway and Shah (2009, Ch.14)

<sup>39</sup> A further argument for central authority for implementing a value added tax stems from the need for one government to act on behalf the entire nation to deal with the complexities of tax administration

<sup>40</sup> Which is not readily accomplished with Somalia's dollarized economy.

hostile environs the poor inhabit in different regions and communities, provide advantages to decentralized governmental units in designing and implementing antipoverty policies. (Bird, et.al, 1995; Rao, 2002). The policy implication is that, in the developing-country context, the central government will (i) have to have the revenue tools to generate the resources for poverty alleviation programs as well as (ii) be able to turn to state and local governments to undertake program design and implementation.<sup>41</sup> Again, federalism as a cooperative venture.

*Places.* Once the new Somali becomes intergovernmentally revenue capable, two types of fiscal imbalances will emerge. The first is a *vertical fiscal imbalance* between expenditure and revenues among different types of government. The vertical imbalance reflects the fiscal reality that, as intended, central governments will have control of the nation's most productive tax bases –e.g., the taxes on personal and general business income. The second, which is already now the Somali case, is a *horizontal fiscal imbalance* that occurs when the differences in expenditure needs and revenue-generating ability vary across similar types of subnational governments since some jurisdictions are more revenue base rich and/or less need impacted than others. The policies for addressing /adjusting for these twin fiscal imbalances, which goes to the third of the four fundamental questions facing any intergovernmental society, is adequately discussed elsewhere (Abdullahi, 2017).

#### Why Local (FMS) Revenue Policy Matters

The Allocation Function. The foregoing discussion leads to a focus the third of the three competencies of the public budget— commandeering resources to paying for a public goods and services ranging from health clinics and elementary/secondary education to picking up the garbage to arranging for police and fire safety (Peteri, 2017). Getting the allocation competency right is the *raison d'être* for the state/local role in revenue mobilization.

The reason for the primacy of the state/local role in allocation competency stems from the “decentralization theorem” that the set of governments closest to the citizens can adjust budgets to local preferences in a manner that best leads to the delivery of a bundle of public services responsive to community preferences. Subnational governments—the FMS and its localities—thus become the vehicle provide services to identifiable recipients until the tax price for those services reflects the benefits received (Oates, 1972). To put it more casually, but aptly, the elected legislative bodies of Puntland and Somaliland will have far more knowledge of the public service demands and how to supply and pay for those services than will the Somali national parliament. It follows that to in order to be able perform this role for what they have been elected to do, state/local officials-- subnational governments-- must be

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<sup>41</sup> This is an example of the *delegation* variant of an intergovernmental fiscal system. (Peteri, 2017),

allowed to exercise own source taxation at the margin and, too, be in a financial position to do so. This is why getting right state and local revenue autonomy matters to the success of a federal society.

### *Who Should Pay? Benefits Received*

Along with the decentralization theorem, the *benefits received* serves as a foundation for the efficiency and equity gains that a well- designed system of federalism can provide. In this context, “efficiency” requires that revenue policy should be designed so that this who benefit from the provision of a flow of public services are those who pay for those services. This fits the public economist’s broader concept of efficiency that occurs when a society is getting the maximum benefits from the use of its scarce resources. (Mankiw, 2015, 7e.). As it turns out, the benefits approach tends to be not only efficient but also equitable. Thus, just as one who consumes a private good or service in the market place pays a market prices for that purchase, the user of the public service will pay a tax price.

In a private market exchange where there is reasonable degree of competition among buyers and sellers matters, the private market price mechanisms provides the efficient user/payor *quid-pro-quo*. But, when one turns to how to collectively set tax/revenue prices, spatial considerations come into play, not only regarding the type of revenue for a government to utilize but, too which type of government is best-placed to utilize which revenue

Though at first glance the matter of “which government shall have the authority to raise which set of revenues?” may appear overly complex, if the policymaker proceeds by applying the principle of spatially matching benefit areas to financing areas and, then, having done that, locally applying the principle to the special fiscal architecture circumstances of Somalia, things can work out rather well.

To further sort this out, consider the two classes of public service benefits: *specific* and *general*. In each case the resolution of question of “which government” shall have the authority over which revenue source” comes down to the principle of matching those who benefit to those who will pay. Thus, when the match of the benefits of a public service are largely (if not exclusively) derived largely by the residents of an FMS or to an even smaller area with in an FMS, the financing area should be state and/or local. However, when the flow of services “spills over” over local boundaries with there will be a case for tax base overlapping, or concurrent revenue assignment among governments. This benefit area may so significantly cross FMS boundaries and/or be of such benefit-importance to the broader Somali population that there will be a concurrent federal role.

In its most strict interpretation, the benefit principle dictates a reliance on user charges and fees. Note that application of the benefits principle does not necessarily require full cost recovery or the restriction

of levying the tax or fee on only residents of the taxing jurisdiction. This is because the beneficiaries of the net fiscal benefits of a flow of subnational public services may not reside in the tax or fee levying benefit area.<sup>17</sup> In this case, some of the beneficiary charge (or tax) must be designed so that it can be shifted to the non-resident. Take, for example, the visitor to a Somali city who benefits from being able to use local streets and enjoy the other public amenities of her/his visit. Now the task for the local council to come up with a set of taxes and/or fees that while legally levied (tax impact) on all users of visitor activities such as lodging, entertainment, and restaurant meals, will be effectively shifted on to the non-resident (tax incidence).

### Specific Benefits

FMS and its localities. As policymakers consider the imposition of a system of beneficiary charges, a key consideration will be on how large a specific a benefit area may be. In most cases it will be determined that fees and charges are particularly well suited for use by a state and local authority. As Bird (1996) advises, “wherever possible charge”. Examples from sub-Saharan Africa include: <sup>42</sup>

- Fees charged for direct use of a facility or consumption of a service: schools, school text books, slaughterhouses, utility consumption (electricity, water), sewers and sanitation, refuse collection, bus terminals and bus terminal services, rental cars, funeral services and funeral service cars, cemeteries billboard and banner advertising, garage services, fire brigade services, parking, road and canal tolls, entry fees to facilities such as museums, stamp (documentary) fees, sports facilities, and parks, motor vehicle tags and inspection, motor vehicles including motor bikes and land cruisers, right of way use (e.g., on telecoms) and road use charges (which may be structured as a tax for example, on motor fuel or other vehicle characteristics such, as in Somaliland, the value of the vehicle).
- License fees paid for the privilege of an activity (business establishment, driving permits, vehicle use, and stamp fees to defray the cost of public monitoring of an activity such as land transfer and titling).
- The betterment levies noted above that defray the to pay for local infrastructure (measured by increases in land values consequent on the granting of planning decisions, special

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<sup>17</sup> The term "net" is stressed to indicate that those spillover flows (externalities) may be positive or negative. For the negative externality (the most obvious case is pollution), a tax or fee may be levied to reduce the net costs through reducing consumption or production.

<sup>42</sup> Some fees and charges listed here may be central in some countries.

assessments to cover costs for things such as sidewalk construction and repair, and developer fees to finance both on-site and off-site infrastructure).<sup>18</sup>

Central Fees and Charges. When the service derives from the role of the central sovereign state, the following examples match centrally: Fees for (i) clearing customs; (ii) patents and trademarks and (iii) passport issuance, (iv) airport arrivals and departures; (v) airline landing and slotting; (vi) ocean fishing permits; and (vii) food and drug safety inspections.

Overlapping/Concurrent Charges. Recognizing the multijurisdictional (polycentric) nature of infrastructure services that cross government boundaries, user charge finance takes the policymakers into the realm of coordinating benefit areas, including that of developing regional (e.g., multistate or even international) compacts for revenue authority. The charging for potable water services is a good example whereby the source—the supply—of water is typically in a different location than the place of distribution to the final user, who, though distant from the supply area, nonetheless benefits from water supply the provision and, thus the costs associated with infrastructure planning, construction, maintenance, and monitoring (Frank and Martinez-Vazquez, 2016; Ebel and Vu, 2016). Now a water system-wide charge must be authorized for imposition by a multistate regional authority, the center or the FMS (or the center or FMS that is acting as an agent for a regional authority). The supply charge may be both a lump sum fee (capital cost recovery) and periodic fee (operating and maintenance) on the final consumer.

But this is just the water *supply* factor. Next comes the charges required to cover the cost of *distribution* to the final user. Now identifying the benefit area is a more straightforward matter since there is likely to be a clear local character to the distribution function and thus, the payment mechanism; e.g., a commercial and household connection fee complemented with a water use fee that may vary with the (i) amount of water consumed; (ii) timing of use; and/or (iii) by property type or type of consumers (Bahl and Linn, 1992). Similar examples of having to sort out revenue assignment to satisfy the matching of beneficiary with payor include the supply and distribution of other utility services (telecommunications, electricity), the use of canals and other waterways; mass transit, and disposal of solid waste.

There are two final observations to be made regarding special benefit charges: (i) to the extent that *quid pro quo* relationship between user and payor eases the identification aspect of revenue

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<sup>18</sup> On-site infrastructure, some of which may be part of the developer's own responsibility, includes public facilities constructed on or adjacent to an area being developed (roads, pavements, water and sewage distribution networks), Off-site infrastructure includes development-related arterial roads, schools, fire and police stations, parks, and museums, whether or not built on the developed area,

administration, this also solves the question of which government shall manage and monitor a service; and, (ii) quite apart from which government levies which fee, there is also an educational merit of reminding the citizen that prices (costs) can be public as well as private—that is, the reason governments tax and charge is to address spending needs.<sup>43</sup>

### Generalized Benefits

More conceptually problematic, but easier to implement (administratively, if not politically), are the "generalized benefits" that can be related in a logical way to services received. Thus, there is a rationale for FGS and well a FMS (and, in some large area cases, localities) for the *broad-based taxation of the business enterprise* on income or receipts: using the business enterprise as a tax collecting intermediary serves as a conduit for taxing individuals wherever they may reside (including nonresident factor suppliers, such as shareholders) for the benefit of local services accruing initially to the business enterprise. Now government services, central and local, are appropriately treated as a factor of production similar to land, labor, and capital, and their costs should be incorporated into the pricing structure.

The generalized case also arises for state/local *broad-based personal taxation (PIT)* if it can be determined that the generalized benefits of local government spending are related to one's improvement in production (income earned) or the ability to consume (income spent). That governments create those taxable benefits are applicable for a central government (there is little controversy here) and, in many situations, a subnational entity (for example, employment-generating agglomeration centers such as Mogadishu, Kismayo, Bosaso, and Hargeisa). In the case state and /or local use of the a PIT, unless there is some other reason to believe that benefits change more or less rapidly than income or consumption, it is reasonable to rely on flat-rate taxes for financing generalized services (McLure, 1999). Too, for purposes of simplicity and ease of revenue administration (both of which are aspects of efficiency), there is merit to a harmonization (conformity) of the tax base across all PIT levying jurisdictions.

For the central or state entity, either a production (origin) tax, such as those on personal income or payroll, or a destination approach is acceptable ( e.g., a FMS surcharge levied on top of the central VAT base).

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<sup>43</sup> What is not straightforward are the twin questions of and level of a charge. There are several options, the choice of which depends on both the nature of the activity for which there is a charge and administrative considerations. The design (and, with that, the level) options include: marginal cost pricing (for the economist, conceptually neat, but hard to define and measure); average cost pricing (easier to calculate if, as with other design approaches, only financial costs are considered); multipart tariffs (in the simplest form, fixed asset charges, such as a connection fee combined with an additional fee for use of a system); and going-rate charges (or, perhaps more aptly, fiscal expedient whereby the degree of user demand elasticity is captured).

However, for the local (eg. a sub-state urban area), an additional inquiry is necessary, because people may not work where they live. If the benefits are most closely linked to the production or earning of income, the jurisdiction should opt for a production-base tax, such as a tax on payroll levied where the employment occurs. But, if the benefits from tax payment local spending are more likely to be related to the public's enabling of a destination market, the policy design argues for resident-based income taxation and/or a sales tax. Which is the stronger case? *A priori*, "basic" local services (for example, schools, health clinics, and neighborhood libraries, maintenance of local roads and sidewalks, and street lighting) are consumed by (benefit) those who live in, rather than work in, a jurisdiction. This suggests that the FMS and its localities should stick to resident-based taxes on personal income and a retail sales tax.

Using the generalized benefits argument, could a FMS end up with generalized benefits taxation on both production and consumption? Yes. The production rationale follows from the business enterprise rationale, the consumption from the tax-financed services to residents. Individuals have several roles as taxpayers: factor suppliers; income earners; consumers; and wealth holders.<sup>44</sup> Each role provides a "tax handle".

A similar benefits case can be made for local use of the tax on real property, residential and commercial. Users of property, owners and tenants alike, are beneficiaries of a wide array of generalized local services for which specific charges are either not feasible or adequate for cost recovery. These services range from community public safety and the judiciary, to primary education and community health and sanitation.

#### *Further Spatial Considerations. Degree of Tax Base Mobility.*

As noted, well-functioning FMS and its local governments are able to access some benefit tax bases more readily than can a central government (some user charges, retail sales taxes, and real property taxes).<sup>45</sup> The FMS/ local list includes revenues that not only tend to satisfy the benefits rule, but also have the merit of being levied on activities, and tax bases that are relatively immobile (real property and, depending on the degree of resident or worker mobility, payroll); and for which the benefits of subnational services (expenditure assignment) can be identified. A range of specific taxes and fees that have already been identified above fit that criterion.

The *taxation of natural resources* presents a special case. Since natural resources such as petroleum (including for Somalia the potential for off-shore exploitation) and mineral mining (feldspar, gypsum, iron

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<sup>44</sup> The imposition of tax on inheritances or estates is not addressed here.

<sup>45</sup> Taxes on other forms of property (for example, an intangibles or wealth tax) are not well suited to open economy jurisdictions.

ore, kaolin, limestone, quartz, silica sand, tantalum, tin, and uranium) are often location-specific, they satisfy the tax base immobility guideline and, thus, a case for FMS and local taxation.<sup>46</sup>

However, other considerations argue for national taxation. There are three. First, as noted above in the discussion of the center's stabilization role, natural resources revenues are notoriously volatile, thereby making it just the wrong revenue to rely upon for local government that must have tax certainty to pay for the "necessary" local public goods such as water distribution, health clinics, and preschool and primary education. Second, because an FMS government cannot take on debt to the extent that the center can, the FMS a locality is not in a position to deficit finance once there is a downturn in global prices of the natural resources and revenues plummet. Third, the equity argument against local taxation of natural resources is a powerful one. Since natural resources are typically unevenly distributed across regions, assigning natural resources to local governments would generate subnational differences in fiscal capacities among jurisdictions.

The assignment solution is one of concurrent, but not necessarily, tax base overlapping taxation: First, assign to the central government the role of broad based taxation of income or receipts generated by business firm that is extracting/farming/managing the natural resource; and then also set up a state/local tax regime to cover the costs of (i) controlling (and/or cleaning up) local environmental degradation and (ii) building and maintaining a local off-site local infrastructure that services the natural resource business activity.

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A matrix that pulls together the forgoing discussion is presented in Table 2. The presentation is different from the typical revenue assignment matrix that is organized by type of revenue (which, for getting a quick first-glance at how revenue assignment might work can be useful), and instead by following text presentation is arranged so that one can readily see the logic of how the *Universal Principles* (reading down the left vertical column) serve to organize and illustrate *Local Applications* (reading across and then down the four columns). The format further allows one to note practical illustrations of how different countries sort out (or, in many cases agree upon) whether certain types of revenues are central, state, local or concurrent or overlapping (the column on the right side of the Table). A special effort has been made to illustrate Sub-Saharan African practice.<sup>47</sup> When using table to it is important to keep in mind that because of the Universal Principles/Local Applications format, in "assigning" a type of revenue among governments it is the principle that should prevail. But, this said, there are cases whereby for type of tax is inappropriate *vis-à-vis* one principle, but acceptable considering another principle. This does not mean that a revenue assignment cannot be, and should not be, made; rather that the principle that

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<sup>46</sup> [www.faoswalim.org/.../geology-and-mineral-resources-somalia](http://www.faoswalim.org/.../geology-and-mineral-resources-somalia)

<sup>47</sup> With the assistance of Ms. Nellie Wanjiku Gaithuma

justifies the assignment of a particular tax—central vs. subnational—should be applied with an awareness that balance of competing, or even, contractor objectives must be considered. .

To take an example: in going through Table 2 it is clearly noted (and also in the text) that for purposes of *macro-stabilization* policy (e.g., ability of a government to engage in countercyclical fiscal policy) assignment of a broad based general business tax on business enterprise (e.g., taxes on gross receipts, value added, VAT, business net income (profits) to a FMS is inappropriate. Thus, for example, the VAT should be assigned to the FGS.

However, when one then considers the principle of benefits received, then the case for an apportioned FMS general business tax is quite clear. There is not an inconsistency or contradiction here. What is being said is that for reasons discussed in the text, the FSG must be the primary/most intensive user of the tax, but that for reasons of tax base accessibility an FMS should certainly also turn to general business taxation and in the interest of ease of revenue administration and minimization of taxpayer compliance costs consider a the approach of an FMS imposed “own-source” surcharge that conforms to the FGS base. Canada employs just such a “Dual VAT” system. (Ebel and Kalambokidis, 2005).

[Refer to Table 2 which is attached at the end of this document]

## Revenue Administration

Just as the tax assignment sequence is a way of thinking logically about how to go about the job of resource mobilization in an intergovernmental society, so, too, is that of sorting out revenue administration functions for Somali federalism. Thus, it is not too early in this historical Somali process to be simultaneously thinking about the question of which government, FGS or FMS should collect the revenues.<sup>48,49</sup>

### Why Revenue Administration Matters

There are three reasons why as paying attention to, and getting “right”, the revenue administration process matters. The first is that to address only the topic of revenue assignment topic begs the question of how to collect the assigned revenues, which, of course, is why one goes through the assignment sorting out task in the first place.

The second is that “tax administration is tax policy”—that is, although it appropriate to first focus on the questions of intergovernmental assignment tax policy, it is also the case that well how the tax is administered can determine the extent to which the intended policy outcomes are accomplished (Casanegra de Jantscher, 1990). Once a Parliament or Legislature drafts and then approves a tax law, tax administrators step in: (i) writing the a rules and regulations to implement the law (ii) identifying and registering the taxpayer; (iii) notifying taxpayers of their tax obligations; (iv) setting up a taxpayer assistance facility; (v) sending out the tax bill while, *inter alia*, having to consider what to do if there is not a reliable postal and street address system; (vii) establishing tax payment/collection mechanisms; (viii) establishing a payment process; (ix) enforcing the tax payment obligation; (x) setting up a taxpayer appeal process; (x) putting in place internal and external audit regimes, and (xi) coordinating with the offices of the Budget, Treasury, and Comptroller to producing on schedule a required set of financial reports to the satisfaction of credit rating agency experts and the taxpaying public alike.

The third reason why the topic of how revenues are implemented matters is that revenue administration is not only key minimizing the costs of taxpayer compliance, but also about creating a “tax culture” whereby citizens have confidence that the process efficient, uniform, and free of corruption. Why?

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<sup>48</sup> On terminology: for purposes here the terms “tax administration”, “revenue administration” and a system for system for “tax collection” are used interchangeably.

<sup>49</sup> Further on terminology: recognizing that in the Somali federal system local governments are chartered by the state (FMS), a reference to FMS revenue administration is made with the understanding that such reference may include local government administration.

Because when it all comes together, for a fiscal system work requires a high degree of voluntary citizen taxpayer compliance (Cyan, Koumpias, and Martinez-Vazquez, 2016).

### Which Government Should Administer Which Set of Revenues?

In establishing an intergovernmental system of revenue administration, several critical questions arise for Somalia's to sort out.<sup>50</sup> These include: is there a sequence for addressing the components of revenue administration listed above—that is, what is *the* priority when everything is a priority? How does Somalia's revenue architecture—its demographics, economic base, institutions (private and public), and access to technology—shape what makes will “work”? Will there have to be “presumptive” set of taxes, charges and fees to complement tools that typically apply to a formal and relatively easy to tax economy? How can costs of collection and operation be measured, let alone managed? What is the nature of the tradeoff between the accounting cost argument that tax administration design should implemented to minimize the costs of operation *1985 vis-à-vis* the implicit, difficult to measure and yet very important costs of a loss of political and social accountability that may result from a cost accounting focus? (Vaillancourt, Clemens, Palacios, 2008; Martinez Vazquez, 2010; Commins and Ebel, 2010). And, as it embarks on building its organizational capacity to become a function federal state, what can experiences of other nation-states can Somalia draw on to inform the intergovernmental arrangements for administering revenues?

The focus of this discussion is on the last of these five questions. As with the preceding sections on revenue assignment, the purpose here is to take a first Somali-relevant look at international practice with a special focus on the question of whether an activity, in this case revenue administration, should become a central, state, local or concurrent task.

### Universal Principles, Once Again

For a start to look into this topic, there are four “overarching” findings that emerge from international practice and “fit” with the revenue assignment discussion (Bird, 2015.)

- The questions of (i) “which type of revenues are appropriate government” and (ii) “which type of government shall administer which taxes” are related but separable.

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<sup>50</sup> Questions, some of which Martinez-Vazquez and Timofeev note have received far too little attention (Martinez-Vazquez and Timofeev, 2010).

- As is also the case for addressing the all four of the fundamental questions facing any intergovernmental society (page 4 of this paper), there is “no one-size-fits-all” right answer to choosing between central vs. subnational revenue administration.
- Recognizing the content of these first two findings does not imply that one that there are no lessons to be learned addressing the question of “which government administers”.
- Just as with federalism generally (as noted above, Watts 2008) “getting right” revenue administration will be a work in progress. Although are guidelines for a well-designed and well-implemented system of revenue administration, what may make sense in one era may not be the right way for another time.

### Centralized vs. Decentralized Administration

International practice reveals several models of how governments sorted out the intergovernmental structure of revenue administration. Four models are illustrated in Table 3.

- Fully Centralized Administration, which may, or may not, be accompanied by SNG revenue autonomy;
- Independent Tax Authority whereby each type takes on the role of administering its set of own-legislated revenues;
- Decentralized Administration where the federal member state serves as an agent for collecting its own revenues as well as all or some centrally legislated taxes;
- And systems that can best be described as an asymmetric mix each of the three types bulleted above.

Also as with Table 2, the format of Table 3 is designed to focus on (i) federal systems but, too, with appropriate references to unitary arrangements and (ii) the type of tax practice (in this case, administration rather than assignment) rather than organize the topic on a tax-by-type of tax.

#### *Centralization of Revenue Administration*

For countries that functioning central government and central government tradition, the minimization of cost-of- administration approach is often (but as one will see in the case of China and Germany, not always) cited as a decision in favor of some form of central revenue administration.

A core argument is that there are cost-minimization merits a centralized system that allows one to take advantage of economies of scale and scope that range from drawing on overhead-spreading activities bulk purchasing of supplies and equipment (scale) to being able to have in one place a large, well trained technical staff that can collaborate on related tasks (scope).<sup>51</sup> The case for centralization further goes to

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<sup>51</sup> Clearly there may be other that cost factors at play. These range from the factors such as a continuing tradition, or on some cases, the legacy, of command and control political systems (notably, for Africa, including post WWI

the merits of reducing costs of taxpayer compliance—e.g., reducing the number of points of filing and other regulatory contacts between taxpayer and tax administrator (a “one-stop taxpayer window”). There is also the argument that centralized administration that the tax agency can best institutionalize anti-corruption offices.

#### *Decentralization to State/Local administrations*

The argument that smaller can be better recognizes the merits taking advantage of features such as overhead cost-management. But the then argument proceeds that having a tax office that is closer to the taxpayer and taxpayer circumstances reduces other indirect (including implicit) costs that will occur by having the taxpayer have to deal with a revenue official in some distant large bureaucracy. Factors cited include the advantage of local tax officers having local knowledge of a revenue base and the unique profiles “their” the taxpayers.<sup>52</sup>

There is also the argument that in with decentralized operations citizens can more readily recognize and address and corrupt administrative practices—the same merit asserted for pro-centralization, but with a two different “twists” The first is that citizens tend to pay much closer attention to how their local government is operating, and when it violates certain social norms, they can more easily politically organize to control those practices (Smoke and Taliercio, 2007) The second, which is a combination of the expedient and practical a bit perverse, is that it is can be more difficult to clean up a large central bureaucracy than it will be to “fence off” one of many state/local bureaucracies. (for a review of the corruption literature, see Boadway and Shah, 2009)

#### *Making the Choice of Which Government Administers*

So, which works “best”, central or state/local? It depends on the presence and interplay of many organizational, institutional, and human resource variables. To recognize this—that there are complexities-- does not make making the choice an insurmountable task. Just for a start for Somalia to consider: it may make sense for the FGS to make as one of its priorities the setting of up of a bureaucracy to structure and administer one of the most important and generally agreed upon of centrally assigned taxes, the value added tax (VAT). , which, among other things, entails tracking nationwide activities such as the proper filing of multistate credit and invoices and the imposition of border tax adjustments . Similarly, a case can be made that since the Constitution makes international trade policy is a central government competency, there is merit in further customs tax administration.

However, when it comes administrating of a clearly local tax base such as the property tax, a retail sales tax, or the range of user fees for funding the current flow of infrastructure serves to locally owned public assets (e.g., local roads, utility service distribution agencies, parks and recreational facilities), the tilt is will be largely state/local.

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colonialism) to efficiency consideration of (small) geographical size and population density. There are also similar non-cost accounting decentralization of administration factors again including geography size and population but also the nature of a nation state that is fragmented due to variables such as ethnicity, language, religion, and the urban vs. rural mix (Bird and Ebel, 2007). For a checklist of revenue centralization “pros and cons” see Mikesell, 2007.

<sup>52</sup> The topic of the role of traditional authorities in revenue administration is not addressed here. For a discussion of how traditional authorities function as local governments, see Jackson and Marquette, 2003 and UNECA, 2007.

In addition there is the fiscal autonomy argument that if one type –of-government agency (centralized or decentralized) is tasked with collection of revenues for another type of government, that there may be an incentive for the tax administrator to make a greater effort to collect “its government’s” revenues. Mikesell characterizes the Soviet Union during the transition as having dual administration: while the tax inspectors were officially and organized as part of the central government (deconcentration), the local field staff had an incentive to be responsive to the interests of the local authorities that provided them office, heat, and supplements to their salaries. One result was that regional authorities received cash and the central government in Moscow received an in-kind payment that was arbitrarily valued. This illustrates the incentive problem/question: will revenue administration efforts be when proceeds of that effort go to another government treasury? (Mikesell, 2007).

As for the “one –stop-window” arrangement for easing compliance-- it can cut either way. The typical Scandinavian practice opts for the centralized administration. That works for the Scandinavians. But the same one-stop arrangement fits the decentralized approach in the case of Germany.

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The task ahead for Somalia is to sort out the “it depends” by taking into account several factors ranging from the (i) type of revenue to be administered (eg. VAT vs. the real property tax ); (ii) ability to take advantage of institutional lead of the already established revenue administration capacity of Puntland and Somaliland, and (iii) a cooperative recognition by all that although will take some time for the FSG to become fully revenue administration capable, there are potentially significant payoffs to be had for FGS and FMS alike..

Regarding this last point (iii) above, consider the experience, and evolving progress of, revenue administration in post-conflict Bosnia and Herzegovina. (World Bank, 2015; Fox and Wallich, 2007; Wallich and Zhang, 2013). With the Comprehensive Peace Agreement (Dayton Accords, 1995), the confederal state Bosnia and Herzegovina (BiH) was established with a fiscally weak single sovereign State of Bosnia and Herzegovina and two sovereign “entities”: Republika Srpska and the Federation of Bosnia and Herzegovina. Under the terms of the Accords, the State of Bosnia and Herzegovina was provided with no independent tax sources, thus having to rely on intergovernmental grants from the two entities. The immediate post-Accords era was a fiscally tense one; but overtime the confederation has become to look a bit more federal. A harmonized customs law was adopted in 1998, followed in 2001 by legislation for harmonized excises taxes and a sales tax. Then, in January 2006 with the introduction of a centrally assigned VAT, the State of Bosnia and Herzegovina single tax administration, the Indirect Tax Authority, was established (World Bank, 2015). Attesting to Kornai’s axiom (1956) that a change in a government is not a change in a system, but merely a pre-condition for a historical process, the BiH experience suggests something very important for Somalia: sorting out and implementing intergovernmental fiscal arrangements can serve as a bridge to functioning federal system

### Coordination and Cooperation

And, on this whole matter of revenue policy-meets- revenue administration, one further observation is merited: the making the choice between FGS, FMS or an overlapping/ cooperative system of revenue administration is not an “either/or” zero sum game. Vertical (FGS and FMS) and horizontal (FMS to

FMS) coordination of tax administration is the norm in many in federal systems. Indeed, the efficiency of tax administration will suffer if independent tax authorities do not coordinate (Martinez-Vazquez and Timofeev, 2010). The types of administrative coordination, which can reduce costs of both tax administration and tax compliance for FGS and FMS alike, includes (i) the sharing of knowledge on common problems, old as well as emerging; (ii) trading information of innovative practices (e.g., from e-filing to how to deal with the hard-to-tax informal economy); (iii) joint auditing of taxpayers whose operations cross state and/or international borders; (iv) tax base harmonization that preserves meets the tests of own-source revenue autonomy; (v) taxpayer identification (e.g., common taxpayer identification numbers), (vi) joint research including cooperation in developing of revenue estimating models, and for some revenues, especially the property tax, (vii) tax base valuation and assessment administration. (Garzon and Freire, 2014; Franzsen and McCluskey, 2017)

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**Table. 2. Sorting Out Revenue Authority Among Types of Government: Principles and Applications**

Universal Rationale	Principle/	Revenue Instrument	Central (FGS)	State (FMS)	Local (Sub-State)	Further Notes
<b>Macroeconomic Stabilization</b>						
Broad Based Tax on Business Enterprise		Value Added Tax (VAT)	It is essential to assign broad base taxes to implement stabilization and distribution.	State and substate (local) government use of these taxes are not justified as tools for stabilization policy; indeed use by an FMS and its substate entities may be cyclically perverse.		Worldwide: assignment of broad based taxes on business receipts (GRT, VAT) to the Center. African examples include VAT: Botswana, Cameroon, Cape –Verde, Chad, Congo, Côte d’Ivoire, Equatorial, Guinea, Gabon, Ghana, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Morocco, Mozambique, Namibia, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Tunisia, Uganda, Zambia and Zimbabwe ; GRT: Ethiopia; Rwanda; Profits ( $\pi$ ): Ethiopia, S. Africa, Uganda All but one of the OECD countries assigns a VAT to the central governments. (US, taxes $\pi$ only )
		Gross Receipts , Turnover Tax(GRT)				
		Corporate Net Income (profits, $\pi$ )	Because central can engage in deficit finance, the center best positioned utilize due volatility of revenue yield. The ability engage in countercyclical deficit finance also pertains to VAT and GRT.			
Broad Based Tax on Personal Income		Personal Income Tax	_ On residents and nonresidents alike; include capital income			Sub-Saharan African countries include: Chad, Côte d’Ivoire Ethiopia, Gabon, Ghana, Namibia, Nigeria, S. Africa, Swaziland, and Zambia.
<b>Unevenly Distributed Revenue Bases</b>						
Natural Resources (e.g., minerals, petroleum, forestry, water supply)		Taxes on Revenues derived from exploration and extraction of products arising from the	_ Natural Resource exploration and extraction; royalties	<u>Not generally applicable</u> except in the case where FMS and Local property taxation become appropriate in areas where the exploration and extraction		Note that with petroleum production countries often enter into a cost of production sharing arrangement rather than institute a tax regime (Sudan).

	<p>sale of mining, petroleum, forestry). These tax bases may be shared with an FMS under a broad based business tax regime</p>		<p>occurs, especially if the local environment is damaged (Sudan in disputed areas of S. Sudan). Also (i) FMS/local tax and fee policy for paying for costs (capital and O &amp; M) for off-site related infrastructure (e.g., roads, water and sanitation) and (ii) share of central royalty income base (SNG sets the rate).</p>	<p>Adoption of a central tax regime keep available the option for some form of SNG taxation of the exploration and extraction process.</p>
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**Table. 2 Continued Sorting Out Revenue Authority Among Types of Government: Principles and Applications**

Universal Principles/Rationale	Revenue Instrument	Central (FGS)	State (FMS)	Local (Sub-state)	Further Notes
<b>Role of The Central “Sovereign”</b>					
International Trade	<p>Customs and Trade Taxes</p> <p>Central best suited to keep national border integrity</p>	<p>Not an appropriate FMS revenue. However, Puntland and Somaliland employ a wide set of customs and trade (tariffs) taxes.</p>		<p>Worldwide: nearly always an exclusive central role. How to sort out the customs and trade tax authority between the FGS and FMS will be a matter to be sorted out as Somali federalism becomes organizationally and institutionally capable. When/if the FMS vacates these tax bases the FGS will have to consider compensatory payments as part of the Intergovernmental transfer system (grants and /or a shared revenue arrangement)</p>	
User Fees	<p>Passport issuance; immigration registration and fees; patents and trademarks, copyright fees, fees for use of central land, mail delivery charges.</p>	Not applicable.			
Protecting the Commons	<p>Effluent Fees; Carbon and other Taxes Environmental Taxes. The open, globalized economy calls for the cooperation of central governments (and, as appropriate, their regional and global partners)</p>	<p>Though the centre must take the lead in environmental protection due to the economics of closed vs. open economies, to the extent that an FMS and/or its locality can identify a local source of environmental damage, there is an FMS Role for adopting and “own” environmental tax and fee policy.</p>			
<b>Distribution:People</b> (vertical equity)	Entire set of central revenues regardless of source. Access to broad based taxes on business and personal receipts & income essential	[the degree “fairness’ of revenue incidence---how revenue payments are distributed across household/individual income classes-- while an important policy implementation matter, is not part of the revenue assignment question]			
<b>Distribution: Places/</b> (horizontal equity across jurisdictions).		Entire set of FMS revenues if the FMS	Not applicable	In some cases (e.g., Pakistan) the intermediate government may serve as	

Equalization may be part of a transfer system goal.		establishes a state→ local aid program		the center's agent to develop a state→local aid system
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**Table. 2 Continued Sorting Out Revenue Authority Among Types of Government: Principles and Applications**

Universal Principals/Rationale	Revenue Instrument	<i>Central (FGS)</i>	State (FMS)	Local (Sub-State)	Further Notes and Illustrations
<b>Benefit Principle</b>					
Specific Benefits other than for infrastructure services.	Not-tax revenues (user taxes and fees employed as revenue producers as well as to adjust for spillover (e.g., environmental) effects; selected sales (excises)	Motor Fuel Taxes; Carbon and other taxes on use of the environment (e.g., effluent fees); use of central govt. land (Rwanda), game and other national parks and reserves (Kenya)	<p><u>Yes</u>: principle of wherever possible levy charges/beneficiary fees on users of state and local services. Fees range from use of library services and care for the elderly to access to judicial services and fire protection. S. Africa law includes more than 125 user charges and fees (2015/16). Ethiopia, Kenya and Uganda also employ a long list of fees and charges</p> <p>There may also be fees that overlap, but are not harmonized with, central levies. E.g., a variety of charges on motor vehicle use, care for the elderly, food quality inspection, and court fees. A lack of harmonization of the tax/fee base will likely occur since the central/state/local benefit area will vary spatially and by the demographic profile of the users.</p>		<p>Kenya single business application tax and license fees, market and slaughterhouse fees, school nursery and matatu fees. Uganda and Ethiopia also turn to market and stall fees. Rwanda includes fees for billboard advertising Puntland utilizes (i) a series of registration fees on businesses including stamp/documentary fees&amp; taxes; (ii) taxes on transfer of ownership of intangible assets; (iii) rental of property vehicles and vessels; and (iv) registration of vehicle rentals.</p> <p>—</p> <p>Local governments in some country levy “terminal taxes” on goods, vehicles or passengers entering or leaving the jurisdiction.</p>
Infrastructure: Capital Revenues	Betterment levies, special assessments, developer exactions that may be for both on-site and off-site construction	<u>Yes</u> . When infrastructure services cross state and international boundaries (e.g. national roads; water supply systems).	<u>Yes</u> . When services are state (local) supplied: state (local) levied user charges. Betterment levies, special assessments, developer exactions for both on site and related off-site infrastructure.		Infrastructure services—e.g., school building, hospitals, highways/roads, rail systems, sewers and sanitation, solid waste collection, treatment, disposal parks and recreation entrance. When the service being charged crosses local jurisdictions overlapping/coordinating fees and charges has merit. In some countries there are

<p>Infrastructure: Current Flow of Infrastructure services</p>	<p>There are two steps to the revenue sorting out process: first, identify the mode to be financed and funded and, second, the type of beneficiary tax or (most likely) fee/charge to be associated with each mode.</p>	<p>Illustrations, the application of which will depend on the spatial matching of the user of the flow of services to the user cost of operations and maintenance. E.g., school buildings (tuition); highways (tolls); airports (taxi service access); parking facilities (which with new technology can be peak-load priced). S. Africa levies charges related to the use of electricity, water, sanitation, and removal of refuse.</p>	<p>multi-jurisdictional joint service districts and/or multi-state revenue compacts for which taxes and fees are coordinated and accessed (Peteri, 2007).</p>
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**Table. 2 Continued Sorting Out Revenue Authority Among Types of Government: Principles and Applications**

Universal Principal/Rationale	Revenue Instrument	<i>Central (FGS)</i>	State (FMS)	Local (Sub-State)	Further Notes and Illustrations
<b>Generalized Benefits</b>					
Broad Based Business Taxes	Taxes in value added, net income (profits), and Gross Receipts.	The key rationale for Central government use of these levies derives from there stabilization and distribution roles; not from application of the benefits principle.	_An appropriate FMS tax handle. For simplicity, merit in conforming (typically via surcharge) to the Central Base, if there is one; apportionment of the tax base required to reflect the FMS share of the total tax base (which may or may not be multi-jurisdictional)	Large cites may turn to this broad based taxation; again some form of apportioning of the tax base is required.	Ethiopia (turnover taxes and a VAT) Puntland: (i) Agricultural income tax; (ii), tax on profit from resident industrial, commercial, vocational activities including.  There are several ways to coordinate a central VAT with use by SNGs, Bird, 1993; Lee 92004); Keen, 2005; Le Duncan, 2012). Building a fiscally capable center need not require FMSs to abandon their VATs ; although how its structure may change in order to harmonize with a central VAT
Personal Income Taxes			Resident based tax; tax compliance simplicity is promoted if the tax base conforms with the center	As economies become more advanced, application of a simple resident income (e.g., wages earned) has merit	Puntland levies an employer collected tax on wages and salaries (Pay-as-You-Earn), and capital gains, as well as income (net of depreciation) on real or presumed income from use of buildings or other permanent structures. Somaliland levies a PIT on 6% of gross income and 10% on net capital gains.



	Special Selected Sales (Excises) including motor vehicle and vessel fees and taxes.	intermediate stages of production, natural resource extraction is not included. This revenue base is included above (unevenly distributed tax bases) as a central revenue.	Overlapping shared/tax bases: Hotel and other visitor taxes; motor vehicle and vessel registration; tobacco, alcohol, soft drinks, bottled water.	Text: wherever possible, apply specific user fees and charges. For FMS and its localities, the matching principle and tax base mobility meet.
Specific Revenues including a fee or tax that <i>may</i> be earmarked for specific purposes. Kenya labels these as <i>Cess Receipts</i>	Livestock	May be central or FMS; or overlapping or shared revenue bases; the tax base immobility suggests state and local application on livestock and agricultural products.		Kenya levies a cess at different rates on charcoal, livestock, maize, miraa (Khat), potatoes, sugar cane and tobacco.
	Agricultural Products			
	Fish			

**Table 3. Illustrations of Significant Features of Revenue Administration**

Country or Region	Non-Revenue Profile Note	Description
<i>Baseline Somalia</i>		Nascent central government; prospective member states each of which brings with it an own-revenue administration. A large geographic horn-of-Africa area (44 <sup>th</sup> of 267 countries) but, relative to geographic area, a relatively small population (11 m. in 2015).
<i>Centralized Model</i>		Centralization may “fit” with size of country, political culture & history, and/or legacy of colonial presence
Sweden (unitary)	21 counties (OECD classified as local governments)	In Sweden, all taxes are collected by the central government. Regional tax authorities operate under the supervision of the National Tax Board. Attesting that centralized revenue administration need not imply a lack of decentralized revenue autonomy, the OECD data show that, due to nearly full discretion that local governments have over setting the local tax rate at the margin (e.g., “piggybacked” surcharges on central governments), Swedish local governments rank among the most fiscally decentralized of local governments in OECD member states. A similarly high degree of central revenue administration

		but with more restricted local discretion on own-tax rates occurs in the other Scandinavian countries of Denmark, Finland, Iceland and Norway (JM, 20073; OECD 2011).
Vietnam (unitary)	58 provinces and 5 municipalities	Central administration with tax sharing
Russia (tight federal)	21 republics (oblasts/regions), 46 oblasts, 22 republics (one of which, Crimea, is disputed), 4 autonomous okrugs (districts), 9 kray, 2 federal cities, 1 autonomous oblast. World's largest geographical area.	Although the Russian Constitution reads as an asymmetrical federal system, with respect to tax practice the Russian Federation is more unitary than federal. Though subnational governments may levy taxes assigned to them—e.g., surcharges attached to a central tax (e.g., the enterprise profit tax) and local retail sales taxes, subnational governments have no formal tax administration powers (JM). Taxpayers pay taxes to all governments through the Federal Tax Service. This sometimes results in under collection of subnational taxes because the Service, as federal body, is interested in primarily collecting the taxes that accrue to the federal budget (Deryugin and Kurlyandskaya).
French West Africa (unitary)	Colonial legacy	Generally: countries with limited revenue autonomy, accompanied by limited own-revenue administration; typically accompanied by tax sharing at the Central government's discretion.
Cambodia (unitary)	23 provinces, local communes, and the municipality of Phnom Penh	Minor taxes assigned to provincial governments
<i>Independent Tax Authorities</i>		Each type of government is given the revenue administration role consistent with the taxes assigned to/enacted by each government. Various coordination mechanisms between or among SNGs may be established (e.g., tax base conformity, joint audits). This model tends to be associated with medium/large federal countries (MVT, 2010).
Australia (federal)	Six (6) states and two self-governing territories	Per the national constitution, the federal government solely levies and administers the “major” broad based taxes: (i) customs and excise duties, and taxes based on (i) value added (tax on goods and service); (ii) individual and corporate net income and income. Independent state/territorial governments administer payroll taxes and taxes on land transfer taxes. Municipalities levy and collect the real estate tax, for which the states take on the role of assessment administration (JM, MVT). The state/territorial/local governments have full own-tax rate setting discretion (OECD, 2011).

**Table 3. Illustrations of Significant Features of Revenue Administration, continued**

Country or Region	Non-Revenue Profile Note	Description
United States (loose federal)	50 states, s federal district that has both state and local fiscal, 89,004 local governments.	The US constitution contains no detailed revenue assignments to the federal or state governments other than to vest the federal government the (i) exclusive authority to tax foreign imports and (ii) concurrent authority (with the states) to levy other unspecified taxes. No taxes are “assigned” to the states since, as sovereign fiscal entities, state governments possess inherent plenary tax and tax administration powers. The federal government mainly relies on taxes on income (personal and corporate), payroll, estates, and various excises. The states independently levy administer taxes on a wide range of taxes on income and sales. Local governments, which are chartered by the states, rely mainly on real estate taxes, user charges, and, with the permission of its state, levies on income and sales that may, or may not, piggyback on a state tax base. (Kincaid, 2012). Moreover, as sovereign entities, they are free to join and jointly administer multijurisdictional special taxing and fee generating districts for purpose of regulating commerce, and financing and funding of infrastructure modes and schools (EW).
<i>Decentralization of Administration</i>		“Sub-Central” revenue administration, typically of all SNG revenues and all or a significant set of central revenues.
Germany  (world’s first parliamentary federation; loose federal)	16 Länder (state/province), 11,336 Municipalities, plus municipal federations and counties	German intergovernmental arrangements attest to the practice that in a functioning federal state there often is, but that there is no <i>a priori</i> reason why there must be, a relationship between revenue autonomy and revenue administration. Tax policy is fully centrally determined: the constitution assigns revenues from particular taxes to subnational government (thus a first-glance indicator of sub-central revenues as a percent of local revenues suggests Germany is decentralized), and yet the sub-central governments have no discretion over tax rates or other aspects of tax structure (RB, MVT). Thus, with respect to revenue policy, Germany is the most fiscally centralized of OECD states.(OECD, 2011) However, with the exception of federally managed and collected customs duties, some excise taxes (e.g., on beer), the VAT on imports and charges imposed within the framework of the European Union, it is the state/ länder (or, if the lander so delegates, its municipalities) that, subject to broad federal guidelines (e.g., uniform application of the law), is fully in charged with the role of revenue administration. Not only do the länders administer almost all German taxes, they also have wide latitude in how to organize their administrative agencies. (RB).Tax policy is centralized; tax administration is decentralized.
Switzerland  (loose federal)	26 Cantons with 2,294 canton dependent municipalities and in some cantons further subdivisions such as “home right” communes (Heimatrecht) and school districts.	With a history of a (i) loose confederation (a treaty-based system of independent states (1815-1848) to that of a federation wherein power is shared between the center and constituent/ or member states (1848-present) and (ii) people many of whom to today still need to be suspect of “creeping centralization”, Switzerland is among the most fiscally decentralized of nations (Linder, 1994; Dafflon, 2007; OECD, 2011). Reflecting an emphasis on the sovereignty of cantons and communes, the Swiss Constitution is explicit in a vertical separation of taxing powers: indirect taxation of consumption, excises, and customs duties are exclusively central; direct taxes on personal income and wealth and on business income may be levied concurrently by all types of governments, and each government may have full or partial authority for more than one tax base (MVT). Further reflecting the Swiss tax culture, the Cantons are responsible for administering their own revenues as well as all direct federal taxes (MVT).
	23 Provinces, 5 autonomous regions 4	The world most populated country (1.4 b 2016) and 4 <sup>th</sup> in geographic area China by practice has one of the world’s most decentralized fiscal systems with the central government accounting for only about a fourth of budgetary expenditures (Wong,

China  (unitary)	province level municipalities, sub-provincial prefectures, counties and towns and townships.	2013). It also turns out to be the country in which the tax administration look more like the German and Swiss models and for which an “astonishingly small central office” relies on a vast network of provincial and local tax offices for tax collection. Indeed, prior to 1994, there was essentially no central tax administration (RB).
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**Table 3. Illustrations of Significant Features of Revenue Administration, concluded.**

Country or Region	Non-Revenue Profile Note	
<i>Central, Local, and Asymmetric</i>		A mix—and with respect to revenue assignment fiscal policy (but not always revenue administration) special
Bosnia and Herzegovina  (confederation)	A central authority with two “first order” entities plus an internationally supervised district (Brcko) which is a self governing unit under the sovereignty of Bosnia Herzegovina and held in condominium between the two entities	Established as a confederation in 1995 the “Three Nation State” (FW) of Bosnia and Herzegovina (BiH) has a fiscally weak State of Bosnia and Herzegovina (BiH) and two sovereign entities: the Bosniak/Croat Federation of Bosnia and Herzegovina and the Serb/Bosnian Republika Srpska (RS). The Bosnia War (1992-1995) post-conflict arrangement agreed to by the warring reflects the decentralized fiscal legacy of Yugoslavia, in which most revenues were raised and retained by the decentralized republics (BiH, Croatia, Macedonia, Montenegro, Serbia and Slovenia) that made transfers to fund the federal government. This “upward” transfer arrangement created considerable budget uncertainty and vulnerability for the federal government (World Bank, 2015). Distribution on the basis of origin of revenue generated further generated substantial interregional (horizontal) inequity. With the support of international actors a harmonized customs law was adopted in 1998 followed by harmonized excise taxes in 2000 and sales taxes in 2001 Agreement on the introduction of a national VAT was reached in the mid-2000s and implemented on January 1, 2006. With the VAT came the establishment of the State of Bosnia and Herzegovina Indirect Tax authority. The parties agreed to share VAT revenues on a formula based transfer system that guaranteed shared revenues to the cantons and municipalities in the Federation and, the municipalities of the Republika Srpska (the Serb Republic does not have a Canton level of government). One result has been a significant reduction if horizontal fiscal disparities (World Bank, 2015).
Canada  (loose federal)	Ten (10) provinces and 3 territories.	Measured as a sub-central taxes as a percent of total tax revenue (49.4%), Canada ranks as the most fiscally decentralized OECD country (OECD 2011). <i>Inter alia</i> , the provinces are free to determine which SNG tax bases they do, or do not, choose to adopt (e.g., one province and three territories do not levy a sales tax) and have near full tax rate discretion (one province and three territories do not levy a sales tax). However, Canadian revenue administration is substantially less decentralized than (as noted below) in China, Germany and the United States (RB, 2015). The federal Canadian Revenue Agency administers provincial personal income taxes in nine provinces, corporate income taxes in eight provinces, and general sales taxes in five provinces. Of special importance to note is the asymmetrical system of tax administration. Thus, Quebec administers federal value-added tax (Goods and Services Tax, GST) on behalf of the federal government, for which the federal government pays a collection fee to the province (RB, 2015). Income from petroleum operations are separately taxed and administered by the federal government and the three petroleum based provinces
Spain  (asymmetrical federalism)	17 autonomous communities, “5 Places of Sovereignty” each of which is administered directly by the central government. This includes the 2	One will note that in the left column there Spain is not identified as either clearly federal or unitary ...it’s just a real mix and difficult to characterize—a classic case, even more so than Canada, of asymmetrical decentralization (RB). Harty (2005) notes it is “not a federation...nor is it a state made up of constituent unit...but that it does share many of the institutional features of a federal state”. The Spanish Constitution recognizes both the “indissoluble unity” and “indivisible country”, yet there are constitutional provisions that promote aspects of federalism and that for all communities autonomy is a voluntary right (Harty, SH, JMM). For centuries the communities of Navarra and the Basque Country have had a special political arrangement ( <i>fueros</i> ), whereby, <i>inter alia</i> , “tax revenues are and always have been collected at buy the state” the state level (via its three provinces

	<p>autonomous cities of Ceuta and Melilla plus three small Islands in the Mediterranean Alboran Sea.</p>	<p>that make up the state: Nafarroa, Vizcaya and Guipuzcoa).These regions have administrative control over all their revenues and all central taxes other than import duties and payroll taxes (RB). Other states have also established their own tax administration departments. As for the overall degree of state/local fiscal autonomy, on the OECD scale of percent of autonomous tax revenues as a percent of total government revenues is, perhaps surprising so, falls in the mid-range of fiscal autonomy.</p>
<p><i>Notes:</i> The shorthand format embedded in the table refer to the following: JM: Mikesell, 2007; MVT: Martinez-Vazquez &amp; Timofeev, 2010; EW: Ebel &amp; Wang, 2017; FW: Fox and Wallace, 2007. The profile column draws from the <i>CIA Factbook</i>.</p>		

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