

Experiences with implementing CEQ: Ethiopia

Tassew Woldehanna, Eyasu Tsehaye, Ruth Hill,
Gabriela Inchauste and Nora Lustig



WORLD BANK GROUP

CEQ Learning Event

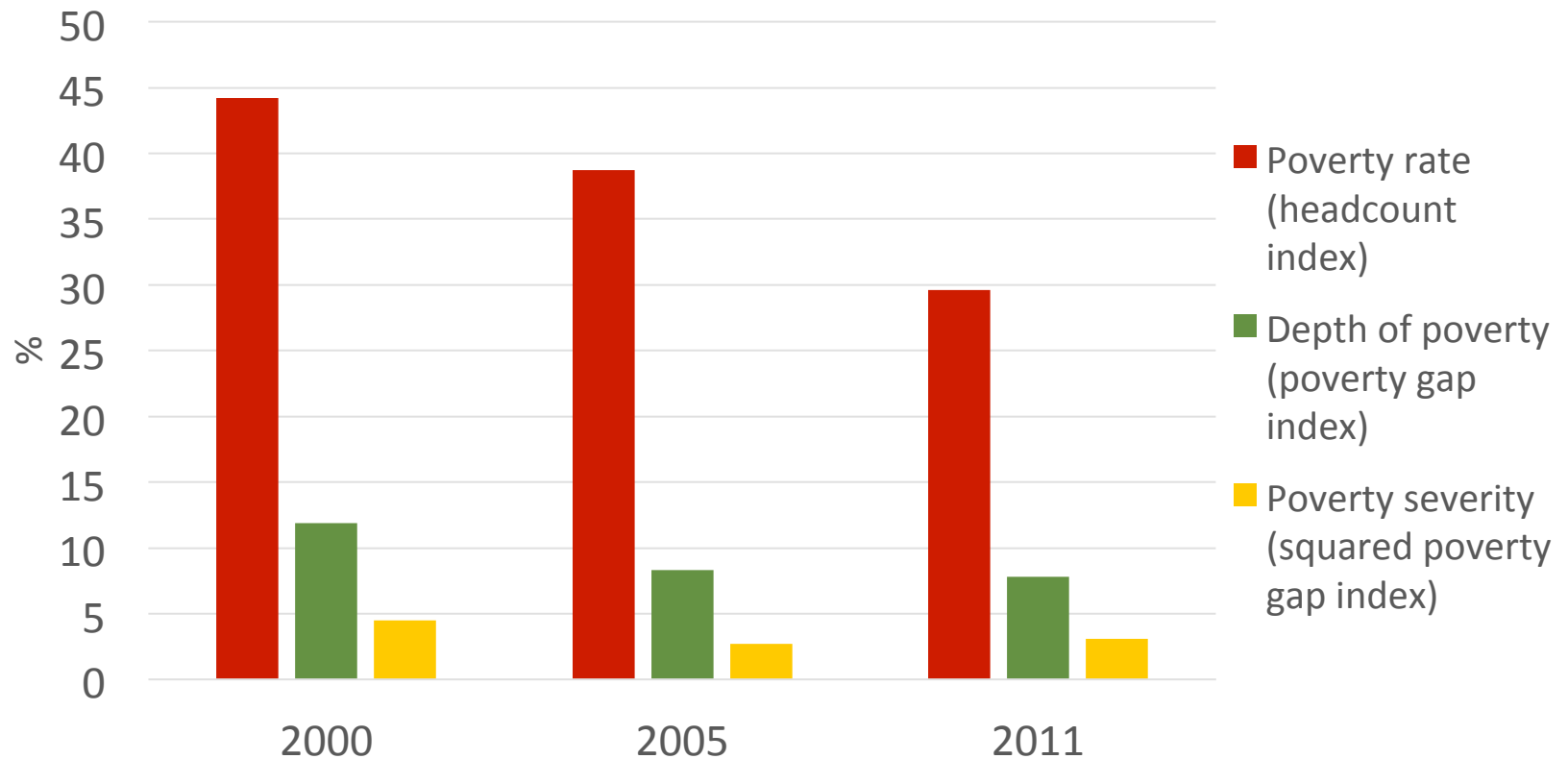
February 18, 2015

Outline

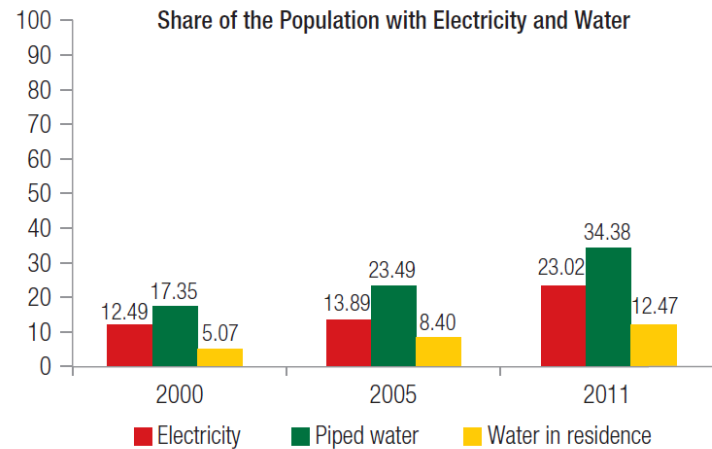
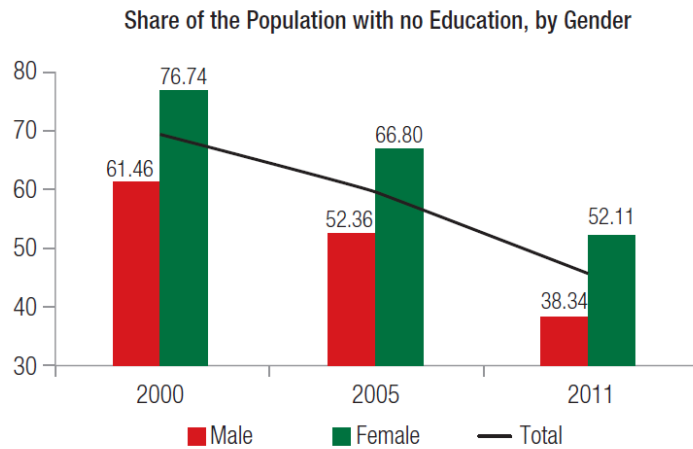
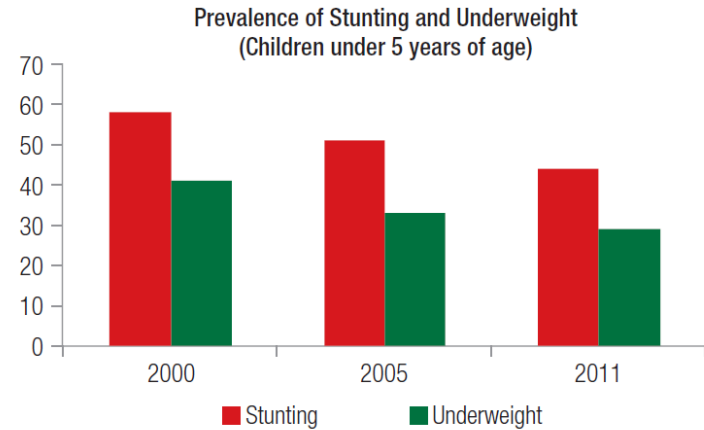
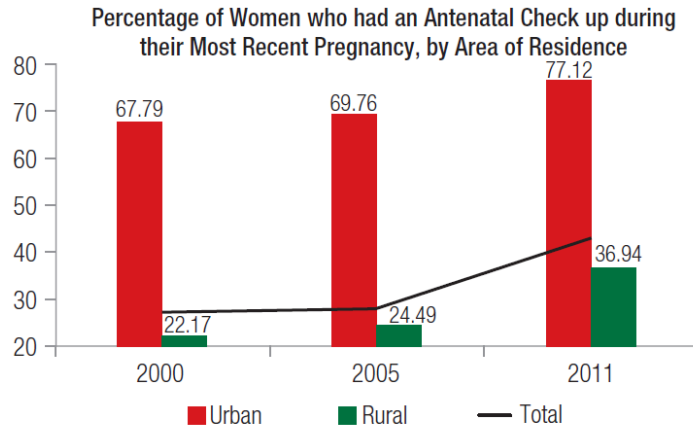
- Context and motivation for study
- Main results
- Dissemination and next steps

Context

Poverty has fallen quite rapidly in Ethiopia: the national poverty rate fell by 33% since 2000



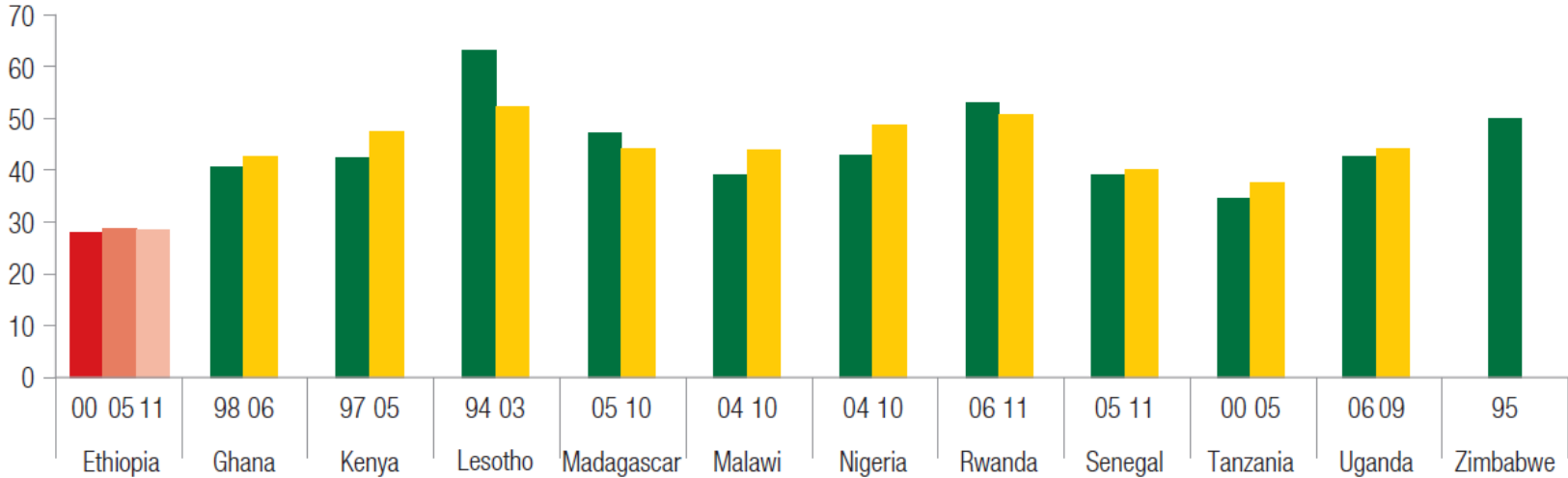
And there have been improvements in nutrition, health, education and access to services



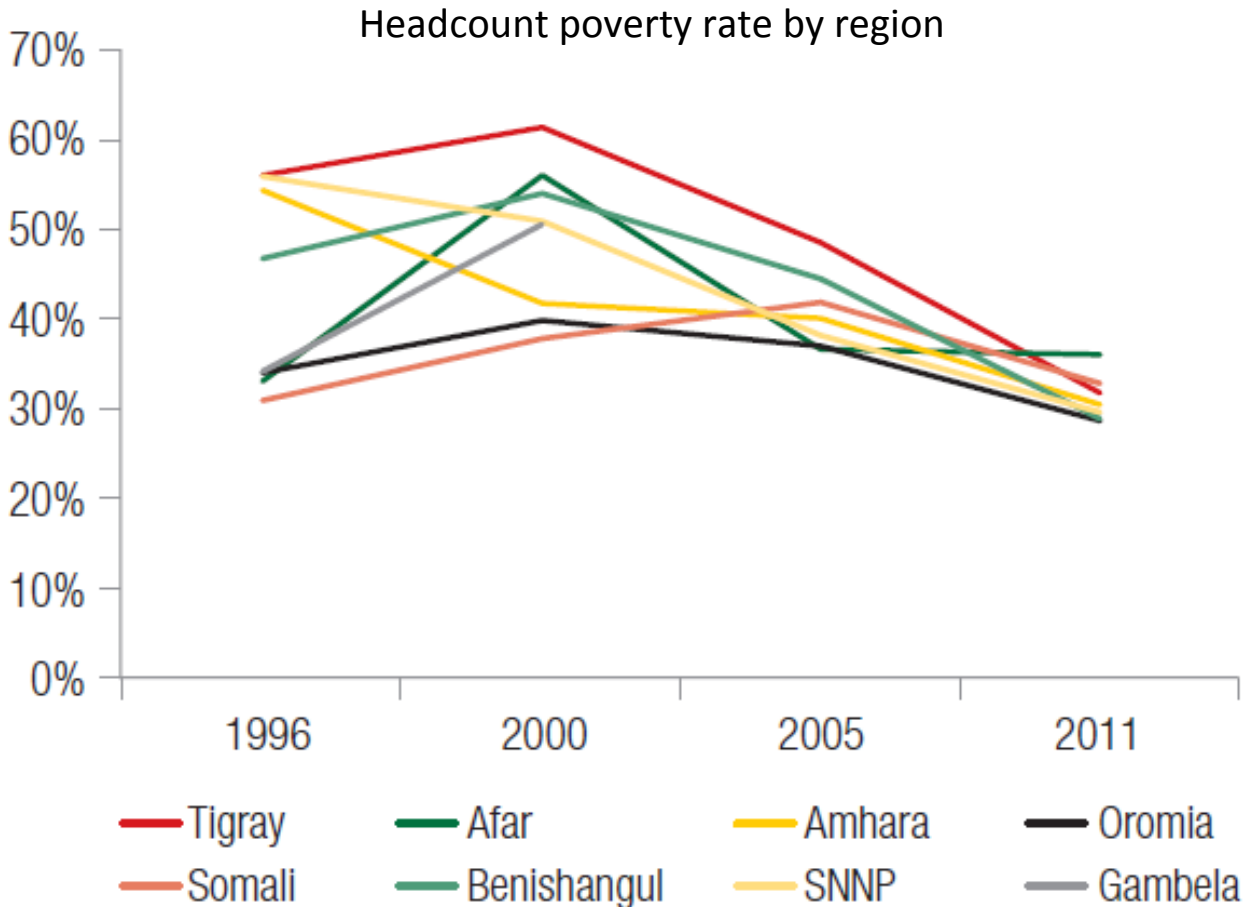
Source: Ethiopia Demographic and Health Surveys, Carranza and Gallagos (2013).

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

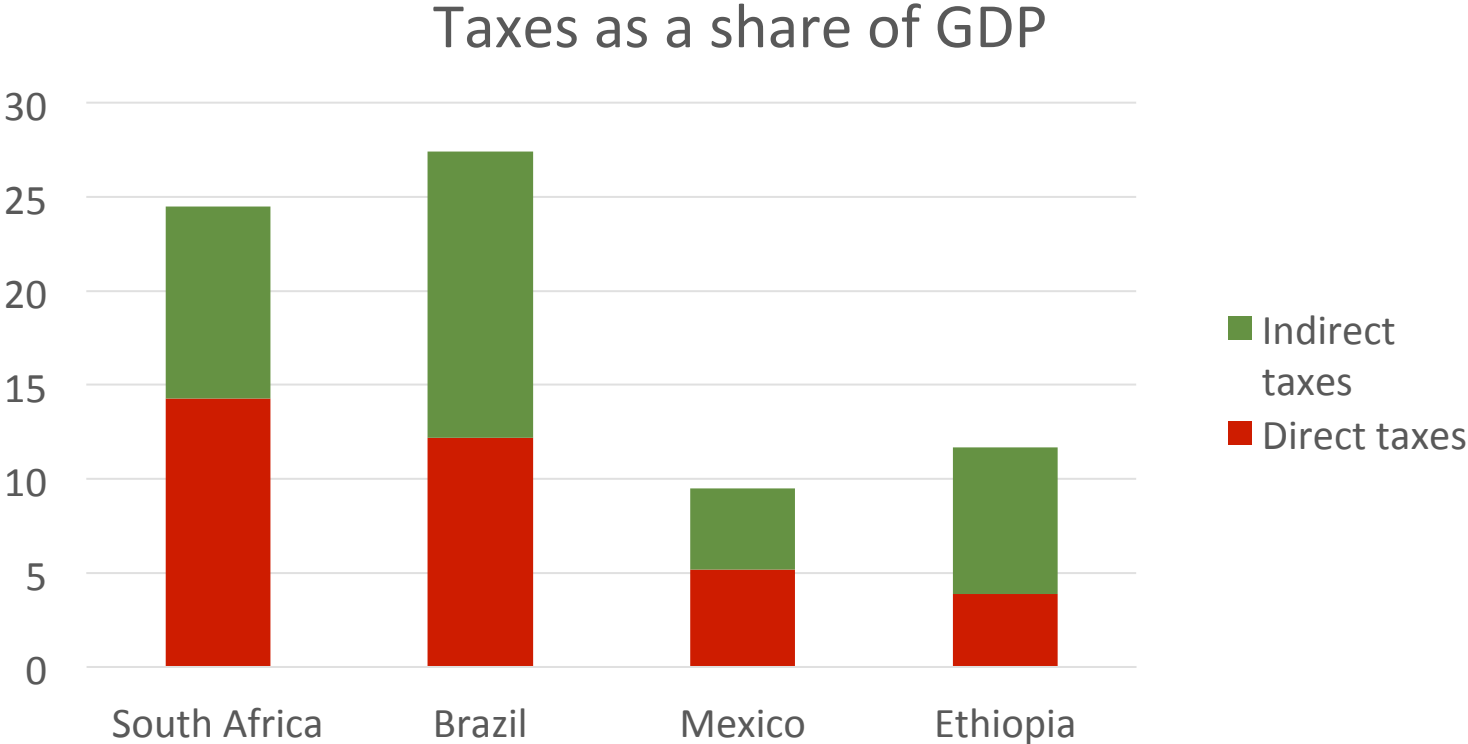


The role of fiscal policy

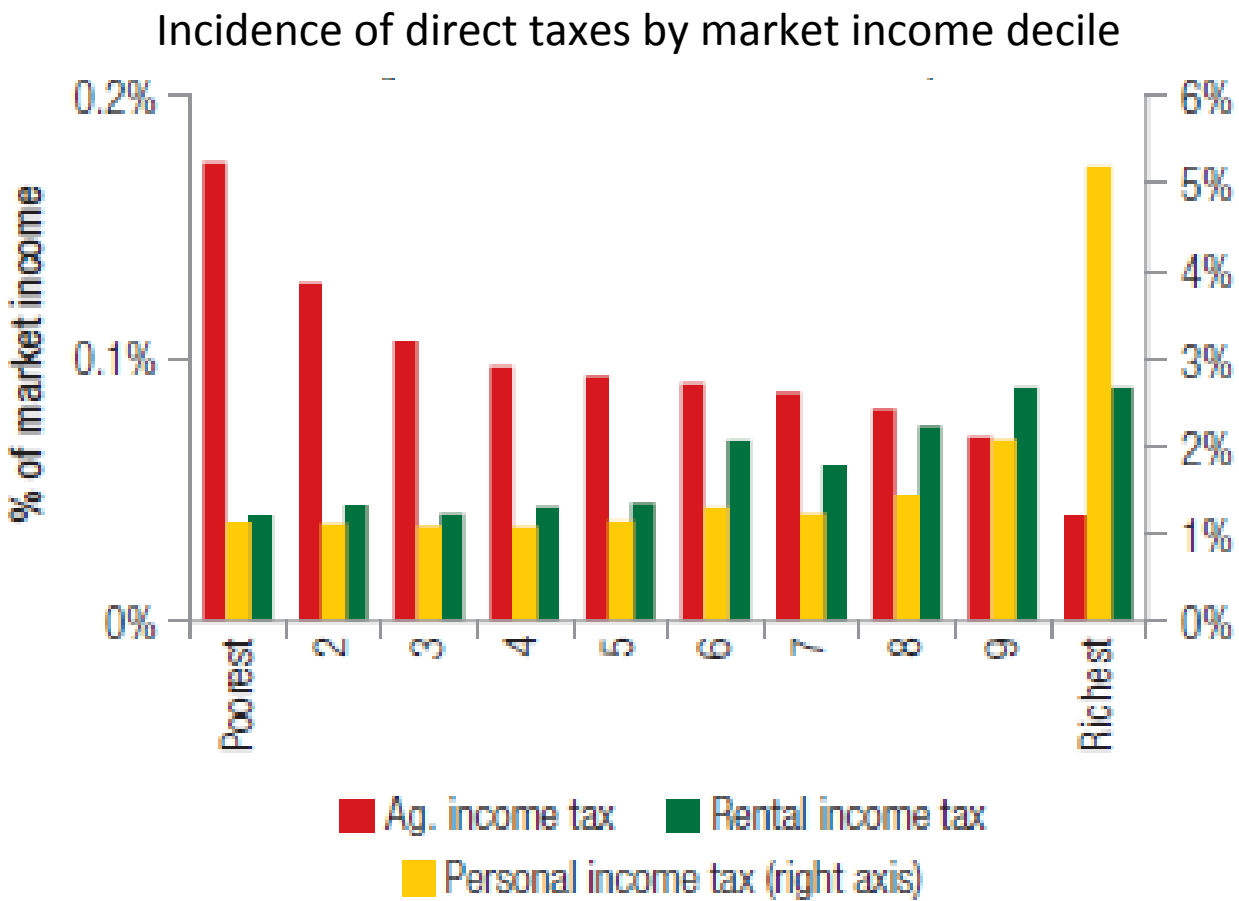
- The largest contributor to poverty reduction was growth, and in particular agricultural growth
- What has been the role of fiscal policy?
 - A large share of public spending is devoted to pro-poor sectors, how effective has it been in improving the financial position of the poorest?
- How can fiscal 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

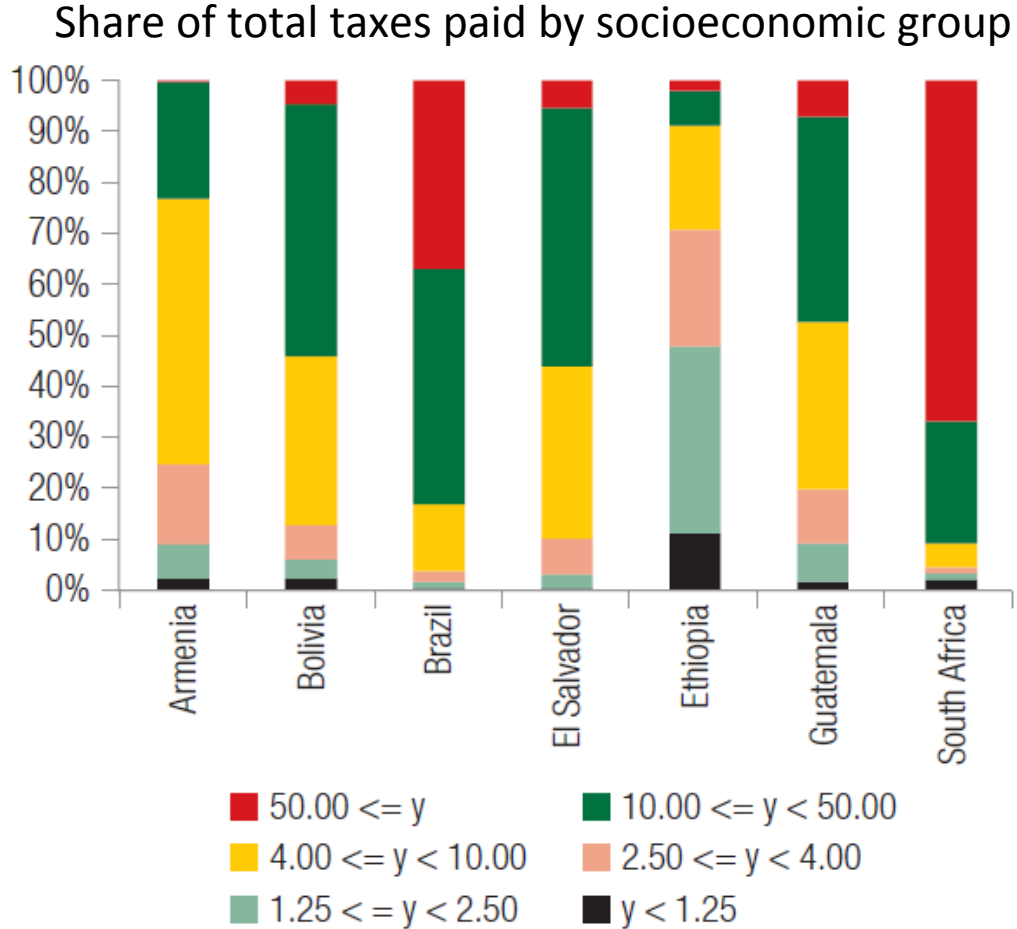
Direct taxes are low and a large share of tax revenue from indirect taxation



But many poor households pay direct tax, as a result of small but prevalent rural taxes and limited progressivity in personal income tax



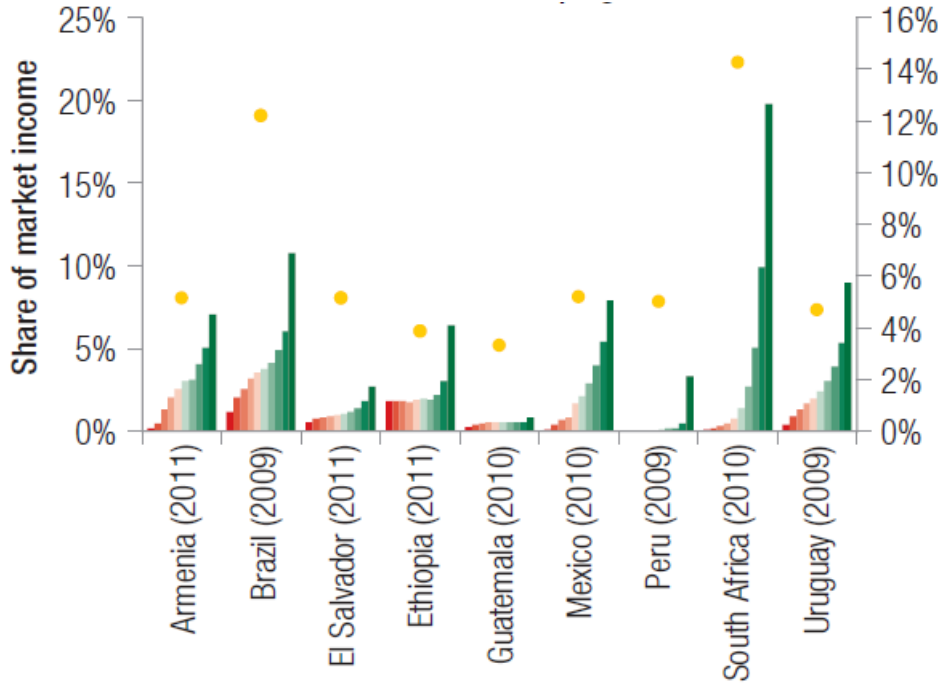
And the poor pay a comparatively large share of revenue, highlighting the challenge of revenue generation in a low income country



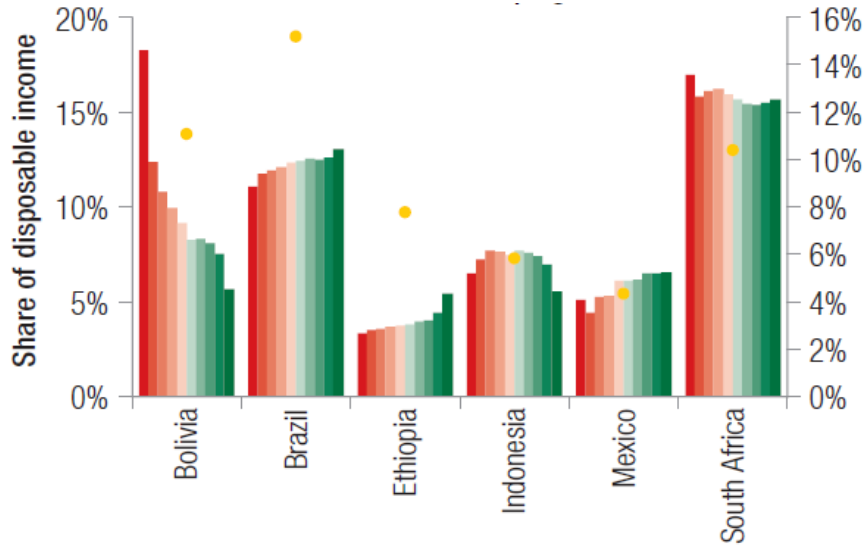
Source: Argentina: Lustig and Pessino 2014; Armenia: Younger et al., 2014; Bolivia: Paz et al. 2014; Brazil: Higgins and Pereira 2014; Indonesia: Jellema et al. 2014; Mexico: Scott 2014; Peru: Jaramillo 2014; South Africa: Inchauste et al. 2014; Uruguay: Bucheli et al. 2014; and Lustig (2014) based on Beneke et al., 2014 and Cabrera et al. 2014. For Ethiopia, own estimates based on HCES 2011.

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

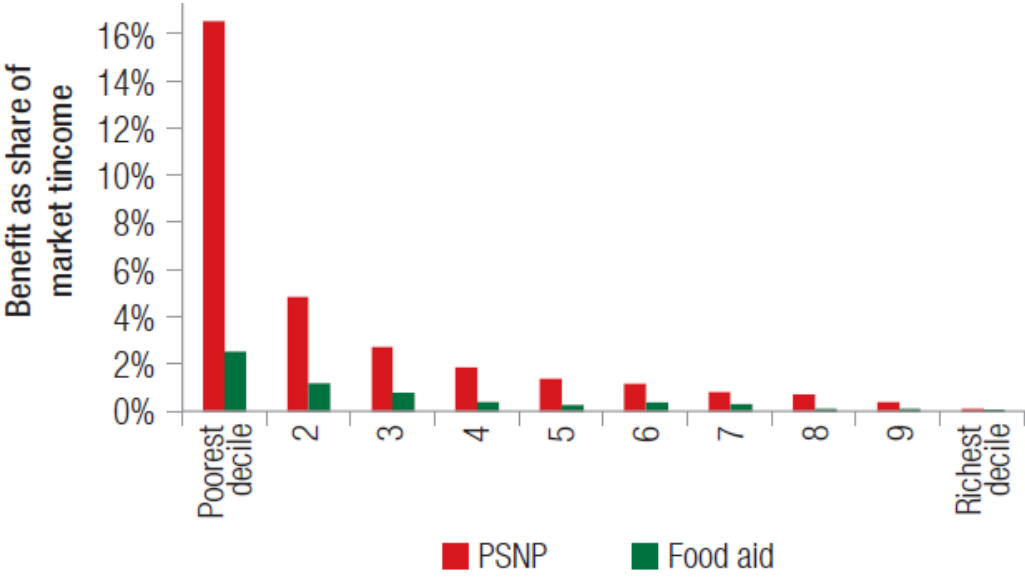


■ Poorest decile
 ■ Richest decile
 ● Share of GDP (right axis)

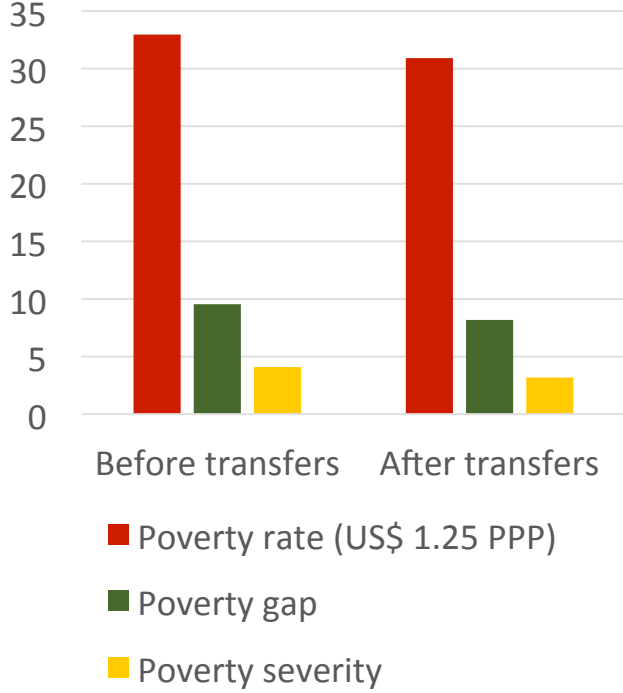
Source: Argentina: Lustig and Pessino 2014; Armenia: Younger et al., 2014; Bolivia: Paz et al. 2014; Brazil: Higgins and Pereira 2014; Indonesia: Jellema et al. 2014; Mexico: Scott 2014; Peru: Jaramillo 2014; South Africa: Inchauste et al. 2014; Uruguay: Bucheli et al. 2014; and Lustig (2014) based on Beneke et al., 2014 and Cabrera et al. 2014. For Ethiopia, own estimates based on HCES 2011.

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

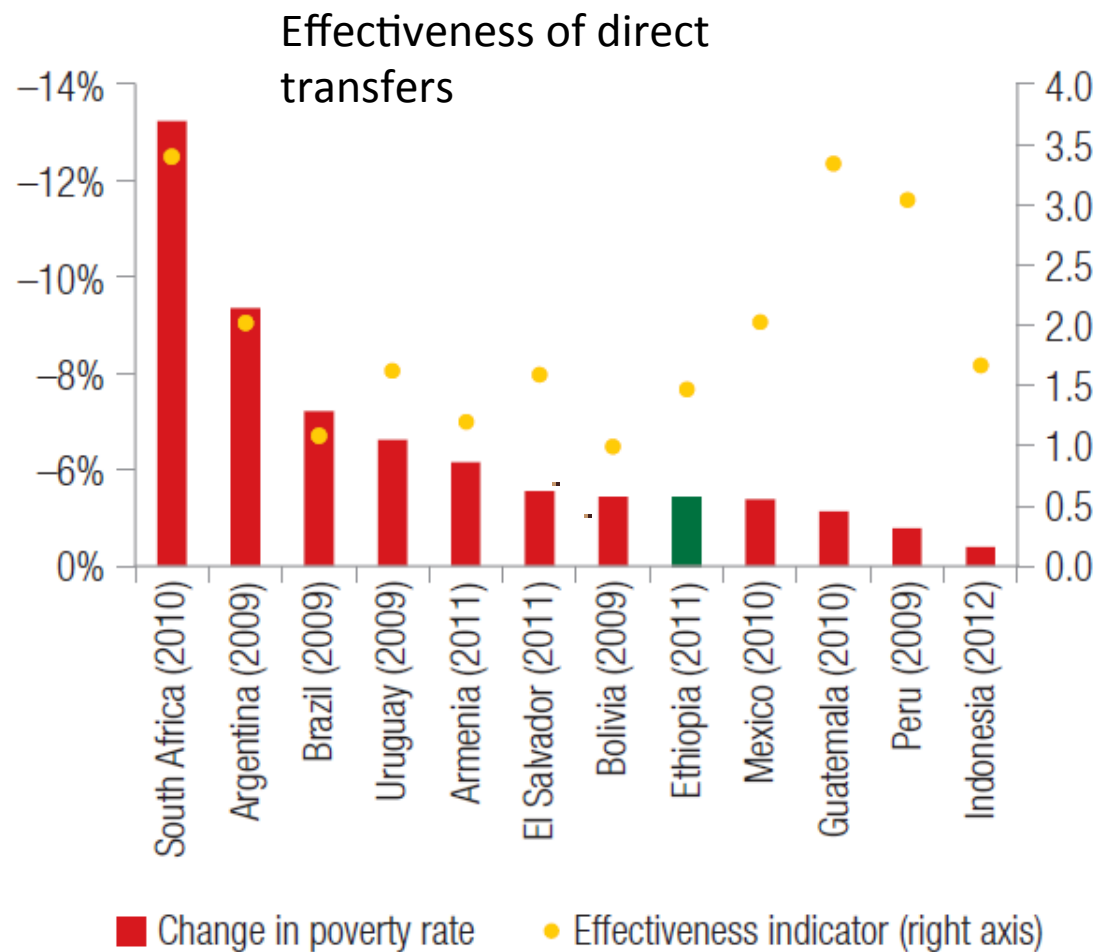
Direct transfers as a share of market income



Impact of direct transfers on poverty reduction



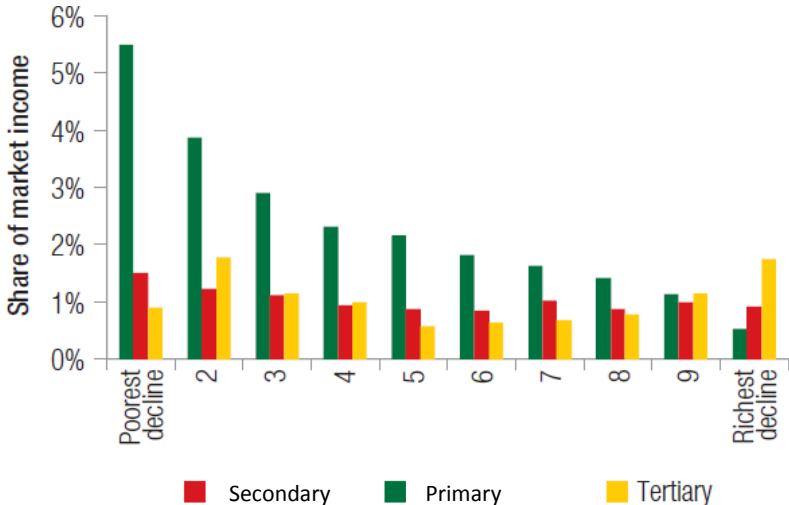
But reduce poverty less than direct transfers in other countries, because less is spent on them



Source: Argentina: Lustig and Pessino 2014; Armenia: Younger et al., 2014; Bolivia: Paz et al. 2014; Brazil: Higgins and Pereira 2014; Indonesia: Jellema et al. 2014; Mexico: Scott 2014; Peru: Jaramillo 2014; South Africa: Inchauste et al. 2014; Uruguay: Bucheli et al. 2014; and Lustig (2014) based on Beneke et al, 2014 and Cabrera et al. 2014. For Ethiopia, own estimates based on HCES 2011. Note: Poverty line of US\$1.25 PPP is used for Ethiopia. For all the other countries the poverty line is US\$2.5 PPP.

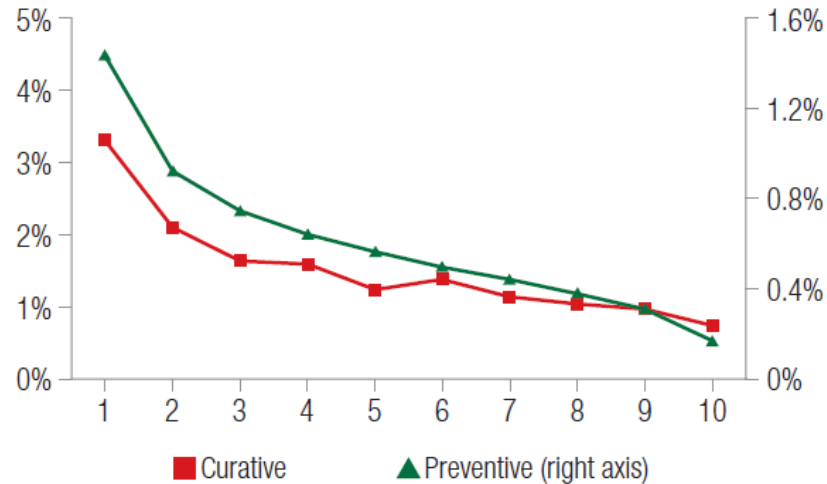
Public spending on education and health is progressive; spending on primary education and preventative health care is pro-poor

Incidence of education spending by market income decile



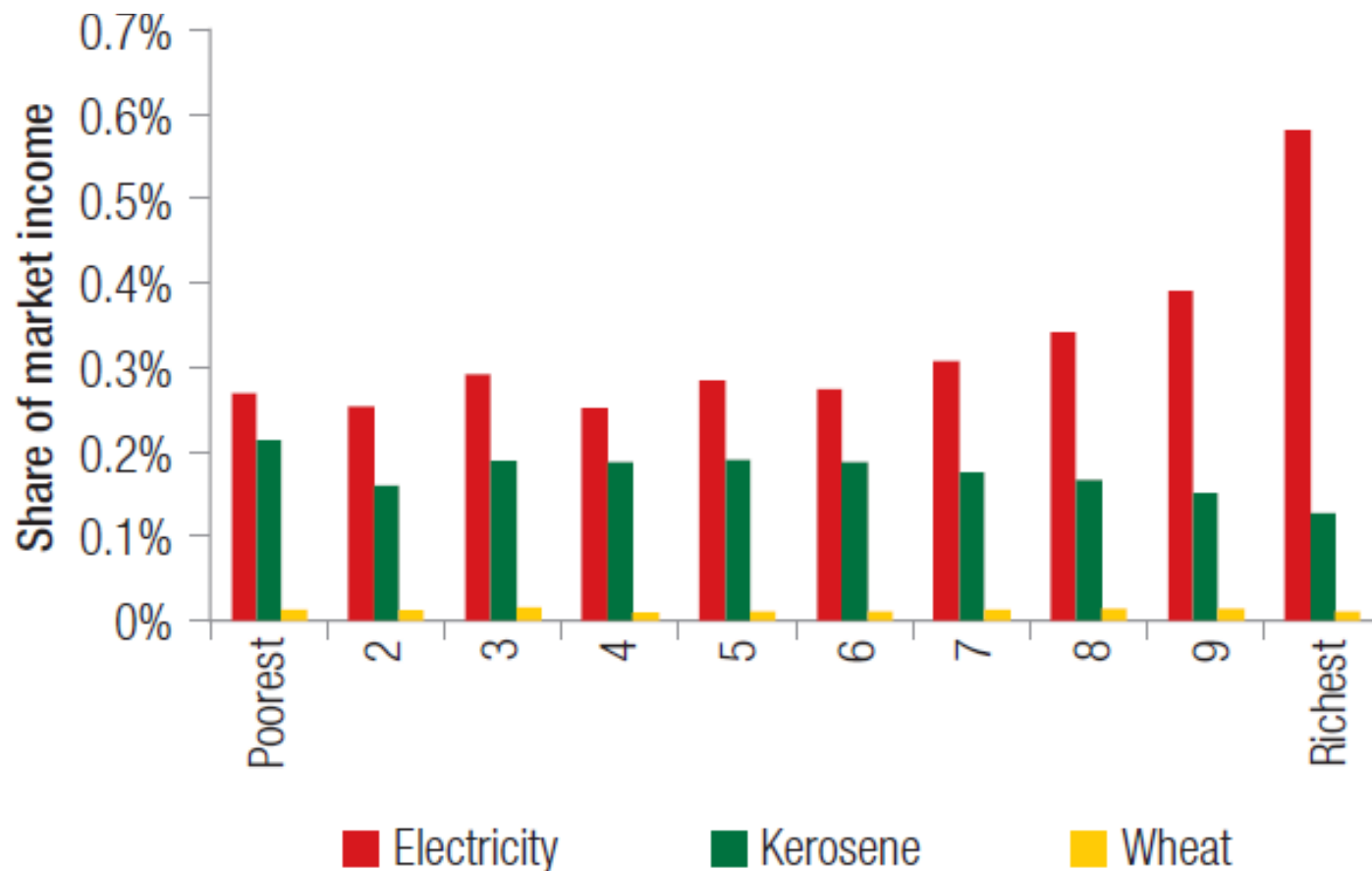
Source: Own estimates based on HCES 2011 and WMS 2011.

Incidence of health spending by market income decile

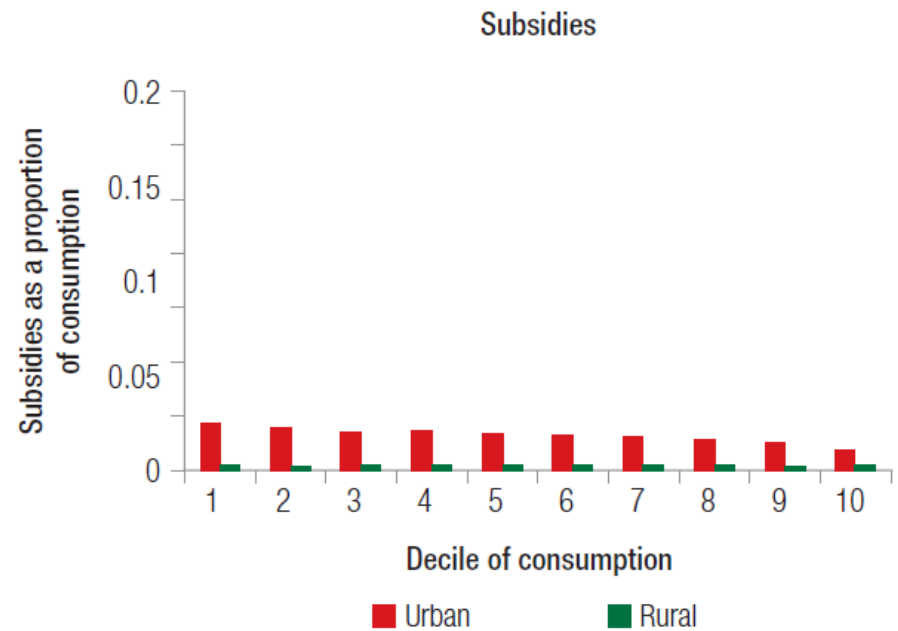
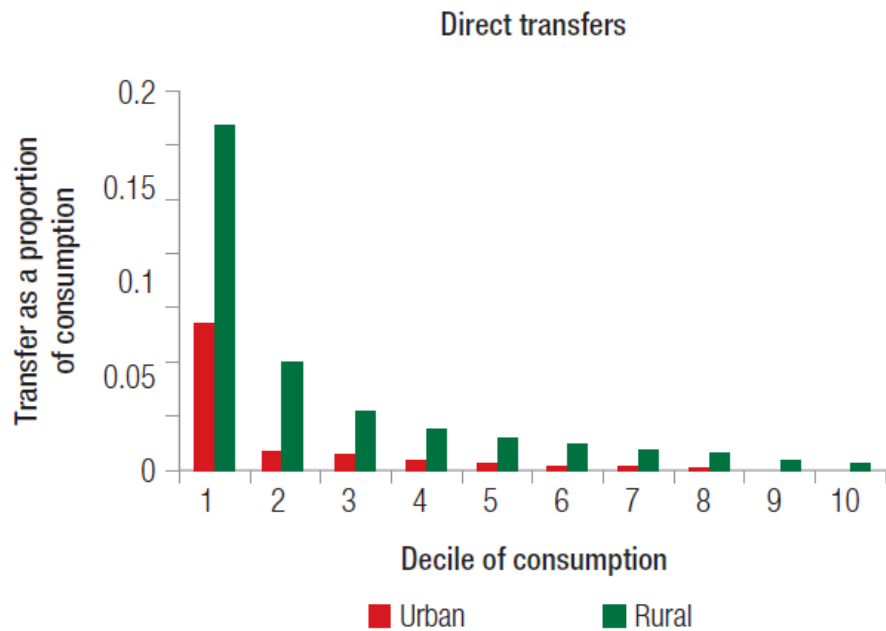


Source: Own estimates based on HCES 2011 and WMS 2011.

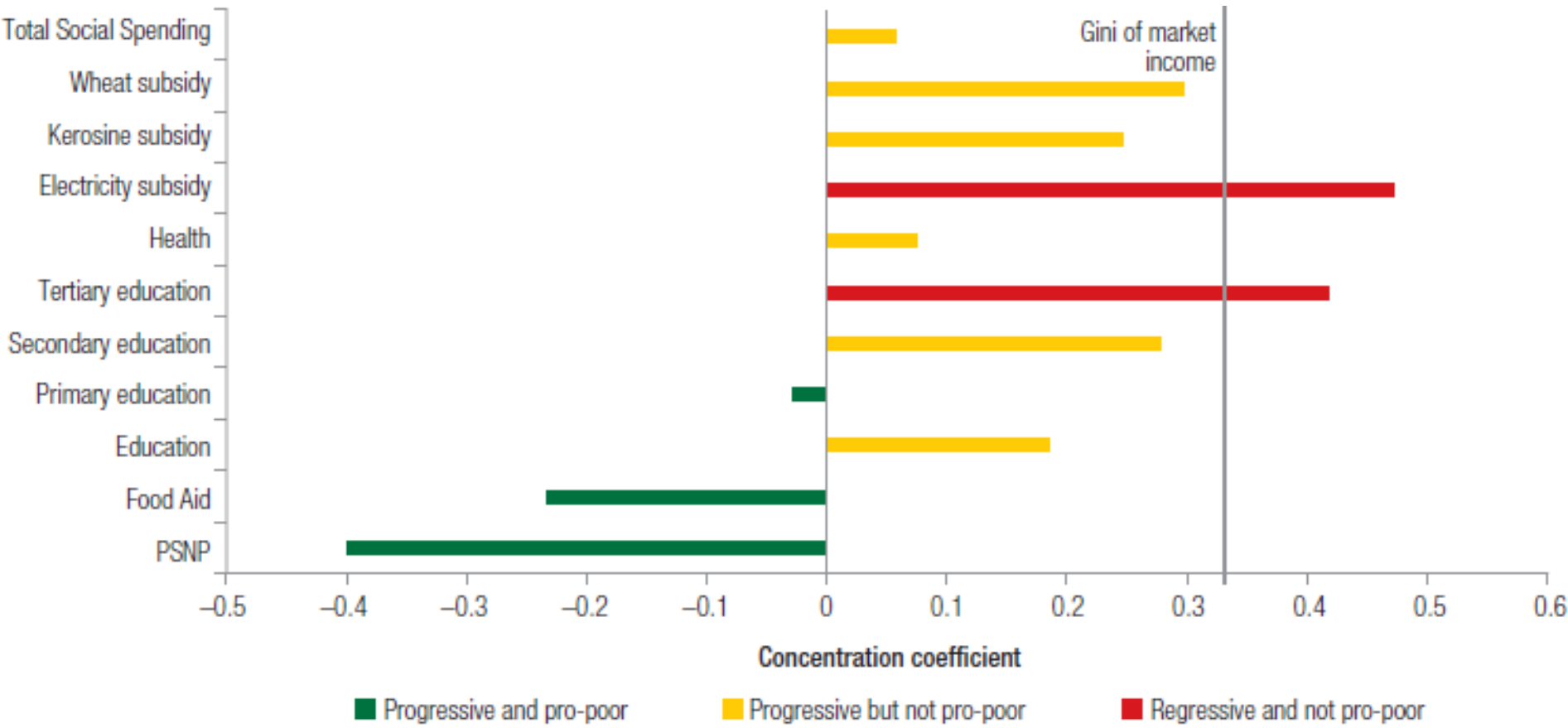
Spending on subsidies is less progressive, and electricity subsidies are highly regressive



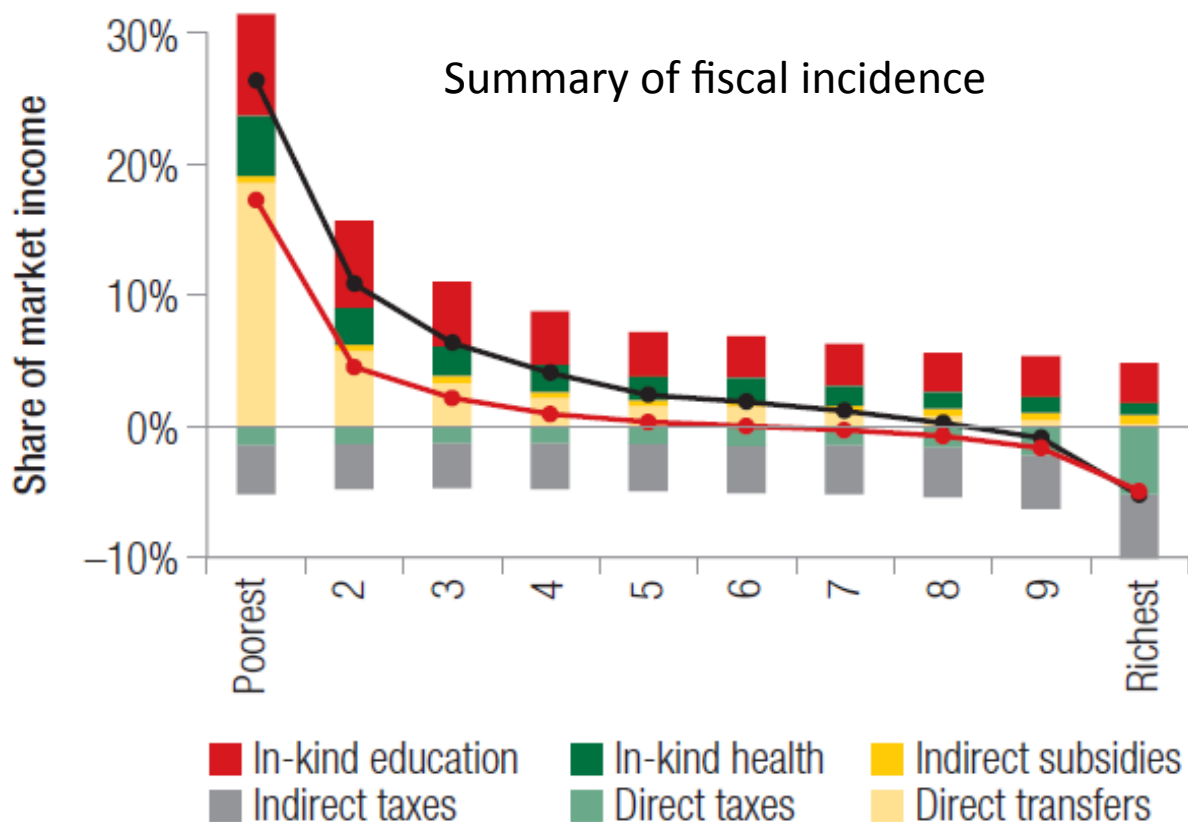
Subsidies are justified as targeted to the urban poor; in aggregate they are but are small compared to transfers to rural households



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

- 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