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Fiscal Aspects of the Transition from War to Peace:
with Illustrations from Uganda and Ethiopia

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1. Introduction

When a country emerges from a lengthy war, it is inevitable that the transition to a peacetime economy should have profound budgetary consequences. A number of African countries have embarked on this transition in recent years, and it is to be hoped that others will soon follow suit. In these circumstances, it is natural to enquire whether the fiscal challenges and opportunities accompanying the transition have common features, and whether the experience of countries which began the process relatively early may be useful in the formulation of policy in the others. This paper considers this question, using the experiences of Uganda and Ethiopia to illustrate. Section 2 identifies a number of potentially systematic features, and later sections look at these in more detail. Section 3 discusses the revenue characteristics of the transition and Section 4 considers expenditure patterns. Section 5 looks briefly at the impetus to decentralise, and Section 6 concludes.

2. Fiscal Characteristics of Transition

In one sense the fiscal implications of the cessation of hostilities must be benign. At the very least, there will be the possibility of a substantial redirection of government spending from military to civil and, hopefully, socially productive purposes; alternatively, the resources can be released from public to private control, permitting a reduction in government financing. Unfortunately, it does not follow that there is a substantial "peace dividend" for distribution in the short run, relative to the period immediately before the cease-fire. The potential redirection or reduction is relative only to what would have been possible had the war continued.

To make the point clear, we may contrast two hypothetical transitions. In the first, the country had been engaged in a long-running border dispute, had never lost control of territory, and had reached a military stalemate and fiscal steady state. The war was costly but sustainable, and the end of it does release resources which can be shifted into beneficial uses. In the second example, the country had been engaged in an exhausting civil war. Neither of the warring factions had been able to maintain control of national territory, and the war led to the steady erosion of the country's infrastructure, its productive base, and the government's

revenue base. Eventually, the war became unsustainable as a result of economic and fiscal exhaustion, and ended. Since it would not have been feasible to continue military spending at its previous inflated level, the end of the war does not release resources for civil purposes. Far from there being any peace dividend in the conventional sense, the economic and fiscal collapse which accompanies the transition may mean that the government's resources are falling faster than its commitments. Without an increase in external finance, the short run outlook for civil expenditures would then be contractionary rather than expansionary. Of course, these circumstances also offer the prospect of accelerated change in the medium or long run as the lost ground is recovered.

While these two cases are stylised, they serve to demonstrate how very different the fiscal consequences of transition may be, depending on the antecedent circumstances. The overwhelming majority of military disputes in Africa involve civil war, so that very substantial damage to the infrastructure and to the economy in general is routine. Both Uganda and Ethiopia fall into this category. The immediate post war period is therefore characterised by unusually high expenditure requirements for rehabilitation. Whether the government's revenue base (relative to the inevitably diminished GDP) has also been damaged is more various; in Uganda, for example, it had been massively contracted for some time before the peace, while in Ethiopia it remained at a very high level. In consequence, the immediate revenue prospects were quite different in the two countries. In Uganda, there was every reason to suppose that revenue effort could usefully be increased, though it remained unclear how fast revenue actually collected could be raised. In Ethiopia, the very high wartime collections reflected an unacceptably authoritarian approach, rather than an efficient structure of taxation. Domestic revenue would inevitably fall sharply in this case, prior to a probably slow and partial recovery as a reformed structure is put in place.

Even the view that military expenditure must necessarily fall is mistaken. In a civil war, there are (at least) two armies; during the fighting, only one of these is on-budget. It may not be thought prudent immediately to release the defeated army because of the dangers of banditry or insurrection, and it may be felt necessary to reward the victorious guerilla contingents by regularising them. In the short run, the new government may end up financing two armies. To the extent that the military hardware was supplied off-budget by foreign governments, there may be little scope for major reductions in material military spending

either. In consequence, the compressibility of the military budget in the short run may be quite limited or even perverse.

To summarise the argument, in African transitions there appears little prospect of any substantial domestically generated peace dividend in the short run. On the contrary, expenditure needs are likely to be temporarily high and revenue may well be temporarily low. The real peace dividend lies in the enhanced flow of aid which is typically triggered by the ending of hostilities. This carries with it three distinct fiscal complications. First, since the level of aid is typically very substantial and must be expected to decline in the medium term, there is an important issue concerning the feasibility of substitution of domestic revenue and/or contraction of expenditure in the medium term. Second, since the aid necessarily accrues as foreign exchange, whereas the government's rehabilitation spending is largely nontradable, the real exchange rate will be affected. Third, aid flows are subject to conditionality and a variety of release procedures which means the flow of revenue is volatile and unpredictable. These issues are not unique to economies undergoing war to peace transitions; indeed very similar circumstances arise in countries like Zambia where the trigger for serious increases in aid is the combination of thoroughgoing political and economic reform. However, it is certainly likely to be a systematic and important feature of war to peace transitions.

The discussion so far has focused on a fairly narrow interpretation of fiscal impact; in effect, we have assumed that the underlying view of the role appropriate to the state is little changed. The war may have devastated the economy, it may have severely damaged the public capital stock, it may have eroded the institutions of government themselves. In consequence, it may have distorted the shape and scale of government for a time, but in due course it is intended to revert to the original pattern. This is a perfectly plausible outcome, particularly when the incumbent government is victorious. However, there is an alternative possibility, which is more likely when the government is overthrown, so that the peacetime administration marks a break from that which fought the war as government. In this case, it is possible that the transition will be more thoroughgoing, with a general reconsideration of the purposes and mechanisms of public activity. There are examples of both types of transition in Africa, but recently cases where the incumbent is overthrown have predominated; both Uganda and Ethiopia fall into this category.

There are a number of reasons why an incoming administration may wish to break not only with selected policies but with the entire policy regime of its defeated predecessor. One follows naturally if the war was fought partly on ideological grounds. Curiously enough, this does not well describe recent events in either Uganda or Ethiopia. In both countries, a government of predominantly socialist - or at least interventionist - leanings was defeated by forces of rather similar economic outlook. While in both cases the transition has been marked by a profound shift in the role that is perceived to be appropriate for the state, that was not a consequence in any profound way of the incoming government's prior economic philosophy.

A second reason is that the policies of the defeated regime may have become discredited, either by simple association, or more comprehensively as a contributory factor in the defeat. In this case extensive changes may be attractive, even in the absence of any ideological commitment, simply because what went before is perceived not to have worked. In fact, substantial changes in economic regime may have been inevitable even in the absence of the switch in political regime; the latter may simply permit the former to take place more rapidly and comprehensively. An interesting illustration is provided by Ethiopia; as already noted, the economic philosophy of the incoming regime differed little from that which had characterised their predecessors. Indeed, inexorable economic decline had persuaded those predecessors to adopt a substantial package of liberalising reforms; in the first months of the transition it appeared possible that the new government might attempt to put the clock back, and refuse to maintain the impetus to reform. In the event, this paradoxical outcome did not materialize. However, it is clear that important components in the economic policy switch predate the end of the war and the associated change of government.

A third reason, not wholly unrelated to the second, is that the incoming regime typically has no experience of government, or experience of an unusual kind, for example that obtained when territorial gains are made but do not include the administrative institutions of government. In these circumstances, the leaders of a guerrilla army may have to undertake at least a limited delivery of public services outwith the usual institutional channels. Good examples of this process are provided by the organs of the National Resistance Movement in Uganda, and by those of the Eritrean People's Liberation Front which had effectively barred the institutions of the Ethiopian government from operating in Eritrea for some years before the end of the war. These institutional improvisations may prove quite durable after the end of hostilities. First, they constitute an important part of the apparatus which brought the new

regime to power, may still provide a significant power base subsequently, and may also engage many loyalties. Second, they may be perceived to have been effective vehicles for the delivery of local services and other functions, and this against a background where the more routine institutions of government are perceived to have failed. These circumstances are calculated to induce a relatively experimental approach to institution building by the incoming regime.

There is a fourth reason, linked to the second and third; it is that ousting the previous regime required a coalition to be assembled, of groups which had been previously excluded from power. This process is likely to bring into the successor regime ethnic and other groups which are suspicious of centralisation. Indeed, in the limiting case, the war may have been fought on secessionist grounds. More generally, the transition may involve a powerful impetus towards devolution. The secession of Eritrea is an example of the former extreme, but there is ample evidence in both Uganda and the remainder of Ethiopia of the strength of the latter. The circumstance in which a government is overthrown also means that the old constitution is effectively suspended; while the new regime could in principle simply adopt the old constitution, in practice it typically does not. The actions of the Transitional Government of Ethiopia provide a case in point, with an extended process of constitutional redefinition still under way as well as an accompanying redrafting of legislation.

Finally, there is the fact that, for the reasons outlined earlier, the successor government will both be in need of, and able (conditionally) to obtain, enhanced donor financing. The nature of the conditionality will vary only in minor respects, and will largely reflect the international community's current view of good practice. This is not only understandable, it is in many respects admirable. However, conventional wisdom is itself somewhat fickle, and not ideology free. When an incoming government does not have a deeply entrenched position in respect of some public activity, and is in need both of funds and guidance, it is not only vulnerable to external pressure, it may even welcome some aspects of it. In these circumstances, part of a policy shift may simply reflect an external agenda, whether this has been imposed or accepted by the domestic government.

Several of these reasons tend to reinforce each other in shaping the type of policy shift that occurs. Since the ousted regime was often highly centralised, interventionist, and perceived to lack both legitimacy and competence, and since the international community has been pressing for liberalisation and deregulation, there is a convergence of forces toward

markets and away from controls; toward devolution and away from the centre; toward expenditure on social services and away from (non-infrastructure) economic services; and toward greater fiscal prudence.

These various strands may be summarised, for a representative case, as follows. There is no real prospect of a domestic peace dividend in the short run; on the contrary, the immediate prospect may be one of low or falling domestic revenues and elevated expenditure requirements. There is, however, the likelihood of a substantial temporary increase in aid. Within the available resources, major changes in public spending patterns are inevitable. These will probably involve both redirection between military and civil purposes, and shifts within the civil category. However, the phasing of these shifts is uncertain, and the process may be slow.

3. The Revenue Transition

As the preceding discussion stressed, the revenue positions inherited by new regimes are extremely varied. Ethiopia and Uganda had very contrasting initial positions, both as regards explicit tax and non-tax revenue, and as regards the availability of seigniorage.

Ethiopia has had a remarkably varied fiscal history, culminating in the later years of the Derg in a very high rate of resource extraction by the government, albeit with a still higher rate of public spending. Since the overthrow of the Derg in 1991, there has been a substantial fall in revenue collection.

The data for the 1980s exhibit a number of striking features (Bevan, 1992). Tax revenue itself was not unusually high by African standards, averaging 17% of GDP over the decade, with relatively little trend. Non-tax revenue, by contrast, was both substantial, and broadly rising, so that total revenue averaged 24% over the decade (22% in the first five years, 27% in the second). This non-tax revenue was comprised largely of the residual surplus of public enterprises. Despite the relatively high level of total revenue, it fell very substantially short of total expenditure, which climbed rapidly at the beginning of the 1980s, to settle thereafter at a fairly trendless level around 39% of GDP. In consequence, the overall deficit between 1982/3 and 1989/90 only twice dipped below 10% of GDP, and averaged

13%. A little over half of this was externally financed (7%), with the domestically financed component being more or less entirely financed by bank borrowing.

It has been a remarkable, and much discussed, feature of the Ethiopian economy that such a high rate of monetisation of the deficit should have been associated with so little inflation especially given the lack of real growth. The Ethiopian government's record is often described as one of fiscal prudence, but this can only be justified by the fact that it did not engender a high rate of inflation. Approaching the matter from the other end, an overall deficit of 13% of GDP, half financed from the banking system, looks anything but prudent. The rapid monetary deepening that made this fiscal stance consistent with so little inflation may have been a transitional process leading to a permanent shift in the economy, or it may have been a temporary and reversible process which will be unwound in the near future. However, it seems inconceivable that this process of deepening could continue. Equally, it is not feasible for Ethiopia's external debt to be much increased, except on the softest of terms. In consequence, a very substantial reduction in budget deficit had become a necessity towards the end of the war as a matter of financing imperatives if accelerating inflation or excessive debt service was to be avoided.

Two further aspects of the inherited situation are important. First, despite the very substantial scale of the fiscal intrusion into the economy that is revealed by these data, they significantly underestimate the real weight of the government's fiscal operations. In particular, the direct taxation of agriculture embodied in the reported figures is only a small part of the total, since there was heavy implicit taxation via compulsory quotas levied on producers at artificially depressed prices as well as a plethora of forced contributions in kind, in cash and in labour services.

Secondly, and notwithstanding this substantial degree of under-reporting of fiscal impact, the data do make it clear that, by any conventional standards, the Ethiopian government had become too big relative to the economy. It would probably not have been feasible and would certainly not have been desirable to attempt to close the excessively large budget deficit by increasing revenue; the bulk of the adjustment inevitably had to take place on the side of expenditure (World Bank, 1990). Even if the present short run revenue problems are put to one side, the longer run perspective must be that the fiscal stance of the 1980s was unsustainable, and that massive expenditure reductions would relatively soon have become inevitable.

To put the matter somewhat differently, the direct fiscal costs of the war were being carried either off-budget (as already noted) or by an unsustainable increase in the deficit. Indeed, ostensible, on-budget defence expenditure averaged a little under 10% of GDP over 1980/2–87/8, compared to the average budget deficit over this period of a little under 12% of GDP. In consequence, there was virtually no scope for substituting peaceful government expenditure for the reduced military spending; in the absence of peace, any continuation of military expenditure at its previous level would have required both continued (*de facto*) grants of equipment from the Eastern bloc and a reduction in non-military spending. In this sense, the transition to peace did not so much provide a fiscal dividend as avert a fiscal catastrophe.

In any event, the early part of the transition has been accompanied by a sharp fall in domestic revenue, from 25% of GDP in 1989/90 to 20% in 1990/91 and around 16% thereafter. Of this, tax revenue amounts to barely 11%, down from around 17%; this fall partly reflects the operation of a relatively primitive and as yet somewhat unreformed tax system when excessive coercion is removed. One feature that has been much discussed is the virtual disappearance of revenue from the explicit taxation of agriculture. This was partly due to the collapse of the institutions which acted as tax collectors, partly to the fall in the world coffee price and the increase in smuggling, partly to the relatively tenuous control which the central government was initially able to exert in the regions of agricultural surplus, and partly to the decentralising thrust of its fiscal thinking.

Non-tax revenue — mainly from state-owned enterprises — continued to provide substantial resources to central government, though not at the previous scale. Similarly, financing from the domestic banking system fell over the period from around 10% of GDP to less than 4%. Apart from a brief surge in prices as the war came to a close, inflation has remained low and the level of seigniorage revenue high. (For example, seigniorage of nearly 3% of GDP will be available if inflation remains at its current level of around 10%, real growth is at the level assumed for planning purposes of 5.5%, and the main money to GDP ratios are stable.) Finally, foreign financing has risen from about 10% of GDP in 1989/90 to 13% in 1992/93, in each case very roughly evenly split between grants and loans.

The aggregate fiscal experience of these four years, two before and two after the end of the war, may be summarised as follows. Domestic revenue fell by 8 percentage points, from 25% to 17%; total expenditure fell by 12 percentage points, from 46% to 34%; in consequence the overall deficit narrowed from 21% to 17%. The contribution of foreign

financing rose from 10% to 13%, and that of domestic financing (overwhelmingly from the banking system) fell from 11% to 4%. The increase in external finance was therefore less than sufficient to match the much needed contraction in domestic borrowing, and spending had to fall further than the already large fall in domestic revenue.

As regards the future, there are reasonable prospects that tax reforms currently under way or under consideration, coupled with an economic resurgence in the modern sector, will lead to a recovery to a more adequate level of revenue collection in the medium term. There are also opportunities for generating capital revenue from the sale of state-owned houses and other assets. On the other side of the ledger, there is the danger that success in creating the conditions for a recovery in private investment may lead to a switch out of domestic liquid assets and a fall in the demand for money; this would claw back a part of the seigniorage enjoyed by the previous regime. There is also the longer run question of how to handle the possible tapering of official capital inflows.

In Uganda, the fiscal circumstances accompanying transition could hardly have been more different. When the National Resistance Movement seized power in 1986, it not only acquired a ruined economy, but a fiscal and administrative apparatus which had been virtually destroyed. Reflecting this, and also the fortunes of the coffee industry, revenue had fallen from a fairly normal level (for Africa) of around 15% of GDP 15 years before, to a level of less than 5%. In consequence, expenditure had been compressed from 20% to 10% of GDP, with only the deficit exhibiting any stability, remaining around 5% (Republic of Uganda). In stark contrast to the Ethiopian experience, the share of government in domestic resources was clearly far too low. Equally, while the Ethiopian authorities had escaped the inflationary consequences of a proportionately greater deficit, those in Uganda had not; by 1986 inflation was 170%. In some respects, this high inflation penalty is as much in need of explanation as the lack of such a penalty discussed earlier. The deficit itself is not a sufficient explanation; what really did the damage was juxtaposing it with a velocity of circulation (of broad money) of 16 (more or less exactly ten times that of Ethiopia).

Of course, these very discrepant velocities need explanation; what this comparison suggests is that the scale of deficit financing, the fact of long running military confrontation, and the associated disruption to modern sector activities in Uganda is not itself adequate, since all these features were present in Ethiopia too. For some reason, the people in Uganda reacted to these uncertainties by a flight from domestic money, and those in Ethiopia did not.

Part of the explanation probably lies in the extent to which relatively normal life remained possible throughout the war and transition in Addis Ababa, but not in Kampala. In any event, loss of confidence in currency is cumulative, so that a stationary real level of deficit finance becomes increasingly destabilising.

Having inherited so diminished a revenue base, the Ugandan authorities embarked on a programme of reforms of both the tax structure and the tax administration. In the latter, they followed the example of Ghana, and set up an independent revenue authority. Despite these changes, the revenue problem has proved very intractable; by 1992/93, domestic revenue had only clawed its way back up to 8% of GDP, virtually all of it in taxes, split roughly equally between trade and domestic taxes. A major part of the problem is that good taxpayer compliance in an economy with a poor informational base is largely a matter of habit and culture. When the willingness to pay at least a reasonable proportion of what is due has been lost, it is a slow and difficult process to reinductate it. This does not mean that Uganda should not aspire to more normal collection levels; but it must probably be accepted that this will take a long time. This appears to be a fairly general lesson. Attempts to rapidly raise collection rates appear either to be infeasible, or to succeed only temporarily. The special case of attempting to raise them quickly back to previous levels following a collapse appears as if it should be easier, and Ghana is sometimes quoted as an illustration. However, the argument depends on the nature and duration of the collapse, and Uganda's experience is not encouraging for countries which have undergone a protracted revenue erosion during wartime.

While the recovery in domestic revenue has been slow, there has been a major increase in external resourcing. When the NRM government took power, this amounted to less than 1% of GDP. By 1989/90, halfway through the transition to date, it had reached 8%, and during the 1990s it has been running at around 14%. Since total expenditure has stabilised at about 21%, this has enabled the average net call on domestic financing to be very low. Even so, inflation continued in the high double digits until this year, when it appears, for the time being at least, to have been eliminated.

4. Expenditure Patterns

The path of revenue during the transition necessarily dominates the aggregate evolution of expenditure. Given the very different revenue outcomes, it follows that the two countries have had very different expenditure stories. What they shared at the outset of the transition was a history of decades of violent upheaval and economic decline, with much of the infrastructure destroyed, and the provision of social services in total disarray.

The very substantial and - at least in part - temporary reduction in revenue generation in Ethiopia, coupled with the pressing need to reduce domestic deficit financing, meant that a large cut in spending was mandatory. At the same time, since the recovery from a state of war placed a high premium on reconstruction, there was a concomitant need for high public spending for civil purposes. There was a sharp reduction in military spending from nearly 20% of GDP in 1989/90 to perhaps a quarter of that in 1992/93. This rather more than matched the total expenditure decline, so the problem reduced to engineering the redeployment of economic and social spending, within a stable total of around 30% of GDP. As previously noted, this situation depends on donors being prepared broadly to match domestic resource mobilisation, which they are currently prepared to do. This may pose serious medium term problems of revenue enhancement or expenditure reduction when the present high degree of donor enthusiasm fades; but it does mean that, even though the problems facing the Ethiopian government early in its transition are severe enough, it is at least spared the need for a very sharp contraction of civil expenditures.

As regards the composition of spending, the start of the transition has been marked by three features. First, the share of (non military) material expenditures in the recurrent budget has fallen very sharply. The share of wages in recurrent spending, by contrast, has risen, despite the declining trend in the real wage rate. Second, what is categorised as capital spending, which actually includes substantial recurrent components, initially fell sharply, though it has since made a partial recovery. The decline was due more to poor implementation than to design, and given the worse than expected revenue performance, this may not have been altogether a bad thing. Third, while the attempt to switch from a military to a civil focus in spending was quickly successful, the attempt to switch within the civil category away from non-infrastructure economic services toward infrastructure and social

services has to date been much less so. A full scale expenditure review, due to be embodied in the budget for 1994/95 may help to tackle these problems.

To summarise, the revenue position preempted any real possibility of shifting resources from reduced military uses to increased civil ones. Indeed, a rapid military reduction was necessary even to maintain the level of civil spending, leaving a major role for redirection within the civil category. To date, the Transitional Government of Ethiopia has succeeded with the former, but not to any large extent, with the latter.

Similarly, Uganda's expenditure options were dominated by her revenue situation, in this case the very low and only slowly growing share of domestic revenue in GDP, coupled with the much steeper trajectory of external finance. With expenditure initially so low, there was little scope for substantial contraction of any category, including defence expenditure, to make room for substitution in favour of social services or infrastructure. In the event, the share of defence in total recurrent spending initially rose, and had still not fallen below its 1986/87 value (40%) in 1990/91, though it has fallen since, partly at the instigation of public expenditure reviews (World Bank, 1991). This absence of trend in functional shares in the early years of transition is not specific to defence; it is true of economic services, social services, and public administration also. This is rather similar to the Ethiopian case in respect of the apparent difficulty of managing switches within the civil budget, but very different in respect of the switch out of defence.

As regards the economic classification of spending, the picture is again markedly different. The share of capital is somewhat volatile but trendless at around 40%, as is non-wage operations and maintenance expenditure, around 35%. The big swing is between the falling share of employee costs and the rising share of interest payments. In part, this represents the greater maturity of the Ugandan transition, with the interest burden of even soft loans beginning to cumulate. But the difference between the maintenance of material expenditure at the cost of compressing the wage bill, in Uganda, and the converse, in Ethiopia, is striking.

One critical characteristic of a budget so dependent on external finance, particularly in the context of very low monetisation, was discussed in the opening section of the paper. It is the potentially great vulnerability of macroeconomic stability to the vagaries of donor finance, in particular to relatively minor lags in the release of funds. The Ugandan experience of 1991/92 illustrates the point well. There was a shortfall in import support receipts early in

the fiscal year, due to implementation delays. Expenditure continued at programmed levels, before being cut back later in the year. The consequent deficit, which was financed through the domestic banking system, barely exceeded 1% of GDP. Given the excess sensitivity noted earlier, this small monetary shock triggered a serious inflationary surge, at an annual rate of 70% (with the monthly rate reaching 10%). The response of the government to this unwelcome demonstration of the vulnerability of its programme to relatively minor aid shocks was to adopt monthly cash budgeting. If the path of revenue is volatile, then the path of expenditure is made equally so. If properly executed, this system does indeed prevent unprogrammed deficits from materialising, but at the cost of a disruption in the delivery of services and in efficient public activity. Once again, there is nothing in this story which fixes it uniquely into the war peace framework; indeed, a more or less identical story could be told for Zambia. However, war peace transitions are more likely than most to be characterised by the combination of heavy external dependence and inflation sensitivity which makes this outcome likely.

5. Decentralisation

While emergence from a war is neither a necessary nor a sufficient condition for an impetus towards decentralisation, there is evidence for a strong link, at least when the incumbent regime loses a civil war. There is certainly such an impetus in both Ethiopia and Uganda, which appears to be partly rooted in the guerrilla origins of the resistance, and partly a response to the imperialistic behaviour attributed to the defeated centre. By way of contrast, there appears to be no decentralising impetus of comparable strength in countries undergoing thoroughgoing but peaceful transitions, such as Zambia.

Ethiopia has a long history of centralised government, a feature carried over from the imperial period and maintained after the revolution. In consequence, political institutions outside of the centre are rudimentary, and there is little administrative experience or capacity at the regional and district level. This high degree of past centralisation is perceived as being intimately connected with a history of unsatisfactory and authoritarian government (Eshetu Chole, 1992). There is now a strong political commitment to create a substantial degree of decentralisation, and statements to this effect were among the first actions of the Transitional

Government. While it would have been possible to pursue this aim by devolution of power within a unitary state, the present intention is to go further than this and adopt a federal constitution. Fourteen regions were declared in the transitional charter (subsequently reduced to ten) and a series of proclamations have been issued which have progressively defined regional policy. Elected councils are now in place in all regions. Two complications with the new structure should be noted. First, the regional boundaries have been determined to a great extent by ethnic rather than administrative or economic considerations. Consequently, they vary enormously in nature, size and viability, and will pose difficult challenges to the designers of the federal constitution. Particularly acute difficulties will be involved in the design of the revenue sharing arrangements. Second, the new regions have been inserted into an already existing local government structure, and it is far from clear how the various parts of the system will relate to each other.

While the question of regionalisation is immensely pervasive and there have been a number of policy statements, it remains unclear what the net effects will be, not least in the fiscal sphere (Bevan, 1993). It is very difficult to assess what the partition of revenue will be, either between centre and regions in aggregate, or amongst the regions themselves. This partly reflects uncertainties over the eventual ownership of state assets, partly the absence to date of any public statement concerning the rules for partitioning joint revenues, and partly the lack of a comprehensive fiscal data base. However, it appears inevitable that all the regions will require heavy subsidisation, given the scale of the obligations devolved to them. This suggests that the central government not only possesses the means to maintain macroeconomic control (via borrowing restrictions) but, informally, will have the bargaining power to control the composition of expenditure as well.

There have also been extensive statements setting out the powers and duties of central and regional governments. The most interesting feature of these arrangements is the dual accountability that is implicit in them, with a regional bureau typically responsible both to the regional government of which it is an executive agency, and to the Ministry which formulated the policy it must implement. This construction seems certain to cause considerable tension both between the central and regional tiers and within each tier, between the executive and budgetary branches. Indeed it may prove an unworkable hybrid between administrative decentralisation and a more thoroughgoing federalism.

The administrative aspects of the new arrangements are also far from clear. There have been movements of personnel between central and regional administrations, and some between regions. However, in view of the general lack of capacity with which the regions started, most of them remain well short of being capable of executing their new responsibilities. So far it has been necessary for the central government to continue to fulfil functions which have theoretically been devolved; in some ways, this may have postponed some of the potential efficiency losses.

While in other respects the Ugandan transition is further advanced than that in Ethiopia, this is not true of its decentralisation programme. As in Ethiopia, the eventual shape of the institutional arrangements and their fiscal consequences remain obscure. Two major differences are the more highly disaggregated structure in Uganda (39 districts), and what appears to be a less thoroughgoing degree of devolution. However, primary education and health are now the responsibility of the district councils, as of the Ethiopian regions, and there seem to be similar ambiguities as regards the chain of command and the financing arrangements which will permit these responsibilities to be executed. In both countries, policy in this area is being made "on the hoof".

Drawing these various considerations together, what can be said about the likely fiscal consequences of these developments? First, will decentralisation reduce the efficiency with which the rest of the transition is managed? The main danger here is probably the potential diversion of scarce political and administrative resources. So far, though the relatively small cadre of policy makers in both countries is very stretched, there is no evidence that the devolution issue has impacted adversely on other policy areas.

Second, will expenditure rise as a consequence of duplication? In the long run, as in other countries which have undertaken extensive devolution, this appears all too likely. However, in the short run, the sheer lack of appropriately qualified and experienced personnel should prevent this outcome, always provided that reasonably tight control of recruitment is maintained.

Third, will the central government's control of macroeconomic management be compromised? In the case of Uganda, the district budgets will apparently be considered within the central budgetary process, so there should be no additional problem. In Ethiopia, the central government is likely de facto to retain more direct control of general government outcomes than was intended, because of the practical difficulty of devolution in the short run;

but the new arrangements appear in any case to give adequate control, provided that proper budgeting and accounting procedures can be operated. A serious danger in the medium run may be the difficulty of maintaining macroeconomic control in a federal system if many of the constituent governments are incapable of producing accurate and timely management information.

Fourth, will the central government be able to maintain control over the composition of public expenditure? Here again, the retention of central control over the national policy agenda should in theory ensure this. The two caveats are first, whether the informational base will be adequate to permit effective control, second whether the new arrangements are politically workable. In particular, will the lower tier governments go on being content to accept policy from the centre, and what action will the centre be prepared to take if its policies are not implemented?

6. Conclusion

The three preceding sections have summarised aspects of the two countries' fiscal experience that bear on the issues raised in the introduction. Despite remarkably different initial conditions, they provide ample evidence that there need be no peace dividend from the reduction in military spending. The increased spending on social services and infrastructure that is certainly required must therefore be found by reducing other categories of civil expenditure, which appears very difficult to execute, or by increased flows of aid, which appear to be easier to achieve.

One danger of going this route is that it may induce a form of Dutch Disease, inhibiting the structural recovery of the economy. This is most likely if the government uses import support to finance nontradable activities. However, if it is also liberalising the economy, and correcting for an overvalued exchange rate, the effect may only be to slow the reallocation of resources, not to reverse it. In any case, the alternative is a radically smaller level of government activity, which is likely to constitute a still more serious brake on economic rehabilitation.

There are three other problems with this dependence on aid. For one, the volatility and potential inflationary leverage of aid, Uganda provides a cautionary note. For the other two,

the jury is still out. Whether it will prove possible to substitute domestic revenue for aid rapidly and durably enough as aid tapers down, and whether governments can reacquire effective capacity for public service provision remains to be seen.

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