Experiences with implementing CEQ: Ethiopia
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Outline

• Context and motivation for study
• Main results
• Dissemination and next steps
Context
Poverty has fallen quite rapidly in Ethiopia: the national poverty rate fell by 33% since 2000.
And there have been improvements in nutrition, health, education and access to services.

Source: Ethiopia Demographic and Health Surveys, Carranza and Gallagos (2013).
Inequality is low and has remained so

Gini coefficient in select countries in sub-Saharan Africa
And poverty has fallen faster in regions where poverty was highest.
The role of fiscal policy

• The largest contributor to poverty reduction was growth, and in particular agricultural growth

• What has been the role of fiscal policy?
  • A large share of public spending is devoted to pro-poor sectors, how effective has it been in improving the financial position of the poorest?

• How can fiscal policy be improved to further reduce poverty and ensure shared prosperity?
  • Ethiopia has large public investment needs (infrastructure, basic service provision, safety nets) and there is limited fiscal space. Efficient, equitable fiscal policy is needed.

• CEQ analysis prepared as part of the Ethiopia Poverty Assessment
Key findings
Direct taxes are low and a large share of tax revenue comes from indirect taxation.
But many poor households pay direct tax, as a result of small but prevalent rural taxes and limited progressivity in personal income tax.
And the poor pay a comparatively large share of revenue, highlighting the challenge of revenue generation in a low income country.
Direct and indirect taxes are progressive, direct taxes more so

Incidence of direct taxes by market income decile

Incidence of indirect taxes by disposable income decile

Direct transfers—particularly those made through the large rural safety net—are well targeted and reduce poverty.

**Direct transfers as a share of market income**

**Impact of direct transfers on poverty reduction**

- **Poverty rate (US$ 1.25 PPP)**
- **Poverty gap**
- **Poverty severity**
But reduce poverty less than direct transfers in other countries, because less is spent on them.

Public spending on education and health is progressive; spending on primary education and preventative health care is pro-poor.

Incidence of education spending by market income decile

Incidence of health spending by market income decile

Source: Own estimates based on HCES 2011 and WMS 2011.
Spending on subsidies is less progressive, and electricity subsidies are highly regressive
Subsidies are justified as targeted to the urban poor; in aggregate they are but are small compared to transfers to rural households.
Overall incidence of spending
Overall impact of fiscal policy: reduces poverty and inequality but at a cost to some who are poor

- The poorest 80% benefit from fiscal policy when all benefits are taken into account (solid black line)
- However, some of the poorest do not benefit: 9% of households are impoverished—made poor or were poor and made poorer—by fiscal policy
Dissemination and next steps
• The nature of the work is technical and politically sensitive.
• Closed door discussions have been important, more so than public dissemination, particularly when results have challenged existing assumptions, for example:
  • Many in the poorest deciles pay direct taxes.
  • The regressive nature of electricity subsidies, even among urban households.
• Cross-country comparison have been particularly useful.
• Areas of discussion:
  • Direct taxes: more progressive tax brackets.
  • The need for more efficient system of transfers in urban areas.
  • Regressivity of electricity subsidies
Next steps

• Continued policy dialogue on existing results
• Analysis of the incidence of additional important areas of public spending, e.g. agriculture, that require more assumptions about the nature of externalities
  • Government has requested this
  • Plan is to do this with our counterparts