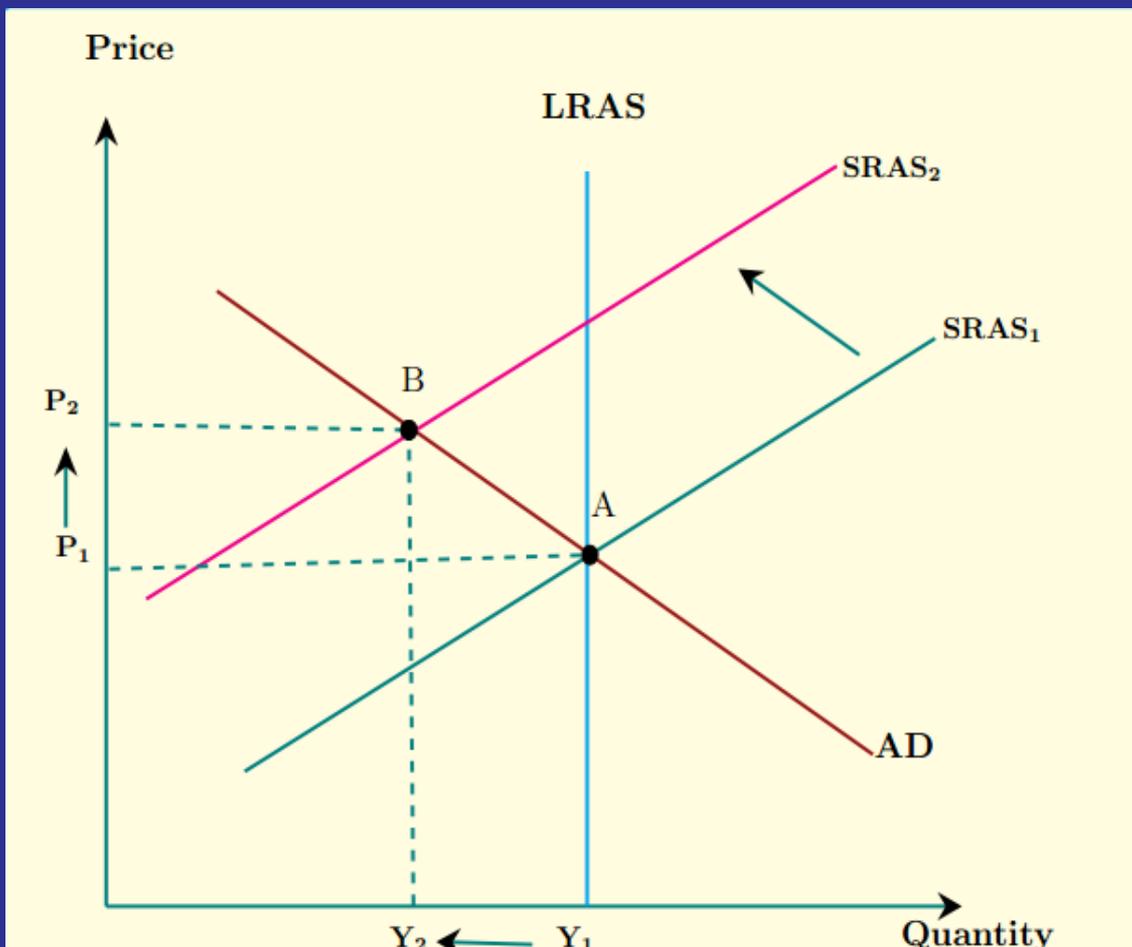




# ECONOMICS

## DISTANCE MODULE II

### GRADE 12



FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA  
MINISTRY OF EDUCATION



# ECONOMICS

## Distance Module II Grade 12

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FEDERAL DEMOCRATIC REPUBLIC  
OF ETHIOPIA



HAWASSA UNIVERSITY

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## Introduction

Economics is an important discipline which has an increased significance in recent years in response to worldwide economic problems. For example, problems like poverty, unemployment, inflation and recession, are worldwide today. Hence, to understand these problems and find solutions, an adequate knowledge of economics is required.

Dear learner, please answer the question “**why is it important to study economics?**” before you read the notes below. We trust you that you do not read the following before trying to answer this question. That is very nice of you! Now, you can read what is written below and compare it with what you have tried in answering the question.

The study of economics is expected to equip you with subject knowledge, understanding, skills, values and attitudes about important questions and issues of economy, society and environment. It will also help you develop competencies to engage in the community as informed and active citizens.

This module is intended to support the learning of economics so that you possess the right tools to understand economic world and how to interpret events that will affect you, either directly or indirectly. Moreover, you will be supported to relate and translate economic concepts to explain economic reality on the ground. You will also be helped to acquire and develop knowledge on what to expect in the future and how to manage your economic decisions.

Finally, as the distance education learner, you need to invest the required time on studying the subject. We expect you to learn at your own pace; we also expect you to learn and cover some portions of the subject within a defined time frame as compulsory requirement.

In line with the above expectations, the student profile and the module contents are presented below.

## Student Profile

At the end of **Grade 12 Economics** study, you are expected to have better attributes in terms of the following:

### Knowledge

- ✓ Knowledgeable in subject area (principles, theories, applications, etc.)

### Attitude

- ✓ Cooperation
- ✓ Curiosity
- ✓ Motivation to become successful

## Digital literacy

- ✓ Data collection
- ✓ Data analysis
- ✓ Data analysis skills and tools
- ✓ Report writing

## Communication skills

- ✓ Group discussion
- ✓ Teamwork
- ✓ Presentation

## Business management skills

- ✓ Start one's own business
- ✓ Support family business
- ✓ Work in government and non-government organizations

By the end of **Grade 12**, you are expected to exhibit the following profile:

- Continue your education in various disciplines of social and business sciences using your economics knowledge and skills in higher education institutions.
- Demonstrate an appreciation about the link between production, distribution and consumption.
- Articulate contemporary issues in economic growth, and development.
- Participate in collaborative engagements which aim at social and economic development.
- Respect democratic values, rules and regulations.
- Participate in various citizenship activities by recognizing and appreciating cultural aspects (including languages and religions) and livelihood of various places.
- Find solutions to key contemporary issues including unemployment, inflation, and poverty reduction using enquiry skills.
- Articulate the link between poverty and environmental degradation.
- Contribute to efforts that aim at bringing about sustainable development in Ethiopia and beyond.

This module is prepared with a view to meet the growing needs for distance education that cannot be met by traditional school systems. Its benefits include offering access to educational opportunities for people who are unable to go to school to learn face to face (regular program).

With this in mind, this module is prepared to stimulate and sustain your interest in the subject. We aimed to make use of effective communication to support and facilitate your learning and then to assess your progress.

*Grade 12 Economics* is divided into two modules, each containing 4 units. The first part is

based on theories of macroeconomics, and it is covered in the first semester. This module deals with the application of macroeconomic theories in real world. [Module 2](#) is expected to be covered in the second semester. The units in this include:

- ❑ Unit 5: Tax Theory and Practice
- ❑ Unit 6: Poverty and Inequality
- ❑ Unit 7: Macroeconomic Reforms in Ethiopia
- ❑ Unit 8: Economy, Environment and Climate Change

The units in both modules will help you prepare for the national entrance examination.

## Resources

The following resources would help you to concretize the issues in different units and sections. They include:

- ✓ This distance education module
- ✓ Activities and self-test exercises that are listed in this module
- ✓ Reference books, some are available on Google Scholar
- ✓ ICT tools and emerging technologies including online videos
- ✓ ICT digital tools (mobile phones, tablets, etc.) and emerging technologies
- ✓ Internet based educational resources including online videos (e.g. YouTube, educational mobile apps)

## Module Learning Strategies

As a student of distance education, you may want to space or spread out learning opportunities over time. Try to balance different dimensions of your life, education, family, and other commitments. Examples of some strategies for successful distance learning are listed here under:

1. create a schedule and follow it.
2. Take the time to research questions and involve teachers.
3. Assess the technology used in the course.
4. Utilize alarms and calendars to keep you abreast with deadlines.
5. Appreciate yourself.
6. Take part in distant discussions.
7. Identify clear goals.

Dear learner, please note that these are not the only strategies, but also you can have other strategies of your own too.

## Icons in the Module

Throughout each module, you will find the following icons or graphic symbols that alert you to a change in activity within the module. Only the icons that are required are used in each module.

Icon	Meaning	Description
	Text or Reading Material	Provides information about the topics that are covered.
	Self-check	Requests that you double-check your comprehension. If you mark any box under the 'No' column, please look at the corresponding item to the left and go back to your text and read about it.
	Summary	Highlights or provides an overview of the most important points covered.
	Overview	Introduces you to focus on the content that will be discussed.
	Suggested Answers	Indicates the suggested answers for the given exercises
	Objective	Indicates what you should know after completing a section or unit.
	Self-Assessment	Enables you to check your understanding of what you have read and, in some cases, to apply the information presented in the unit to newsituations.
	In text Question	Indicates you that the sentence in the text in question.
	Recall for prior learning	Requires you to focus on the content that will be discussed in a section or unit

### How to use this Module?

This module is designed to help you manage your study of economics by yourself in your own time. It requires you to be proactive and efficient in the use of the resources at your disposal. Every unit in the module contains general overview and introduction, learning outcomes, required study time, learning strategies and content sections. In each section, you have also section overview, learning outcomes, resources and the contents followed by self-test exercises and a checklist of things you need to do. Here, checklist refers to a list of things that you must think about, or that you must remember to do. In other words, they are the list of tasks that need to be completed by yourself. Checklists help you create ownership, deadlines, and expectations as to when things will be finished. They ensure that you have a sense of direction and know what you need to do next.

We wish you an effective and a successful mastery of the module. Please, go on reading.

**Module Development Team**

**July 2023**

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# UNIT 5

## TAX THEORY AND PRACTICE

**Time Allotted: 14 hours**

### INTRODUCTION

In this unit, taxation is a cross-cutting issue and important national agenda for Ethiopia. Here or elsewhere around the world, it forms a critical element of modern government.

The unit is divided into five sections. The first section defines the concept of taxes, presents and discusses their classification, principles and objectives. The second one covers approaches to equity. The third and fourth sections explore tax system and structure and describe the types of tax and tax accounting in Ethiopia respectively. Finally, the fifth section examines the problems which are associated with taxation in Ethiopia.

Dear learner, we expect you to complete this unit in *14 hours*. Please, assess your progress and performance by referring to the learning outcomes, self-test exercises and checklists. Try to learn at your own pace and cover some portions of the subject within a defined time frame as a requirement.



### Unit Learning Outcomes

**At the end of this unit, you will be able to:**

- ❑ understand the concept of taxes.
- ❑ justify the objectives of taxes.
- ❑ distinguish differences among the various types of taxes.
- ❑ articulate the basic principles of taxation and characteristics of a good tax system.
- ❑ outline the nature and problems of taxation in Ethiopia.

How will you achieve these outcomes? Please, think of the things you are going to do in order to achieve them. Now, compare your own strategies with the following ones and use those you think are helpful to achieve the intended outcomes.

### Learning Strategies

Dear learner, please, use the following and other learning strategies of your own to successfully learn this unit.

1. Create a schedule to study and follow it.
2. Take the time to research questions.
3. Assess the technology used in the subject.
4. Utilize alarms and calendars to keep you abreast with deadlines.
5. Appreciate and value yourself for what you are doing regarding this subject.
6. Take part in distant discussions.

7. Search for different available learning opportunities that will help you to better understand the subject.

### **Contents of the Unit**

#### **5.1 Taxes: Definition, Principles, Objectives and Classifications**

#### **5.2 Approaches to Tax Equity**

#### **5.3 Tax System and Structure in Ethiopia**

#### **5.4 Types of Taxes and Tax Accounting in Ethiopia**

#### **5.5 Problems Associated with Taxation in Ethiopia**

#### **Unit Summary**

#### **Self-assessment questions**

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## **5.1 Taxes: Definition, Principles, Outcomes and Classifications**

### **Overview**

This section covers the definitions, principles, outcomes and classifications of taxation.

### **Learning Outcomes**

*At the end of this section, you will be able to:*

- ❑ define taxation.
- ❑ list the basic principles of taxation.
- ❑ explain the characteristics of a good tax system.
- ❑ compare and contrast taxation systems across the world.

### **Key Concepts**

- |                  |                   |
|------------------|-------------------|
| ☞ Types of taxes | ☞ Tax shifting    |
| ☞ Direct taxes   | ☞ Tax base        |
| ☞ Indirect taxes | ☞ Impact of a tax |
| ☞ Tax rate       | ☞ Effect of a tax |

#### **5.1.1 Definition and Terminologies in Taxation**

Dear learner, from your past experience, what do you understand by taxes and why they exist? Have you attempted? It is appreciable.

Tax, as defined by the Organisation for Economic Cooperation and Development (OECD) is the “compulsory, unrequited payments to general government”. The term “compulsory” indicates that taxes are not voluntary purchase payments but mandatory impositions which

are payable in line with what is legislated. To enforce the compulsion, different governments have constitutions, proclamations, regulations and directives to charge tax for different categories of people. The term 'unrequited' is used in the sense that benefits provided by government to a taxpayer are not in proportion to the payments which are made by that taxpayer. Obtaining direct benefit is not the main condition of paying tax. Hence, tax is levied without a *quid pro quo* (i.e. without anything in direct return).

Indicating the inevitability of taxation, it is said that there are two things that are certain in life: death and taxes. It is also said that without tax, there will be no revenue, and hence, no government. However, taxation is not the only source of government revenue. This is to mean that there are other sources such as borrowing, imposition of fees for services rendered, or printing money. Nevertheless, taxation typically accounts for 90% or more of total governmental receipts in times of peace except during unusual situations like war time.

Generally speaking, taxation is the most important system of collecting public revenue in modern economic systems. In minimalist terms, governments impose taxes for three basic purposes: to cover the cost of administration, to maintain law and order and to defend the public. They also impose taxes to raise revenue to fund economic infrastructure, health facilities, transport, education, telecom, electricity, or free facilities for the disabled members in society. Moreover, governments shoulder the responsibility to provide public goods, promote redistribution of income and wealth, and discourage consumption/production of harmful goods to society (i.e., goods with negative externalities or demerit goods such as cigarettes and alcohol). The field of taxation is rich in terminologies. Among these, the following are widely used in the literature of taxation. Please, read each of them carefully and take very short notes in your own words so as to help you understand them.

Tax rate is the per-unit amount of the tax or the percentage rate at which the economic activity is taxed.

Tax base is the level or quantity of an economic activity that is taxed. Higher tax rates reduce the level of the tax base as they make the activity less attractive.

Tax incidence relates to the way the burden of a tax is distributed among economic units (consumers, producers, employees, employers). It points who is legally responsible for paying the tax. It is said that taxes are the price we pay for a civilized society; the question is who pays? Taxes are almost always levied in a way that a particular person or firm should pay the tax. The incidence of a tax is determined by looking to see who is made worse off by the tax and by how much. It is also known as tax incidence analysis. Through tax incidence analysis, we can trace and identify the final tax burden distribution. Though taxes may be collected from business firms, their ultimate burden may fall on individual consumers. Incidence of tax is defined as its final resting place.

Impact of tax is tax's first point of contact with the taxpayers. It is up on those who bear the first statutory responsibility of paying it to the government.

Effect of tax refers to responses from taxpayers and the economy to the imposition and collection of taxes. Such responses can be of great variety and influence the working of the economy in terms of production, growth, saving, investment, inequality, etc. Hence, these responses and their results are collectively called the effects of tax.

Once tax and taxation terminologies are defined, we move to the objectives of taxation, principles of taxation, and so on.

### **5.1.2 Objectives of Taxation**

Do you know why governments require taxes? Please, try to write whatever comes into your mind regarding this question. Don't worry too much for you are going to read the detail discussion to enrich your understanding.

Governments impose taxes to achieve several important macroeconomic and social goals which are mentioned below. -

- a) minimize income and wealth inequalities,
- b) stabilize the economy of a country,
- c) discourage the consumption of harmful products,
- d) provide incentives for capital formation in the private sector,
- e) reduce regional imbalance,
- f) enhance standard of livings,
- g) utilize the scarce resources to produce more essential goods, and
- h) minimize unemployment and encourage export.

From what you have written, is there anything which is related with the objectives of taxes mentioned above? That is very good!

Although governments have monetary and fiscal tools to achieve the above and other related goals, taxation plays a significant role in the allocation, distribution, and re-distribution of resources. In this role, taxation is based on certain principles, discussed below.

### **5.1.3 Principles of Taxation**

In the Wealth of Nations (1776), Adam Smith proposed the principles/cannons of taxation as summarised below.

1. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.
2. The tax which everyone is bound to pay ought to be certain and not arbitrary. The time and manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.
3. Every tax ought to be levied at the time or in the manner that makes it the most convenient for the contributor to pay it.

4. Every tax ought to be so contrived (planned) as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.
5. Every tax has a cost of collection. It is important that the cost of collection should be the minimum possible. This is called canon/principle of economy.
6. The tax system should be able to yield enough revenue for the government so that it should not be forced to resort to deficit financing. This is called the canon of fiscal adequacy.

These classical maxims can be translated into modern principles of taxation. According to these principles, a tax system should not distort the optimal allocation of production factors in efficient markets; but it should be fair; flexible automatic stabilizer; clear and transparent, definitive, and provide inexpensive collection. In sum, the principles of taxation touch issues of equity or fairness, certainty, convenience, economy, flexibility, simplicity, diversity, and buoyancy.

#### **5.1.4 Characteristics of a Good Tax System**

Taxation is broadly characterised by compulsory nature whereby it imposes obligations on taxpayers. It cannot be escaped, as non-payment is a criminal offense. Moreover, revenues from taxation are supposed to be spent on collective use, thus serving a common interest where both payers and non-payers will benefit. Taxation is also paid on regular and periodic basis with known due dates. Finally, tax is levied on all people without discrimination, yet according to their ability to pay.

A good tax system is characterised by the following features:

- a) Simple, financially adequate and elastic,
- b) Broad based - tax is levied not only on income but also on property and commodities,
- c) Administratively efficient,
- d) Balanced and harmonious,
- e) Ensures the reduction of economic inequalities,
- f) Ensuring economic stability,
- g) Ensures that national income or standard of living increases,
- h) Acts as an instrument of economic growth,
- i) Is socially advantageous, and
- j) Enables optimum allocation of resources.

In addition, the revenue yield should be adequate; the distribution of the tax burden should be equitable. Moreover, taxes should be chosen so as to minimize interference with economic decisions in otherwise efficient markets. The tax system should also permit fair and non-arbitrary administration and should be understandable to the taxpayer. The tax structure should facilitate the use of fiscal policy for stabilization and growth objectives. These and other requirements may be used as criteria to appraise the quality of a good

tax structure. Eventually, a good tax system should not only be equitable, but also efficient.

### 5.1.5 Classification of Taxes

There are two major types of taxes based on impact or incidence. The first is direct taxes which imposes the burden or impact and incidence on the same person who earns the income. They are computed based on the ability of the taxpayer to pay, which means that the higher the person's capability of paying, the higher the taxes. Examples of direct taxes include employee's income, business income, rental income, agricultural income, poll, land, property, royalty, capital gain, property, gift and inheritance taxes. Here, the tax paying ability is assessed directly in relation to one's income.

Direct taxes are further divided into income, transfer, entitlement, property and capital gains taxes.

- i. Income tax** - The type of tax that governments impose on income generated by individuals and businesses within their jurisdiction
- ii. Transfer tax** - The most common form of transfer tax is levied on real estate. such a tax is levied on the taxable portion of the property of a deceased individual including trusts and financial accounts.
- iii. Property tax** -This tax is charged on properties such as land and building and is used for maintaining public services.
- iv. Capital gains tax** - This tax is charged when an individual sells assets such as stocks real estate, or a business. This tax is computed by acquisition and the selling amounts.

The second one is indirect taxes which imposes the impact (immediate burden) and incidence (ultimate burden) on different persons. Examples of indirect taxes include consumption taxes such as value added tax (VAT), excise tax, turnover tax (TOT), surtax, customs duty, and stamp duty.

### 5.1.6 Major Categories and Sources of Taxes

Different countries have different names to classify their tax systems. In the UK, for example, the main types of taxes are:

- ✓ **Income tax** – a tax on one's income. The basic rate of income tax is 20%, paid on income over the income tax threshold of £11,500.
- ✓ **National insurance contributions** – a kind of income tax based on a similar principle of taking a certain percentage of income.
- ✓ **Consumption tax** – VAT – 17.5%
- ✓ **Excise duties** on alcohol, tobacco
- ✓ **Corporation tax** – tax on company profit
- ✓ **Stamp duty** – tax on buying houses/shares

The UK also has a minor category known as "sin tax" which is imposed on goods and services

that commonly include tobacco, alcohol, sugar-added drinks, and gambling. The main purposes of imposing sin taxes are to reduce the consumption of harmful goods and to increase government revenue.

In the USA, there are five most common types of taxes which are mentioned below.

1. Earnings (payroll tax)
2. Individual income, (individual income tax, capital gains)
3. Corporate income (corporate income tax),
4. Wealth (property taxes, estate taxes), and
5. Consumption (consumption tax, sales taxes, excise tax).

Dear learner, can you guess which of the taxes listed above are direct and which of them are indirect taxes? That is good! Now, relate your answers with the following ones.

From this list, items 1-4 are direct taxes and item 5 is indirect tax. In terms of the share of tax sources, the U.S. Federal Government generates tax revenue from individual income tax (41.6%) and payroll taxes (34.8%), corporate income tax (15.1%), with very small shares from consumption and other taxes (like wealth taxes) (Gruber, 2015).

Dear learner, have you understood all the concepts discussed above? That is very good. If there is something not clear, please reread it, before doing the following Self-test exercise.

### **Self-test Exercise**

1. What is the OECD definition of taxation?
2. Define tax base.
3. Write down the reasons which force governments to impose taxes.
4. Explain the modern principles of taxation.
5. List at least four characteristics of a good tax system.
6. There are two major types of taxes based on impact or incidence. Explain each of them shortly and clearly.
7. Use different reference texts like library books or Internet (e.g. Google search) to compare and contrast tax structures in a country of your choice in Africa, Latin America and South Asia.



### **Checklist of Self-test Exercise**

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick mark(√) in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Provided OECD definition of taxation.		
Defined tax base.		
Wrote down why governments impose taxes.		
Explained the modern principles of taxation.		
Listed at least four characteristics of a good tax system.		
Explained two major types of taxes based on impact or incidence.		
Google searched and compare and contrast countries' tax systems.		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 5.2 Approaches to Tax Equity

### Overview

There are two approaches for tax equity: the benefits approach and the ability to pay approach. In this section, we explore the two approaches for tax equity.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ list the different approaches to tax equity.
- ❑ explain ability-to-pay approach.
- ❑ describe the incidence of taxes.
- ❑ explain tax shifting.

### Key Concepts

- ☞ Tax equity
- ☞ Benefits approach
- ☞ Ability-to-pay approach
- ☞ Horizontal equity
- ☞ Vertical equity
- ☞ Impact of a tax
- ☞ Effect of a tax
- ☞ Tax shifting

Dear learner, from your past experience, what do you understand about the idea of tax fairness or equity? Should the rich pay less or more taxes? Why? Why not? Please, try to think of these questions and answer them shortly and briefly before you start reading the following detail discussions.

### 5.2.1 The Benefits Approach

According to the benefits approach, an equitable tax system is one which each taxpayer contributes in line with the benefits which she/he receives from public services. In other words, it is a principle for distributing the tax load among separate individuals and groups indicating that tax obligations should be based on the benefits received from the enjoyment of public services. Here, the aim is to work out how much each person gains from public spending.

The benefits approach has the advantage of linking the discussion of tax equity with the expenditure side of the public budget. However, it is much easier to state an abstract basis than to apply it in a real situation. The reason for this lies in the fact that while some types of government spending such as health, education, and social subsidies can easily be attributed to beneficiary households, about half of government spending may not be so allocated. It is difficult, if not impossible, to determine who benefits most from spending on such items as the army, police, diplomatic service, or the judicial system.

### 5.2.2 The Ability-to-pay Approach

According to this approach, tax is levied on each taxpayer in line with his/her ability to pay. This approach focuses on the distributive nature of taxation. In this approach, taxes should be distributed as per the capacity of taxpayers to pay them. Taxation based on ability-to-pay calls for people with equal capacity to pay the same and for people with greater ability, to pay more. The key questions here are how to measure ability to pay, how to determine a fair set of tax rates based on differing abilities to pay and how to compare the economic status of various individual taxpayers.

The ability to-pay approach is based on *horizontal* and *vertical* equities. Horizontal equity is a situation where people in the same circumstances should pay the same taxes. Vertical equity, on the other hand, is a situation where a degree of proportionality is important whereby unequals should be treated unequally.

The concepts of progressive, proportional, and regressive taxes help address this issue, also known as taxation type by impact (Greenlaw and Taylor, 2017). Accordingly, a *progressive tax* is one where those with higher incomes pay a higher share of taxes out of their income compared to those with lower incomes. That is, the average tax rate rises with income and people with higher incomes will pay a higher percentage of their income in taxes.

A *proportional tax* is one where everyone pays the same share of taxes regardless of income level. Here, the average tax rate is the same at all income levels. To put it simple words, everyone pays the same percentage of income in taxes.

A *regressive tax* is one where those with high income pay a lower share of income in taxes than those with lower incomes. Here, the average tax rate falls with income. People with higher incomes will pay a lower percentage of their income in taxes.

In connection with the ability to pay approach, one may ask: How is the ability to pay

measured? Or what tax base is better proxy for ability to pay (or taxable capacity of individuals)? Ideally, measure for ability to pay would reflect the entire welfare which a person can derive from all options which are available to him/her including consumption (present and future), holding of wealth, and the enjoyment of leisure. Unfortunately, such a comprehensive measure is not practicable.

### Self-test Exercise

1. Discuss the two approaches which are related to the idea of tax fairness or equity.
2. Distinguish progressive and regressive taxation.



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (√) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Discussed the two approaches which are related to the idea of tax fairness or equity.		
Distinguished progressive and regressive taxation.		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 5.3 Tax System and Structure in Ethiopia

### Overview

In Ethiopia taxes are classified as schedules that include incomes from employment, rental of buildings, businesses, and other incomes. This section explains the tax system and structure in Ethiopia.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ explain the tax systems in Ethiopia.
- ❑ explain government agencies that determine tax structure and policies.

## Key Concepts

- ☞ Proclamation No. 33/1992
- ☞ FDRE Constitution (1995)
- ☞ Regional governments
- ☞ Central government

Dear learner, from your past experience, try to explain Tax System and Structure in Ethiopia. Please, try this question before you start reading the following details. We hope you attempt it! Ok! Now, please read the next text.

## Tax System and Structure in Ethiopia

Ethiopia introduced the concept of income taxation in 1944 when the Emperor issued a decree requiring all peasants to pay one-tenth of their agricultural products to tax officials. Since then, the tax regimes have changed with associated changes in governments such as the Dergue and EPRDF regimes. Currently, the government agency which is responsible for tax collection is the federal Ministry of Revenues (MoR). The latter prepares decrees, directives and regulations on fiscal policy matters and submits them for parliament to legislate. As a federal country, the Ethiopian constitution allows revenue sharing principle of federal and regional governments.

The legal framework for taxation is provided by Proclamation No. 33/1992, the Federal Democratic Republic of Ethiopia (FDRE) Constitution (1995) that promulgated the sharing of revenue between the central and regional governments. Accordingly, the Federal government shall levy taxes and collect duties on revenue sources which are reserved to the federal government. Moreover, it draws up, approves, and administers the federal government's budget (Article 51(10)). The Regional states levy and collect taxes and duties on revenue sources which are reserved to the states and draw up and administer their respective state budget (Article 52 (2(e))). As of April 2022, Ethiopia has 11 regional states and 2 autonomous administrations (Addis Ababa and Dire Dawa Cities).

### Self-test Exercise

1. Explain the tax regimes in Ethiopia.
2. Explain government agencies that determine tax structure and policies.
3. Elaborate taxing and tax revenue sharing responsibilities of central and regional governments in Ethiopia.



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick mark (✓) in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Explained the tax regimes in Ethiopia.		
Explained government agencies.		
Elaborated taxing and tax revenue sharing responsibilities.		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 5.4 Types of Tax and Tax Accounting in Ethiopia

### Overview

This section discusses the types of taxes as per the law. It also briefly notes the notion of tax accounting.

### Learning Outcomes

**At the end of this section, you will be able to:**

- describe the various types of taxes and tax systems in Ethiopia.
- explain tax accounting.

### Key Concepts

-  Schedule A-E
-  VAT
-  Excise tax
-  Pension
-  contribution
-  Surtax
-  Withholding tax
-  Customs duty
-  Tax accounting

### Types of Tax and Tax Accounting in Ethiopia

According to the Tax Proclamation No. 286/2002 and Regulations No. 78/2002 of Ethiopia, there are four schedules of income in addition to exempt income.

- a) Schedule A: Income from employment,
- b) Schedule B: Income from rental of buildings,
- c) Schedule C: Income from business,
- d) Schedule D: Other income, and
- e) Schedule E: Exempt income.

**Schedule A** - Income from employment is taxed at rates ranging from 10 to 35%. Employment income tax is withheld by employers and is a final tax. This is to mean that employees

who earn income exclusively from employment are not required to declare income to tax authorities.

Employment income includes the following earnings:

- a) Salary, wages, an allowance, bonus, commission, gratuity, or other remuneration received by an employee in respect of a past, current, or future employment,
- b) The value of fringe benefits received by an employee in respect of a past, current, or future employment,
- c) An amount received by an employee on termination of employment, whether paid voluntarily, under an agreement, or because of legal proceedings, including any compensation for redundancy or loss of employment, or a golden handshake payment.

Employment income tax rates in Ethiopia are shown in *Table 5.1* below

**Table 5.1 Employment Income Tax Rate**

Monthly employment income (Birr)	Employment income tax rate
<b>0-600</b>	0%
<b>601-1650</b>	10%
<b>1651-3200</b>	15%
<b>3201-5250</b>	20%
<b>5251-7800</b>	25%
<b>7801-10900</b>	30%
<b>More than 10900</b>	35%

**Table 5.2 Employment Income Tax Deduction**

Employment Income per Month (I) (Birr)	Employment income tax rate	Deduction	Tax computation I=Employment income EIT=Employment income tax
0-600	0%	0	
601-1650	10%	60	$EIT = I \times 10\% - 60$
1651-3200	15%	142.5	$EIT = I \times 15\% - 142.5$
3201-5250	20%	302.5	$EIT = I \times 20\% - 302.5$
5251-7800	25%	565	$EIT = I \times 25\% - 565$
7801-10900	30%	955	$EIT = I \times 30\% - 955$
More than 10900	35%	1500	$EIT = I \times 35\% - 1500$

Source: Ethiopian Investment commission (2020)

**Schedule B** - Rental income tax is imposed for each tax year on a person renting out a building/s who has taxable income for the year. The taxable income tax of a taxpayer for a tax year is the gross amount of income which is derived by the taxpayer from the rental of a building/s for the year reduced by the total amount of deductions allowed to the taxpayer for the year. Rental income tax rates refer to a taxpayer's taxable rental income for a tax year which is the gross amount of income that a taxpayer derives from rental of a building reduced by the total amount of deductions allowed.

**Schedule C** – Refers to income from business is the third schedule of the Income Tax law of Ethiopia, provides for the taxation of income earned from businesses. Business income tax is imposed for each tax year. The taxable income for a tax year is the total business income reduced by the total deductions allowed to the taxpayer for the year.

**Schedule D** – Includes other income such as income from royalty, income paid for services rendered outside of Ethiopia, income from games, dividends, income from casual rental of property, interest income, specified non-business capital gains.

**Schedule E** – Refers to exempt income. A list of exempted income items includes the cost of medical treatment of employees, hardship allowance, salary paid to domestic servants, maintenance, or child support payments, travelling expenses paid to employees who are recruited from elsewhere than the place of employment, pension contribution, and payments made to a person as compensation.

Apart from the above direct taxes, the following indirect taxes are levied by Ethiopian Government. They are VAT, TOT, Excise tax and Sur tax, as detailed below. The list also includes tax related legal provisions in Ethiopia.

**Value added tax (VAT)** - VAT is a tax levied based on the value added at different stages. It is a sales tax that is administered in a different form. It is an indirect tax. Ethiopia introduced VAT Act for the first time on January 1, 2003 with the standard rate of 15% of which is applied on every taxable transaction by a registered person. According to the law, VAT must be included in the selling price of every taxable supply of goods or services made by a vendor during that vendor's enterprise. A vendor is a person who is registered, or required to be registered for VAT. Thus, VAT is a destination-based or consumption tax, which means that only the consumption of goods and services in specified country is taxed. VAT exemptions also apply whereby the supplier of goods does not levy VAT (output tax) on those exempt supplies but must bear VAT (input tax) on the purchases incurred in making such supplies.

**Turnover tax (TOT)**- This is an equalization tax that is imposed on persons not registered for value-added tax to fulfil their obligations and to enhance fairness in commercial relations and to complete the coverage of the tax system. Administrative feasibility considerations limit the registration of persons under the value-added tax to those with annual transactions to the total value exceeding 500,000 Birr. The rate of turnover tax is 2% on goods sold locally. For services rendered locally, the rate is 2% on contractors, grain mills, tractors and combine harvesters, 10% on others as provided by the Excise Tax Proclamation No. 307/2002.

**Excise tax** - This is imposed and payable on selected goods such as, luxury items and basic goods which are demand inelastic. In addition, it is believed that imposing the tax on goods that are hazardous to health and which cause social problems will reduce the consumption. Excise tax will be applicable on 19 groups of items and 378 goods. The tax rate ranges from 5% to 500%. In terms of the time of payment, tax on excisable goods shall be payable when imported at the time of clearing the goods from the customs area, and when produced locally, not later than 30 days from the date of production (EIC, 2020)

**Surtax** - It is an additional 10% tax that is applicable on imported goods except for fertilizers, petroleum and lubricants, motor vehicles for freight, passengers and special purpose motor vehicles, aircraft, spacecraft, and parts thereof, and capital (investment) goods. The Ministry of Finance is authorized to increase or decrease the list of goods exempt from surtax.

**Pension contribution** - The contributions payable to the Private Organizations Pension Fund is based on the employee's salary, be by the employer (11%) and by the employee (7%).

**Table 5.3: Summary of taxes other than Schedule D or other income**

Tax types	Rate	Frequency of payment
<b>Business income tax</b>	30% for bodies Progressive rate of 10-35% for individuals	Annual
<b>Employment income tax</b>	At progressive rate of 10%-35%	Monthly
<b>Rental Income tax</b>	30% for bodies At progressive rate of 10%-35%	Annual
<b>Mining and petroleum tax</b>	25% of taxable income	Annual
<b>Value added tax</b>	15%	Monthly for taxpayers with annual transactions of more than ETB 70 million Quarterly for taxpayers with annual transactions of less than ETB 70 million
<b>Turnover tax</b>	2% on goods 10% on services	Annual, quarterly
<b>Excise tax</b>	From 5%-500%, depending on type of goods. The lowest and highest tax rates are applicable to: 5% tax is applicable on rubber tyres, various types of new completely built-up cars and cars assembled by domestic industry, while 500% tax is applicable on various types of used cars of age exceeding seven years.	Monthly and on import
<b>Withholding tax</b>	2% on domestic transactions 30% on suppliers without a tax identification number (TIN) and business license	Monthly

**Withholding Tax** - All bodies and specified sole proprietor businesses are required to deduct withholding tax on domestic transactions at a rate of 2% of the value of the transaction and

remit to the tax authority monthly.

Stamp Duty is another form of taxation which is basically imposed on the services given to individuals through affixing seals. Stamp is an official mark or seal placed on a document specially to indicate that a requirement tax has been paid. Thus, stamp duty is a tax raised by requiring stamps sold by the government to be affixed to designed documents, which form one kind of revenue to the government treasury.

Customs Duty is tax like other taxes but it is imposed on imported or exported goods. This is the best instrument to prevent or reduce importation of goods. It serves as trade barrier. Whenever a state needs to ban or reduce importations to its territory, it can impose high rate in some goods (excise taxation) it might reach a rate of 100% or above. Thus, such importation will be discouraged. Of course, this measure helps to protect infant domestic factories /industries from stiff competitions with the products of competitive and subsidized foreign companies/ importers.

Finally, let us describe taxes and tax accounting. Taxes and tax accounting are two separate entities that are also linked. Dear learner, don't forget that you should bear in mind that all taxation involves accounting processes.

Tax accounting is part of accounting that deals with the preparations of tax returns and tax payments. It is used by individuals, businesses, corporations and other entities. Tax accounting for an individual focuses on income, qualifying deductions, donations, and any investment gains or losses.

The primary purpose of tax accounting is to determine taxable income. In this sense, tax accounting involves the practice of calculating financial statements and figures. These statements are used to make tax calculations. Thus, tax accounting is used by individuals, businesses and other entities. Tax accounting for an individual focuses on income, qualifying deductions, and any investment gains or losses. Individuals with employment in different public establishments in Ethiopia get their income tax paid their employers. Businesses need to keep up to date financial records to help determine their tax liabilities.

### Self-test Exercise

1. Do a Google search on the major sources of taxation in Ethiopia?. Then, write down your findings.
2. Explain Schedule A-E taxes in Ethiopia.
3. Compare value added tax and turnover tax.
4. Compare stamp duty and customs duty.



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your

understanding. Please, read each question and put a tick mark (√) in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Done a google search on the major sources of taxation in Ethiopia. Then, kept a memo of your findings. Also related these finding with what is written in this module.		
Explained Schedule A-E taxes in Ethiopia.		
Compared value added tax and turn over tax.		
Compared excise and surtax.		
Compared stamp duty and customs duty.		
Explained tax accounting.		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 5.5 Problems Associated with Taxation in Ethiopia

### Overview

Tax systems encounter problems worldwide. This section briefly looks into problems which are associated with taxation in Ethiopia. It starts by exploring the problems in developed and developing countries with a view to drive lessons home.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ explain prevailing problems of taxation in Ethiopia.
- ❑ suggest possible remedial actions to alleviate the problems associated with tax collection in Ethiopia.

### Key Concepts

- ☞ Tax administration
- ☞ Customer orientation
- ☞ Complexity of tax system
- ☞ Perception of corruption
- ☞ Fairness perception
- ☞ Cost of compliance
- ☞ Tax avoidance
- ☞ Tax evasion

### Problems Associated with Taxation in Ethiopia

In developed countries, one of the tools for improving efficiency in tax administration is to

modernize customer services. This activity is based on the recognition of new management techniques with new concepts of “client orientation” or “customer orientation”.

In developing countries including Ethiopia, on the other hand, tax systems face diverse problems. Few of these include the complexity of tax system, perception of corruption, the cost of compliance, fairness perception of the tax system as well as tax knowledge. The latter has a positive effect on voluntary tax compliance. Broadly, these problems can be categorised under tax compliance and bureaucracy in tax systems.

Problems that are related to tax compliance are the most important problems which are faced by any tax administration. The term tax compliance refers to the degree to which the taxpayers comply with the tax laws. Tax non-compliance problems take the form of tax avoidance and tax evasion.

*Tax avoidance* refers to arranging one's affairs so as to minimize the tax burden. It entails taking full advantage of the provisions of the tax code or schedule to reduce one's tax obligations. An example is a reduction of one's tax burden through exemptions, deductions or incentives approved in the tax schedule. From the perspective of law, tax avoidance is not illegal; however, it poses problems for tax administration. On the other hand, tax avoidance is illegal.

*Tax evasion* is falsifying information on tax return in order to reduce one's tax liability or even not filing at all (failing to pay legally due taxes) which is illegal. Tax evasion is rooted in underground economic activities that exist for, at least, for two reasons: (a) because certain activities are illegal and individuals do not want records of those activities having taken place, and (b) because high marginal tax rates give people an incentive to obtain income without reporting it.

Beyond Ethiopia, widespread tax evasion is reported in the transition countries of Eastern Europe. These include introduction of VAT with its large reporting and paperwork requirements which could not be met in a system of non-automated cash registers and accounting systems, the constant changes to the tax code which no one could comprehend or comply with, the lack of qualified staff and audit organizations to enforce the tax code, and extensive bribery and corruption in the tax and customs services which enabled many to avoid paying their full tax burden.

Other problems which the tax administrations face, both in Ethiopia and elsewhere, are a steadily growing workload, the complexity of fiscal legislation, the attitude of taxpayers and the degree of non-compliance, the need to improve customer service, the need to reduce costs of tax assessment and collection, and the need for efficient and effective management. These problems raise questions about the efficiency and the effectiveness of tax collection and the ways in which they can be improved.

## Self-test Exercise

1. Do you think that there are problems of taxation in Ethiopia or not? Elaborate this shortly and briefly in a piece of paper.
2. Do a small-scale research to find out if there are tax clubs, associations or any related groups that aim to increase awareness in your locality? If you get one, write down its background, goals and activities. Then, suggest ways to alleviate the problems that are associated with tax collection. If you do not get such a group, think of what you can do to contribute to increased awareness about tax matters.
3. Distinguish between tax avoidance and tax evasion.
4. Visit a business shop in your locality and find out how they pay taxes.



## Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Thought of or elaborated the problems of taxation in Ethiopia.		
Done a small-scale research: Notes taken about tax clubs, associations or any related groups. I also thought about my role as a citizen to increase awareness about taxation and its importance.		
Distinguished between tax avoidance and tax evasion.		
Visited a business shop in my locality and find out how businesses pay taxes. Wrote a brief note about my findings.		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!



## Unit Summary

Dear learner, we hope that you have read all the sections in this unit carefully and understand. Now, it is time for you to think what you understand in the unit. Before going to

do the following self-assessment questions, please read the Summary of this unit.

Taxes are compulsory, unrequited payments to general government. Governments impose taxes to achieve several important common goals. Moreover, they impose tax to raise revenue for government spending, ~~to~~ promote redistribution of income and wealth as well as discourage consumption/production of harmful goods and services.

A **good tax system** is equitable and efficient. Equitability involves horizontal and vertical equity. Good tax system should also be easier to administer or economical to collect, difficult to evade, efficient, non-distortive and easy to understand.

Taxes are divided into **direct** and **indirect taxes**. Direct taxes impose the burden or impact on the same person who earns the income whereas indirect taxes impose the burden on a different person.

Different countries have different names to classify their tax systems. In Ethiopia's taxes are classified as **Schedules**. Tax systems face different problems, most of them surround the issues of **complexity of administration** and the difficulty for taxpayers to understand and comply with the laws. Ethiopia is not immune to these problems. **Tax avoidance** and **evasion** remain a challenge.



## Unit Review Exercises

### Part I: True or False

Read the following statements and write 'True' for correct statements and 'False' for incorrect ones.

1. One of the objectives of taxation is to minimize income and wealth inequalities.
2. A good tax system is characterised by being administratively inefficient.
3. Direct taxes impose the burden or impact on the same person who earns the income whereas indirect taxes impose the burden on a different person.
4. Customs duty is imposed on imported or exported goods.
5. Tax accounting is part of accounting that deals with the preparations of tax returns and tax payments.

### Part II: Multiple Choice

For each of the following questions choose the best answer from the given alternatives

1. Regressive tax is:
  - A. one where those with high income pay a lower share of income in taxes than those with lower incomes.
  - B. the average tax rate that falls with income.
  - C. people with higher incomes will pay a lower percentage of their income in

taxes.

- D. All of the above
- 2. A tax imposed on and payable on selected goods which are demand inelastic is known as:
  - A. Withholding tax,
  - B. Turnover Tax (TOT)
  - C. Custom Duty
  - D. All of the above
- 3. A good tax system is **not** characterised by being:
  - A. Simple, financially adequate and elastic.
  - B. Administratively efficient.
  - C. Balanced and harmonious.
  - D. Ensures the reduction of economic inequalities.
  - E. None of the above.
- 4. According to the Ability-to-pay Approach:
  - A. Tax is levied on each taxpayer in line with his/her ability to pay.
  - B. The distributive nature of taxation. In this approach, taxes should be distributed as per the capacity of taxpayers to pay them Administratively efficient
  - C. Calls for people with equal capacity to pay the same and for people with greater ability, to pay more.
  - D. All of the above

### Part III: Short Answers

For each of the following questions write short answers.

- 1. Define tax incidence.
- 2. What are the main types of taxes in Ethiopia?



### Answer Key for Review Questions

#### Part I: True or False

- 1. True
- 2. False
- 3. True
- 4. True
- 5. True

#### Part II: Multiple Choice

- 1. D
- 2. B
- 3. E
- 4. D

#### Part III: Short Answer

- 1. Tax incidence relates to the way the burden of a tax is distributed among economic units (consumers, producers, employees, employers). It indicates who is legally responsible for paying the tax.
- 2. There are four schedules of Income, as per the Tax Proclamation No. 286/2002 and

Regulations No. 78/2002 of Ethiopia: Schedule A: Income from employment, Schedule B: Income from rental of buildings, Schedule C: Income from business, Schedule D: Other income, and Schedule E: Exempt income.



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# UNIT 6

## POVERTY AND INEQUALITY

Time Allotted: 16 hours

### INTRODUCTION

Dear learner, you should note that poverty and inequality are interrelated concepts which are also a daily reality for millions of people around the world. Hence, this unit focuses on these two aspects of reality. The unit contains five main sections. The first part defines the concepts of poverty and inequality. The second one provides a brief overview of global and regional poverty. The third section overviews the poverty situation in Ethiopia. The fourth section looks at the situation of women, poverty and inequality. The final section introduces indigenous knowledge and institutions and their roles in reducing poverty in Ethiopia.



### Unit Learning Outcomes

At the end of this unit, you will be able to:

- ❑ understand the meaning of poverty and its measurements.
- ❑ know the meaning and measurement of income inequality.
- ❑ recognise the social groups that are mainly affected by poverty and inequality problems.
- ❑ compare and contrast the global, regional and national poverty figures.
- ❑ appreciate the role of indigenous knowledge and institutions in reducing poverty and inequality in Ethiopia.

### Unit Contents

#### 6.1 Concept of Poverty and Its Measurement

#### 6.2 Concept of Inequality and its Measurements

#### 6.3 Global and Regional Poverty

#### 6.4 Women and Poverty

#### 6.5 Overview of Poverty and Inequalities in Ethiopia

#### 6.6 Role of Indigenous Knowledge in Reducing Poverty (Iqub, Idir, and Local Cottage Industries).

#### Unit Summary

#### Self-assessment questions

#### Answer Key for Self-test Exercises

#### References

Dear learner, we expect you to complete the unit in **16 hours**. Please, assess your progress

and performance by referring to the learning outcomes, self-test exercises and checklists of your understanding. We expect you to learn at your own pace and cover some portions of the subject within a defined time frame as a requirement. We hopefully expect you to do this as an active learner!

## Learning Strategies

Dear learner, please use the following and other learning strategies to successfully learn this unit.

1. Create a schedule and follow it.
2. Take the time to research questions and involve teachers.
3. Assess the technology used in the subject.
4. Utilize alarms and calendars to keep you abreast with deadlines.
5. Appreciate and value yourself.
6. Take part in distant discussions.
7. Search for different available learning opportunities that will help you to better understand the subject.

## 6.1 Concept of Poverty and Its Measurement

### Overview

Dear learner, in this section, you will explore the notion of poverty, the types of poverty, how poverty is measured and finally Sen's approach to poverty and wellbeing.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ conceptualise the meaning of poverty.
- ❑ describe how poverty can be measured.

### Key Concepts

- ☞ Absolute poverty
- ☞ Relative poverty
- ☞ Poverty headcount index
- ☞ Capability approach
- ☞ Poverty reduction
- ☞ Foster-Greer-Thorbecke index
- ☞ Multidimensional poverty index
- ☞ Indigenous knowledge & practices

Now, let us proceed to the detail discussions of this section. We wish you good reading!

### 6.1.1 Poverty

Dear learner, from your past experience what do you understand about poverty and inequality? How are they measured? Think about these questions before you start reading the following text.

To learn the meaning of poverty, it is useful to start by understating what poor people think and say about their circumstances. The following quotes represent the voices of the poor.

*“When one is poor, she has no say in public, she feels inferior. She has no food, so there is famine in her house; no clothing, and no progress in her family.”* A poor woman from Uganda

*“...low salaries and lack of jobs. And it's not having medicine, food, and clothes.”* A discussion group in Brazil.

*“Life in the area is so precarious that the youth and every able person has to migrate to the towns or join the army at the war front in order to escape the hazards of hunger escalating over here.”* A discussion group in rural Ethiopia (Todaro, 1999, p.7)

The common thread running through the above quotes are the manifestations of poverty. They indicate that poverty is multidimensional. At least six dimensions feature prominently in poor people's definitions of poverty (Nafziger, 2006, pp.163-64).

First, poverty consists of many interlocked dimensions. Although poverty is rarely about the lack of only one thing, the bottom line is always hunger – the lack of food. Second, poverty has important psychological dimensions, such as powerlessness, voicelessness, dependency, shame, and humiliation. The maintenance of cultural identity and social norms of solidarity helps poor people to continue to believe in their own humanity, despite inhumane conditions. Third, poor people lack access to basic infrastructure – roads (particularly in rural areas), transportation, and clean water. Fourth, while there is a widespread thirst for literacy, schooling receives little mention or mixed reviews. Poor people realize that education offers an escape from poverty – but only if the economic environment in the society at large and the quality of education improves. Fifth, poor health and illness are dreaded almost everywhere as a source of destitution. This is related to the costs of health care as well as to income lost due to illness. Finally, the poor rarely speak of income, but focus instead on managing assets – physical, human, social, and environmental – as a way to cope with their vulnerability. In many areas, this vulnerability has a gender dimension.

Apart from the perception of the poor about their conditions, development discourse too defines and describes poverty in several ways. Poverty is a widely used term; it encompasses both income and non-income dimensions of deprivation, including lack of income and other material means, lack of access to basic social services such as education, health, and safe water, lack of personal security, and lack of empowerment to participate in the political process and in decisions that influence someone's life.

The World Bank (2000) defines poverty as “the pronounced deprivation in wellbeing”. Wellbeing is seen from three angles. First, the conventional view perceives wellbeing as linked to command over commodities. The poor are those who do not have enough income or consumption to put them above some adequate minimum threshold. This view sees poverty largely in monetary terms. Second, poverty is tied to a specific type of consumption (people

could be house poor, food poor or health poor). Third, the broad approach to wellbeing focuses on the capability of the individual to function in society. Poor people often lack key capabilities. This means that they may have inadequate income or education, or be in poor health, or feel powerless, or lack political freedoms (Haughton and Khandker, 2009).

Irrespective of divergent views on the definitions of poverty, there is convergence of thinking on the types of poverty, as explained below.

### 6.1.2 Types of Poverty

Poverty is classified into **relative** and **absolute** poverty. Relative poverty is defined in comparison to other people's standing in the economy. A person can be poor in the relative sense although he/she can meet his/her basic needs. This can be observed by looking at relative standings within a society, or internationally. For example, one can think of relative poverty of some groups of people in rich countries compared to other groups. Relative poverty is, sometimes, seen as a phenomenon which is the most relevant in societies in which there is no acute problem with absolute poverty.

Absolute poverty is the situation of someone being unable or only barely able to meet the subsistence essentials such as food, cloth, and shelter. It is simply the deprivation of basic needs. The extent of absolute poverty is expressed by the number of people who are unable to command sufficient resources to satisfy the basic needs. They are counted as the total number living below a specified minimum level of real income, an international poverty line such as those living on less than \$1.25 per a day or \$2 per day in purchasing power parity (PPP) dollars. Thus, absolute poverty is seen as a failure of meeting the requirements of basic dignity of human beings or even a failure to meet human rights while relative poverty is seen as a matter of failure of distributive justice.

Apart from relative and absolute aspects of poverty, there are also other dimensions. It is argued that perhaps the most valid generalizations about the poor are that they are disproportionately located in rural areas, that they are primarily engaged in agricultural and associated activities, that they are more likely to be women and children than adult males, and that they are often concentrated among minority ethnic groups and indigenous peoples. These generalisations are supported by empirical data from a broad cross section of developing nations (Todaro and Smith, 2015). On average, about 80% of all target poverty groups are located in the rural areas in Africa and Asia, and the percentage for Latin America is about 50%.

### 6.1.3 Measuring Poverty

Dear learner, do you know why we need to measure poverty? There are four reasons to measure poverty. The first is to keep poor people on the agenda. The second is to be able to identify poor people and so that we are able to target appropriate interventions. The third is to monitor and evaluate projects and policy interventions geared to poor people. The fourth is to evaluate the effectiveness of institutions whose goal is to help poor people.

Once the reasons for measuring poverty are clear, the next step is to list the three steps that are needed to measure poverty.

1. Defining an indicator of welfare.
2. Establishing a minimum acceptable standard of that indicator to separate the poor from the non-poor (the poverty line).
3. Generating a summary statistic to aggregate the information from the distribution of this welfare indicator relative to the poverty line (Haughton and Khandker, 2009).

Poverty is measured in a number of steps. The first step is to know which people are poor. This follows with specifying a minimal socially acceptable level of income or consumption (the poverty line). The second is to implement a representative survey in which the corresponding income or consumption concept is measured. Finally, one has to choose and calculate a specific poverty measure. The most common implementation of these steps is to have a fixed, monetary, consumption-based threshold for poverty, with data coming from a household survey, and poverty measured as the percentage of individuals with per capita consumption below the poverty line (Hughton and Khandker, 2009).

There are different ways of measuring poverty. One measurement is called the poverty headcount index. Assume a headcount ( $H$ ) of those whose incomes or consumptions fall below the absolute poverty line ( $Y_p$ ) whereby the headcount is taken as a fraction of the total population ( $N$ ). Then, headcount index or headcount ratio can be defined as  $H/N$ . The idea is to set this level at a standard below which we would consider a person to live in absolute human misery such that the person's health is in jeopardy (Todaro and Smith, 2015).

Another measure is what is known as a *total poverty gap* (TPG). This measures the total amount of income that is necessary to raise everyone who is below the poverty line up to that line. It is defined as the sum of the difference between the poverty line and actual income levels of all people who are living below that line. Similarly, the average poverty gap (APG) is found by dividing the TPG by the total population.

The Foster-Greer-Thorbecke index is another measurement. It is defined as a class of measures of the level of absolute poverty. This measurement helps to understand the degree of income inequality among the poor (Todaro and Smith, 2015).

The aforementioned ones are unidimensional measures which are based on income. There are also other composite or multidimensional poverty measures.

The Multidimensional Poverty Index (MPI) is the most prominent application of multidimensional poverty measurement which incorporates three dimensions at the household level: health, education, and wealth. The MPI takes into account that people have multiple deprivations.

In 2010, the UNDP used the MPI by building up the index from the household level. It used the three dimensions (health, education, and standard of living) and each of their corresponding indicators as they reflect problems which are often mentioned by the poor, and they have

been long considered important by the development community. Moreover, they are well established philosophically as human rights or basic needs.

Each of the dimensions has its own indicator. For example, health has two indicators: a) whether any child has died in the family and b) whether any adult or child in the family is malnourished. Both are weighted equally, and each counts one-sixth toward the maximum possible deprivation in the MPI.

Education, too, has two indicators: a) whether or not even one household member has completed five years of schooling and b) whether or not any school-age child is out of school for grades one through eight. Again, both are given equal weight, and each counts one-sixth towards the MPI.

Finally, in terms of standard of living, equal weight is placed on six deprivations: a) lack of electricity, b) insufficient safe drinking water, c) inadequate sanitation, d) inadequate flooring, e) unimproved cooking fuel, and f) lack of more than one of five assets (telephone, radio, television, bicycle, and motorbike or similar vehicles) (Todaro and Smith, 2015).

Multidimensional poverty measurement cannot be adequately measured with income alone. To fill this gap, Sabina Alkire and James Foster have extended the FGT index (mentioned above) to multiple dimensions. In the multidimensional poverty approach, a poor person is identified to be multidimensionally poor through what is called the “dual cut-off method”: first, the cut-off levels within each of the dimensions (analogous to falling below a poverty line such as \$1.25 per day if income poverty were being addressed) and second, the cut-off of the number of dimensions in which a person must be deprived (below the line).

#### **6.1.4 Sen’s Approach to Poverty and Wellbeing**

Amartya Sen, the 1998 Nobel Laureate in economics, contended that traditional welfare economics, which stresses the revealed preferences or desire-based utilities of individuals in their acts of choice, lacks enough information about people’s preferences to assess the social good. Accordingly, as an alternative, Sen’s welfare theory relies not on individuals’ attainments (for example, of basic needs) but individuals’ capabilities.

His approach, also known as Capability Approach, states that income and wealth are not ends in themselves but rather instruments for other purposes. For him capability to function is what really matters for one’s status as a poor or non-poor person. According to him, the expansion of commodity production is valued not for its own sake, but as a means to human welfare and freedom.

In effect, Sen argued that poverty is not low wellbeing but the inability to pursue wellbeing because of the lack of economic means. Hence, poverty cannot be properly measured by income or even by utility as conventionally understood. Here, what matters is not the things that a person has but what a person *is*, or *can be*, and *does*, or *can do*. What matters for wellbeing is also not just the characteristics of commodities consumed, as in the utility

approach, but what use the consumer *can* and *does* make of commodities. For example, a book is of little value to an illiterate person, except perhaps as a cooking fuel.

Sen argues against relying only on the poverty percentage or headcount approach to measure poverty and deprivation, the approach pursued by the World Bank economists. To make any sense of the concept of human wellbeing in general, and poverty in particular, it is necessary to think beyond the availability of commodities and consider their use: i.e., to address their *functionings*. *Functionings*, according to Sen, is what a person does or can do with the commodities of given characteristics. Sen also considered the freedom of choice, or control of one's own life, as a central aspect of wellbeing. Moreover, what people have reason to value ranges from being healthy, well nourished, and well clothed, to being mobile, having self-esteem, and taking part in the life of the community.

Sen coined another term, *capabilities*, which literally means the power or ability to do something. Capabilities represent the real freedoms that people have to achieve their potential doings and beings. Whether someone can convert a set of resources and public goods into a functioning (i.e., whether one has a particular capability) depends on personal, socio-political, and environmental conditions, which are called *conversion factors*. Capabilities are thus, real or substantive freedoms as they denote the freedoms that have been cleared of any potential obstacles, in contrast to mere formal rights and freedoms.

Eventually, human wellbeing means being well. In other words, it means being healthy, well nourished, well clothed, literate, and long-lived. More broadly, being able to take part in the life of the community, being mobile, and having freedom of choice in what one can become and can do. The lack of these indicates deficiency in wellbeing, and therefore to poverty.

### Self-test Exercise

1. Explain the reasons why poverty is said to be multidimensional.
2. Contrast absolute and relative poverty.
3. Explain the term Multidimensional Poverty Index (MPI).
4. Write down the salient points in Amartya Sen's Capability



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Contrasted absolute and relative poverty		
Explained the term Multidimensional Poverty Index		
Wrote down the salient points in Amartya Sen's Capability Approach relating to wellbeing and poverty		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 6.2 Concept of Inequality and its Measurements

### Overview

In this section, you will learn about the concept of inequality and its measurements.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ explain the meaning of inequality.
- ❑ analyse the measurements of inequality.

### Key Concepts

- ☞ Economic inequality
- ☞ Functional or factor share distribution of income
- ☞ The personal/size distribution of income
- ☞ Lorenz curve

### The Concept of inequality and its measurements

So far, we covered the definition of poverty and its measurement. We have also explored a different approach to human wellbeing which moves away from income alone and towards what the incomes translate into functioning and capabilities. Now, we will explore inequality, a concept which is closely related to poverty.

Inequality refers to the situation of being unequal or uneven, or a social disparity of distribution or opportunity. Inequalities take different dimensions: economic, social, political, etc. For example, there are inequalities of power, prestige, status, gender, job satisfaction, conditions of work, degree of participation, freedom of choice. The focus here is on the economic (mainly income) dimension.

Economic inequality is the disproportionate distribution of total national income among households. This income distribution is divided into two: the functional/distributive factor share distribution of income and the personal/size distribution of income.

Functional or factor share distribution of income depicts the share of total national income that each of the factors of production (land, labour, and capital) receives. The theory of functional income distribution queries the percentage that labour receives as a whole and compares this with the percentages of total income distributed in the form of rent, interest, and profit (i.e., the returns to land and financial and physical capital). In other words, the concept of functional income distribution attempts to explain the incomes of factors of production by the contribution they make to production (Todaro and Smith, 2015).

The personal/size distribution of income is the most commonly used indicator of income distribution. It deals with individual persons or households and the total incomes they receive regardless of the way in which they received that income. Next, we will see some of the methods of measuring income inequality.

First, arrange all individuals by ascending or increasing personal incomes. Second, divide the population into successive quintiles (fifths) or deciles (tenths) according to ascending income levels and then determine what proportion of the total national income is received by each income group. For example, take the hypothetical data in [Table 6.1](#) below. In this data, 20 individuals (households) representing the entire population of a given developing country are arranged in order of ascending annual personal income, ranging from the individual with the lowest income (0.8 units) to the one with the highest (15.0 units). Then, the ratio of the incomes received by the top 20% and bottom 40% of the population, sometimes called a Kuznets ratio (named after Simon Kuznets) is used as a measure of the degree of inequality between high -income and low-income groups in a country.

**Table 6.1 Typical Size Distribution of Personal Income in a Developing Country by Income Shares-Quintiles and Deciles**

Individuals	Personal Income (Money Units)	Share of Total Income(%)	
		Quintiles	Deciles
1	0.8		
2	1		1.8
3	1.4		
4	1.8	5	3.2
5	1.9		
6	2		3.9
7	2.4		
8	2.7	9	5.1
9	2.8		
10	3		5.8
11	3.4		
12	3.8	13	7.2
13	4.2		
14	4.8		9
15	5.9		
16	7.1	22	13
17	10.5		
18	12		22.5
19	13.5		
20	15	51	28.5
<b>Total (National Income)</b>	<b>100</b>	<b>100</b>	<b>100</b>

The total income of all individuals amounts to 100 units and is the sum of all entries in column 2. In the third column, the population is grouped into quintiles of four individuals each. That means; the first quintile (4 out of 20) represents the bottom 20% of the population on the income scale. This group receives only 5% (a total of 5 money units) of the total income. The second quintile receives 9% of the total income. Alternatively, the bottom 40% of the population (quantities 1 plus 2) receives only 14% of the income while the top 20% (the fifth quintile) of the population receives 51% of the total incomes.

A common measure of income inequality that can be derived from column 3 is the ratio of incomes that is received by the bottom 40% and top 20% of the population. This ratio is often used as a measure of the degree of inequality between the two extremes; this inequality ratio is equal to 14 which is divided by 51, or approximately 0.28.

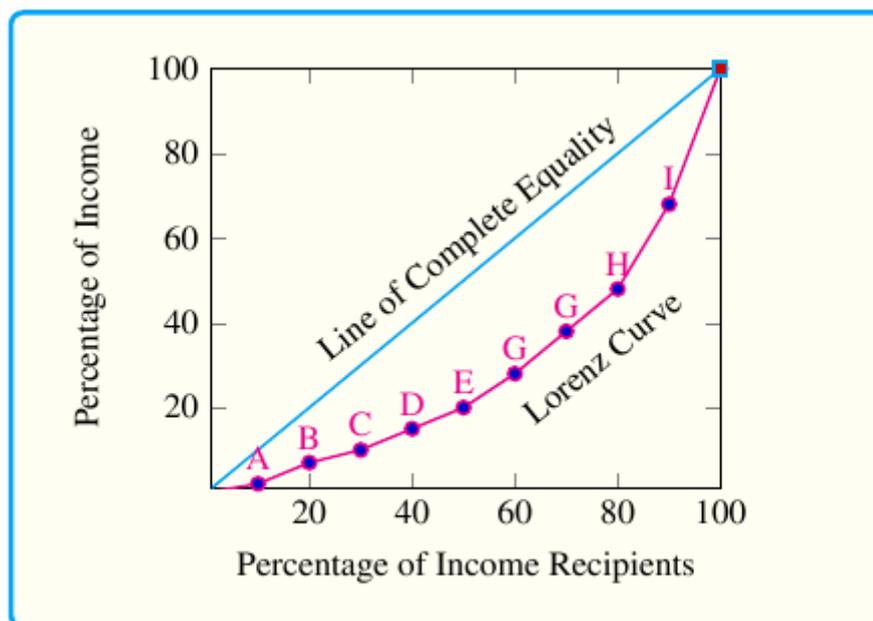
To provide a more detailed breakdown of the size distribution of income, decile (10%) shares are listed in column 4. We see, for example, that the bottom 10% of the population (the two poorest individuals) receive only 1.8% of the total income, while the top 10% (the two richest individuals) receives 28.5%.

Finally, if you want to know what the top 5% receives, you divide the total population into 20 equal groups of individuals (i.e. each of the 20 individuals) and calculate the percentage of total income that is received by the top group. This means that the top 5% or the 20<sup>th</sup> individual receives 15% of the total income, a higher share than the combined shares of the lowest 40% individuals (i.e. only 14%).

## **Lorenz Curve as a Measure of the Distribution of Income**

Another common way to analyse personal income statistics is to construct the Lorenz Curve. The Lorenz Curve shows cumulative shares of income received by individuals or groups. It was developed by economist Max Lorenz in 1905 as a way to analyse personal income statistics. The Lorenz Curve and Gini Index (G) measure the distribution of income.

To construct a Lorenz Curve, we put the number of income recipients in cumulative percentage on the horizontal axis and the share of income received by each group on the vertical axis (see [Figure 6.1](#) below). For example, at point 20, we have the lowest (poorest) 20% of the population, at point 60 we have the bottom 60%, and at the end of the axis all 100% of the population has been accounted for.



**Figure 6.1** The Lorenz Curve

Similarly, the vertical axis shows the share of total income received by each percentage of the population. It is also cumulative up to 100%, meaning that both axes are equally long. So, the entire figure is enclosed in a square, and a diagonal line is drawn from the lower left corner (the origin) of the square to the upper right corner.

At every point on that diagonal, the percentage of income received is exactly equal to the percentage of income recipients. For example, the point halfway along the length of the diagonal represents 50% of the income being distributed to exactly 50% of the population.

At the three-quarters point of diagonal, 75% of the income would be distributed to 75% of the population. In other words, the diagonal line is representative of “perfect equality” in size distribution of income. This means that each group of income recipients receives the same percentage of the total income. The bottom 40% receives 40% of the income, while the top 5% receives 5% of the total income.

In sum, the Lorenz curve shows income inequalities. If income distribution were perfectly equal, it would be represented by the 45-degree line. In practice, Lorenz Curves are located between the 45-degree line and the line of complete inequality (see [Figure 6.2](#) below). The more bowed out the curve, the less equal the distribution.

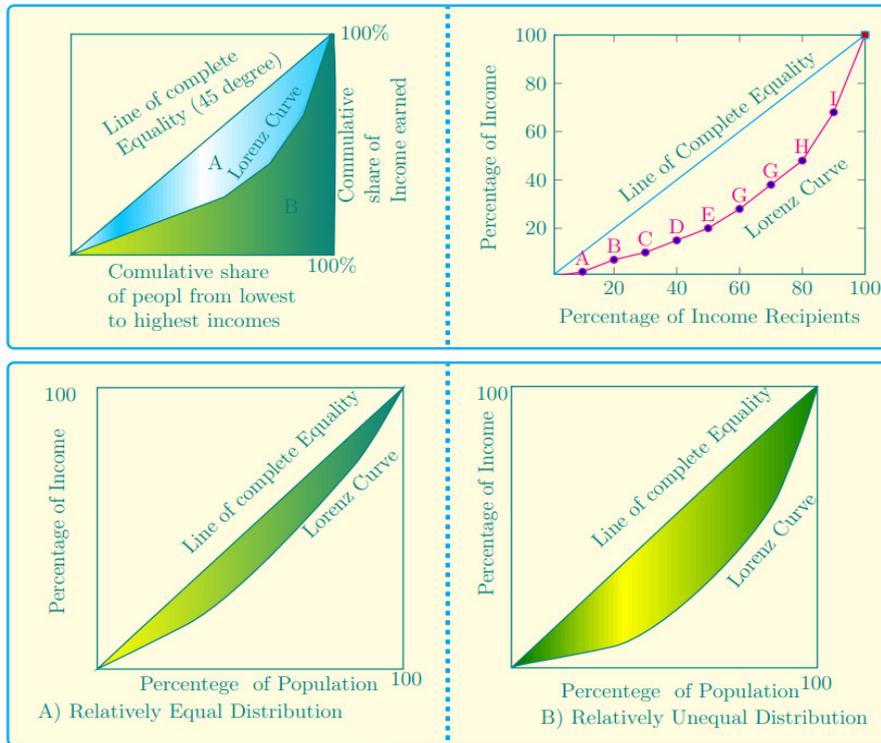


Figure. 6.2 The Lorenz Curve

### Gini Coefficient

Gini Coefficient is a measure of inequality, which is often expressed by the ratio of the area between the Lorenz Curve and a 45° line and the total area under the 45° line. The Gini Coefficient is named after the Italian statistician, Corrado Gini, who first formulated it in 1912. Figure 6.3 illustrates the diagrammatic representation of the Gini Coefficient.

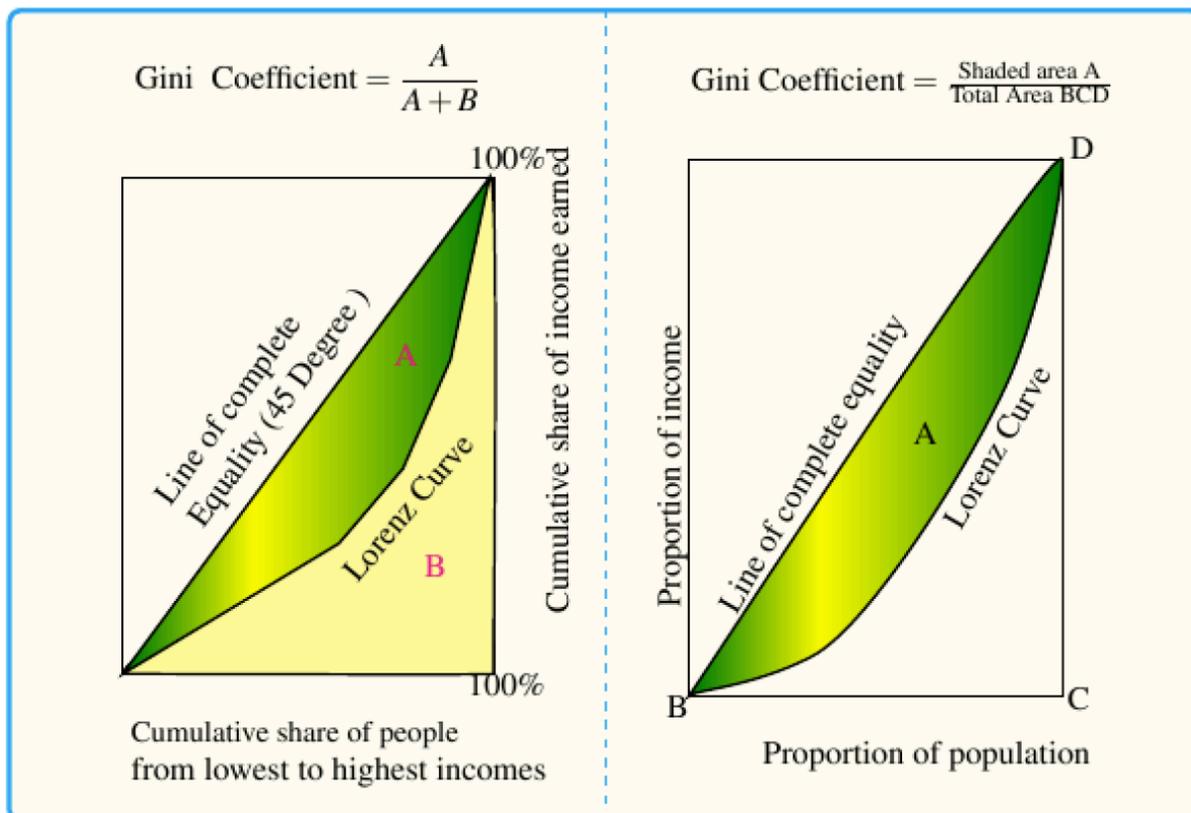


Figure 6.3 Gini coefficient

The higher is the value of Gini-coefficient, the higher the inequality. If Gini coefficient is 0, the Lorenz curve coincides with the main diagonal and implies perfect equality. If Gini-coefficient is 1, it shows perfect inequality when all income is owned by one person. For example, if there are two countries A and B with Gini-coefficient 0.28 and 0.60, respectively, it implies that Country B is characterized by more unequal distribution of income than A.

### Self-test Exercise

1. How do you conceptualise the meaning of inequality?
2. Explain how economic inequality is measured.
3. Discuss the use of the Lorenz curves. Use diagrammatic representation, when necessary.
4. Outline the use of the Gini co-efficient. Use diagrammatic



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Conceptualised the meaning of inequality		
Explained how economic inequality is measured		
Described the use of the Lorenz Curves		
Outlined the use of the Gini co-efficient		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 6.3 Global and Regional Poverty

### Overview

In this section, you will learn about the global and regional poverty.



### Learning Outcomes

**At the end of this section, you will be able to:**

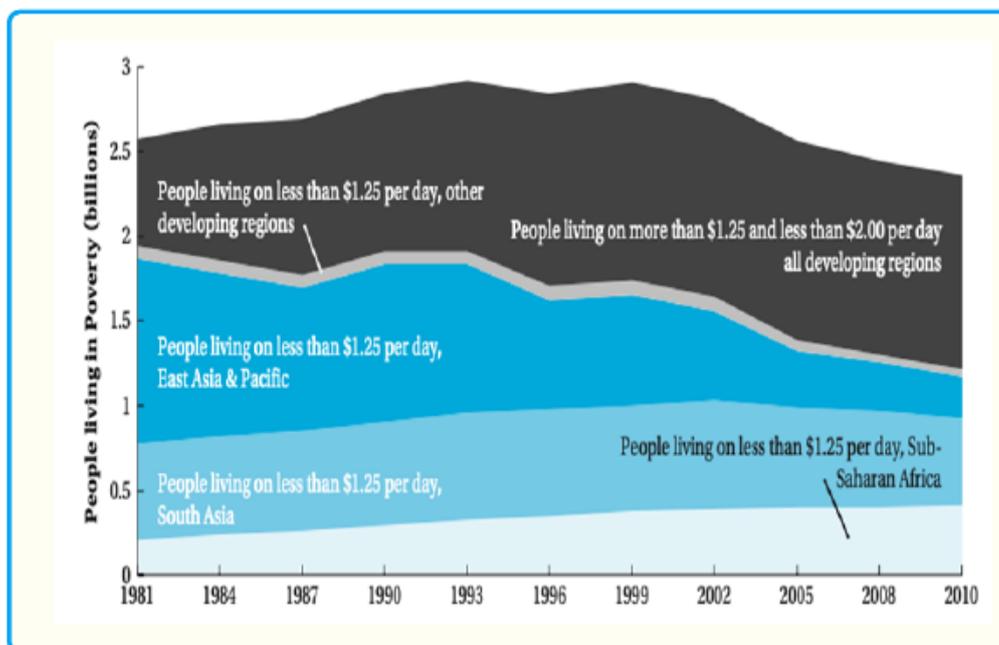
- ▣ recognise the situation of poverty from global and regional perspectives.

- explain the reasons why extreme poverty still remains a challenge in parts of the world, especially sub-Saharan Africa, including Ethiopia.

## Key Concepts

- ☞ Regional poverty
- ☞ Sustainable Development Goals
- ☞ Poverty Reduction Strategy Paper
- ☞ Global poverty
- ☞ Sub-Sahara Africa

## Global and Regional Poverty



**Figure 6.4 Global and Regional Poverty Trends 1981-2010**

Source: Figure drawn using data from PovcalNet/World Bank; data downloaded 13 February 2014 from <http://iresearch.worldbank.org/PovcalNet/index.html>.

It is difficult to arrive at a tight estimate of the extent of global poverty at any point in time. However, there are clear indications that the conditions of poverty had improved over the past half century. For example, countries like China made significant progress in lifting millions of their citizens out of poverty. Subsequently, the number of people living in extreme poverty declined from 36% in 1990 to 10% in 2015. Yet extreme poverty remains widespread in the developing world, and especially in sub-Saharan Africa.

In 2010, more than 1.2 billion people lived on less than \$1.25 per day and some 2.4 billion (more than one-third of the world's population) lived on less than \$2 per a day (Todaro, 2015). The UN reported that more than 700 million people, or 10% of the world population were still living in extreme poverty and the majority of people were living on less than \$1.90 per a day in sub-Saharan Africa. Indeed, sub-Saharan Africa experienced virtually no rate reduction from 1950 to 2000. The gravity of the situation led developing countries to make the eradication of poverty as their policy goal. This desire is also reflected in the Sustainable Development Goals, 2015-2030.

According to the UNDP, the SDGs were adopted by the United Nations in 2015 as a universal call to action to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity. They contain 17 integrated goals — they recognize that action in one area will affect outcomes in others, and that development must balance social, economic and environmental sustainability (UNDP: <https://www.undp.org/sustainable-development-goals>). Accordingly, Goal 1 aims to end poverty in all its forms. It is framed as “No Poverty” or end poverty by 2030. Whether these goals will be realised remains to be seen; yet the issue of poverty remains critical agenda globally.

**Table 6.2 The 17 SDGs to transform our world**

<b>Goals</b>	
Goal 1	No Poverty
Goal 2	Zero Hunger
Goal 3	Good Health and Well-Being
Goal 4	Quality Education
Goal 5	Gender Equality
Goal 6	Clean Water and Sanitation
Goal 7	Affordable and Clean Energy
Goal 8	Decent Work and Economic Growth
Goal 9	Industry, Innovation and Infrastructure
Goal 10	Reduced Inequality
Goal 11	Sustainable Cities and Communities
Goal 12	Responsible Consumption And Production
Goal 13	Climate Action
Goal 14	Life below Water
Goal 15	Life on Land
Goal 16	Peace and Justice Strong Institutions
Goal 17	Partnerships to achieve the goal

The World Bank is said to favour the Poverty Reduction Strategy Paper (PRSP) process to help countries think systematically about how the position of poor people may be improved, and to act accordingly (Hughton and Khandker, 2009). Many developing countries have undergone this process in their development endeavours, including Ethiopia.

As far as inequality is concerned, it has been rising globally due to globalisation, technical progress as well as policies and institutions of different countries.

### Self-test Exercise

1. Consider the following statement: “there are clear indications that the conditions of poverty had improved over the past half century.” Explain how.
2. Consider this statement: inequality is concerned, it has been rising globally. Explain the reasons for this.
3. What are Sustainable Development Goals (SDGs)?



## Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Considered how "there are clear indications that the conditions of poverty had improved over the past half century."		
Explained what Sustainable Development Goals (SDGs) are?		
Which goals relate to dealing specifically with poverty?		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 6.4 Women and Poverty

### Overview

In this section, you will learn about women and poverty, especially in developing countries.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ summarise why some groups in society such as women face poverty.
- ❑ identify measures to address the problem of poverty facing women.

### Key Concepts

- ☞ Economic status
- ☞ Household resources
- ☞ Human capital

### Women and Poverty

Globally, women make up a substantial majority of the world's poor. Among the poorest communities throughout the developing world, virtually everywhere women and children experience the harshest deprivation. They are more likely to be poor and malnourished and less likely to receive medical services, clean water, sanitation, and other benefits.

The prevalence of female-headed households, the lower earning capacity of women, and

their limited control over their spouses' income all contribute to this phenomenon. Moreover, a disproportionate number of the poorest people live in households which are headed by women who have lower incomes. A portion of the income disparity between male-headed and female-headed households can be explained by the large earnings differentials between men and women. Since the earning potential of women is considerably below that of their male counterparts, women are more likely to be among the very poor.

In addition, women have less access to education, formal-sector employment, social security, and government employment programmes. These facts combine to ensure that poor women's financial resources are meagre and unstable compared to those of men.

In urban areas, women are much less likely to obtain formal employment in private companies or public agencies and are frequently restricted to illegal, low-productivity jobs. Similarly, rural women have less access to the resources that are necessary to generate stable incomes. Social customs and laws sometimes play a restrictive role in owning property.

Household income alone fails to describe the severity of women's relative deprivation. This is because a higher proportion of female-headed households are situated in the poorest areas, which have little or no access to public services such as piped water, sanitation, and health care, household members are more likely to fall ill and are less likely to receive medical attention. In addition, children in female-headed households are less likely to be enrolled in school and more likely to be working in order to provide additional income.

The degree of economic hardship may also vary widely within a household depending on the distribution of income within the household, which may be unequal. In terms of intra-household resource allocation, there may exist a bias against females in areas such as nutrition, medical care, education, and inheritance.

The extent of these internal biases is strongly influenced by the economic status of women. Studies have found that where women's share of income within the home is relatively high, there is less discrimination against girls, and women are better able to meet their own needs as well as those of their children.

When household income is marginal, most of women's income is contributed towards household nutritional intake. Since this fraction is considerably smaller for men, a rise in male earnings leads to a less than proportionate increase in the funds available for the provision of daily needs. It is thus unsurprising that programmes designed to increase nutrition and family health are more effective when targeting women than when targeting men.

Women's control over household income and resources is limited for a number of reasons. Of primary importance is the fact that a relatively large proportion of the work performed by women is unremunerated, for example, collecting firewood and cooking, and may even be intangible, as with parenting.

Women's control over household resources may also be constrained by the fact that many women from poor households are not paid for the work they perform in family agriculture

or business. It is common for a male head of household to control all funds from cash crops or the family business. These combined factors perpetuate the low economic status of women and can lead to strict limitations on their control over household resources.

When public programmes to alleviate poverty work exclusively with men, they tend to exacerbate these inequalities. In urban areas, training programmes to increase earning potential and formal-sector employment are generally geared to men, while agricultural extension programmes promote male-dominated crops, frequently at the expense of women's vegetable plots.

Thus, the design of development policy needs to integrate women into development programmes so long as the latter influences the welfare of women and children. This would entail increasing female participation rates in educational and training programmes, formal-sector employment, and agricultural extension programmes.

It is necessary to ensure that women have equal access to government resources provided through schooling, health and other services. In cases where the majority of female labour force is employed in informal-sector, formalising or legalising such employment would improve the economic status of women.

The consequences of a decline in women's relative or absolute economic status have both ethical and long-term economic implications. Any process of growth that fails to improve the welfare of the people experiencing the greatest hardship, has failed to accomplish one of the principal goals of development. Likewise, the low status of women, in the long run, is likely to translate into slower rates of economic growth. Thus, the benefits of current investments in human capital are more likely to be passed onto future generations if women are successfully integrated into the growth process.

In addition, considering that human capital is perhaps the most important prerequisite for growth, education and enhanced economic status for women are critical to meeting long-term development objectives. Women-centred poverty strategies often require us to challenge basic assumptions. Understanding is necessary of the crucial role that women can play in a community's escape from poverty. The involvement of women will be most effective if it forms the basis for action, when addressing poverty. In general, women must be drawn into the economic mainstream in order to improve living conditions for the poorest individuals (Todaro and Smith, 2015).

### Self-test Exercise

1. Explain why women in developing countries are disproportionately poor.
2. Explain the consequences of decline in women's economic status.
3. Identify measures to address the problem of poverty facing women.



## Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Explained why women in developing countries are disproportionately poor		
Explained the consequences of decline in women's economic status		
Identified measures to address the problem of poverty facing women		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 6.5 Overview of Poverty and Inequalities in Ethiopia

### Overview

In this section, you will view poverty and inequalities from your local and from Ethiopia perspective.

### Learning Outcomes

*At the end of this section, you will be able to recognise the extent of poverty and inequality in Ethiopia.*

#### Key Concepts

- ☞ Headcount poverty in Ethiopia
- ☞ Poverty in rural areas
- ☞ Poverty in rural areas
- ☞ Vulnerabilities

### Overview of Poverty and Inequalities in Ethiopia

Ethiopia has an estimated population of 118 million as of 2021. The World Bank (2020) reckons that Ethiopia's economy experienced strong, broad-based growth averaging 9.8% a year from 2008/09 to 2018/19, with the share of the population living below the national poverty line declining from 38% to 24% over the same period. Yet Ethiopia remains one of the poorest countries in the world with a per capita annual income estimated, according to the government, at \$883 (MoFEC, 2019).

The government also reckons that the headcount poverty in Ethiopia declined from 59% in

1992 to 29.5% in 2011 (MoFED, 2012). In 2019, Ethiopia's HDI value was 0.485 positioning it at 173 out of 189 countries and territories. This puts the country in the low human development category (UNDP). Moreover, 44% of people earn less than a dollar per day, and 89% falls below the 2 US\$ per day poverty line.

Similarly, the International Fund for Agricultural Development (IFAD) estimated that more than 12 million people are chronically or at least periodically food insecure. Most of these people live in rural areas whose households live on a per capita income of less than US\$ 0.50 per a day. The majority are smallholder farmers who are the largest group of poor people in Ethiopia.

While poverty has generally decreased, it is still a challenge in Ethiopia especially in rural areas where the rate of decrease is slower than the urban areas, where most rural livelihoods depend on rain-fed agriculture, exposed to climate related vulnerabilities. The poverty and vulnerability of the people are also reflected in the inadequate health and education systems and poor access to basic services.

Ethiopia pursues the World Bank's Poverty Reduction Strategy Paper (PRSP) process. As part of this process, the Central Statistical Agency conducts regular Household Income and Consumption Expenditure Surveys (HICES) and the Welfare Monitoring Survey (WMS), established in 1996, while the Ministry of Finance and Economic Development prepares the corresponding analytical Poverty Analysis Report that provides the status and trends of national-, rural-, urban- and regional-level poverty incidence, gap and severity as well as income inequality measured by Gini Coefficient (MOFED, 2013).

### Self-test Exercise

1. What is happening to poverty and inequality in your locality? Write down your observations.
2. "While poverty has generally decreased, it is still a challenge in Ethiopia especially in rural areas where the rate of decrease is slower than the urban areas" Discuss this in your own words shortly and briefly.



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Wrote down own observations about what is happening to poverty and inequality in your locality		

Discussed the statement: Most rural livelihoods depend on rain-fed agriculture, exposed to climate related vulnerabilities.		
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Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 6.6 Role of Indigenous Knowledge in Reducing Poverty

### Overview

In this section, you will appreciate the role of indigenous knowledge in reducing poverty in Ethiopia.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ appreciate the role of indigenous knowledge and practices in reducing poverty.
- ❑ identify different local actors and actions that work to improve wellbeing of the society.

### Key Concepts

- ☞ Indigenous Knowledge
- ☞ *Idir*
- ☞ *Debo*

- ☞ *Iqub*
- ☞ Local cottage industries
- ☞ Informal

### The Role of Indigenous Knowledge in Reducing Poverty (*Iqub*, *Idir*, and Local Cottage Industries)

Dear learner, what do you understand when we say indigenous knowledge? That is great!

Indigenous knowledge is the accumulated set of common-sense knowledge and ideas of the local people about their everyday realities of living which is unique to the given community. It forms the basis for local level decision-making in agriculture and connects people directly with their environment (Warren and Rajasekaran, 1993). Thus, indigenous knowledge is locally based and developed within the communities and used to solve problems within society; it is also dynamic.

Variously known as "Traditional knowledge," "Local knowledge" and "Traditional wisdom." Indigenous knowledge is used to solve different problems, including relief of poverty. More often than not the practices associated with indigenous knowledge serve as pooling resources for a common good.

Ethiopia is endowed with diverse cultures and peoples that are rich in indigenous knowledge

and associated practices. Some of the indigenous knowledge and practices are unique to specific localities and others are common to the wider environment. The following sections explore some of the common practices in different parts of Ethiopia.

“*Idir*” is the most common informal institution in Ethiopia. Although it is a form of burial society, it also provides other supports and consolation to its members in times of death and grief. It is an association that is established among neighbours or workers to raise funds that will be used during emergencies, such as death within these groups and their families. It is also known as a traditional burial association. *Idir* is characterized as a group life insurance. As such it usually has a large membership and the weekly or monthly membership is minimal and affordable by all. *Idir* guarantees grieving families the complete assistance (financial or otherwise) they seek in times of emergency. *Idir* members are required to attend funerals and must always be ready to help the ceremony of burial. *Idir* can be established by a community or village, at the workplace, or among friends and family.

*Iqub* (also called “*Ikub*”) is a rotating credit association which is established by a small group of people in order to provide substantial funding for members to improve their lives and living conditions. Serving as a savings club, each member contributes to the pool of money weekly or monthly.

*Iqub* enables a family, particularly a poor family, to obtain the necessary funding for activities such as weddings, building a house, or starting a small business. The rotating fund is a means for poor people to make investments that they would normally never consider making due to lack of money. *Iqub* is more flexible and accessible than banks and requires minimal paperwork. As a result, people without formal education are not discouraged from joining. Moreover, for a small payment each week or month, members of *Iqub* can keep a steady flow of money to help any member of the group on a rotational basis.

*Iqub* and *Idir* can be characterized as traditional financial associations. While *Idir* is a long-term association, *Iqub* can be temporary or permanent, depending on the needs of the members. Yet the two are informal, bottom-up, and widely practiced socio-economic traditions in Ethiopia. They serve the needs of the society in a sustainable way and they are based on available human or material resources.

These informal associations guarantee that everyone is taken care of in times of need through participatory and enabling means. For example, in times of death, the community is kept intact and the grieving family instantly gets financial and social support. *Iqub* and *Idir* are remarkable examples to show that poverty does not define a person or a society. Economically disadvantaged societies are able to use traditional practices and knowledge to sustain themselves. Their motto is: “*Idir, Iqub, for mutual benefits, to lessen societal burden.*”

These associations are based on participatory principles, and as a result, they promote accountability, transparency, tolerance and dialogue. In addition, they tend to foster friendship among members. The strong ties established among *Iqub* members also tend to discourage defaults.

Other informal associations include “Debo” or a work group where community members (who are also “Debo” members) assist an individual on a rotational basis, often for free. It is often organised by men to pool their labour to work on each other’s farmland, on rotational basis.

There are numerous similar institutions across the country, each playing important roles in poverty reduction and as pathways to upward mobility. However, being informal associations, they do not figure out in the formal, documented arena of social and economic life.

In addition to the above forms of associations, rural and urban cottage industries play an important role in lifting people out of poverty. Cottage industry refers to small-scale, decentralized manufacturing units which are involved in the production of goods and services using conventional and low-technology methods. A cottage industry is often operated out of a home rather than a purpose-built facility. Cottage industries are defined by the amount of investment required to start, as well as the number of people employed.

Examples of cottage industry are locally produced handicrafts and textiles, which are still the backbone of many rural economies around the globe. The oldest forms of cottage industry in Ethiopia are weaving, leather working, pottery, basket and blacksmithing as well as making agricultural, household and construction equipments.

Even though they require very little investment, they make significant contribution to local and national economies. Cottage industries have the advantage of employing labour-intensive techniques providing employment, thus, reducing unemployment and offering opportunities for self-employment for both men and women.

Finally, apart from informal associations and cottage industries, modern cooperatives such as coffee unions are key vehicles for the implementation of poverty reduction and sustainable livelihood development in Ethiopia.

### **Self-test Exercise**

1. Does any member of your household benefit from indigenous practices?
2. What mechanisms do people in your locality use to reduce poverty?
3. Identify different local actors and actions that work to improve wellbeing of the society.



### **Checklist of Self-test Exercise**

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick mark (✓) in the ‘yes’ or ‘no’ box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Responded if family members are involved in indigenous practices such as <i>Iqub</i> , <i>Edir</i> and <i>Debo</i> or similar groups.		
Found out what mechanisms do people in your locality use to reduce poverty.		
Identified different local actors and actions that work to improve wellbeing of the society.		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!



## Unit Summary

Widespread poverty and high inequality are the two fundamental economic manifestations of underdevelopment. The conditions of poverty are reflected in the lack of income and assets to attain basic necessities, lack of access to education and other basic services. Different views and definitions exist on poverty. While some focus on income poverty, others focus on consumption poverty. Still others focus on wellbeing expressed as the capability (or lack) of the individual to function in society. Poverty can be seen in relative and absolute terms. The reduction or eradication of absolute poverty is one of the crucial goals of developing countries. It is also the subject of concern internationally as recommended in the SDGs.

The analysis and measurement of poverty is crucial for understanding people's wellbeing and the factors determining their poverty. Different measurements are used to measure poverty and inequality. Inequality, in particular, is expressed in terms of distribution of income which is measured by the Lorenz curve. Both poverty and inequality have global, regional and gender dimensions.

In the last few decades, Ethiopia attempted to reduce poverty; yet the challenge remains. The role of indigenous knowledge and institutions in the reduction and relief of poverty is significant and needs to be explored further.



## Unit Review Exercises

### Part I: True or False

Read the following statements and write "True" for correct statements and "False" for the incorrect ones.

1. Inequality is classified into relative and absolute poverty.
2. Poverty and inequality are interrelated concepts which are also a daily reality for

millions of people around the world.

3. Absolute poverty is the situation of someone being unable or only barely able to meet the subsistence essentials such as food, clothing, and shelter.
4. Indigenous institutions such as *Ikub and Edir*, play important roles in poverty reduction and as pathways to upward mobility in Ethiopia.
5. Poverty is a challenge in Ethiopia especially in rural areas where the rate of decrease is slower than the urban areas, where most rural livelihoods depend on rain-fed agriculture, exposed to climate related vulnerabilities.

## Part II: Multiple Choice

For each of the following questions choose the best answer from the given alternatives.

1. Which one of the following is among the SDGs?
  - A. quality education
  - B. reduced equality
  - C. climate action
  - D. gender inequality
  - E. A and C
2. One of the following rightly characterises absolute poverty:
  - A. It is the situation of someone being unable or only barely able to meet the subsistence essentials such as food, clothing, and shelter.
  - B. It is the deprivation of basic needs.
  - C. The extent of absolute poverty is expressed as the number of people who are unable to command sufficient resources to satisfy basic needs.
  - D. All of the above.
  - E. None of the above.
3. Which one of the following best describes the situation of global poverty and women?
  - A. Women make up a substantial minority of the world's poor.
  - B. Among the poorest communities throughout the developing world, virtually everywhere women and children experience the harshest deprivation.
  - C. Women are less likely to be poor and malnourished and less likely to receive medical services, clean water, sanitation, and other benefits.
  - D. All of the above.
  - E. None of the above.
4. Examples of cottage industries include:
  - A. Weaving,
  - B. Leather working,
  - C. Pottery,
  - D. Basket and blacksmithing
  - E. All of the above.
5. Which one of the following statements represents economic inequality and income distribution?
  - A. Economic inequality is the disproportionate distribution of total national income among households.
  - B. Income distribution is divided into two: the functional/distributive factor share

- distribution of income and the personal/size distribution of income.
- c. Functional or factor share distribution of income depicts the share of total national income that each of the factors of production (land, labour, and capital) receives.
  - d. All of the above

### Part III: Short Answers

For each of the following questions write short answers.

- 1. Summarise the three steps which are involved in measuring poverty.
- 2. Summarise Amartya Sen's approach to wellbeing and poverty.
- 3. Define Multidimensional Poverty Index.



## Answer Key for Review Questions

### Part I: True or False

- 1. False
- 2. True
- 3. True
- 4. True
- 5. True

### Part II: Multiple Choice

- 1. E
- 2. D
- 3. B
- 4. E
- 5. D

### Part III: Short Answers

- 1. The three steps needed in measuring poverty are: Defining an indicator of welfare, establishing a minimum acceptable standard of that indicator to separate the poor from the nonpoor (the poverty line), and generating a summary statistic to aggregate the information from the distribution of this welfare indicator relative to the poverty line.
- 2. Amartya Sen, the 1998 Nobel Laureate in economics, contended that traditional welfare economics, which stresses the revealed preferences or desire-based utilities of individuals in their acts of choice, lacks enough information about people's preferences to assess the social good. Accordingly, as an alternative, Sen's welfare theory relies not on individuals' attainments (for example, of basic needs) but individuals' capabilities. His approach, also known as Capability Approach, states that income and wealth are not ends in themselves but rather instruments for other purposes. For him capability to function is what really matters for one's status as a poor or non-poor person. According to him, the expansion of commodity production is valued not for its own sake, but as a means to human welfare and freedom.
- 3. Multidimensional Poverty Index incorporates three dimensions at the household level: health, education, and wealth. It takes into account that people have multiple deprivations.



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# UNIT 7

## MACROECONOMIC REFORMS IN ETHIOPIA

Time Allotted: 8 hours

### Introduction

Dear Learner, do you know where and when did economic reform begin in Africa? That is good! Now, go on reading the following notes.

Economic reform began throughout Africa in the mid-1990s. Before that, the two decades of donor-sponsored reform efforts to Africa failed to help most sub-Saharan economies to overcome the fiscal and balance of payment deficits. During the mid-1990s, several civil wars ended and a wave of democratization started. It has been documented that, as indicated by socio-economic indicators, Ethiopia appears to be one of the poorest countries in the world. To reverse this image, a number of economic reforms were taken by different governments.

This unit presents an overview of macroeconomic reforms in Ethiopia. We will also examine the national development objectives and strategies under the Monarchy, Derg, and FDRE before and after 2018 reform. Finally, we will study an overview of home-grown economic reforms and fiscal decentralization in Ethiopia.

### Unit Learning Outcomes

After completing this unit, you will be able to:

- ❑ know economic reforms in Ethiopia.
- ❑ understand national development objectives and strategies
- ❑ understand home grown economic reforms.
- ❑ recognize the role of private sectors in the reform process

#### Unit Contents

**7.1 National Development Objectives and Strategies- Historical Review**

**7.2 Overview of Home-grown Economic Reforms in Ethiopia**

**7.3 Fiscal Decentralization**

**Unit Summary**

**Self-assessment questions**

**Answer Key for Self-test Exercises**

**References**

Dear learner, we expect you to complete this unit in 8 hours. Please, assess your progress, performance and overall understanding by referring to the learning outcomes, self-test exercises and checklists. We also expect you to learn at your own pace and cover portions of the subject within a defined time frame as a requirement.

## Learning Strategies

Dear learner, please, use the following and other learning strategies of your own to successfully learn this unit.

1. Create a schedule and follow it.
2. Take the time to research questions.
3. Assess the technology used in the subject.
4. Utilize alarms and calendars to keep you abreast with deadlines.
5. Appreciate and value yourself.
6. Participate in tutorial classes
7. Search for different available learning opportunities that will help you to better understand the subject

## 7.1 National Development Objectives and Strategies: Historical Review

### Overview

Dear learner, in this section you learn about national development plan objectives and strategies, and historical overview of the national development plans of the monarchy, military and EPRDF governments.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ▣ identify national development plan objectives and strategies.
- ▣ analyse the national development plans of the Monarchy, Military and EPRDF governments.

### Key Concepts

- ☞ National development plan objectives and strategies.
- ☞ Imperial regime
- ☞ Derg
- ☞ EPRDF

Dear learner, from your past experience, what do you understand about national development plan objectives and strategies? When did Ethiopia begin to launch national

development plans? Please, try these questions before you start reading the following detailed discussions. We hope you attempted it! Ok! Now, please read the next text!

Dear learner, Ethiopia is the oldest independent country in Africa and one of the oldest countries in the world. The ancient monarchy maintained its freedom from colonial rule with the exception of a short-lived Italian occupation effort from 1936–1941. In 1974, a military junta, the “Derg”, deposed Emperor Haile Selassie I (who had ruled since 1930) and established a socialist state. Torn by bloody coups, uprisings, widespread drought, and massive emigration problems, the regime was finally toppled in 1991 by a coalition of rebel forces, the Ethiopian People’s Revolutionary Democratic Front (EPRDF). A constitution was adopted in 1994, and Ethiopia’s first multiparty election was held in 1995.

### 7.1.1 National Development Plan during the Imperial Period (1950-74)

When their occupation of Ethiopia ended in 1941, the Italians left behind a country whose economic structure was much as it had been for centuries, although there had been some improvements in communications, particularly in the area of road building, and attempts had been made to establish a few small industries and to introduce commercial farming.

During the late 1940s and the 1950s, much of the economy remained unchanged. The government focused its development efforts on expansion of the bureaucratic structure and ancillary services. By the early 1950s, Emperor Haile Selassie I had renewed calls for a transition from a subsistence economy to an agro-industrial economy. A key element of the emperor’s new economic policy was the adoption of centrally administered development plans. Between 1945 and 1957, several technical missions, including one each from the United States, the Food and Agriculture Organization of the United Nations (FAO), and former Yugoslavia, prepared a series of development plans. However, these plans failed to achieve any meaningful results, largely because basic statistical data were scarce and the government’s administrative and technical capabilities were minimal. In 1954/55 the government created the National Economic Council which helped to prepare Ethiopia’s three five-year development plans.

#### The First Five-Year Plan (1957 – 1961)

Main Objectives were:

- ✓ Development of a strong infrastructure, particularly in transportation, construction, and communications, to link isolated regions.
- ✓ Establishment of a cadre of skilled and semi-skilled personnel to work in processing industries to help reduce Ethiopia’s dependence on imports.
- ✓ Acceleration of agricultural development by promoting commercial agricultural ventures. During the plan period, the gross national product (GNP) increased at a 3.2% annual rate, as opposed to the projected figure of 3.7%, and growth in economic sectors such as agriculture, manufacturing, and mining failed to meet the national plan’s targets. On the other hand, exports increased at a 3.5% annual rate, whereas imports grew at a

rate of 6.4% per annum, thus failing to correct the negative balance of trade that had existed since 1951. The First Five-Year Development Plan promoted improved production of cash crops, including coffee, which accounted for 70% of foreign exchange earnings.

### **The Second Five-Year Plan (1962 –1967)**

Similarly, the second Five-Year Development Plan (1962-1967) continued to prioritize industrial development. Large-scale commercial farms for production of cotton, coffee and sugar were promoted as a source of income over small-scale subsistence farms, which accounted for about 80% of cereal production.

The second plan's objectives were:

- ✓ to change Ethiopia's predominantly agricultural economy to an agro-industry alone.
- ✓ diversification of production, introduction of modern processing methods, and expansion of the economy's productive capacity to increase the country's growth rate.

### **The Third Five- Year Plan (1968–1973)**

The third Five-Year Development Plan shifted its focus to the development of the agricultural sector in order to address the rising problem of food shortages in Ethiopia. The Integrated Rural Development project was also established to address rural development challenges and expand the agricultural commercial market system. It predominantly focused on improving the distribution of agricultural inputs, such as fertilizers and seeds used by commercial farmers, and expanding rural health services. Nonetheless, the monarchy continued to envision the development of the non-agricultural sector as the main driver of economic development.

The third plan's objectives:

- ✓ raising manufacturing and agro-industrial performance.
- ✓ expansion of educational opportunities.
- ✓ improvement in peasant agriculture.

The second five-year and the third five-year plans anticipated that the economy would grow at an annual rate of 4.3% and 6.0%, respectively. But the Planning Commission never assessed the performance of these two plans, largely because of a shortage of qualified personnel.

However, according to data from the Central Statistical Authority, from 1960/61 to 1973/74, the economy achieved sustained economic growth. Between 1960 and 1970, for example, Ethiopia enjoyed an annual average growth rate of 4% in per capita gross domestic product. The manufacturing sector's growth rate more than doubled (from 1.9% in 1960/61 to 4.4% in 1973/74), and the growth rate for the wholesale, retail trade, transportation, and communication sectors increased from 9.3% to 15.6%. By the early 1970s, Ethiopia's

economy not only had started to grow but also had begun to diversify into areas such as manufacturing and services. However, these changes failed to improve the lives of most Ethiopians.

This failure could be attributed to the feudal land tenure system that deprived millions of rural peasants of the right to appropriate land and other resources. A combination of public dissatisfaction, food shortages and the rise of a military government led to the overthrow of the monarchy in 1974.

### 7.1.2 National Development Plan under the Socialist Period (1974-1991)

The 1974 revolution by the Derg resulted in the establishment of a socialist state which aimed at the nationalization and restructuring of the Ethiopian economy. The Derg changed the previous national development strategy, placing the emphasis on a centrally planned economy. Industry-led development was deployed as the main development strategy. Rural land and other productive assets were nationalized, and land was distributed among farmers. Commercial farms were put under government control, and land tenancy was abolished. Furthermore, private commercial labourers and commercial farming were marginalized, and large collectivization programmes were promoted through resettlement and villagisation programmes. The military government maintained an overvalued currency and implemented marketing and pricing policies. In addition, the government established the Agricultural Marketing Corporation (AMC) to set pricing systems, for agricultural goods and set quotas for grain production which were significantly lower than market prices. Economic planning and development in the post-revolution period had four distinct phases.

- I. 1974-1978: during this period, there was little economic growth. Instead, the government's nationalization measures and the highly unstable political climate caused economic dislocation in sectors such as agriculture and manufacturing. Additionally, the military budget consumed a substantial portion of the nation's resources. As a result of these problems, gross domestic product increased at only an average annual rate of 0.4%.
- II. 1978-1980: during this period, the economy began to recover as the government consolidated power and implemented institutional reforms. The government's new Development through Cooperation Campaign (commonly referred to as "Zemecha") also contributed to the economy's improvement. Consequently, gross domestic product grew at an average annual rate of 5.7%. Benefiting from good weather, agricultural production increased at an average annual rate of 3.6%, and manufacturing increased at an average annual rate of 18.9%.
- III. 1980-1985: various annual development campaign programmes were implemented during this period, but still the economy experienced a setback as gross domestic product declined, manufacturing took a downturn, and agriculture reached a crisis stage. This happened due to four reasons:
  - ✓ widespread drought all over the country,
  - ✓ manufacturing sector stagnated as agricultural inputs declined,
  - ✓ lack of foreign exchange and declining investment

- ✓ high rise in defense expenditure.

IV. 1985-1990: the government prepared a ten-year perspective plan for the period 1984-1994, which aimed at the development of agriculture, enhancement of exports, and improvement in the quality of livestock. To achieve this, strategies of cooperativisation and establishment of state farms, etc., were adopted. As a result, the agricultural decline was reversed and the manufacturing sector also grew. Gross domestic product increased at an average annual rate of 5%. However, the lingering effects of the 1984/85 droughts undercut these achievements and contributed to the economy's overall stagnation during this period.

### **7.1.3 National Development Plan under FDRE (1992-)**

The Ethiopian People's Revolutionary Democratic Front's (EPRDF's) rise to power in 1991 resulted in a considerable shift in national development strategies. The EPRDF moved Ethiopia's development vision away from the previous centrally planned industrial development and towards a new agricultural-led development approach. Many of the previous government's policies were reversed, agricultural price controls were removed, and state farm assets were privatized. In addition, the new government adopted an export-oriented development strategy and implemented structural adjustment programmes (SAPs). In 1994, the home-born Agricultural Development-Led Industrialization (ADLI) was launched as the foundation for national development, with the main objective of attaining food self-sufficiency by increasing agricultural productivity and output.

Under the ADLI, the government envisioned agricultural sector-driven economic transformation. The programme entailed three main strategies: expansion of agricultural technologies; investment in agricultural infrastructure, including inputs; and boosting rural non-agricultural sectors. The programme aimed at boosting agricultural productivity by improving the use of fertilizers and seeds, with the ultimate aim of boosting agricultural production to serve as input and drive industrial development.

The ADLI also encompassed wider socio-economic development programmes, including investment in infrastructure such as roads, telecommunication and electricity grids. Furthermore, the plan aimed at enhancing the flow of finance, local governments' administrative capacity, and the development of agro-processing industries. A series of investment plans were made under the ADLI, including rural technical and vocational education and training services (TVETs), the development of water resources (hydro power and irrigation), improvements in microfinance institutions, improvements in the marketing of agricultural products, and the restructuring of smallholder co-operatives.

The government heavily invested in extension programmes and introduced the Participatory Demonstration and Training Extension System (PADETES). PADETES was used to distribute fertilizers, seed and credit, as well as to spread information on better agricultural practices, to smallholder farmers. The ADLI remains the key pillar and guiding framework for other successive development plans, including the Sustainable Development and Poverty Reduction (SDPRP), Plan for Accelerated and Sustained Development to End Poverty

(PASDEP), Growth and Transformation Plan I (GTPI) and Growth and Transformation Plan II (GTP II)

The Ethiopian People's Revolutionary Democratic Front (EPRDF) government initiated the Five-Year Development Programme known as Peace, Democracy and Development Programme which emphasized the interrelationships between peace, democracy and development. The major goals and objectives of the programme were as follows:

- ✓ Poverty alleviation through rapid economic growth.
- ✓ Ensuring peace and security by strengthening a political system that promotes people's equality and fraternity, guaranteeing administrative justice and peaceful coexistence with neighbouring countries.
- ✓ People's participation in the democratic governance of the country.
- ✓ Implementation of an efficient educational system and improvement in the quality of education.
- ✓ Development of a governance system that ensures social justice.
- ✓ Implementation of a prevention-oriented health care system based on cooperation and participation of the private sector.

### Development Programmes of EPRDF

Sustainable Development and Poverty Reduction Programme (SDPRP)

The programme was launched in 2002 following wide-ranging public consultations in 2001 and covered a period of three years 2002/03–2004/05. It was built on the following goals and concepts:

- ✓ agricultural Development-Led Industrialization–ADLI
- ✓ food security
- ✓ decentralization and empowerment
- ✓ capacity building in the public and private sector, and
- ✓ reforms in both the justice system and the civil service.

The first year of the programme was marked by a drought which led to an 11.6% fall in agricultural productivity, contributing to a 3.6% fall in gross domestic product. It was because of this that the average growth for the three-year period was 5.5%. However, the country experienced 11.3% and 8.8% growth during the second and third years, respectively.

### Plan for Accelerated and Sustained Development to End Poverty (PASDEP)

The development policies and strategies pursued during the three year Sustainable Development and Poverty Reduction Programme (SDPRP) (2002/03-2004/05) together with the vision expressed in and achievements realized by the SDPRP were the foundation for the design of the PASDEP. The PASDEP was Ethiopia's second poverty reduction strategy, covering the periods between 2005/06 and 2009/10. It was built on the directions pursued under SDPRP and aimed at private-sector development and at the scaling up of resources

to achieve the MDGs (Millennium Development Goals).

The main objective of PASDEP was to lay out the directions for accelerated, sustained, and people-oriented development and to pave the groundwork for the attainment of the MDGs by 2015.

The purpose of achieving this PASDEP objective was to contribute to the attainment of Ethiopia's vision of becoming a middle-income country.

The country's vision, specifically for the economic sector, set the following goals:

- ✓ to build an economy which has a modern and productive agricultural sector with enhanced technology and an industrial sector that plays a leading role in the economy;
- ✓ to sustain economic development and secure social justice
- ✓ to increase per capita income of citizens so that it reaches at the level of those in middle-income countries in 2025.

To achieve these objectives, the PASDEP was built on the following eight strategic goals:

1. Building all-inclusive implementation capacity.
2. A massive push to accelerate economic growth.
3. Creating the balance between economic development and population growth.
4. Unleashing the potentials of Ethiopia's women.
5. Strengthening the infrastructural backbone of the country.
6. Strengthening human resource development.
7. Managing risk and volatility
8. Creating employment opportunities.

Based on these strategic pillars, two alternative economic growth scenarios were considered. In the base case scenario, it was considered that to achieve the MDGs, an average economic growth rate of 7% per annum was necessary. For the high case scenario, which aimed beyond achievement of MDGs targets, a 10% annual average economic growth target was set so as to lay the foundation for the realization of the development vision of the country.

### **Growth and Transformation Plan I (GTP I) (2010/11-2014/15)**

GTP I was the third national development plan covering the period between 20 10/11 and 20 14/15. GTP I advanced the Ethiopian national agenda towards becoming a lower middle-income economy by 2025. Regarding agricultural sector growth strategies, GTP I highlighted the need to identify and scale up smallholders' best agricultural practices. It introduced new agricultural technologies which aimed at helping to improve soil productivity, and it provided support to small-scale farmers through training and fertilizer provisions. In addition, GTP I promoted the production of high-value crops and set sector-based targets

GTP I built on the PASDEP and widened its remit to include industrialization as a way of creating structural transformation. The plan recognized the importance of urban areas and industrial development for structural transformation and for creating employment for Ethiopia's growing population. It promoted investment in labour-intensive micro and small-scale enterprises (MSEs), as they provide significant opportunities for processing of agricultural goods. The plan envisioned labour-intensive manufacturing MSEs as a strategy for creating linkages with the rest of the economy (including the agricultural sector), as well as a strategy for an import substitution and export-oriented industrialization programme.

The first Growth and Transformation Plan (GTP) was articulated through the following four overarching objectives.

- i. Maintaining at least an average real GDP growth rate of 11% per annum and attaining the Millennium Development Goals (MDGs) by 2014/15.
  - ii. Expanding access and ensuring the qualities of education and health services and achieving MDGs in the social sectors.
  - iii. Establishing conditions for sustainable nation building through the creation of stable democratic and developmental state.
  - iv. Ensuring the sustainability of growth through maintaining macroeconomic stability.
- These four overarching objectives were in turn cascaded in to seven pillar strategies that cut-across all socioeconomic sectors.

The achievements of the first GTP, lessons drawn from its achievement, and challenges faced during its implementation were used as inputs in the preparation of the second Growth and Transformation Plan. In addition, economic and social development projects commenced during the first GTP and still under construction are also considered as the bases of the plan.

### **Growth and Transformation Plan II (GTP II) (2015/16-2019/20)**

The overarching objective of GTP II is to sustain the accelerated growth and establish a springboard for economic structural transformation thereby realizing the national vision of becoming a lower middle-income country by 2025. To this end, GTP II has set out the following specific objectives:

- i. Achieve an annual average real GDP growth rate of 11% within a stable macroeconomic environment and thereby contribute towards the realization of Ethiopia's vision of becoming a lower middle income country by 2025, while pursuing comprehensive measures towards narrowing the saving-investment gap and bridging the widening trade deficit.
- ii. Develop the domestic engineering and fabrication capacity and improve productivity, quality, and competitiveness of the domestic productive sectors (agriculture and manufacturing industries) to speed up structural transformation.
- iii. Further solidify the on-going public mobilization and organized participation to ensure the public become both owners and beneficiaries from development outcomes.

- iv. Deepen the hegemony of developmental political economy by strengthening a stable democratic developmental state.

### **Pillar Strategies**

The pillar strategies of GTP II are built on that of GTP I complemented by additional pillar strategies that serve as foundation for sectorial plans. Therefore, in order to achieve the objectives of GTP II, the following pillar strategies were pursued:

- i) Sustain the rapid, broad based and equitable economic growth and development witnessed during the last decade.
- ii) Increase the productive capacity and efficiency to reach the economy's production possibility frontier through concurrently improving quality, productivity and competitiveness of productive sectors (agriculture and manufacturing industries).
- iii) Speed up and catalyse transformation of the domestic private sector and render them a capable development force.
- iv) Build the capacity of the domestic construction industry, bridge critical infrastructure gaps with particular focus on ensuring the quality of infrastructure services through strengthening the implementation capacity of the construction sector.
- v) Properly manage and administer the on-going rapid urbanization to unlock its potential for sustaining growth and structural transformation of the economy.
- vi) Accelerate human development and technological capacity building and ensure its sustainability.
- vii) Establish democratic and developmental good governance through enhancing implementation capacity of the public sector and mobilization of public participation.
- viii) Promote women and youth empowerment, ensure their participation in the development process and enable them to equitably benefit from the outcomes of development.
- ix) Build a climate resilient green economy.

### **GTP I and II Performances and their Major Challenges**

During the implementation of the two Growth and Transformation Plans (GTP I and II), Ethiopia has registered rapid and high economic growth. For example, based on constant basic prices (2015/16 base year), gross domestic product (GDP) grew on average by 9.2% per year and the volume of real GDP rose from Birr 828 billion in the 2009/10 fiscal year to Birr 1.99 trillion in 2019/20 fiscal year. Compared to an average of 11% annual growth target during the period, the actual growth performance was 9.2% (i.e. 1.8% short of the target). When the economic growth performance is disaggregated into major economic sectors, agriculture, industry and services respectively registered an average annual growth rate of 5.3%, 17.2% and 9.7% (See Table 7.1).

**Table 7.1: Growth in gross domestic product by major economic sectors (%)**

	Average growth rates		
	2010-2015	2016-2020	2010-2020
Agriculture	6.6	4.1	5.3
Crop	7.5	4.8	6.1
Livestock	5.0	2.5	3.7
Industry	19.1	15.2	17.2
Manufacturing	15.1	13.0	14.1
Construction	27.7	17.3	22.5
Service	11.1	8.2	9.7
Wholesale and retail trade	11.7	8.9	10.3
Transport and communication	13.0	11.5	12.2
Financial industry	11.4	12.5	11.9
Gross domestic product	10.1	8.2	9.2

Source: FDRE Planning and Development Commission

The agricultural sector, on average, contributed 24% to the GDP growth, whereas the crops sub-sector contributed 72.7%. Similarly, the industry sector contributed 37.9% of which the construction and manufacturing sub-sectors respectively contributed 77.1% and 22.8% to the overall industry sector GDP growth performance. This shows that the major source of gross value additions (GVA) registered in the industry sector has been the construction sub-industry. On the other hand, the service sector has contributed 40.8% to the GDP growth. The wholesale and retail trade sub-sector had the share of 37.8% within the services sector. In general, the overall economic growth performance shows that construction, crops, and wholesale and retail trade were the main sources of supply side growth, in that order.

Based on current prices, the economy registered an average growth of 9.2% per year from 2009/10 to 2019/20 years, and nominal GDP increased from Birr 395.9 billion in 2009/10 to Birr 3.37 trillion in 2019/20. From the demand side, total final consumption expenditure contributed 79% to GDP where more than three-quarters of this has been attributed to the private final consumption expenditure (see Table 7.1). On the other hand, total investment, exports and imports of goods and services, on average, were 35.1%, 10.1% and 25.9% of GDP, respectively.

The share of gross domestic investment (as% of GDP) increased from 31.1% in 2009/10 to 38.4% in 2015/16. However, because of the prevailing political instability during much of 2016/17, domestic and foreign direct investment slowed down, and similarly, government capital expenditure decreased. This brought the share of total investment (as a percentage of GDP) down to 34.1%. Nevertheless, following the political transition that took place in 2017/18, total investment performance improved during 2018/19 and the share increased to 35.2%. In 2019/20, however, due largely to the COVID-19 pandemic, the share of total investment declined to 30.8%.

**Table 7.2: Share of final consumption expenditure in GDP (%)**

	Average share (as % of GDP)		
	2010-2015	2016-2020	2010-2020
Total final consumption expenditure	80.7	77.6	79
Government final consumption expenditure	10.5	10.2	10.3
Private final consumption expenditure	70.0	67.5	68.7
Total investment	35.0	35.2	35.1
Exports of goods and services	12.5	7.8	10.1
Imports goods and services	29.5	22.2	25.9
Resource balance	(17.1)	(14.5)	(15.8)
Gross domestic savings	19.3	22.4	21

Source: FDRE Planning and Development Commission

Net export (the difference between export and import trade) has shown a widening gap and the annual average resource deficit was 15.8% per year in the 10 years up to 2020. This was mainly attributed to the fact that export performance has been very weak, and the country's productive capacities to generate export earnings were limited. Moreover, the overall economic growths were largely dependent on import trade.

The rate of gross domestic savings rose from 17.3% of GDP in 2009/10 to 20.9% of GDP in 2019/20. Similarly, GDP per capita registered an average annual growth of 10.7% and as a result, it increased from USD 389 in 2009/10 to USD 1,080 in 2019/20.

The poverty headcount ratio at the national poverty lines (percentage of population) reduced from 29.6% in 2009/10 to 23.5% in 2014/15 and the poverty rate went down from 30.4% in 2009/10 to 25.6% in 2020 in the rural areas. Similarly, urban poverty rates fell from 25.7% to 14.8% during the same period. With regard to equitable distributions of growth, Gini Coefficient has increased from 0.30 in 2009/10 to 0.33 in 2014/15. During this period, the Gini Coefficient in rural areas went up from 0.37 to 0.38 while in the urban areas it increased from 0.27 to 0.28.

On the other hand, the urban unemployment rate showed that an upward trend in both sexes. The unemployment rate increased from 18% in 2009/10 to 18.7% in 2019/20. The youth (aged between 15 and 29) unemployment rate was on average 25.7% in 2019/20, a significant increase when compared to the total urban unemployment rate. When it is seen in terms of gender decomposition, urban unemployment rate of men in 2009/10 was 11.4% while it was 25.3% for women. The unemployment rate went up for both sexes and reached 12.2% for men and 26.1% for women in the urban areas in 2019/20 respectively.

### Major Development Challenges

Despite the faster and high economic growth, the economy has encountered several challenges in terms of sustaining the growth and making all citizens equitably benefit from the growth proceeds. The major challenges are identified below. :

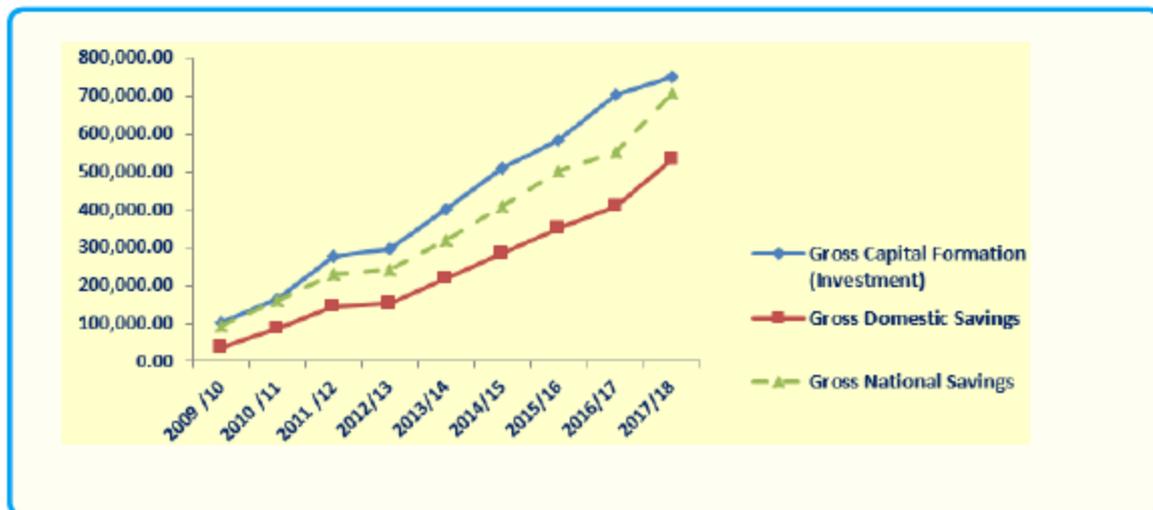
Failure to ensure quality economic growth: although high economic growth was registered, there were gaps in terms of creating adequate job opportunities, ensuring equitable distributions, and structural transformations, and creating sectoral linkages and synergies.

External debt distress: besides the lack of or limited competitiveness in international markets, our domestic products were also not able to compete with imported commodities. The bulk of Ethiopia's export commodities come from a limited number of agricultural products without significant value additions. Moreover, domestic productions were unable to fulfil the demand for input for domestic economic activities and industrialization. As a result, the economy largely depended on import, and the demand for imported commodities increased from year to year and the gap between export and import trade widened.

Imbalance between domestic savings and investment: Ethiopia experienced a high rate of growth in investment between 2010 and 2020. However, domestic savings were unable to satisfy the domestic investment demand, causing large investment-savings imbalance.

To realize the objective of boosting domestic saving, a host of reform measures were undertaken during the GTP-I and GTP II period in Ethiopia. The measures include: awareness creation and community mobilization activities, expanding financial institutions (banks) and services, raising the minimum deposit rate, strengthening existing and introducing new saving mobilization instruments such as saving for housing programmes, Renaissance Dam Bond, introducing private social security schemes, strengthening government employees social security scheme, etc. Besides these measures, allocating government expenditure on capital investment that augments capital accumulation has also been used to increase domestic saving. Accordingly, the share of gross domestic saving in GDP increased from 9.5% in 2009/10 to 24.3% in 2017/18 from 22.4% in 2014/15 end of GTP-I period and slightly lower than the 24.6% GTP II target for the fiscal year. In parallel with the increase in domestic savings, the rate of gross national savings in GDP ratio also increased from 24.7 in 2009/10 to 32.2% in 2017/18. The difference between the two rates was mostly covered by net current transfer from the rest of the world.

At the same time, the share of gross domestic investment in GDP increased from 22.3% in 2009/10 to 34.1% by 2017/18. This domestic investment ratio is believed to have made a significant contribution to the rapid economic growth registered during the planning period. This very high investment rate is the result of both private and public investment spending.



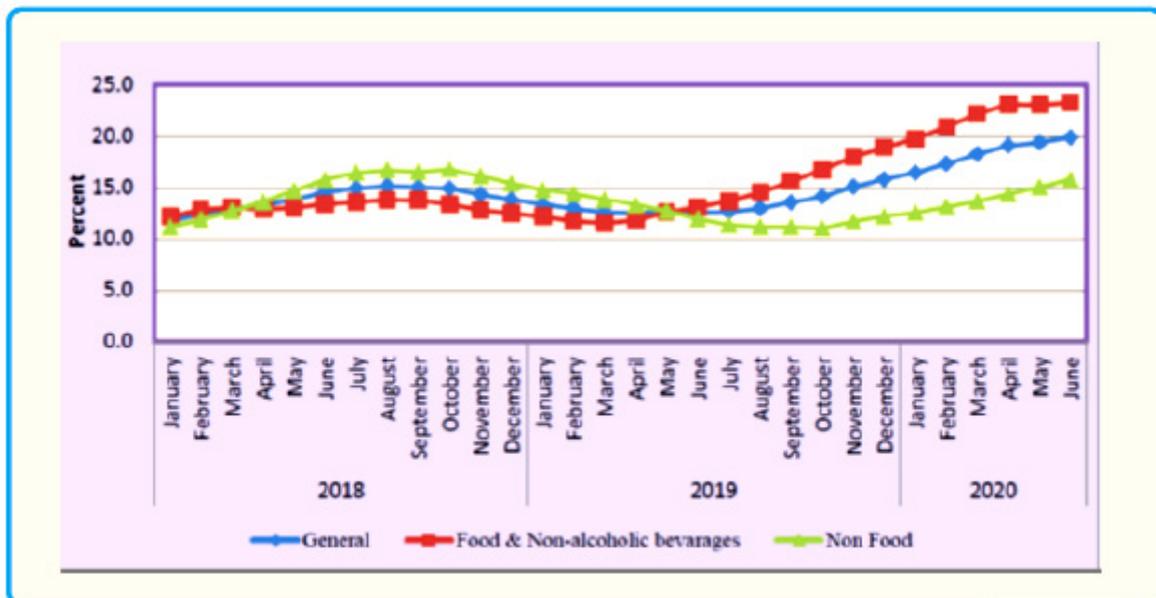
**Figure 7.1** Gross domestic saving. Gross national saving and Investment

Source: *Ministry of Finance and Economic Development (MoFED) annual reports*

Challenges to stabilize inflation: although there are numerous factors that can cause inflation, high and persistent inflation is evidently highly associated with macroeconomic instability. The persistently high inflation rate registered over the past years, which exposed citizens to high cost of living, put the sustainability of the economic growth into question by affecting the sustainability of investment.

Historically, the Ethiopian economy was known for its low inflation. Prior to 2003/04, the country had not suffered from high inflation. The major hikes in the general price level occurred during the times of war and drought only. However, since 2003/04 Ethiopia has experienced the highest inflation and higher inflation rate of 55.2% was recorded during 2008. The major causes for this were the then high fuel and food prices shocks, weaker foreign exchange earnings, and rising demand for imports that depleted foreign currency reserves of the country. The highest prices were for food, housing, fuel and transport services. It is the effects of inflation that makes the urban poor the most vulnerable.

In 2019/20, the annual average headline inflation rose to 19.9% from 12.6% in the previous year. This was largely owing to a 10.2% rise in food and non-alcoholic beverages inflation from 13.1% to 23.3% and a 3.9% increase in non-food inflation from 11.9 to 15.8%. Likewise, annual average non-food inflation scaled up by 3.9% and reached 15.8% in 2019/20 due to higher inflation in alcoholic beverage and tobacco (11.9%), transport (11.0%), housing, water, electricity, gas and other fuels (9.6%), restaurant and hotel (4.3%), recreation and culture (2.8%), communication (1.5%), health (1.3%) and miscellaneous goods (0.8%). Similarly, headline inflation surged to 21.5% from 15.3% in the previous year on account of a 3.3% increase in food and non-alcoholic beverages inflation and 9.2% in non-food inflation (Figur.7.2) (NBE2019/20).



**Figure 7.2** Developments in Average National Inflation Rates

Source: MoFED annual reports

Rise in unemployment: one of the key indicators of a stable macroeconomic is the creation of adequate and decent employment opportunities. In general, the high economic growth registered over the past 10 years (between 2010 and 2020) was unable to create sufficient job opportunities, and failed to bring the desired increase in the standard of living for most citizens.

Sluggish structural transformation and weak sectoral linkages: between 2010 and 2020, the process of transition from a low productivity agricultural sector to sectors with high productivity was very weak. Ethiopia's export has always been dominated by a small number of agricultural products and has failed to transit to exports led by manufacturing products in order to secure sustainable and reliable export earnings.

Poor capacity to mobilize domestic resources: although Ethiopia's capacity to collect taxes improved, the tax to GDP ratio dwindled. The government's commitment to improve the overall public resource management and its efforts to minimize misallocations of public expenditure is minimal.

Limited accessibility of financial institutions: between 2010 and 2020. State-owned commercial and development banks channelled a significant amount of long-term loans to state-owned development enterprises with inadequate appraisal and monitoring. This affected the supply and quality of loans issued by the commercial banks. On the other hand, insurance companies were restricted to the provision of traditional services, and their licenses in diversifying to other services and products hampered growth in the insurance industry. In general, although the financial infrastructure shown growth, it was not commensurate with the level of growth of the economy and its accessibility was low.

Deficient and low quality provisions of social services and basic infrastructure: between 2010 and 2020. Although particular attention was paid to the expansion of roads, railways,

energy, irrigation and various infrastructure development activities, there were still significant deficiencies in the supply when compared with the demands across different geographies. There was also a wide gap in terms of quality infrastructure provisions. There were also deficiencies in social service provisions, particularly in health and education. Moreover, evidence indicates that the accessibility of social services was very low, and wide gaps in equitable distribution of basic services were observed between urban and rural areas. This has affected attempts to create equal opportunity for all citizens.

Limited government capacity and widespread malpractices: between 2010 and 2020. Limitations in government capacity were evident in terms of achieving the development goals set in various sectors. In particular, besides the limited capacity and coordination failures observed in areas of project management, there was serious resource wastage and corruption. There were no robust systems established in order to correct the failures and ensure accountability.

### **7.3.4 National Development Plan after a Reform (2021-2030)**

The ten-year development plan lays a long-term vision of making Ethiopia an “African Beacon of prosperity” by creating the necessary and sufficient conditions. Ensuring high per capita income through rapid economic growth is one of the sources of prosperity, but not a measure of prosperity on its own. Prosperity is largely defined in terms of happiness, improvement in standard of living and quality of life, and the level of complete satisfaction created by the overall capability we build through economic gain, human and social development by harnessing tangible and intangible wealth, including social capital and natural resource wealth. Hence, prosperity should be defined in terms of the overall human and institutional capability created over the long-term whose development outcomes can be expressed as follows:

1. Improvement in income levels and wealth accumulations so that every citizen will be able to satisfy their basic needs and aspirations.
2. Basic economic and social services such as food, clean water, shelter, health, education, and other basic services should be accessible to every citizen regardless of their economic status.
3. Creating an enabling and just environment where citizens will be able to utilize their potentials and resources so that they can lead a decent quality life.
4. Improvement in social dignity, equality, and freedom where citizens can freely participate in every social, economic, and political affairs of their country regardless of their social background.

#### **Objectives of the Development Plan**

To achieve the national long-term plan of making Ethiopia an African beacon of prosperity, the following major development objectives are:

1. Building a prosperous country by creating a pragmatic market-based economic

system and enhancing the role and participation of the private sectors.

2. Maintaining macroeconomic stability, ensuring rapid and sustainable economic growth, and creating decent jobs.
3. Ensuring structural economic transformation by promoting overall productivity, and competitiveness.
4. Creating an enabling environment where every citizen will become the owners and beneficiaries of the development endeavour by ensuring the quality and accessibility of basic social services and the provision of infrastructure.
5. Ensuring a competent, independent, and quality civil service system by building the capacity of the government and establishing good governance.
6. Building strong and inclusive institutions that will ensure peaceful society, access to justice and upholding the rule of law and human rights.

### **Strategic Pillars and Key Priority Areas**

The overall development goal is to achieve improved welfare of the society by improving the standard of living and quality of life that are captured in the broader national prosperity vision. The key strategic pillars of the ten-year development plan are:

1. Quality economic growth and shared prosperity
2. Economic productivity and competitiveness,
3. Technological capability and digital economy
4. Sustainable development financing
5. Private sector-led economic growth
6. Resilient green economy
7. Institutional transformation
8. Gender and social inclusion
9. Access to justice and efficient civil Services
10. Regional Peace Building and Economic Integration.

From the national prosperity vision, development objectives and strategic pillars, a set of overarching priority areas are identified for the efficient allocation of resources, as well as the effectiveness of reforms, policy initiatives and implementation actions. The priorities are set for the medium-term to provide substantial milestones for the long-term development plan against which progress will be measured. These key priority areas are the basis for the homegrown economic reforms and policy direction at the macroeconomic and sectoral levels. These key priority areas are:

1. multi-sectoral and diversified sources of growth and job opportunities
2. sustainable and inclusive financial sector development
3. harnessing the demographic dividend
4. quality and efficient infrastructure development
5. sustainable urban development
6. peace, justice, and inclusive institutions.



## Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding about national development plan objectives and strategies, and an historical overview of the national development plans of the monarchy, military and EPRDF governments.

Read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Can you explain the overall objectives of setting national development plans during the monarchy period?		
Can you list the challenges faced by the EPRDF development plan adopted for 2002/03 – 2004/05?		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and reread about it.

## 7.2 Overview of Home-grown Economic Reforms in Ethiopia

### Overview

Dear learner, in this section you will study about home-grown economy reforms in Ethiopia and the needs for reform.

### Learning Outcomes

*At the end of this section, you will be able to explain the home-grown economy reforms and the needs for the reform.*

### Key Concepts

- ☞ Home-grown economic reform (HGER) reform?
- ☞ Objectives of home-grown economic ☞ Macroeconomic Reforms

Dear learner, what important ideas come into your mind when you think of new home-grown economic reform taken by the Ethiopia government? Have you attempted? Oh, it is appreciable. Now, have a look at the next text about home-grown Economic Reforms in Ethiopia.

The rapid and sustained economic growth that Ethiopia registered between 2010 and 2020 which is mainly driven by aggregate demand and it was recorded largely as a result of the

expansion of government funded large-scale infrastructure developments. These public investments were financed through heavy debt and external aid. The manner in which these public investments were realized and the rapid growth achieved over the years has also caused continuous inflationary pressures. In addition, despite its rapid growth, the economy failed to raise productivity and create adequate job opportunities. Due to the heavy debt burden, it has become challenging to sustain the rapid pace of the growth, calling for a new growth financing approach doing away from the heavy reliance on public spending and debt financing.

The home-grown economic reform (HGER) with the central objectives of sustaining rapid growth, maintaining stable macroeconomic environment by reducing debt vulnerabilities and creating adequate and sustainable job opportunities has, therefore, been domestically initiated. The economic reforms are being translated into action through policy that enhances the supply side of the economy. The main aim and focus of the HGER is the enhancement of productivity and competitiveness of the overall economy, and a gradual transition from public to private sector-led growth. As a result, a stable macro economy will be ensured and the economy should be able to generate adequate jobs to arrest the rampant unemployment and the inflationary pressures. The HGER plan is classified into macroeconomic reforms, sectoral reforms, and structural reforms.

### **Macroeconomic Reforms**

In order to eliminate macroeconomic imbalances and create a stable macro economy, strict macroeconomic management has been put in place. With regard to the overall macroeconomic management, strict monitoring has been put at work, and the following key focus areas have been identified in the macroeconomic reform plan.

- ✓ Ensuring fast, sustainable and broad-based economic growth. Reform efforts have been underway across various sectors of the economy to ensure high economic growth that has been slowed over recent years. The efforts are being implemented in the way that involves several actors in the economy including the private sector and development partners. Evaluation of past development plans has been thoroughly done in order to learn from past strengths and rectify the weaknesses through the experiences gained from the challenges so as to design and implement inclusive development plans in the future. Economic growth performance that has been registered over the past years has been assessed in detail and it has been used as an input for subsequent reform measures.
- ✓ With regard to the fiscal policy reform process, new operational mechanisms are taking effect to modernize and enhance tax collection capacity as well as citizens' awareness about tax paying duties and responsibilities, proper public expenditure management and strict reform actions in the public debt management. The operational dimensions of the fiscal reform process mainly focused on making the overall tax administration fair, transparent and accountable. Similarly, strict justice sector reforms and operations have targeted the informal sector and contraband, which has a detrimental impact on domestic income, and the business community. These measures have already started

showing encouraging results.

- ✓ Moreover, budget administration and auditing system have given due attention. Strict auditing and monitoring is necessary in order to ensure that the allocated budget is utilized for the intended social and economic purposes by ensuring that development projects designing follows thorough appraisal and feasibility studies. Proper administrations and systems have also been designed to facilitate support, monitoring and accountability so as to complete the projects within the timeline and without leading to waste of resources.
- ✓ With regard to the financial sector reform process, the ultimate objective is ensuring financial stability and inclusion, and promoting productivity and competitiveness of the private sector and thereby solving structural financing constraints of the economy by encouraging domestic savings and facilitating credit supply for the private sector investment. In order to achieve this goal, it was found necessary to undertake market-oriented financial sector reform, through which the financial sector will eventually promote market-based interest rate and foreign currency exchange rate determination, establishing and expanding capital markets, and strengthening the monitoring and regulatory capacity of the National Bank of Ethiopia.
- ✓ Several policy reform measures have also been initiated to expand the inflow of foreign currencies. Particular emphasis has been paid to identify structural constraints of export market performance and taking macroeconomic reform actions to improve the diversification of export commodities by addressing the supply side problems of low production capacity and productivity. These reform processes has not only targeted broadening the export base, but also creating value additions to export commodities so that the competitiveness of the economy in the regional and global value chains will improve.
- ✓ Emphasis has also been paid to other sources of foreign currency inflow. For instance, in order to increase the inflow of remittances, the reform aims to eventually broaden the incentive structure to encourage the diaspora to send foreign currencies through the formal banking system. Moreover, the promotion of quality foreign direct investment is also vital not just for the inflow of foreign currencies but also for technological transfer and creation of job opportunities. Similar focuses have been paid to reforming the overall foreign currency allocation directives and policies to promote the predictability and efficiency of foreign currency allocations across different sectors of the economy.
- ✓ With regards to external public debt, the macroeconomic reform process emphasized two main aspects and these are minimizing the commercial external loans, searching more for concessional loans and rescheduling the existing external public debt.

### **Sectoral Reforms**

The country will follow a multi-sectoral growth approach by diversifying sources of economic growth and job creation and undertaking necessary and substantive policy reforms across the different sectors. In this context, particular attention has been given to the agricultural, manufacturing, mineral tourism sector and the ICT sector as sources of growth.

1. Agriculture: in the past, the agricultural sector has received particular attention, yet it is still characterized as the lowest productive in its performance. During the HGER process, there have been significant political commitments to improve research and development in agriculture and to improve all-rounded support given to all actors in the agricultural sector. From this perspective, the HGER agricultural sector reform aims to improve the role and participation of the private sector, expanding of small- to large-scale irrigation development, improving supply of inputs and finance, enhancing the productivity of livestock, protecting the environment and natural resources, improving agricultural production methods, reducing post-harvest loss, promoting research-based food security systems, and promoting import substituting major agricultural crop production.
2. Mining: based on global and regional experiences, existing mining policies and legal frameworks have been under the reform process so as to create a conducive investment climate and attract a large number of foreign and domestic investors into the subsector. Particular emphases have been given to the promotion of geological data and their dissemination for mining investment promotion. As Ethiopia is at the early stage of mining subsector development, the role of the government in terms of infrastructure development and other targeted support in the subsector is vital for boosting private sectors' confidence and trust.
3. Tourism: although Ethiopia is endowed with abundant tourism destinations, the subsector has not fully utilized the available opportunity. As the subsector has a characterized with high potential for domestic and foreign revenue generation, and job creating opportunities, the tourism reform has paid particular attention to improving and expanding tourism destinations and related infrastructure, as well as improving the role and participation of the private sector.

### **Structural Reforms**

Although the role of government in the economy shall continue, adjustments and reforms will be made based on strategic policy performances and prevailing conditions. It is, in fact, very important that the government plays a role in the economy, and in particular, through public investments and lead the overall economy to a desired direction based on market principles. In order to ensure an efficient government intervention, thorough studies would be conducted to see if there are failures that call for government interventions, and also to evaluate the feasibility of any government interventions in order to make sure that the necessary capacity and resource is available to implement the identified public project. It should also be noted that any public development projects, whether they are still at inception phase or even after completion, could possibly be handed over to private investors through fair and transparent approach, as long as the private investor has the necessary capacity and resources to take the projects forward.

The ultimate goal of government intervention is to create strong private initiatives or investment in the economy, and hence the government intervention process should not crowdout private investors but it should encourage their participation in the economy. The

government should support all development forces including private investors not on the basis of their proximity to political elites or power but based on their merits and performances. Broad-based policies and administrative interventions have been put in place to encourage the participation of the private sector in all sectors of the economy, and it has been made sure that all future policy reforms and interventions should enhance the private initiatives. Since the private sector has an indispensable role in creating job opportunities, the government is determined to put the necessary policies and administrative structures in place to assist the private sector development in priority sectors such as agriculture, manufacturing, mining, tourism and ICT.

Other focus areas of structural reform processes include:

- ✓ Ensuring coordinated transport and logistics services: by reducing the transit time and costs of trade, the reform is mainly emphasizing on the competitiveness of agricultural and industrial products, accessibility of coordinated transport services in order to sustainably support the investment and business activities of foreign and local investors, and improving the quality and effectiveness of transport corridors for import and export activities and improving stations providing dry port services.
- ✓ Implementing import substituting development strategy: maintaining the fact that our economic development strategy is outward-looking guided by international integration, extensive domestic support and policy intervention is designed to substitute the import of some strategic commodities that consumes large sums of foreign currencies including food items, edible oil, wheat, and other commodities by domestic productions.
- ✓ Reforming the investment and job creation landscape: in order to encourage domestic job creation as well as direct foreign investment, industrial parks that have been established so far and have the necessary infrastructure should be put to maximum capacity utilization by providing the necessary infrastructure. Furthermore, efforts have been consolidated to improve the overall investment and business environment, eliminate unnecessary bureaucracy and improve the supply of finance under the Ease of Doing Business initiative.
- ✓ Increasing the role and participation of the private sector in the economy: broad-based domestic economic reforms have been under way to thoroughly examine the role that the private sector had in the economy and the challenges it encountered and then to create favourable conditions to enable the sector play the role expected of it in a more appropriate and better way. A lot of endeavours are in progress to make the bureaucracy support and encourage, as opposed to hindering or crowding-out, the participation of foreign and domestic investors and improve the country's business environment. This reform works in line with the reform in the financial and other sectors so as to make Ethiopia a start-up nation in terms of investment promotion and job creations.
- ✓ Expediting the privatization of large state-owned enterprises and liberalization of priority sectors: once the transfer of selected state-owned enterprises to the private sector as well as liberalization of selected sectors is completed, it is expected to bring about a significant change in the efficiency and quality of economic growth and job opportunities.

- ✓ Strengthening Ethiopia's global and regional partnership: the ongoing negotiation for accession to the World Trade Organization (WTO) as well as the ratification of the African Continental Free Trade Area (AfCFTA) proves Ethiopia's HGER commitment to boost the trade and investment partnership both at the global, continental and regional levels. The significance of linking our economy with that of the continent and the region is so paramount. As a land-locked economy, our domestic reform process will embrace strong partnerships to develop across-country development infrastructure and different ports together with our neighbours. Such cross-country partnerships will not only reduce transportation and trade costs, but also ensures shared prosperity.
- ✓ Promoting free movement of labour: in order to alleviate the high rate of unemployment in the country, it is necessary to design mechanisms that ensure free mobility of skilled labour both domestically as well as internationally.
- ✓ Promoting the development of civic societies: domestic reform processes are designed to create a conducive environment for civic societies to play a significant role in economic, social and political activities. Despite the popular misconception about the role and participation of civic societies, promoting the role of civic societies does not stunt the role of the government but facilitates genuine transition to democracy, including for the media, in which ideas and thoughts freely circulate and thereby renders the government effective. This is a way of building a political economic outlook that includes citizens' political and moral authority. It helps to correct previous challenges and exhaustively utilize the capacity that is created as a result of free expression of thoughts. It is necessary to see all actors as an integrated whole. This, in the main, facilitates the opportunity to recognize and appreciate the key roles that all stakeholders play and their impacts. It also helps to understand that development does not focus only on incomplete material being but also expands to multifaceted freedoms to have its complete meaning.
- ✓ Diversifying Ethiopia's development partnerships and the sources of development finances: domestic policy reforms that are designed to secure different sources of development finance depend largely on the strong relationship and partnership with multilateral and bilateral development partners. Moreover, the partnership with development partners encourages technical assistance in different areas of capacity building both for government and private sectors. A diversified development partnership is expected to encourage our development partners to, in addition to providing development aid, motivate their investors to invest in our economy. The contemporary practices of the flow of international development finance do not necessarily follow the conventional approach. Multilateral forums and bilateral financial sources that were previously major sources of development finance for developing countries are dwindling and are being substituted by new bilateral arrangements and agreements. With this understanding, reforms are being domestically tailored to enable Ethiopia properly benefit from the current global supply of development finance.

## Self-test Exercise

Dear learner, we hope that you have read what is discussed in the above sections. Haven't you? That is nice of you! Hence, you need to test yourself whether you have understood what you have read or not by trying the following Self-test exercise.

1. Define home-grown economic reform.
2. List the major objectives of home-grown economic reform.



## Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding about home-grown economic reform, and the major objectives of home-grown economic reform. Read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Can you define what home-grown economic reforms mean?		
Can you list the major objectives of home-grown economic reform?		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and reread about it.

## 7.3 Fiscal Decentralization

### Overview

Dear learner, in this last section of the unit you will study about fiscal decentralization and identify the advantages and disadvantages of decentralization.

### Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ explain main objectives of fiscal decentralization.
- ❑ identify the advantages and disadvantages of decentralization.

### Key Concepts

- ☞ Fiscal decentralization
- ☞ Disadvantages of decentralized system
- ☞ Advantages of decentralized system

Now, before going to read the details in each of these concepts, write down short note of your own about fiscal decentralization, advantages and disadvantages of decentralized in an economy. Then, compare what you have written with the discussion under each of the concepts.

Fiscal decentralization generally refers to the devolution of taxing and spending powers from the control of central government authorities to government authorities at sub-national levels (regional, provincial, municipal, etc.). It deals with studies of which function /expenditure and which instruments/revenue are best centralized and which are best placed in the sphere of decentralized levels of government.

Nowadays in the world many governments including that of Ethiopia are structured into federal systems. However, one federal system differs from another. One country is more centralized than others (i.e. more of its decisions making power are in hands of authorities with a large jurisdiction). The extent of centralization can be measured by centralization ration which is direct government expenditure by central government divided total government expenditure. Direct government expenditure excludes federal grant/transfers.

In Ethiopia, the federal government makes fiscal equalization payments to local governments with the stated goal of equalizing the fiscal capacity of local governments to provide services. It helps regional governments to provide similar sets of public services to their citizens with similar tax incidence. Fiscal equalization aims at reducing or eliminating differences in net fiscal benefits which is the difference between the utility that households derive from consuming public services and the taxes they pay for producing these services. It is a companion of fiscal decentralization which ensures economic governance such as equity, efficiency and stability of fiscal policy.

In the past ten years 2010 to 2020, additional budgetary support has been provided for regional governments to finance capital projects that help achieve the targets of the Millennium Development Goals and Sustainable Development Goals (SDGs). For instance, in 2017/18, Birr 7 billion has be allocated to regional states as per the grant formula for the implementation of the Sustainable Development Goals (SDGs). This also to enhance fiscal equalization and narrow regional disparities in basic social services such as education, health, water and sanitation.

### **Disadvantages and Advantages of Decentralized System**

Most economists agree that spending and taxing decision intended to stabilise (price stability and reduce unemployment) should be made by central government. Local/ state government too small to affect overall economic activity, national governments themselves are finding difficult to influence the economy in this era of globalization requiring action for world government. With respect to the microeconomic activities of efficiency and equity there is disagreement among economists. There are both opponents and proponents.

#### **Disadvantages of Decentralized System**

Interstate/local externalities: there are costs and benefits of local government goods and

services to residents who live in other political jurisdictions. These externalities (positive or negative) create problems for the efficient operation of a federal system. Think of localities /state as a firm producing local public goods such as like Education, sewage

Loss of scale economics in provision public goods: for certain public services the cost per person may fall as the number of user's increases. For example, the more people who use public library, the lower the cost per user. If each community constructs its own library (decentralization) costs per user are higher than necessary. Thus, consolidation is one way to for communities to take advantage of scale economies. Of course, various activities have different scale economies and optimal scale.

Inefficient tax system: efficient tax requires higher a tax rate on inelastic demanded or supplied goods and vice versa. Goods which are inelastic at national level may be elastic at local level. Some goods like capital though inelastic at national level are elastic at local level. But local government usually imposes little tax on capital to promote investment which inefficient from national point of view.

Loss of scale of economies in tax collection: individual communities may not be able take advantage of scale economies in the collection of taxes. Each community has to devote resources (labour, equipment, etc.) to tax administration, made may be made by having a joint taxing authority.

### **Ineffectiveness of redistributing programme (equity measures)**

Suppose the tax and expenditure pattern in a particular community is favourable to the poor. It transfers income to the poor. This attracts more poor to this region and expels the rich (tax payers) out of this region. Finally, the region left with small tax base which leads to abandonment of the programme.

### **Advantages of Decentralized System**

Decentralization renders a number of benefits. They include tailoring output to local taste/local specific, fostering intergovernmental competition, and experimentation and innovation in locally provided public goods and services.

Tailoring output to local tastes/local specific: peoples in different regions and communities have different tastes and preferences. A centralized government tends to provide the same level of public services throughout the country regardless of the fact that peoples tastes differ. Under a decentralized system, individuals with similar tastes for public goods group together, so communities provide the type and quantities of public good desired by their inhabitants. A closely related notion is that local government's greater proximity to the people makes it more responsive to citizen's preference than central government. In the same way, economic regulations enacted at the national level may not make sense in every community.

### **Fostering intergovernmental competition**

It is believed that government managers lack incentives to produce at minimum possible

cost. Private firm managers will be out of business if they fail to minimize cost. But public managers can continue. But if citizens can change among communities/states, it creates incentive for governments' managers/ administrators to produce efficiently and to be more responsive to citizens so as to be able to attract productive citizens.

Experimentation and innovation in locally provided public goods & services: For many policy questions no one is certain what the right answer is, or even whether there is a single solution that is the best in all situations. One way to find out is to let each community choose its own way and then compare the results. The case in Ethiopia is different. One policy used across all parts of the region in the country. Therefore, purely decentralized or centralized system cannot be expected to maximize social welfare. There is some optimal level of federalism.

Dear learner, how did you find the discussions above? Is everything clear? If not, please reread it before doing the following Self-test exercises. Is there anyone who is distance learner like you nearby to you? If there is, get him/her face to face and ask each other if there are points which are not clear. That is nice of you! Now, go on answering the following self-test exercise.

### Self-test Exercise

1. What are the main objectives of fiscal decentralization?
2. What are the advantages and disadvantages of decentralization?



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding about fiscal decentralization and identify the advantages and disadvantages of decentralization.

Read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Can you explain the main objectives of fiscal decentralization?		
Can you mention the advantages and disadvantages of decentralization of systems?		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and reread about it.



### Unit Summary

Under the Monarchy, three Five-Year National Development Plans were implemented:

1957-61, 1962-67, and 1968-73. The National Development Plans formulated under the Derg aimed at the establishment of a socialist state through nationalization of private enterprises and through restructuring the economy. The Ethiopian People's Revolutionary Democratic Front (EPRDF) government initiated the Five-Year Development Programme known as Peace, Democracy and Development Programme which emphasized the interrelationships between peace, democracy and development.

Sustainable Development and Poverty Reduction Programme (SDPRP) was launched in 2002 following wide-ranging public consultations in 2001 and covered a period of three years 2002/03 – 2004/05. The PASDEP was Ethiopia's second poverty reduction strategy, covering the period between 2005/06 and 2009/10. It was built on the directions pursued under SDPRP and aimed at private-sector development and at the scaling up of resources to achieve the MDGs (Millennium Development Goals).

GTP-I was the third national development plan covering the period between 2010/11 and 2014/15. GTP-II was built on that of GTP I complemented by additional pillar strategies that serve as foundation for sectoral plans. During the implementation of the two Growth and Transformation Plans (GTP I and II), Ethiopia has registered rapid and high economic growth. Despite the faster and high economic growth that was realized over the past ten years, the economy has encountered several challenges in terms of sustaining the growth and making all citizens equitably benefit from the growth proceeds.

To achieve the national long-term plan of making Ethiopia an African beacon of prosperity, a 10 years plan was formulated. The home-grown economic reform (HGER) with the central objectives of sustaining rapid growth, maintaining stable macroeconomic environment by reducing debt vulnerabilities and creating adequate and sustainable job opportunities was therefore, been domestically initiated.



## Unit Review Exercises

### Part I: True or False

Read the following sentences and write "True" for correct sentences and "False" for incorrect ones.

1. During the late 1940s and the 1950s, the government focused its development efforts on expansion of the bureaucratic structure and ancillary services.
2. The Imperial, Derge and EPRDF governments set and reformed different types of policies and reforms.
3. In 1974/75, Ethiopia made a transition from controlled economy to mixed economy.
4. The Third Five- Year Plan (1968–1973) shifted its focus to the development of the Industrial sector.

5. In order to eliminate macroeconomic imbalances and create a stable macro economy, strict macroeconomic management is crucial.
6. Private sector reform is undertaken to encourage the participation of the public sectors.
7. The National Development Plans formulated under the Derg aimed at the establishment of a socialist state.
8. The main objective of PASDEP was to lay out the directions for accelerated, sustained, and state-oriented development.
9. The Third Five- Year (1968 – 73) Development Plan shifted its focus to the development of the agricultural sector in order to address the rising problem of food shortages in Ethiopia.
10. In 1974/75, Ethiopia made a transition from controlled economy to mixed economy.

## **Part II: Multiple Choice**

**For the following question choose the best answer from the given alternatives.**

1. The first Growth and Transformation Plan (GTP I) was articulated through one of the following overarching objectives, except.
  - A. Maintaining at least an average real GDP growth rate of 11% per annum
  - B. Nationalizing Rural land and other productive assets
  - C. Expanding access and ensuring the qualities of education and health services
  - D. Establishing conditions for sustainable nation
2. To make Ethiopia an African beacon of prosperity, one of the following is **not** among the major development objectives.
  - A. Maintaining macroeconomic stability
  - B. Building strong and inclusive institutions
  - C. Ensuring structural economic transformation
  - D. None of the above
3. The key strategic pillars of the ten-year (2021-2030) development plan are:
  - A. Gender and Social Inclusion
  - B. Sustainable Development Financing
  - C. Quality Economic Growth and Shared Prosperity
  - D. All of the above
4. One of the following is not the major development challenges in Ethiopia for the last years:
  - A. External debt distress
  - B. Rise in unemployment
  - C. balance between domestic savings and investment
  - D. Challenges to stabilize inflation.
5. One of the following is **not** the advantages of Decentralized System

- A. Loss of scale economics in provision public goods
- B. Fostering intergovernmental competition
- C. Tailoring output to local tastes
- D. Experimentation and innovation in locally provided public goods & services

### Part III: Short Answers

For the following questions write short answers.

1. Summarize the economic planning and development that existed during the Derg (1974-1991).
2. List the objectives and strategies of the Five-Year National Development Plans during the Monarchy (1960-1973).
3. Discuss the goals and objectives of the peace, Democracy and Development Programme of the EPRDF government.
4. What are the advantages and disadvantages of decentralized government?
5. What is the major objective home grown economic reform?



## Answer Key for Self-test Exercises

### Part I: True or False

- |         |          |          |          |           |
|---------|----------|----------|----------|-----------|
| 1. True | 3. False | 5. True  | 7. True  | 9. True   |
| 2. True | 4. False | 6. False | 8. False | 10. False |

### Part II: Multiple Choice

- |      |      |      |      |      |
|------|------|------|------|------|
| 1. B | 2. D | 3. D | 4. C | 5. A |
|------|------|------|------|------|

### Part III: Short Answers

1. Give emphasis on a centrally planned economy. Industry-led development was deployed as the main development strategy. Rural land and other productive assets were nationalized, and land was distributed among farmers. Commercial farms were put under government control, and land tenancy was abolished. Furthermore, private commercial labourers and commercial farming were marginalized, and large collectivization programmes were promoted through resettlement and villagisation programmes. The military government maintained an overvalued currency and implemented marketing and pricing policies; in addition, the government established the Agricultural Marketing Corporation (AMC) to set pricing systems, for agricultural goods and quotas for grain production which were significantly lower than market prices.
2. The First Five-Year Plan (1957–1961) main objectives:
  - development of a strong infrastructure, particularly in transportation, construction, and communications, to link isolated regions.
  - establishment of a cadre of skilled and semi-skilled personnel to work in the processing

industries to help reduce Ethiopia's dependence on imports.

- acceleration of agricultural development by promoting commercial agricultural ventures.

The Second Five-Year Development Plan (1962-1967) continued to prioritize industrial development. Large-scale commercial farms for the production of cotton, coffee and sugar were promoted as a source of income over small-scale subsistence farms.

The second plan's main objectives were: to change Ethiopia's predominantly agricultural economy to an agro-industry alone and diversification of production, introduction of modern processing methods, and expansion of the economy's productive capacity to increase the country's growth rate.

The Third Five-Year Development Plan shifted its focus to the development of the agricultural sector in order to address the rising problem of food shortages in Ethiopia.

The third plan's main objectives were: raising manufacturing and agro-industrial performance, expansion of educational opportunities, and improvement in peasant agriculture.

3. The major goals and objectives of the programme were as follows:

- ✓ poverty alleviation through rapid economic growth.
- ✓ ensuring peace and security by strengthening a political system that promotes people's equality and fraternity guaranteeing administrative justice and peaceful coexistence with neighboring countries.
- ✓ people's participation in the democratic governance of the country.
- ✓ implementation of an efficient educational system and improvement in the quality of education.
- ✓ development of a governance system that ensures social justice.
- ✓ implementation of a prevention-oriented health care system-based cooperation and participation of the private sector.

#### 4. **Advantages of decentralized government**

- Decentralization renders a number of benefits. They include Tailoring output to local tastes/local specific, fostering intergovernmental competition, and experimentation and innovation in locally provided public goods and services.

##### **Disadvantages of Decentralized government**

Interstate/local externalities

- loss of scale economics in provision public goods
- inefficient tax system
- loss of scale of economies in tax collection
- ineffectiveness of redistributing programme

5. The main objectives of home-grown economic reform is sustaining rapid growth, maintaining stable macroeconomic environment by reducing debt vulnerabilities and creating adequate and sustainable job opportunities, enhancement of productivity

and competitiveness of the overall economy, and a gradual transition from public to private sector-led growth.

- a. Ensure macro-economic stability to sustain the rapid economic growth
- b. Rebalance the public and private sectors' role in the economy
- c. Unlock new and existing growth potentials



## References

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# UNIT 8

## ECONOMY, ENVIRONMENT AND CLIMATE CHANGE

Time Allotted: 16 hours

### INTRODUCTION

Dear learner, you should note the concepts of economy, environment and climate change are closely linked. This unit helps you explain these intricate links and their implications for sustainable development. The unit is divided into four sections. The first section explores economy's relation to environment. The second section examines the notions of global warming and climate change. The same section covers issues like the scope of the problem of climate change, its causes, indicators, impacts, vulnerability, and the means to deal with climate change, mainly via mitigation and adaptation. Section three seeks to explain the green economy and green growth. Finally, section four overviews the environment and climate change in Ethiopia.

### Learning Outcomes

At the end of this unit, you will be able to:

- ❑ understand the links between economics and the environment.
- ❑ know the interaction between development, population, resources and the environment.
- ❑ analyse climate change and global warming.
- ❑ summarise the causes, indicators, impacts, and vulnerability to climate change.
- ❑ appreciate the role of green economy for sustainable development.
- ❑ justify climate change and environmental policies of Ethiopia.

#### Unit Contents

##### 8.1 Economy and the Environment

##### 8.2 Global Warming and Climate Change

##### 8.3 Green Economy and Green Growth

##### 8.4 Overview of Environment and Climate Change in Ethiopia

#### Unit Summary

#### Review Questions

#### Answer Key for Self-test Exercises

#### References

Dear learner, we expect you to complete the unit in 16 hours. Please, assess your progress and performance by referring to the learning outcomes, self-test exercises and checklists of

your understanding. We expect you to learn at your own pace and cover some portions of the subject within a defined time frame as a requirement. We hopefully expect you to do this as an active learner!

## Learning Strategies

Dear learner, this unit introduces you to another cross-cutting issue of economy, environment and climate change. Please use the following and other learning strategies to successfully learn this unit. These strategies include:

1. Create a schedule and follow it.
2. Take the time to research questions and involve teachers.
3. Assess the technology used in the subject.
4. Utilize alarms and calendars to keep you abreast with deadlines.
5. Appreciate and value yourself.
6. Take part in distant discussions.
7. Search for different available learning opportunities that will help you to better understand the subject.

## 8.1 Economy and the Environment

### Overview

Dear learner, in this section, you will explore a cross-cutting issues of huge importance examines environment and the economy. In this section, you learn about interactions between rural development and environment, urban development and environment as well and population, resources and the environment.

### Learning Outcomes

***At the end of this section, you will be able to:***

- ❑ explain the interaction between the economy and environment
- ❑ understand the links between population and resources.
- ❑ summarise rural and urban development as well as urbanisation.

### Key Concepts

- ☞ Economy
- ☞ Environment
- ☞ Rural development
- ☞ Environmental degradation
- ☞ Population
- ☞ Urban development

## Economy and the Environment

A range of major forces are set to cause profound changes in natural and human environments across the world over the next 50 or so years. Examples include climate change, the growth of mega-cities, land degradation and the profound consequences of increasing global population which is consuming ever more natural resources (Foresight, 2011).

Economics is the study of the allocation of limited resources to satisfy human wants. The word “resource” is used synonymously with the factors of production (inputs). The commonly identified classes of production inputs include land, labour, capital, and entrepreneurship. Sometimes, energy is also specified as a separate production factor.

The fundamental principle of economic theory argues that economic resources are scarce in a sense that they are in finite quantities, whereas the claims to which these resources are put are at least to a reasonable extent limitless. The scarcity of resources implies that their use is costly and results in an opportunity cost.

We can identify natural and environmental resources as a subset of a more general category of economic resources. Resources provide a broader set of goods and services. Most environmental resources have become increasingly scarce, as the scale of economic activity expands. There is recognition that economic activities degrade and deplete the natural environment. In other words, the stability and resilience of the ecosystem can be threatened by excessive expansion of economic activities. Environmental resources are ultimately finite. Concern for exhaustion of future environmental resources is increasing and the need for conservation is growing.

Environmental resources can be classified into different categories. The prominent classification is between renewable and non-renewable resources. Biologically renewable resources include forests, fish, animal population, and biomass stock. We also have renewable physical stock which is capable of regeneration such as soil structure and fertility, the ozone layer, the earth's waste processing capacity. But both biological and physical renewable resources are potentially exhaustible. Hence, optimal and efficient growth and a sustainable development path has to be pursued. Some resources yield monetized flows such as forests, exploited oil, and minerals. Other resources yield non-monetized benefits such as fresh air, rivers, lakes, and oceans.

The concept of ecosystem is a complex set of interdependencies between the biological and physical systems and is continually in a dynamic process of development and change. The resilience of an ecosystem is a measure of the extent to which it can be subjected to disturbances without the system's parameters being changed. The threshold levels of some system variables can be reduced due to economic behaviour. These insights from ecology have important implications for human behaviour and in particular for the rates of depletion and harvesting of non-renewable and exhaustible resources.

Environmental resources around the world face rising pressures with severe consequences for future growth potential and the quality of life. Generally, the global ecosystem is a flow of raw materials and energy from the planetary sources, which then go through the economy, to the planetary sinks, receiving the wastes of the economic system. Underlying the pressure on the sources and sinks is the growth of the world population and industrial production (Swanson, 2012).

**Related terms**

- ✓ Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.
- ✓ Ecology deals with nature's allocation of scarce resources.
- ✓ Environmental degradation is when there is a decline in the quality of the natural environment in particular of air water and land quality.
- ✓ Depletion of natural capital is reduction in the stock of natural resources such as oil and gas reserves, stocks of fish etc.

Acute awareness about the environment is not new. It dates back to the 1950s with the growing concern over the great smog of London in 1952, the publication of Rachel Carson's *Silent Spring* in 1962 and the "Limits to Growth" report of 1972. The concern is borne of the fact that perpetual economic growth entails severe consequences for the environment. For example, resources may be used up quickly, while more and more by-products of production are dumped into the environment, which leads to severe environmental degradation.

***Is it then possible to achieve growth without further damage to the environment?***

At one point, it was widely believed that as per capita incomes rose, pollution and other forms of environmental degradation would first rise and then fall in an inverted-U pattern. Thus, as incomes rise, societies will have both the means and the willingness to pay for environmental protection. This idea is referred to as the "environmental Kuznets curve". The notion is related Kuznets's hypothesis which states that inequality would first rise and then fall as incomes increased (Todaro and Smith, 2015).

In spite of these theoretical arguments, the growing concern and commitment by the international community over environment and development persisted for decades. Examples include the publication of the Brundtland Commission Report "Our Common Future" in 1987, the UN Conference on Environment and Development (also known as the Rio Earth Summit) convened in 1992, the Kyoto Protocol signed in 1997, the Intergovernmental Panel on Climate Change (IPCC) formed in 1998 followed by the Millennium Development Goals launched in 2000, the Rio+20 Earth Summit in 2012, and the Sustainable Development Goals agreed in 2015.

Nowadays, economists increasingly focused on the implications of environmental issues for the success of development efforts. It has become obvious that classic market failures lead to environmental degradation. It has become equally apparent that the interaction

between poverty and environmental degradation can lead to a self-perpetuating process. This is sometimes referred to as the 'poverty environment nexus' whereby the poor are both agents and victims of environmental degradation. At the same time, the environment disproportionately affects the poor and poverty perpetuates environmental degradation. This happens, for example, when communities unintentionally destroy or exhaust the resources on which they rely for survival due to ignorance or economic necessity. The attendant environmental degradation diminishes the pace of economic development by imposing high costs on developing countries through reduced productivity of resources and health-related expenses. Undoubtedly, the damage to soil, water supplies, and forests resulting from unsustainable methods of production can greatly reduce long-term national productivity but paradoxically can show up as having a positive impact on current gross national product figures.

For as long as the solutions to environmental problems involve enhancing the productivity of resources and improving living conditions, achieving environmentally sustainable growth is synonymous with economic development. Hence, environmental considerations should form an integral part of development policy initiatives. It is also important that the long-term implications of environmental quality should be considered in economic analysis.

In the next sections, we will briefly focus on basic issues that define the economy and the environment involving linkages between the environment and rural development, urban development, population and resources.

### **8.1.1 Rural Development and Environment**

Rural development refers to the process of improving the quality of life and economic wellbeing of people who live in rural areas. When we say improvement, it includes people's livelihoods (e.g., provision of electricity, clean water, access roads, and education). Rural development has traditionally centred on exploitation of land-intensive natural resources such as agriculture and forestry. However, it has to be noted that changes in global production networks and increased urbanization have changed the character of rural areas.

Rural development as a development strategy is an intervention that focuses on the use of natural resources to address the challenges of the rural areas. The interventions include increasing agricultural production and supporting sectors such as education, health, water supply, natural resources, and environmental improvement. In this case, rural development is linked with agricultural development.

Some of the major issues that agriculture and agricultural development face in relation to environment include the use of pesticides, loss of agricultural land fertility, encroachment by increased and rapid urbanization, forest depletion, declining soil fertility, loss of topsoil, desertification and unsustainable rates of water usage, and air pollution (Perman et al, 2003).

The effect of population on the environment is thus, expressed in terms of population pressure and increased demand for food. First, this results in the intensification of soil erosion, natural depletion, destruction of soil structure (water holding capacity), and inorganic nutrients' application unbalances the soil structure. Second, there is the possibility of pollution from inputs such as fertilizer, pesticides, increased resistance of pests, biodiversity loss, reduction of resilience, sometimes irreversible salination, water logging and environmental degradation. There is also extensification (land expansion) which causes deforestation and desertification. Both intensification and extensification are associated with environmental problems.

In developing countries including Ethiopia, most people live in rural areas and agriculture is their main occupation. The prevalence of poverty means that rural poverty and environmental degradation interact. The following example shows how this happens.

Low income households cut trees for firewood and cultivate marginal land during the process of intensification of land use. The logging of trees and cutting of forests for cultivation leads to deforestation. These as well as overgrazing means the soil is exposed to flooding and erosion which in turn acts as factors in the cycle of rural poverty and environmental destruction.

### **8.1.2 Urban Development and Environment**

Urban development is the social, cultural, economic and physical development of cities and the underlying causes of these processes. It covers infrastructure for education, health, justice, solid waste, markets, and street pavements. It also pays special attention to slums in large cities and informal settlements in towns and peri-urban areas.

The World Bank estimates that over 50% of the population lives in urban areas globally. By 2045, the world's urban population will increase by 1.5 times to 6 billion. Hence, city leaders need to move quickly to plan for growth and provide the basic services, infrastructure, and affordable housing that their expanding populations need.

Rapid population increases, accompanied by heavy rural-urban migration, leads to unprecedented rates of urban population growth, leading in turn to economic and social change. The early stages of urbanization and industrialization in developing countries are generally accompanied by rising incomes and worsening environmental conditions. Urban pollution tends first to rise with national income levels and then to fall.

Urbanisation in developing countries creates such problems as housing, power, water, transport etc. (Jhingan, 2012). Many governments are ill prepared to cope with increased strain on existing urban water supplies and sanitation facilities.

Congestion, vehicular and industrial emissions, and poorly ventilated household stoves also inflate the high environmental costs of urban crowding. The inaccessibility of clean water and the lack of sanitation are some of the environmental factors which affect the health of the urban poor.

Moreover, the rising levels of industrial emissions or pollution directly affect the health of urban inhabitants. The urban poor, in particular, are likely to suffer serious consequences resulting from environmental degradation. Besides, the growth of urban slums and attendant malnutrition and poor health among a large proportion of urban dwellers in shantytowns tend to reduce individual resistance to environmental hazards.

One solution to these problems is to deploy clean technologies that by design produce less pollution and waste and use resources more efficiently.

### **8.1.3 Population, Resources and the Environment**

The world's population reached about 7.7 billion in 2019. According to the United Nations Population Division, this figure is projected to rise to about 8.1 billion in 2025 and about 9.6 billion by the year 2050. The overwhelming majority or more than three-quarters of the world's population will live in the developing world (Todaro and Smith, 2015).

In order to meet the expanded food needs of rapidly growing populations, it is estimated that food production will have to increase by at least 50% in the next three decades. Because land in many areas of the developing world is being unsustainably overexploited by existing populations, meeting this output target will require radical changes in the distribution, use, and quantity of resources that are available to the agricultural sector.

Some argue that rapid population growth tends to overuse a country's natural resources such as land, thereby endangering the welfare of future generations. This is particularly the case where the majority of the people are dependent on agriculture for their livelihood. With a rapidly rising population, agricultural land holdings become smaller and unviable to cultivate. There is no possibility of increasing farm production through the use of new land (extensive cultivation). Consequently, many households continue to live in poverty.

Even in countries with rich natural resources such as Brazil and other Latin American countries, rapidly increasing population makes it difficult to invest in roads, public services, drainage and other agricultural infrastructure needed to tap such resources (Jhingan, 2012).

Given limited resources, the consequences are felt by society, economy and the environment. The following example shows some of the linkages between the above factors.

Increasing population density contributes to severe and accelerating degradation of the very resources that the populations depend on for survival in the following manner. Rapid population growth disturbs the land-man ratio. For example, pressure of population on land increases due to inelastic supply of land. It adds to disguised unemployment and reduces per capita productivity further. As the number of landless workers increases, their wages fall. As a result, low per capita productivity reduces the propensity to save and invest. Because of this, the use of improved techniques and other improvements on land are not possible. Moreover, capital formation in agriculture suffers and the economy is bogged down to the subsistence level. The problem of feeding additional population becomes serious due to acute shortage of food products. These have to be imported which increases the balance

of payment difficulties. Thus, the growth of population retards agricultural development and creates a number of other problems discussed above.

Moreover, the pressure of rapid growth forces people to obtain more food for themselves and their livestock. Hence, they over-cultivate the semi-arid areas. This leads to desertification over the long run when land stops yielding anything. Besides, rapid population growth leads to the migration of large numbers of people to urban areas with industrialization resulting in severe air, water and noise pollution in cities and towns (Jhingan, 2012).

It has to be noted, nonetheless, that much of the concern over environmental issues stems from the perception that we may reach a limit to the number of people whose needs can be met by the earth's finite resources. We may or may not reach this point given the potential for new technological discoveries, yet it is clear that continuing on the present path of accelerating environmental degradation will severely compromise the ability of present and future generations to meet their needs (Todaro and Smith, 2015).

A slowing of population growth rates would help ease the intensification of many environmental problems. However, the rate and timing of fertility declines, and thus, the eventual size of world population, will largely depend on the commitment of governments to creating economic and institutional conditions that are conducive to limiting fertility.

What does it take for environmental policies to succeed in countries like Ethiopia? First, such countries must address the issues of poverty, landlessness, and lack of access to institutional resources. Insecure land tenure rights, lack of credit and inputs, and absence of information often prevent the poor from making resource-augmenting investments that would help preserve the environmental assets from which they derive their livelihood. It also requires firm commitment from the government and the policy makers.

### **Self-test Exercise**

1. List the types of resources in your area?
2. Write down the link between resources and the environment.
3. Justify how rural development affects the environment.
4. Outline how urban development affects the environment.
5. Summarise how rapid population growth affects the environment.



### **Checklist of Self-test Exercise**

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Listed the types of resources in your area		
Wrote down the link between resources and the environment		
Justified how rural development affects the environment		
Outlined how urban development affects the environment		
Explained how rapid population growth affects the environment		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 8.2 Global Warming and Climate Change

### Overview

Dear learner, in this section, you will learn global warming and climate change as well as the ways to address climate change, its indicators, impacts, vulnerability and the means to address the climate change problems, namely, mitigation and adaptation of climate change).

### Learning Outcomes

**At the end of this section, you will be able to:**

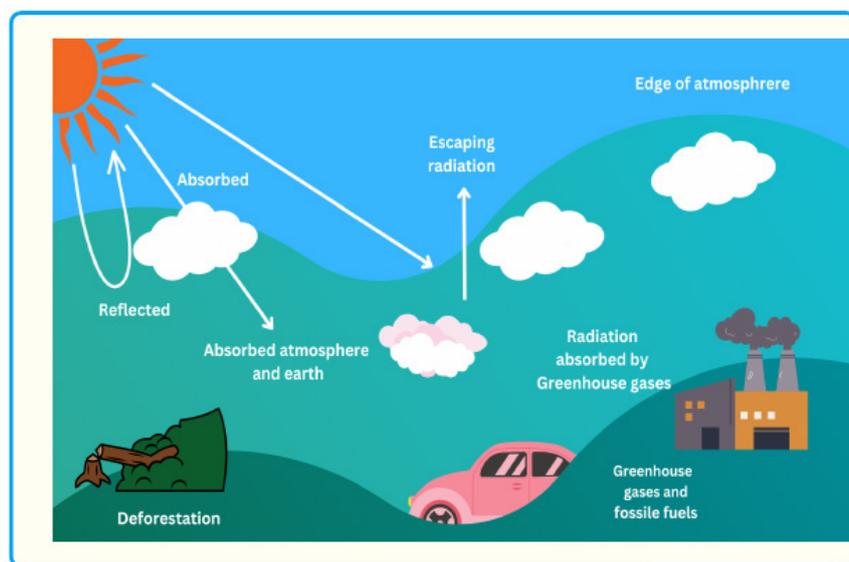
- ❑ describe the link between global warming and climate change.
- ❑ define climate change.
- ❑ explain the causes, indicators, vulnerability and impacts of climate change.
- ❑ examine the means to address the problems of climate change.
- ❑ summarise the policy measures that Ethiopia is undertaking to mitigate and adapt to climate change.

### Key Concepts

- ☞ Global warming
- ☞ Greenhouse Gases
- ☞ Indicators of climate change
- ☞ Mitigation of climate change
- ☞ Environmental Degradation
- ☞ Climate change
- ☞ Impacts of climate change
- ☞ Adaptation to climate change

## 8.2.1 Global Warming

Global warming refers to increasing average air and ocean temperatures. It is often used in reference to the trend that began in the mid-twentieth century and attributed largely to human activities (industrial, forestry, and agricultural) emitting greenhouse gases (GhG). The primary greenhouse gases in the earth's atmosphere are water vapour ( $H_2O$ ), carbon dioxide ( $CO_2$ ), nitrous oxide ( $N_2O$ ), methane ( $CH_4$ ) and ozone ( $O_3$ ). Due to increasing economic activities, global GhG emissions of these gasses have grown since pre-industrial times, with an increase of 70% between 1970 and 2004 (IPCC, 2007). Three GhGs, in particular, had increased in the atmosphere. They are  $CO_2$ ,  $CH_4$ , and  $N_2O$ .



**Figure 8.1** Greenhouse gases and global warming

Greenhouse gases of the atmosphere are both natural and anthropogenic which absorb and emit radiation at specific wavelengths within the spectrum of thermal infrared radiation emitted by the Earth's surface, the atmosphere itself, and by clouds. This property causes what is known as the greenhouse effect.

It so happens that the GhGs trap long-wave radiation in the upper atmosphere, raise atmospheric temperatures and produce other changes in the climate system. Before the Industrial Revolution, from around 1750 to 2011, for example,  $CO_2$  increased by 40% while  $N_2O$  increased by 150% and nitrous oxide by 20% (IPCC, 2013). The increase is due to burning of fossil fuels and reductions in some of the "sinks" for carbon dioxide, notably forests. There is an economic activity-energy-emission link through the greenhouse effect. In other words, the process of global warming relates economic activity to an associated level and pattern of energy and material flows corresponding to which are flows of GhG emissions. Carbon emissions are caused by fossil fuel use while agricultural activities and the decomposition and disposal of waste are important emitters of methane. In all, rising GhGs are the main drivers of climate change.

## 8.2.2 Climate Change

Climate change denotes a variation in the mean state of the climate persisting for an extended period (typically decades or longer) and resulting from anthropogenic greenhouse

gas emissions (IPCC, 2007, 2013). In other words, climate change refers to significant and persistent change in the mean state of the climate system that alters the composition of the global atmosphere which is observed over long periods of time. It includes such changes as average temperatures, precipitation, humidity, wind conditions, and all other aspects of the earth's climate.

There is a difference between climate and weather. Climate is the average weather pattern over many years expressed through variables such as temperature, precipitation and wind. On the other hand, the term weather represents short-term atmospheric conditions expressed in the mix of events such as temperature, rainfall and humidity that occur each day or week.

Climate change is one of the most urgent and complex challenges for societies and economies. For developing countries like Ethiopia, climate change complicates the existing challenges of poverty eradication. Indeed, for many parts of the world, climate change is an everyday reality with implications for people's livelihoods, infrastructure and institutions, as well as beliefs, cultures and identities.

### **8.2.3 Scope of the Problem and the Causes of Climate Change**

The Intergovernmental Panel on Climate Change (IPCC) predicted that, unless something is done to curb intensive fossil fuel emissions, there will be a probable rise in mean temperatures between 1.5°C and 4°C by 2099. By 2016, the mean temperatures had already reached 1°C above the pre-industrial level.

Climate change is caused by or attributed to the emissions of greenhouse gases triggering global warming. Of the greenhouse gases, CO<sub>2</sub> is the largest in causing global warming and hence, climate change. It contributes 77% to the greenhouse effect. Methane (CH<sub>4</sub>) follows with about 14%, and nitrous oxide (N<sub>2</sub>O) with 8% (IPCC, 2007).

According to the American Environmental Protection Agency, the largest source of greenhouse gas emissions from human activities in the United States is from burning fossil fuels (oil, coal, natural gas) for electricity, heat, and transportation.

In developing countries, deforestation is said to contribute over 20% of harmful greenhouse gases, in addition to the losses it causes of valuable biodiversity and the environmental services of cleaning air and water.

### **8.2.4 Indicators of Climate Change**

According to the IPCC, the warming of the climate system is unequivocal. The evidence comes from observations of increases in global average air and ocean temperatures, widespread melting of snow and ice, and rising global average sea level (Tietenberg and Lewis, 2012).

There are several indicators of climate change. They include unpredictable rain patterns, too much and too little rain, higher average air and ocean temperatures, floods, sea

level rise and the melting of glaciers and ice caps. Cold days, cold nights, and frosts have become less frequent while heat waves are more common. Moreover, the emergence of diseases such as malaria (in formerly cold climates due to the spread of mosquitoes) and respiratory diseases are common.

Globally, precipitation has increased in Australia, Central Asia, the Mediterranean Basin, the Sahel, the Western United States. Heavy rainfall and floods have become more common; so are storms and tropical cyclones. Many other regions have seen more frequent and more intense droughts.

### **8.2.5 Impacts of Climate Change**

Climate change has direct impact on the physical and ecological environments, again with lagged effects which may induce additional indirect impacts. For example, with the temperature rising over 2 degrees, people in different countries will suffer different impacts. Some areas will face damage from heat waves; others face harm from hurricanes and tornadoes. The list is long. Flooding from heightened rainfall, moisture stress from reduced rainfall, and displacement from rising sea levels are some of them. There could also be losses of grasslands, farmlands, and marine ecosystems.

Long-term changes can influence agriculture, water, health and other sectors. It is often the shifting frequencies and magnitudes of storms, floods, droughts and other extremes that bring home the significance of climate change for vulnerable populations (IPCC 2014; Todaro and Smith, 2015).

In semi-arid and arid areas, the area that is suitable for agriculture, the length of growing seasons and yield potential are expected to decrease. This will further adversely affect food security and exacerbate malnutrition. Coastal fisheries, mangroves, and coral reefs will be degraded and threatened by rises in sea level and storms.

The worst impact will likely be felt by the very poor, who depend mostly on natural resources, including rain-fed agriculture. Moreover, the housing of the poor in urban as well as in rural areas is often poorly constructed and located in the most environmentally stressed areas. Due to this and other factors, they are vulnerable to heat waves, flooding, mud-slides, and diseases.

Impacts of climate change also have health dimension. The World Health Organization (WHO) estimated that by 2004, over 140,000 excess deaths per year were due to diarrhoea, malaria, and malnutrition. The deaths were caused by the global warming that had taken place since the 1970s. Mosquito-carried malaria is expected to migrate further to higher altitudes, newly threatening Nairobi, Harare, and other cities.

In sum, one or more of the following impacts are expected to affect most of the world's poorest countries during this century. They are prolonged droughts, expanded desertification, increased severity of storms with heavy precipitation and flooding and consequent erosion, longer and more severe heat waves, reduced summer river flow and

water shortages, decreased grain yields, climate-induced spread of pests and diseases, lost and contaminated groundwater, deteriorated freshwater lakes, and coastal flooding. Other likely ecological damage includes the loss of essential species such as pollinators and soil organisms, and forest fires.

### **8.2.6 Vulnerability to Climate Change**

Vulnerability to climate change refers to the degree to which a system is likely to experience harm as the result of exposure to climatic hazard. It depends on the character, magnitude, and rate of climate variation to which a system is exposed, its sensitivity, and its adaptive capacity.

Vulnerability to climate change is multi-dimensional and it is a function of biophysical outcomes that is related to changes in temperature, precipitation, topography and soil, socio-political factors and a country's level of economic development.

Those who are most exposed and vulnerable to the adverse impacts of climate change are the poor and marginalised people who live particularly in low-income areas. For example, the houses of the poor are constructed of mud, bamboo, straw, and other inexpensive or gatherable materials; and they are the most vulnerable to extreme weather events. These problems are compounded by the fact that the poor are underrepresented at all levels of decision-making regarding climate issues, which adds to their vulnerability to climatic risks.

In terms of regions, Africa and South Asia are identified as two of the most vulnerable regions to both current variations in climate and future climate change. The IPCC identified four zones which are highly vulnerable to climate change: sub-Saharan Africa faces drying, Asia faces flooding, and small islands face multiple sensitivities, while the Arctic face melting glaciers.

Small islands remain highly vulnerable to global warming; their size and location make them the potential victims of rising sea level. Likewise, the coastal towns and settlements. Bangladesh, for example, is highly prone to flooding while the Horn of Africa for droughts. Towns like Dire Dawa in Eastern Ethiopia are prone to flooding. The Ethiopian Meteorological Agency provides information and alerts through radio and other media to populations in Ethiopia.

In terms of poverty and wellbeing, poor communities in high-risk areas are especially vulnerable to the impacts of climate change as they tend to have more limited adaptive capacities and are more dependent on climate-sensitive resources such as local water and food supplies.

Moreover, the poorest developing countries will be hit the earliest and hardest by climate change, even though they have contributed little to causing the problem. Their low incomes make it difficult to finance adaptation. The international community has an obligation to support them in adapting to climate change. Without such support there is a serious risk that development progress will be undermined (Stern, 2007).

## 8.2.7 Means to Address Climate Change Challenges

There are two main ways to address the climate change crisis. The first is mitigation, and the second is adaptation. Mitigation deals with the causes of climate change whereas adaptation deals with the consequences.

### Mitigation of Climate Change

Mitigation efforts are linked to reducing GhGs, especially CO<sub>2</sub> or stabilization of GhGs concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system.

Mitigation policy responses are anticipatory policies that would estimate expected costs and benefits of pollution emissions abatement, identify socially optimal abatement targets and select policy instruments which minimize the expected costs of attaining the target. This is a preventive policy approach in some sense by its attempt to reduce costs (Perman et al, 2003).

Many strategies have been proposed for the mitigation of emissions, including development of carbon markets, taxes on carbon, and subsidies to encourage faster technological progress. As a policy strategy, mitigation involves long-term limits on the amount of greenhouse emissions. In the short term, policies could be designed to limit the economic burden if abatement costs turned out initially to be unexpectedly high.

Some of the mitigation measures are linked to forests. The Reducing Emissions from Deforestation and Forest Degradation (REDD) mechanism, along with enhanced incentives for re-establishing and maintaining forests with engagement of indigenous communities that depend on them (known as REDD-plus), are examples. Another mitigatory mechanism is called Clean Development Mechanism (CDM), which emerged from the Kyoto Protocol of 1997 (Todaro and Smith, 2015).

Global warming is primarily but not exclusively a developed-country-caused problem. Although much of the accumulated greenhouse gases to date have been emitted by the high-income countries, action still needs to be taken to contain greenhouse gas emissions of the developing world, which are projected to grow at alarming rates. This has many causes, but the rapid industrial growth in Asia is already a major contributor, and is expected to worsen substantially with the planned expansion of coal-fired electrical generation in China, India, and elsewhere. Policies and mechanisms have been introduced essentially to pay for costs of avoiding emissions in developing countries.

Historically, most of the greenhouse gases have been emitted in developed countries. Therefore, they have historic responsibility to deal with the problem. For example, they should take immediate steps to reduce emissions. They should also develop new technologies that will enable further reductions as well as successful adaptation to climate change.

At the same time, developing countries share current and future responsibilities. With high fertility rates, rising average incomes, and increasing greenhouse gas emissions, developing

countries should take mitigation measures. China is now the world's largest greenhouse gas emitter, although lower on a per capita basis than most rich countries. It will have to reduce emissions, and without such action, reductions in the developed world will only delay the possibly catastrophic consequences (Todaro and Smith, 2015).

The poorer the country, the more difficult it is to absorb the costs of mitigation. Hence, low-income countries need for technical and financial assistance. For this reason, assisting developing countries to reduce greenhouse gas emissions has emerged as an important dimension for foreign aid. Achieving an international agreement on emissions targets, burden sharing, trading mechanisms and technological and financial assistance remains a high priority concern for the mitigation of climate change (Kyoto 1995, Paris 2015, Kigali 2016).

Synergy between the environment and the conditions of the poor should be taken into account when mitigating climate change. This could be done through the use of labour-intensive production mechanisms, access to credit and extension service, provision of necessities and employment, soil and water conservation, defining property rights and land tenure, forest land, grazing land as well as through improvement in health and education and a prudent environmental policy. Yet all these involve a more expensive development path for the poor countries, indicating to the need to share the cost equitably.

### **Adaptation to Climate Change**

Adaptation to climate change refers to the process of responding and adjusting to the actual or potential impacts of changing climate. In other words, adaptation is the process of enabling human and natural systems to adjust to the actual or expected climate stimuli or their effects.

The UNDP defines adaptation to climate change as a process by which strategies to moderate, cope with and take advantage of the consequences of climatic events are enhanced, developed and implemented. As a policy response, adaptation is a reactive policy that attempts to minimize the adverse impact of climate change *ex post* (Perman et al, 2003).

A related term, "adaptive capacity", refers to the ability of a system to adjust to climate change to moderate potential damage, to take advantage of opportunities, or to cope with the consequences.

Why is adaptation to climate change necessary? While action on mitigation is necessary, a significant amount of climate change is already happening and essentially inevitable. That means lags in the climate system means climate change will unfold for many years. Thus, adaptation to climate change is critical to protect livelihoods from climatic risks. It enables the systems to better cope with, manage or adjust to changing conditions.

Adaptation is a universal condition of humanity. This is because adaptability of human systems to changes is as old as human societies, and it is a vital characteristic that ensures the survival of cultures through time. However, adaptation to climate change presents

newer, unique and complex challenges to societies.

Adaptation takes place in two forms: “planned” (or policy) adaptation that is undertaken by governments and “autonomous” (or private) adaptation that is undertaken directly by households, farms, and firms in response to climate change. Local communities also take measures appropriate to their specific geography to address the problems of environmental degradation and climate change. The figure below shows how Konso community in Southern Ethiopia use a terracing system geographically relevant for agriculture.



**Figure 8.2 Konso terracing system**

Source: *Agriculture and culture, Konso, Ethiopia*, [permaculturenews.org](http://permaculturenews.org) (2010)

There are four classes of adaptation strategies: mobility, storage, diversification, and communal pool. Mobility avoids risks across space; storage reduces risks which are experienced over time; diversification reduces risks across assets owned by households or collectives, and communal pool involves joint ownership of assets and resources; sharing of wealth, labour, or incomes from particular activities across households or mobilization and use of resources held collectively during times of scarcity.

### **✂ Self-test Exercise**

1. What is climate change?
2. What is the cause for global warming?
3. What is the impact of climate change?
4. Examine the means to address the problems of climate change.
5. List the initiatives you can take to protect environment at individual level.



## Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the 'yes' or 'no' box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Wrote down the cause for global warming		
Wrote down the meaning of climate change		
Explained the impact of climate change		
Examined the means to address the problems of climate change		
Listed the initiatives you can do to protect environment at individual		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 8.3 Green Economy and Green Growth



Dear learner, in this section, you will learn the concepts of green economy, green growth and sources of renewable energy.



## Learning Outcomes

**At the end of this section, you will be able to:**

- ❑ define green economy.
- ❑ explain green growth.
- ❑ identify the sources of renewable energy.

### Key Concepts

- ☞ Green growth
- ☞ Economic development
- ☞ Green economy
- ☞ Renewable energy

## Green Economy and Green Growth

A green economy is an economy that results in improved human wellbeing and social equity, while significantly reducing environmental risks and ecological scarcities. It uses low carbon; it is resource efficient; and it is socially inclusive.

Green growth is defined as “fostering economic growth and development, while ensuring that natural assets continue to provide the resources and environmental services on which our wellbeing relies” (OECD, 2011). The OECD justifies green growth by citing growing risks to development as growth continues to erode natural capital which means increased water scarcity, worsening resource bottlenecks, greater pollution, climate change, and unrecoverable biodiversity loss.

In a green economy, economic growth is supposed to be driven by public and private investments that reduce carbon emissions and pollution, enhance energy and resource efficiency, and prevent the loss of biodiversity and ecosystem services. The combination of investment and innovation will underpin sustained growth and give rise to new economic opportunities.

This occurs with the use of renewable energy that links low carbon to green growth. The motive for using renewable energy emerges from the perceived scarcity of fuel fossils. Even without climate change, the potential for peak oil (i.e. rising demand and declining fossil fuel production); requires alternative modus operandi.

The sources of renewable energy are: solar, biomass and bio fuel, geothermal, hydroelectricity, tidal, and wind-driven. Given technological support, countries can use untapped renewable energy potential. Hence, the green economy is said to be relevant not only to advanced economies but also a key catalyst for growth and poverty eradication in developing countries.

### Self-test Exercise

1. Define green economy.
2. Define green growth.
3. Explain how green growth is important in the age of climate change.



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (✓) mark in the ‘yes’ or ‘no’ box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Defined green economy		
Defined green growth		
Explained how green growth is important in the age of climate change		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!

## 8.4 Overview of Environment and Climate Change in Ethiopia

### Overview

Dear learner, in this section, you will learn the national efforts to protect the environment and combat climate change in Ethiopia.

### Learning Outcomes

At the end of this unit, you will be able to gain insight into national policies to address climate change in Ethiopia.

### Key Concepts

- ☞ National Adaptation Programme of Action
- ☞ Climate Resilient Green Economy strategy
- ☞ Nationally Appropriate Mitigation Actions
- ☞ Green Legacy Initiative

### Environment and Climate Change in Ethiopia: overview

Ethiopia is an East African country with immense geographical diversity and topographical variation. The country is cited as one of the most vulnerable countries to future climate change. Indeed, for much of the last 100 years, the country has faced recurrent drought, famine and recourse to food aid.

Apart from drought, soil erosion and land degradation are among the most critical and far-ranging environmental issues which have been affecting Ethiopia due to increased crop cultivation in marginal areas and livestock grazing pressure. Studies indicate that agricultural landscapes in parts of Ethiopia have undergone unprecedented changes in an unsustainable direction as manifested in land degradation, biodiversity loss, and low agricultural productivity.

To address the problems of climate change, the Ethiopian government produced the National Adaptation Programme of Action (NAPA) in 2007 and Nationally Appropriate

Mitigation Actions (NAMA) in 2011. These policy documents assessed key underlying causes of the country’s vulnerability to climate change as dependence on rain-fed agriculture, poor water resource development and a high population growth rate. Moreover, the government identified agriculture, health, transport, natural resources, energy and industry sectors as most vulnerable to climate change.

In 2011, the government initiated the Climate Resilient Green Economy (CRGE) strategy. The strategy envisioned carbon-neutral growth based on an energy-efficient development trajectory with a view to address both climate change adaptation (climate resilience) and mitigation (green economy) objectives (FDRE, 2011). The goal of the low carbon or carbon-neutral growth pathway is to achieve middle-income status by 2025, which initially raises GDP per capita level to \$1000 USD.

In June 2020, the Ethiopian Government launched the Green Legacy Initiative, which is a tree-planting campaign aimed at curbing the effects of climate change and deforestation. Its aims are preventing flooding, food insecurity, environment-related conflicts, and other adverse effects of climate change and deforestation. An estimated 4.1 billion trees were planted by August 2020, according to the Ethiopian government.

The agency that is responsible for climate change in Ethiopia is the Ministry of Environment, Forest and Climate Change. It is a lead government body responsible and legally mandated for environmental management.

### Self-test Exercise

1. Analyse the policy measures that Ethiopia is undertaking to mitigate and adapt to climate change.
2. Write down national actions that are being taken to promote climate resilient green economy in Ethiopia.



### Checklist of Self-test Exercise

Dear learner, we hope you enjoyed working on this section. Now, it is time to check your understanding. Please, read each question and put a tick (√) mark in the ‘yes’ or ‘no’ box, which helps you decide your level of understanding of the points presented and discussed so far.

Check List	Your Response	
	Yes	No
Analysed the policy measures that Ethiopia is undertaking to mitigate and adapt to climate change		
Wrote down national actions to promote climate resilient green economy in Ethiopia:		

Dear learner, did you mark any box under the 'No' column? If so, please look at the corresponding item to the left and go back to your text and read about it. That is good! Go on reading the next section!



## Unit Summary

**Exclusive focus on economic growth**, without considering the social and environmental impacts has global implications, including **climate change**. In addition to rising population, the destruction of the world's remaining forests will greatly contribute to climate change. **Rapid population growth** and expanding economic activity are likely to do extensive **environmental damage** unless steps are taken to mitigate their negative consequences. They lead to land, water, and fuel wood shortages in rural areas and to urban health crises stemming from lack of sanitation and clean water.

**Environmental challenges** in developing countries like Ethiopia caused by poverty include health hazards created by lack of access to clean water and sanitation, indoor air pollution from biomass stoves, deforestation and severe soil degradation, all of which are most common where households lack economic alternatives to unsustainable patterns of living.

The developing world, particularly the poorest countries, can expect the major consequences from **global warming**, involving larger and more severe heat waves, hurricanes, floods from heavy rains, prolonged droughts, losses of valuable species, and crop and fishing losses.

Countries take different measures to **mitigate** and **adapt** to climate change. **Green economy** and **green growth** are expected to reduce carbon emissions and pollution, enhance energy and resource efficiency, and prevent the loss of biodiversity and ecosystem services. In this regard, the Ethiopian government initiated the Climate Resilient Green Economy Strategy which envisioned carbon-neutral growth based on an energy-efficient development trajectory. It also undertook the Green Legacy Initiative.



## Unit Review Exercises

### Part I: True or False

Read the following sentences and write "True" for correct sentences and "False" for incorrect ones.

1. The terms "climate" and "weather" are one and the same.
2. Climate change is one of the least urgent challenges for societies and economies.
3. CO<sub>2</sub> is one of the major greenhouse gases.
4. Climate change complicates the existing challenges of poverty eradication for developing countries like Ethiopia.
5. Urban and rural development have no impact on the environment.

### Part II: Multiple Choice

For the following question choose the best answer from the given alternatives

1. Which of the following statement describes the situation of environmental resources globally:
  - A. They face rising pressures with severe consequences for future growth potential and the quality of life.
  - B. The global ecosystem is a flow of raw materials and energy from the planetary sources, which then go through the economy, to the planetary sinks, receiving the wastes of the economic system.
  - C. Underlying the pressure on the sources and sinks is the growth of the world population and industrial production.
  - D. All of the above.
  - E. None of the above.
2. The primary greenhouse gases in the earth's atmosphere are:
  - A. oxygen ( $O_2$ )
  - B. nitrous oxide ( $N_2O$ )
  - C. methane ( $CH_4$ )
  - D. ozone ( $O_3$ )
  - E. All except A above
3. Climate change:
  - A. denotes a variation in the mean state of the climate persisting for an extended period and resulting from anthropogenic greenhouse gas emissions.
  - B. refers to significant and persistent change in the mean state of the climate system that alters the composition of the global atmosphere observed over long time periods.
  - C. includes such changes as average temperatures, precipitation, humidity, wind conditions, and all other aspects of the earth's climate.
  - D. all of the above
4. Mitigation and adaptation to climate change is the responsibility of:
  - A. developed countries.
  - B. developing countries.
  - C. least developed countries.
  - D. all of the above.
5. The Green Legacy Initiative of the Ethiopian Government:
  - A. is a tree-planting campaign aimed at curbing the effects of climate change and deforestation
  - B. aims at preventing flooding, food insecurity, and other adverse effects of climate change and deforestation
  - C. All of the above.
  - D. None of the above

**Part III: Short Answers**

For the following questions write short answers.

1. Write down the causes of climate change.

2. Describe the two main ways to address the problems of climate change.
3. Explain briefly Ethiopia's Climate Resilient Green Economy strategy.



## Answer Key for Review Questions

### Part I: True or False

1. False
2. True
3. True
4. True
5. False

### Part II: Multiple choice

1. D
2. E
3. D
4. D
5. C

### Part III: Short answers

1. Climate change is caused by or attributed to the emissions of greenhouse gases triggering global warming. According to IPCC, the main greenhouse gases that are altering the global climatic system, CO<sub>2</sub> is the largest in causing global warming and hence, climate change. It contributes 77% to the greenhouse effect. Methane (CH<sub>4</sub>) follows with about 14%, and nitrous oxide (N<sub>2</sub>O) with 8%.
2. There are two main ways to address the climate change crisis. The first is mitigation, and the second is adaptation. Mitigation deals with the causes of climate change whereas adaptation deals with the consequences.
3. Ethiopia's Climate Resilient Green Economy strategy envisioned carbon-neutral growth based on an energy-efficient development trajectory with a view to address both climate change adaptation (climate resilience) and mitigation (green economy) objectives (FDRE, 2011). The goal of the low carbon or carbon-neutral growth pathway is to achieve middle-income status by 2025, which initially raises GDP per capita level to \$1000 USD



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## Glossary

**Absolute poverty** - The situation of being unable or only barely able to meet the subsistence essentials of food, clothing, shelter, and basic health care.

**Asset** - Anything that has current or future economic value to a business.

**Biodiversity** - The variety of life forms within an ecosystem.

**Category A taxpayers** - A body or any other person having annual gross income of ETB 1,000,000 or more in Ethiopia. Body, here, refers to an organisation, company or other authoritative group.

**Category B taxpayer** - A person, other than a body, having an annual gross income of ETB 500,000 or more, but less than ETB 1,000,000 in Ethiopia.

**Category C taxpayer** - A person, other than a body, having an annual gross income of less than ETB 500,000 in Ethiopia.

**Climate change** - A variation in the mean state of the climate persisting for an extended period (typically decades or longer) and resulting from anthropogenic greenhouse gas emissions.

**Deforestation** - The clearing of forested land either for agricultural purposes or for logging and for use as firewood.

**Development** - The process of improving the quality of all human lives and capabilities by raising people's levels of living, self-esteem, and freedom.

**Decentralization** - The process by which the activities of an organization, particularly those

regarding planning and decision-making, are distributed or delegated away from a central, authoritative location or group and given to smaller factions within in it.

**Direct taxes** - Taxes levied directly on individuals or businesses – for example, income taxes.

**Excise tax** – A legislated tax on specific goods or services at the time they are purchased

**Ecosystem** - a geographic area where plants, animals, and other organisms, as well as weather and landscape, work together to form a bubble of life.

**Environmental capital** - The portion of a country's overall capital assets that directly relate to the environment—for example, forests, soil quality, and groundwater.

**Environmental Kuznets curve** - A graph reflecting the concept that pollution and other environmental degradation first rises and then falls with increases in income per capita.

**Foster-Greer-Thorbecke (FGT) index** - A class of measures of the level of absolute poverty.

**Gini coefficient** - Statistical measure of economic inequality in a population.

**Global warming** - Increasing average air and ocean temperatures. Used in reference to the trend that began in the mid-twentieth century and attributed largely to human industrial, forestry, and agricultural activities emitting greenhouse gases.

**Greenhouse gases** - Gases that trap heat within the earth's atmosphere and can thus contribute to global warming.

**Green growth** - Fostering economic growth and development while ensuring that natural assets continue to provide the resources and environmental services on which our well-being relies

**Green revolution** - The boost in grain production associated with the scientific discovery of new hybrid seed varieties of wheat, rice, and corn that have resulted in high farm yields in many developing countries.

**Headcount index** - The proportion of a country's population living below the poverty line.

**Human capital** - Productive investments in people, such as skills, values, and health resulting from expenditures on education, on-the-job training programmes, and medical care.

**Human Development Index (HDI)** An index measuring national socioeconomic development, based on combining measures of education, health, and adjusted real income per capita.

**Income inequality** - The disproportionate distribution of total national income among households.

**Indigenous knowledge** - An understandings, skills, and philosophies developed by local communities with long histories and experiences of interaction with their natural surroundings

**Indirect taxes** - Taxes levied indirectly including customs duties (tariffs), excise taxes, sales taxes, value-added taxes (VATs), and export duties levied on goods purchased by consumers and exported by producers.

**Integrated rural development** - The broad spectrum of rural development activities, including small-farmer agricultural progress, the provision of physical and social infrastructure, the development of rural nonfarm industries, and the capacity of the rural sector to sustain and accelerate the pace of these improvements over time.

**Kuznets curve** - A graph reflecting the relationship between a country's income per capita and its inequality of income distribution.

**Lorenz curve** - A graph depicting the variance of the size distribution of income from perfect equality or a way of showing the distribution of income (or wealth) within an economy.

**Macroeconomic instability** - Situation in which a country has high inflation accompanied by rising budget and trade deficits and a rapidly expanding money supply.

**Millennium Development Goals (MDGs)** - A set of eight goals adopted by the United Nations in 2000

**Multidimensional Poverty Index (MPI)** - A poverty measure that identifies the poor, using dual cut-offs for levels and numbers of deprivations, and then multiplies the percentage of people living in poverty times the percent of weighted indicators for which poor households are deprived on average.

**Personal distribution of income** (size distribution of income) - The distribution of income according to size class of persons, for example, the share of total income accruing to the poorest specific percentage or the richest specific percentage of a population without regard to the sources of that income.

**Progressive tax** – A tax that takes a larger share of a person's income as his or her earnings grow or a tax whose rate increases with increasing personal incomes.

**Poverty trap** - A bad equilibrium for a family, community, or nation, involving a vicious circle in which poverty and underdevelopment lead to more poverty and underdevelopment, often from one generation to the next.

**Privatization** - Selling public assets (corporations) to individuals or private business interests.

**Proportional tax** – A tax that takes the same percentage of all people's income.

**Poverty** – A situation where one does not have enough money to meet basic needs including food, clothing and shelter.

**Regressive tax** - A tax structure in which the ratio of taxes to income tends to decrease as income increases.

**Social capital** - The productive value of a set of social institutions and norms, including group trust, expected co-operative behaviours with predictable punishments for deviations, and a shared history of successful collective action, that raises expectations for participation in future cooperative behaviour.

**Soil erosion** - Loss of valuable top soils resulting from over-use of farmland, and deforestation and consequent flooding of farmland.

**Strategy** - A plan of action designed to achieve a long-term or overall aim.

**Sustainable development** - A pattern of development that permits future generations to live at least as well as the current generation, generally requiring at least a minimum of environmental protection.

**Tax avoidance** - Any legal method used by a taxpayer to minimize the amount of income tax owed

**Tax base** - The total value of all of the assets, income, and economic activity that can be taxed by a taxing authority, usually a government

**Tax evasion** – An illegal withholding or underpayment of taxes

**Tax rate** - The ratio at which a business or person is taxed.

**Urban bias** - The notion that most governments in developing countries favour the urban sector in their development policies, thereby creating a widening gap between the urban and rural economies.

**Value-added tax (VAT)** - Levy on value added at each stage of the production process.

**Withholding tax** - the money that an employer deducts from an employee's gross wages and pays directly to the government.

# ECONOMICS

**DISTANCE MODULE II**

**GRADE 12**



FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA  
MINISTRY OF EDUCATION