Highlights of the 2021/22 Federal Government Budget Proclamation

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SUMMARY

- The total approved federal budget for the 2021/22 fiscal year (FY) is Ethiopian Birr (ETB) 562 billion. It shows an 18 per cent increase from the previous fiscal year. However, in real terms, the budget has declined by 1.8 per cent due to the high inflation rate in the country.

- Of the total approved budget, 61.6 per cent is allocated for federal government expenditure, 36.3 per cent for regional subsidies (grants) and 2.1 per cent for capital projects towards achieving the Sustainable Development Goals (SDGs).

- The federal budget allocation between capital and recurrent expenditure has not changed much from the previous year. The share allocated to capital expenditure is 53.1 per cent, while the remaining 46.9 per cent is allocated for recurrent expenditure.

- The federal budget is financed from both domestic and external sources. Around 78 per cent of the approved budget is planned to be financed from domestic sources (65.7 per cent from domestic revenue and 11.9 per cent from domestic loans), while the remaining 22 per cent is to be financed from external assistance (12.3 per cent) and external loans (10.1 per cent).

- When comparing nominal budget shares allocated to different sectors, the highest percentage increase in budget is observed for prevention and rehabilitation, which increased eleven-fold compared to 2020/21. This is mainly reflective of the high budget required to rehabilitate the regions affected by the ongoing conflict in the northern part of the country.
- From the 2021/22 budget to be executed by the federal government, the shares that have been allocated to education and health are 19.1 per cent and 5.9 per cent, respectively. Compared to the approved budget for 2020/21, budget allocation for education and health has slightly declined. However, the nominal value of the budget has increased in absolute terms.
- Federal budget allocation for food security (safety net programmes) and job creation has increased, from ETB 12.1 billion in 2020/21 to ETB 17.1 billion in 2021/22, corresponding to a 41 per cent increase in nominal terms and 17.1 per cent in real terms. The increase mainly came from the urban productive safety net component, with the government increasing its allocated budget from its treasury. The government's treasury contribution has also increased for the rural productive safety net programme.
- The federal budget document outlines the major macro-economic challenges the economy is facing, such as high inflation, a shortage of foreign exchange, weak export performance, a high public debt burden and low domestic revenue mobilization. The COVID-19 pandemic and the ongoing conflict in the northern part of the country are also expected to have an adverse impact on the economy.

1. Background and Context

The federal government of Ethiopia approved a federal budget totalling Ethiopian Birr (ETB) 562 billion for the 2021/22 fiscal year (8 July 2021 to 7 July 2022). The budget consists of capital and recurrent expenditure for execution by the federal government, general-purpose grants (non-earmarked block grants) to sub-national regional governments, and additional capital budgets allocated to regions to help towards achieving the Sustainable Development Goals (SDGs). As a result of the COVID-19 pandemic and the ongoing conflict in the country, the performance of the economy was adversely affected in the 2020/21 fiscal year. Economic growth is therefore expected to be much lower than the projected 8.5 per cent growth.

The presentation of the federal budget for the fiscal year (FY) 2021/22 (which is the Ethiopian Fiscal Year (EFY) 2014) highlighted that the Ethiopian economy is currently facing multiple challenges that are affecting the country's macro-economic stability. Some of these are high inflation, foreign exchange shortage, poor export performance, a high debt burden and low domestic resource mobilization. Adverse impacts of the COVID-19 pandemic and the conflict in the northern part of the country are additional challenges. To bring about a stable macro-economic environment, the government has outlined priority areas to address. These include reducing the inflation rate, mainly through avoiding direct financing from the National Bank of Ethiopia, reducing the debt burden by taking concessional loans only, and improving domestic resource mobilization through tax reform and modernizing the tax collection system. The pandemic and the ongoing conflict in the country require increased government expenditure, which is not matched by domestic resource mobilization. The government has planned to keep the budget deficit under 3 per cent of GDP by soliciting external financing to bridge the budget gap.

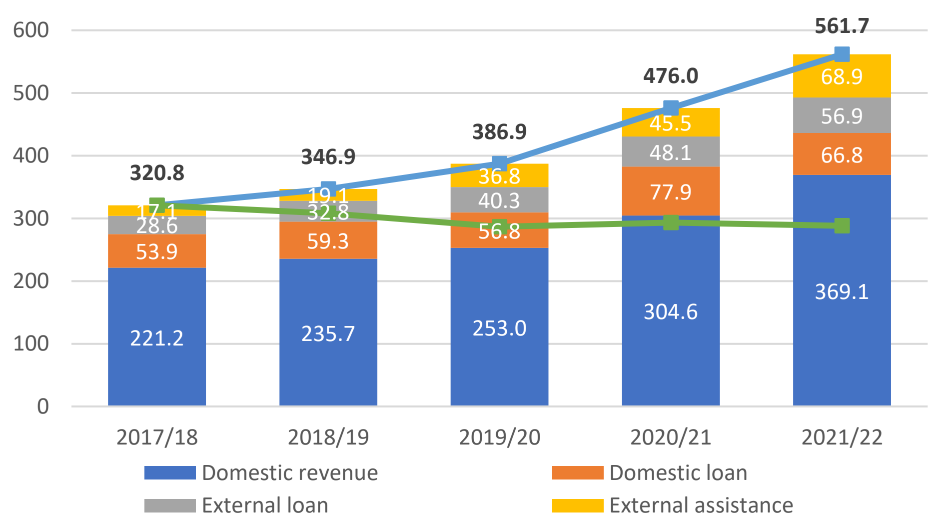
2. FINANCING SOURCES OF THE BUDGET

The federal budget approved by the House of Peoples' Representatives of the Ethiopian parliament for FY 2021/22, ETB 562 billion, has increased by 18 per cent in nominal terms when compared with the budget approved for the 2020/21 FY. With annual moving average inflation standing at 20.2 per cent in July 2021, the real value of the budget has actually declined by 1.2 per cent. High inflation is significantly undermining the nominal budget increase and has become one of the most important sources of macro-economic instability that the country is committed to address in the coming fiscal year.

The approved federal budget is financed from both domestic and external sources. Domestic sources mainly comprise tax, non-tax and capital revenue, while external sources are mainly borrowing and assistance in the form of grants from development partners. Around 78 per cent of the approved budget is to be financed from domestic sources, while the remaining 22 per cent is to be financed via external assistance and external loans.

- ETB 369.1 billion (65.7 per cent of the total budget) is planned to be mobilized from domestic revenue.
- ETB 66.8 billion (11.9 per cent of the total budget) is intended to be mobilized from domestic borrowing.
- ETB 56.9 billion (10.1 per cent of the total budget) is forecasted to be collected from external sources in the form of loans.
- ETB 68.9 billion (12.3 per cent of the budget) is in the form of grants/assistance from bilateral and multilateral development partners.

Figure 1: Sources of finance for the federal budget, 2017/18–2021/22 (in billion ETB)



Source: Data from MoF (Ministry of Finance). Real values are calculated by the authors, with 2017/18 as the base year.

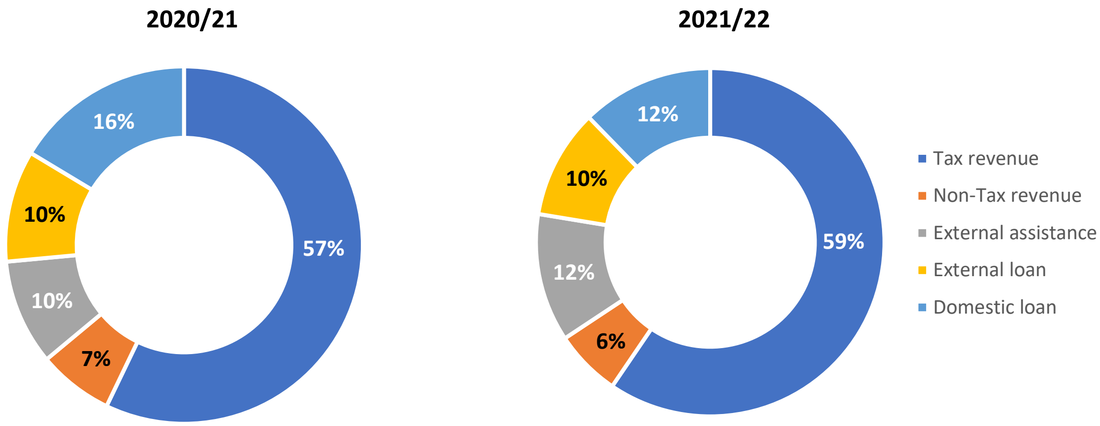
Although domestic resource mobilization has improved during recent years, Ethiopia's tax-to-GDP ratio remains among the lowest in Africa. In 2018/19, the ratio was only 9.41 per cent, much lower than the sub-Saharan average of 18.62 per cent. The low and declining tax-to-GDP ratio is mainly due to poor capacity to mobilize domestic resources. Various government efforts to expand tax revenue include formalizing business transactions and introducing stronger tax administration systems to reduce evasion and collect

[1] Computed using GDP and tax revenue data obtained from MoF (2020).
[2] World Bank Data (2018) retrieved from https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?locations=ZG on September 14, 2021.

unpaid dues. Although these have resulted in improving tax revenue over recent years[3], the increase in tax collection is not yet on par with GDP growth. Given the large proportion of the population that is engaged in agriculture, the capacity to raise tax revenue is low, and a large section of the economy remains untaxed. Tax administration and policy issues, a narrow tax base and prevalent tax evasion are further drivers of the low level of domestic resource mobilization.

With the COVID-19 pandemic and conflict in the country affecting the economy, tax collection performance in 2020/21 was significantly below target. From the planned 271 billion in tax revenue to be generated in 2020/21, only 64.6 per cent was collected in the fiscal year. Total revenue for 2021/22 is forecasted to increase by 24 per cent from what was budgeted in 2020/21. For the 2021/22 budget year, the share of tax revenue out of the total federal budget is 59 per cent, showing an increase of 2 percentage points from the previous fiscal year (Figure 2). On the other hand, the share of domestic loans out of total federal budget declined by 4 percentage points, mainly due to the implementation of a strict monetary policy to curb the high inflation rate. The contribution of external assistance to the federal budget is expected to increase by 2 percentage points, while the share of external loans remains the same. It is important to note that the source of financing presented below applies to the federal budget only. In addition to the general-purpose grants (also referred to as non-earmarked block grants or subsidies) provided by the federal government to sub-national regional governments, regions also raise their own revenues and using the sum plan their own budgets to be approved by their respective autonomous regional parliaments.

Figure 2: Share of financing sources out of the total federal budget for 2020/21 and 2021/22 (per cent)



Source: Data from MoF.

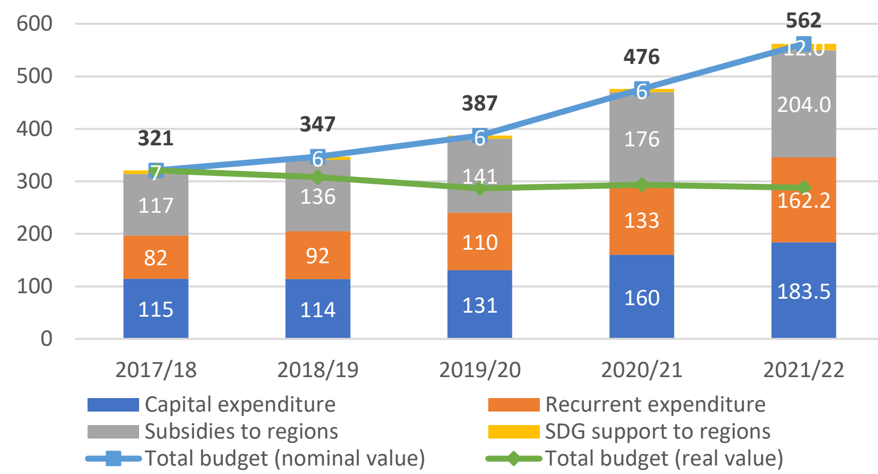
3. Federal Budget Allocation

Of the total approved budget of ETB 562 billion, 61.6 per cent is allocated for federal government expenditure (ETB 345.7 billion), 36.3 per cent (ETB 204.0 billion) for sub-national governments responsible for sub-national budget allocation, and 2.1 per cent (ETB 12 billion) is earmarked for supporting capital projects towards the achievement of Sustainable Development Goals (SDGs) at the sub-national level. The nominal budget allocated for federal government spending has increased by 17.7 per cent compared to 2020/21 (Figure 3). Block grants to regional governments have also shown a 15.6 per cent increase compared to last year. The budget for supporting the achievement of SDGs at the sub-national level has doubled, from 6 billion to 12 billion. However, when accounting for inflation, the total value of the federal

[3] World Bank (2016) Ethiopia Public Expenditure Review 2015. Washington, DC: World Bank Group.

budget has declined by 1.8[4] per cent (versus an 18 per cent increase in nominal terms). For the budget increase to be realized in real terms, the government should take strong measures to control the inflation rate.

Figure 3: Federal budget allocation trends, 2017/18–2021/22 (in billion ETB)



Source: Data from MoF. Real values are calculated by the authors, with 2017/18 as the base year.

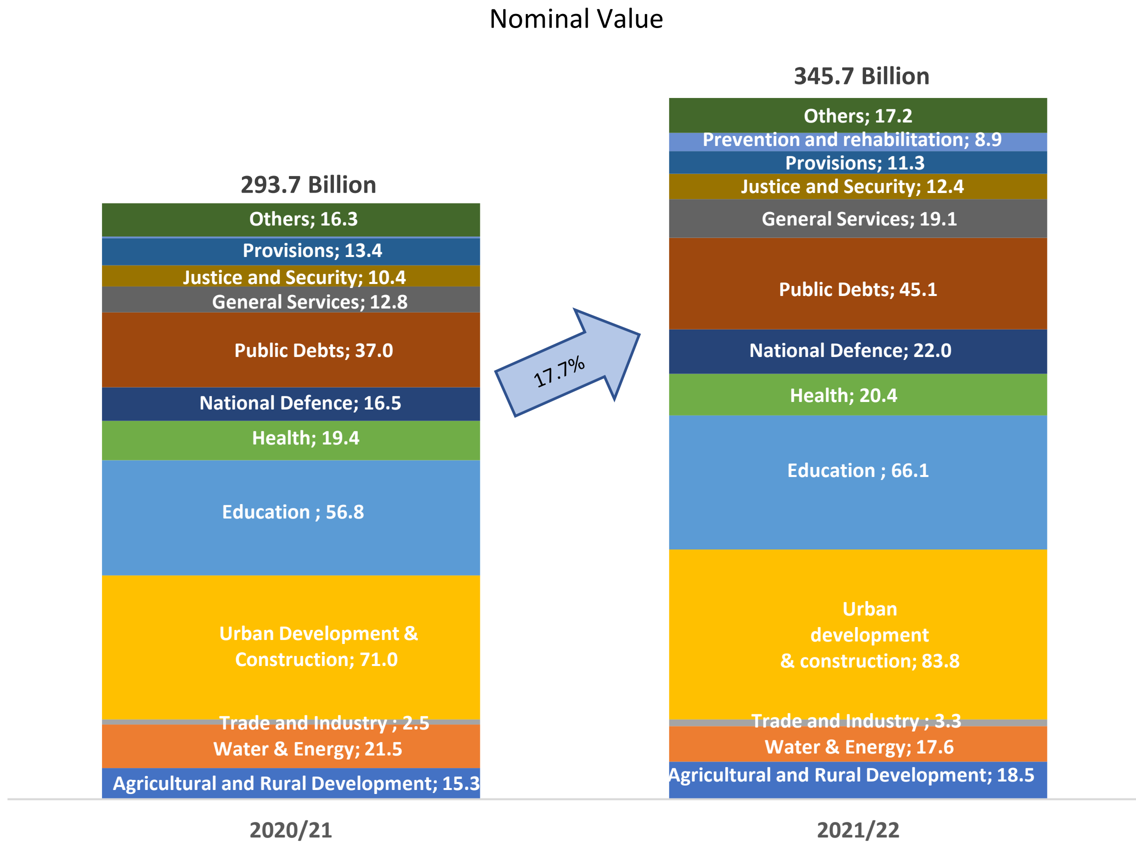
3.1. Federal Government Budget

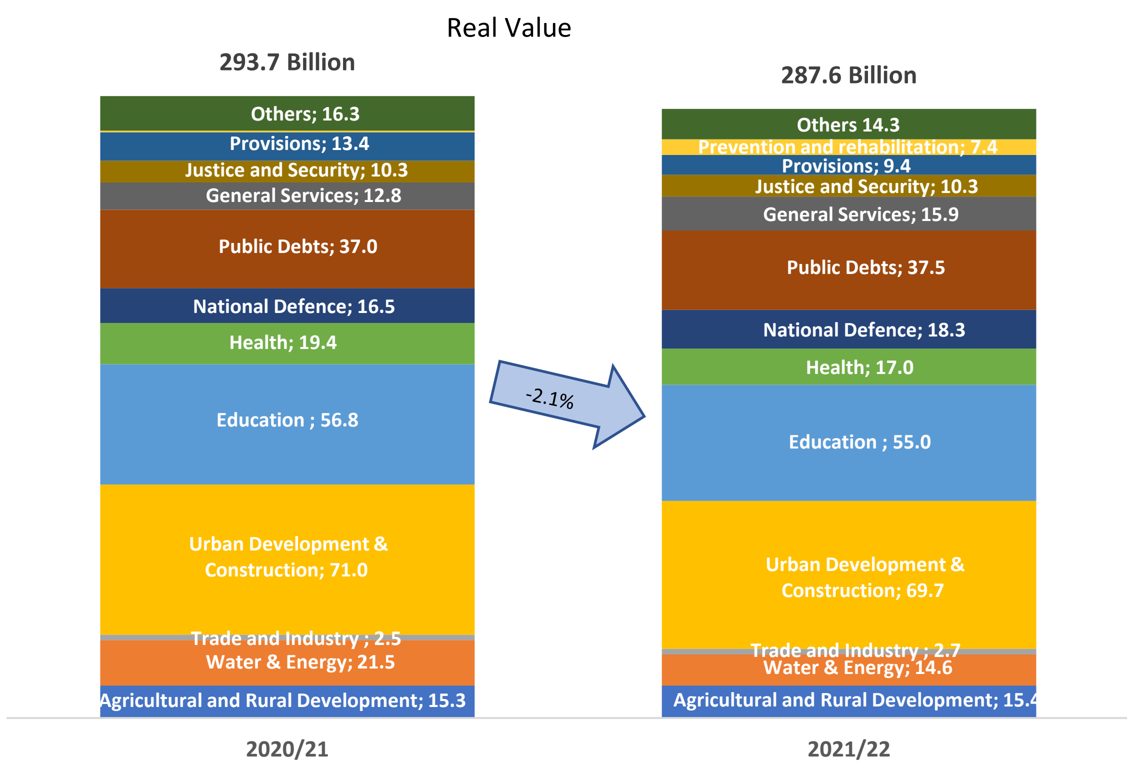
Out of the total federal budget, ETB 345.7 billion are allocated to be executed by the federal government, a 17.7 per cent increase from the 2020/21 budget. Out of this, ETB 162.2 billion (46.9 per cent) are budgeted for federal recurrent expenditure and ETB 183.5 billion (53.1 per cent) for federal capital spending. Compared to 2020/21, the recurrent and capital budgets for the federal government have increased by 21.6 per cent and 14.5 per cent, respectively. Figure 4 presents the federal budget allocated to different sectors. The top three sectors with the highest budget allocation are urban development and construction, education, and public debt financing, with ETB 71.6 billion, ETB 56.8 billion and ETB 37.0 billion, respectively. They account for 24.2, 19.1 and 13.1 per cent of the federal government budget. The budget allocated for debt servicing is increasing in recent years, in line with the rising debt burden of the country, as foreign debts taken to finance major public projects are maturing and pushing the economy into a high risk of debt distress. The share of debt financing from the federal budget increased from 10 per cent to 13.1 per cent between 2019/20 to 2021/22. With the current COVID-19 pandemic and conflict in the country affecting the economy and putting pressure on domestic resource mobilization, external financing is expected to play a greater role in financing the government's budget deficit. This could further increase the debt burden, which is already very high.

Compared to the federal budget in 2020/21, the share of budget allocated to prevention and rehabilitation has increased by 2.3 percentage points, an elevenfold increase. This is mainly due to the planned rehabilitation works that need to be done following the destruction of infrastructure and service delivery facilities in the war-torn northern part of the country. The budget allocated for national defense has also increased by 33 per cent, resulting in a 1 percentage point increase in its share from the total federal budget. On the other hand, the shares of the federal budget allocated to health and education have slightly declined, even though the nominal values for both health and education have increased.

[4] Using 2017/18 as a base year and 2020/21 fiscal year's annual moving average inflation of 20.2 per cent.

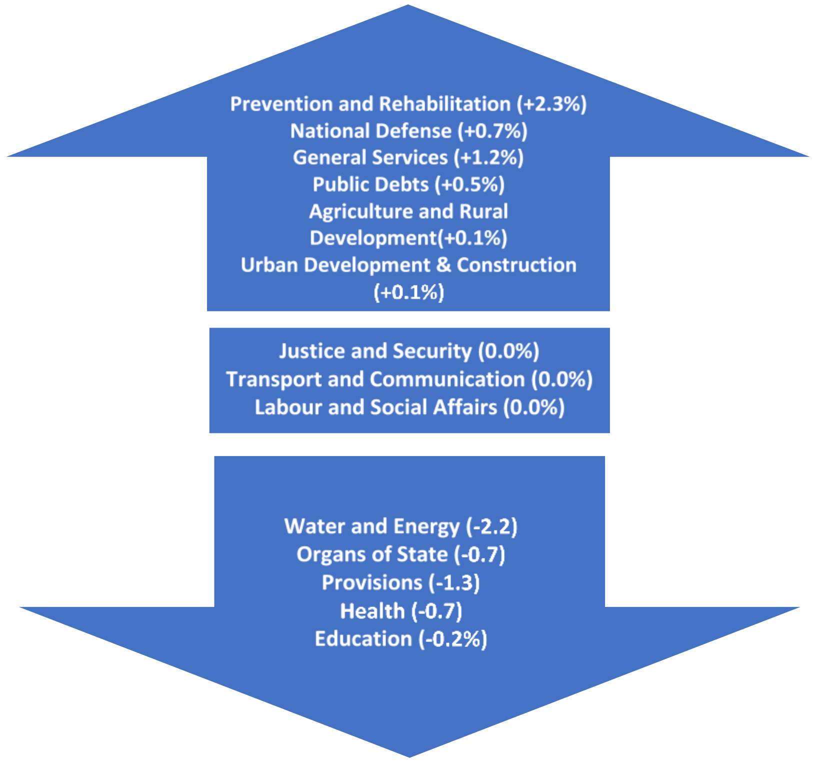
Figure 4. Federal government budget in nominal and real terms (2020/21 and 2021/22)





Source: Data from Ministry of Finance. **Notes:** 'Others' is composed of budget for Organs of State; Culture and Sport; Transport and Communication; Mining; and Labour and Social Affairs. Real values for 2021/22 are calculated using the average inflation rate of 20.2 per cent.

Box 1: Change in the share of budget allocated to sectors from the total federal government budget (2020/21-2021/22)

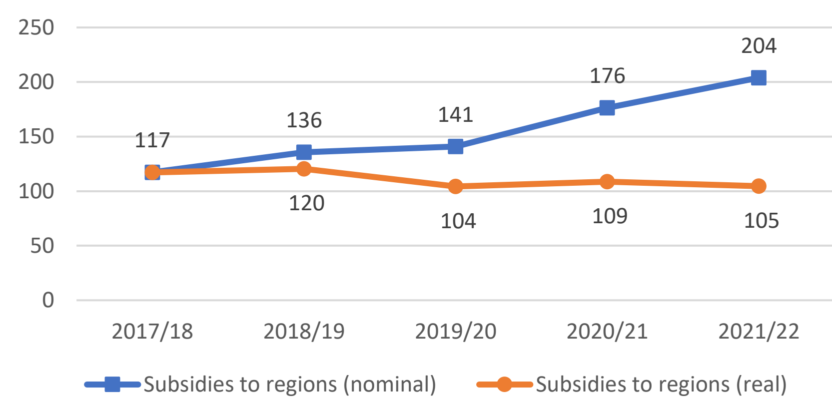


Source: Data from Ministry of Finance

3.2. Federal Subsidies (non-earmarked block grants) to Regional Governments

Every fiscal year, the federal government allocates budget subsidies for regional governments based on a formula developed by the House of Federation. Looking at the trend in recent years, the nominal value of the budget allocated to regions has increased by 75 per cent between 2017/18 and 2021/22 (Figure 5). For the fiscal year 2021/22, this corresponds to ETB 204 billion, an increase of 16 per cent from its value in 2020/21. However, in real terms, the value of the budget has declined by 4 percent due to high inflation.

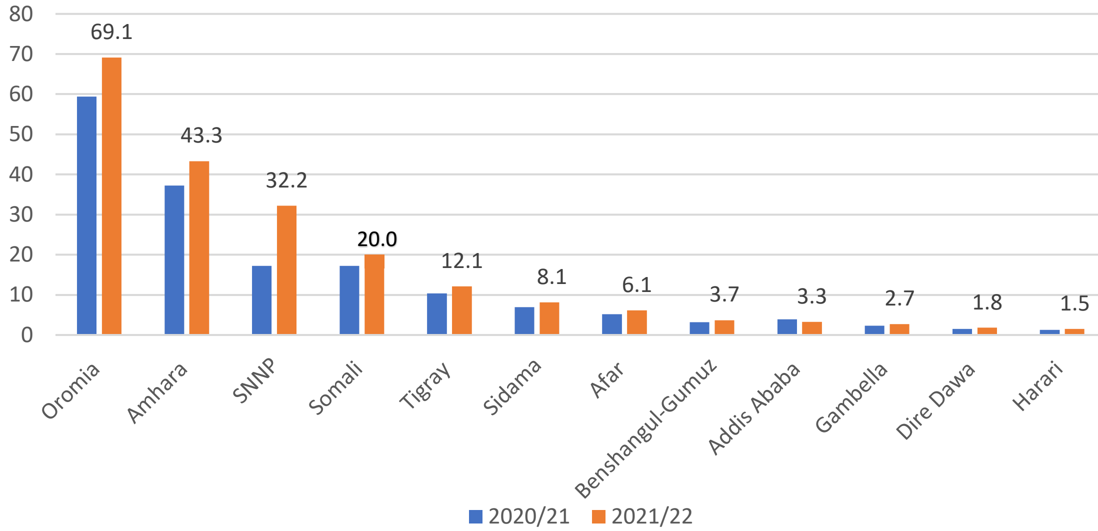
Figure 5. Federal government subsidies to regions in nominal and real terms (2020/21 and 2021/22)



Source: Data from MoF

Out of the total budget allocated to the regions, ETB 69.1 billion is allocated to Oromia regional state (Figure 6). Amhara, SNNP, Somali, Tigray, and Sidama regions receive ETB 43.3 billion, 32.2 billion, 20.0 billion, 12.1 billion and 8.1 billion, respectively. Afar, Beneshangul-Gumuz, Addis Ababa, Gambella, Dire Dawa and Harari receive ETB 6.1 billion, 3.7 billion, 3.3 billion, 2.7 billion, 1.8 billion and 1.5 billion, respectively.

Figure 6: Trends of federal subsidies across regions, 2020/21–2021/22 (in billion ETB)



Source: Data from MoF.

3.3. Support for SDG Implementation in Regions

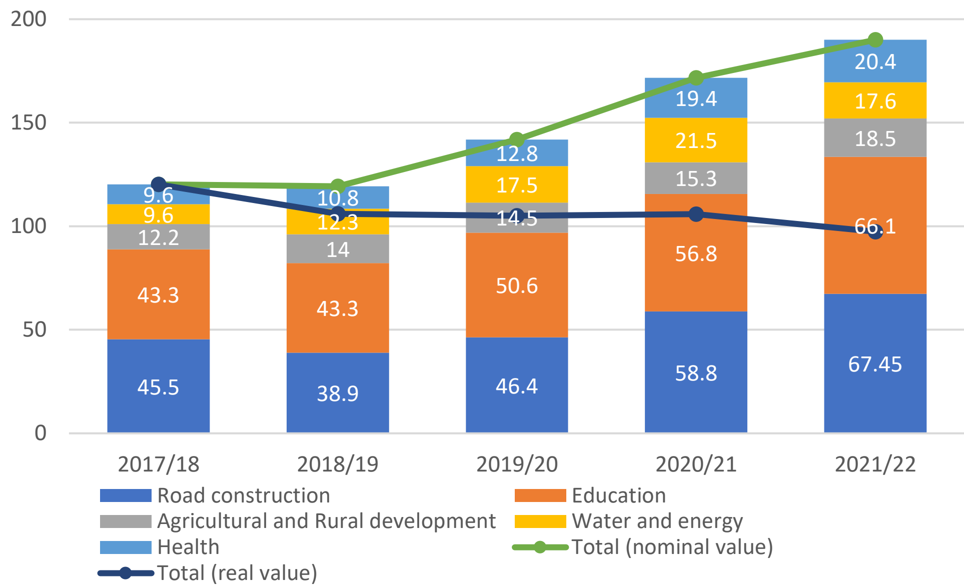
The federal government has been providing budgetary support to regions to help achieve the Sustainable Development Goals (SDGs). According to the 2011/12 FY proclamation, this support for capital expenditure is to be utilized for financing specific sectors that are determined in agreement between the Ministry of Finance and regional governments. The budget is intended to be allocated to poor and vulnerable groups in society, to ensure equitable service delivery and access to productive resources. In 2021/22, ETB 12 billion is to be transferred to regional states as per the grant formula for the implementation of the Sustainable Development Goals (SDGs), which is double of the 6 billion that was budgeted for the 2020/21 fiscal year.

4. Federal Allocations to Sectors of Focus

The federal budget shows only the resources that are allocated across sectors at the federal government level. At the regional level, the resource envelope encompasses federal subsidies and resources mobilized within the regions. The total regional budget is then allocated between sectors by the regions themselves for sub-national level implementation. The sector budget analysis in this section focuses on the budget to be implemented by the federal government only. This may therefore understate the overall budget allocated for each sector.

The budget allocation for selected sectors – education, health, water and energy, agricultural and rural development, and road construction – has shown an increasing trend over the years in nominal terms (Figure 7). Compared to 2020/21, the 2021/22 budget allocated to these sectors increased by 11 per cent in nominal terms. In real terms, the budget allocation has declined by 8 per cent. If real gains are to be reaped from increased budget allocation to these sectors, controlling the high inflation in the economy is imperative.

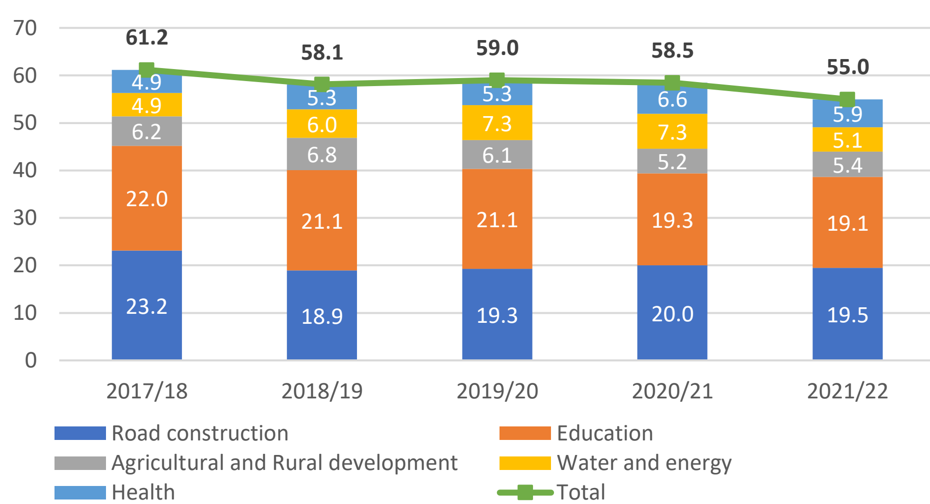
Figure 7: Federal budget allocation to selected sectors, 2017/18–2021/22 (in billion ETB)



Source: Data from MoF. Real values are calculated by the authors, with 2017/18 as the base year.

More than half of the federal budget (55 per cent) is allocated to what the government considers pro-poor sectors, namely education, health, road construction, water and energy, and agriculture (figure 8). The share of the 2021/22 federal budget allocated to these sectors at the federal level is 19.5 per cent for road construction, 19.1 per cent for education, 5.4 per cent for agriculture, 5.1 per cent for water resources and energy (including the budget allocation for electricity) and 5.9 per cent for health (Figure 7). Compared to the approved budget for 2021/22, although the budget amount has increased in absolute terms, the share allocated to these sectors has declined from 58.5 percent in 2020/21 to 55 percent in 2021/22.

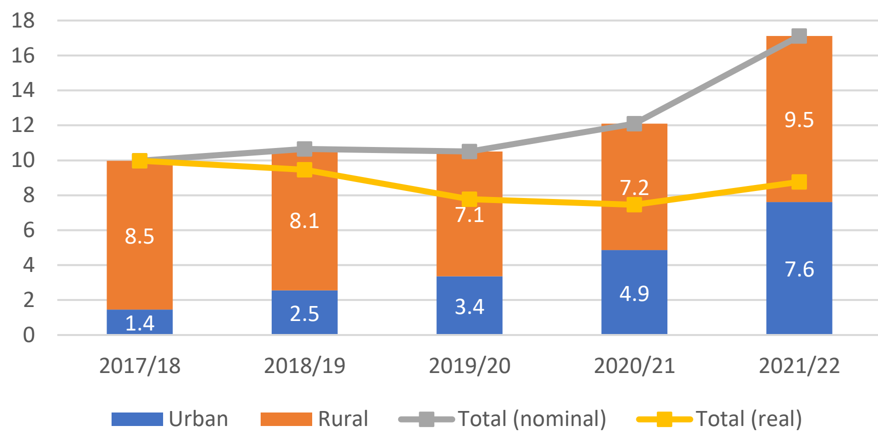
Figure 8: Share of federal budget allocated to selected social sectors, 2017/18–2021/22 (per cent of budget for the federal government)



Source: Data from MoF.

The federal budget allocated to social protection has been increasing over the years, particularly for food security and job creation. It rose from ETB 12.1 billion in 2020/21 to ETB 17.1 billion in 2021/22, which is a 41.4 per cent increase in nominal terms (Figure 9). In real terms, the budget for food security (mainly for safety net programmes) and job creation has increased by 17.6 per cent, corresponding to a budget share increase from 4.1 per cent to 4.9 per cent. The increase mainly came from the urban food security and job creation component, which increased by 57 per cent, while the rural component increased by 31 per cent in nominal terms.

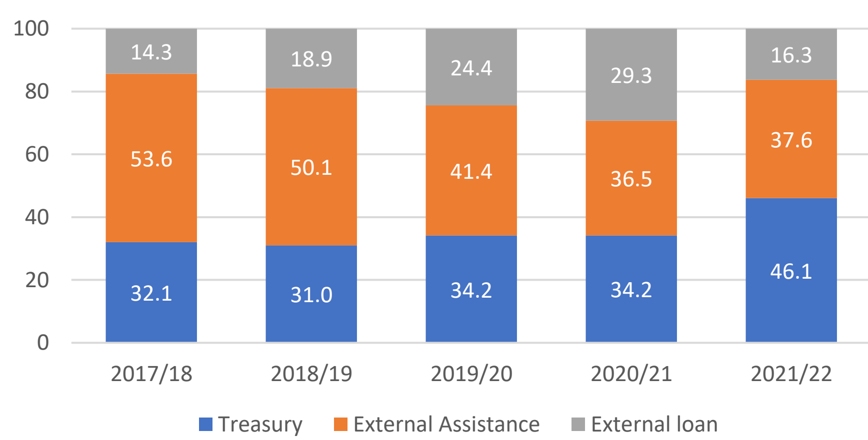
Figure 9: Share of the federal budget allocated to food security and job creation (in billion ETB)



Source: Data from MoF.

The increase in budget allocation for social protection is mainly financed from the government treasury, whose contribution almost doubled for the urban food security and job creation component, while the contribution for the rural component increased by 83 per cent compared to its value in 2020/21. As can be seen from Figure 10, the government treasury contribution to safety net programmes and job creation has been increasing over the years. For the 2021/22 budget, 46 per cent of the total budgeted amount is from government treasury, showing a 12-percentage point increase from 2020/21 budget. The significant rise in contributions from the federal treasury indicates a strong commitment from the government to ensure the sustainability of social protection financing through domestic sources. Although these are budget allocations, actual expenditure is usually much higher than the amount budgeted by the government due to significant off-budget expenditures.

Figure 10: Share of the federal budget allocated to food security and job creation (in billion ETB)

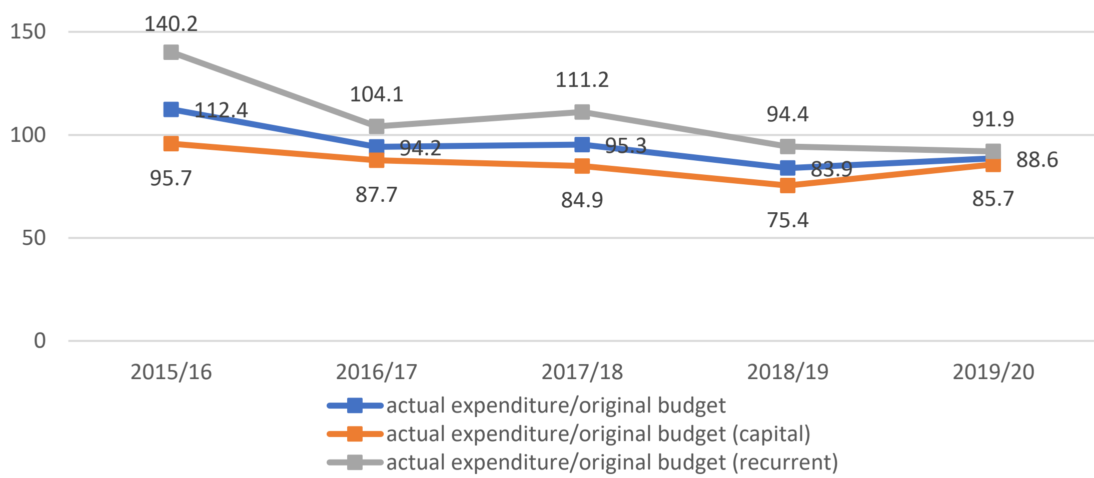


Source: Data from MoF.

5. Federal Government Budget Credibility

Budget credibility is measured as the proportion of actual expenditure at the end of the fiscal year out of the budget that was approved at the start of the fiscal year. For a budget to be an effective instrument, it needs to be credible. In this regard, budget credibility analysis for the period 2015/16 to 2019/20 reveals that the variation between the total amount of federal expenditure and the total federal budget that was originally approved was on average around 7.5 per cent (Figure 11). For 2019/20, the budget credibility was 88 per cent. In analysing the budget credibility disaggregated by budget components, there appears to be a lower budget credibility for capital expenditure, at 86 per cent compared to 92 per cent for the recurrent budget. Capital budget credibility has shown a 10-percentage point improvement compared to 2018/19, with improved project implementation and execution observed at the federal level. However, capital budget credibility remains lower than the recurrent budget credibility. Some of the main reasons for the lower capital budget credibility are procurement issues and the shortage of foreign currency needed to make capital investments.

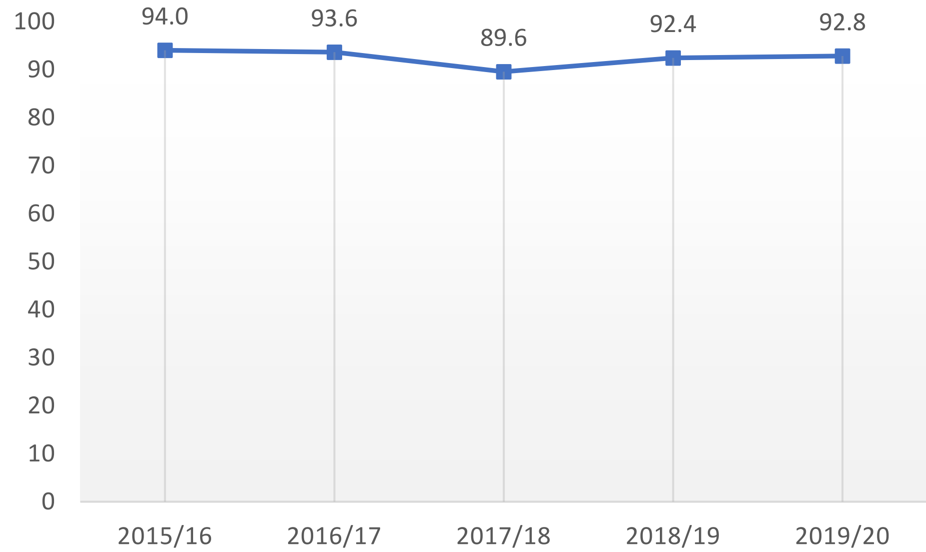
Figure 11: Federal government budget credibility (per cent)



Source: Data from MoF.

As part of the budget credibility assessment, planned federal domestic revenue is compared to the actual domestic revenue collected by the federal government. During the period 2015/16 to 2019/20, on average 93 per cent of the planned federal domestic revenue was collected by the end of the fiscal year (Figure 12). The implementation of various tax reforms, with their increased focus on improving tax administration, has contributed to the improvement of the domestic revenue budget credibility. Federal domestic revenue performance was 92.8 per cent of the budgeted amount for 2019/20. The effect of the COVID-19 pandemic on federal domestic resource mobilization was not as high as expected in 2019/20, mainly because the low performance in the FY's fourth quarter was offset by the high domestic revenue collection performance in the first three quarters. Since tax comprises around 80 per cent of overall federal domestic revenue, maintaining an effective tax policy and further improving its implementation along with tax compliance and tax administration are essential to maintain the improvement in the federal domestic revenue mobilization.

Figure 12: Performance of the federal government domestic revenue: actual federal domestic revenue collected as a percentage of planned federal domestic revenue



Source: Data from MoF.

Annex 1: Timeline for the State Budget Process in EFY 2014 (2021/22)

Planning/Budgeting cycle	Ethiopian Fiscal Year	Gregorian Calendar
Planning cycle		
1. Macro-Economic and Fiscal Framework (MEFF)	By Tahisas 30	By 08 January
1.1 MEFF preparation	Until Hidar 30	Until 09 December
1.2 MEFF approval	By Tahisas 30	By 08 January
3. Notification of the three-year subsidy estimates	By Tir 01	By 09 January
4. Preparation of the annual fiscal plan	By Tir 15	By 23 January
Budgeting cycle		
A. Pre-preparation of budget by public bodies		
1. Pre-preparation of budget	Before Yekatit 01	Before 08 February
2. Notification of annual subsidy	By Yekatit 01	By 08 February
3. Issuing the budget call	By Yekatit 01	By 08 February
4. Budget requests	By Megabit 15	By 24 March
5. Preparation of the draft recommended budget	Megabit 15–Ginbot 15	24 March–23 May
6. Review of the recommended budget by the Council of Ministers	Ginbot 16–Ginbot 25	24 May–02 June
B. Budget approval		
7. Legislative approval and appropriation of the budget	Sene 01–Sene 30	08 June–07 July
C. Implementation		
8. Notification of approved budget	Hamle 01–Hamle 07	08 July–14 July
9. Accepting the approved budget and action plan preparation	Hamle 08–Hamle 30	15 July–06 August
10. Implementing the approved budget	Hamle 01–Sene 30	08 July 2022 –07July 2023

The Federal General-Purpose Grant Distribution Formula (2017/18–2021/22)

The responsibility for deciding the proportion of the general-purpose grant allocation to the regional states has been constitutionally vested in the House of Federation (HoF) since 1994/95. Federal transfers are distributed based on the relative fiscal gaps of regional states, and the HoF has adopted a grant allocation formula to capture the gaps as accurately as possible. The HoF revises the grant allocation formula periodically, so as to adjust the federal grant allocation to the changes in the socio-economic conditions of each regional state, and a number of formulae have been developed and used since the country adopted fiscal federalism.

In 2017, the HoF adopted a revised grant allocation formula (for use in the coming three years) to accommodate the allocation of federal grants to changes in population size, levels of development, revenue collection capacities, employment and poverty, among other factors, across regional states. The new approach to federal transfers is calculated on the basis of representative revenue and expenditure estimates. In this approach, the revenue-raising capacity is estimated using the representative revenue system; the expenditure needs are estimated using the representative expenditure system; and the fiscal gaps are calculated accordingly for each regional state. The grant is therefore distributed based on the relative fiscal gaps of the regional states.

Though there are different approaches used to estimate the revenue-generating capacities of sub-national governments, the federal transfer formula of Ethiopia uses the Representative Tax System (RTS) to estimate the revenue-generating capacities of each region. This system employs the main tax revenue sources of regional states, including agricultural income tax, land use fee, payroll tax, business income tax, turnover tax, and value-added tax. The current grant allocation formula considers new developments in tax rates, particularly for payroll tax. Improvements have also been made to the previous computation method by using weighted averages, rather than simple average tax rates. Moreover, a new method is followed in the calculation of business income tax and value added tax, which represents a major departure from the method used in the previous formula.

According to the new grant allocation formula, the expenditure need of each regional state is calculated by taking into consideration the unit of measurement (which is different across each expenditure category), representative expenditure (per unit average expenditure for each expenditure category), and adjustment index (constructed from factors explaining unit cost differentials across sub-national governments). The current grant allocation formula employs a regression approach to estimate the adjustment index for each expenditure category, which was not the case in the previous formula (previously, the adjustment index was subjectively determined by an expert and then finally settled through consultation with the regional governments). The expenditure categories incorporated in the calculation include general services and administration, primary and secondary education, including Technical and Vocational Education and Training (TVET), public health, agriculture and rural development, drinking water development, rural road construction and maintenance, urban development, and micro and small-scale enterprises.

However, in the current revised grant allocation formula, the lack of adequate and good-quality data on some essential variables of interest have been the most important challenges faced in estimating the revenue-generating capacities and expenditure needs of regional states. Moreover, it is impossible in this revision to capture some of the concerns raised by regional governments, such as the variation in the quality of public services provided and the efficiency differential across regional states.

As a result of this computation, from 2017/18 to 2020/21, the total amount of the federal general purpose block grant is divided and transferred as follows: Tigray, 6.03 per cent; Afar, 3.02 per cent; Amhara, 21.6 per cent; Oromia, 35.38 per cent; Somali, 10.32 per cent; Benishangul-Gumuz, 1.54 per cent; Sidama plus Southern Nations, Nationalities and Peoples 20.41 per cent; Gambella, 1.1 per cent; Harari, 0.21 per cent; and Dire Dawa, 0.38 per cent

Adapted from Federal Democratic Republic of Ethiopia House of Federation. *The Federal General-Purpose Grant Distribution Formula 2017/18–2019/20*. June 2017.

This federal government level budget brief was produced by Fanaye Tadesse Techane ftechane@unicef.org with guidance and contributions provided by Zeleka Paulos zpaulos@unicef.org. The main objective of this budget brief is to synthesize complex budget and expenditure information so that it is easily understood by stakeholders, to foster discourse and to inform policy and financial decision-making processes. The analysis presents budget and expenditure that are recorded on-budget by the Ministry of Finance. UNICEF's work on Public Finance for Children is undertaken under the leadership of Samson Muradzikwa.

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