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ETHIOPIA

Components: Revenue

Modules: RM I – Tax Policy

RM II – Revenue Administration

*ETHIOPIA***PROJECT SUMMARY****COUNTRY (S):** Ethiopia**LEAD DEPARTMENT:** FAD**REGION (S):** AFR**PROGRAM ID:** (To be filled out by Secretariat)**PLANNED DATES:** 02/01/2024 to 4/30/2026**FUNDING PROGRAM TITLE:** GPFP Ethiopia**PROJECT MANAGERS:****RM I /TAX POLICY:** Kevin Shoom – Tax Policy 2**RM II /REVENUE ADMIN:** Faith Mazani – Revenue Administration 2**PROJECT LEAD MANAGER:** Faith Mazani/Dumisani Masilela – Revenue Administration 2**ESTIMATED BUDGET** \$1,167,151**BUDGET FOR ENDORSEMENT** \$760,886 (through FY25)

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*ETHIOPIA***I. PROJECT PURPOSE**

The country's authorities have expressed interest in a new CD project to continue FAD's supported reforms to mobilize tax revenue collection and tax administration modernization. The authorities are in the process implementing an ambitious fiscal consolidation program to ensure debt sustainability while creating fiscal space to address developmental needs supported by a National Medium-term Revenue Strategy (NMTRS), and tax revenue collection is key to achieving the expected results. The tax-to-GDP ratio in the country has been below 10 percent, which is insufficient to meet the country's needs.

The new CD project will focus on supporting the development and implementation of the NMTRS as the centerpiece of the reforms. In the area of tax policy, the CD project will increase the technical capacity of officials, including estimating revenue potential, tax gap analysis, and tax treaty negotiation skills. This part of the project will contribute to more effective analysis of tax revenue potential, supporting Ethiopia's medium-term revenue strategy, and the negotiation of bilateral tax treaties that contribute to providing a more favorable and predictable environment for foreign direct investment. Revenue Administration will support the modernization of core tax administration and support functions while allowing increased governance from transparent and accountable work processes and improved tax administration management.

The three-year project has been discussed with the authorities, and the medium-term objectives and outcomes were agreed upon. The estimated budget for this three-year project is \$1,167,151, but endorsement is requested for \$760,886 through FY25. Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction.

II. BACKGROUND

Macro-fiscal situation

Following several years of high economic growth, the macro-economic situation in Ethiopia has deteriorated in recent years. The pandemic, domestic conflict, drought, and food, fuel, and fertilizer import price shocks have contributed to food insecurity, internal displacement, high inflation, fiscal and financing pressures, and increased debt vulnerabilities. Revenue performance has been weak, with general government tax revenue falling from 10 percent of GDP in FY2018/19 to 7 percent of GDP in FY2022/23 – a critically low level that jeopardizes public service delivery, poverty reduction, and post-conflict reconstruction. The marked decline in revenues and external financing has also been accompanied by spending cuts and resort to monetary financing.

The Cessation of Hostilities Agreement (November 2, 2022) that ended large-scale two-year conflict has been followed with significant implementation progress, removing important obstacles to international support. The country has requested a Fund supported Four-Year Extended Credit Facility (ECF) Arrangement which seeks to strengthen fiscal sustainability, increasing space for social and capital expenditure, and gradual consolidation. Domestic revenue mobilization is a key program objective. To anchor reforms, staff have urged the authorities to publish a medium-term revenue strategy drawing on extensive FAD TA.

IMF priority areas / cross-cutting themes

Ethiopia is a fragile, conflict-affected state, contributing to its need for capacity development assistance with domestic revenue mobilization. The country's balance of payments pressures are acute, with significant social costs. Domestic revenue mobilization efforts will need to be supported by robust policy measures and anchored on the digitalization of the country's tax collection through the implementation of a new Integrated Tax Administration system (ITAS).

Country engagement and alignment to reform priorities

The project aligns with the program priorities and initiatives underway in Ethiopia. The country is developing an MTRS, with a first draft prepared in mid-2023. The Ministry of Revenues (MoRs) has a ten-year strategic plan whose main focus areas are building sustainable institutional capacity, ensuring operational excellence, realizing strategic partnership excellence, ensuring excellence in tax compliance and realizing sustainable revenue growth.

III. PROJECT LEVEL DESCRIPTION

A. Project Scope

Against this background, this project is aligned with the government's priorities and the IMF program which aims to improve the country's DRM performance through targeted tax policy measures and increasing tax compliance and strengthening revenue collection. As part of the ECF program, the country has agreed to strengthen DRM. The project will focus on supporting the strengthening of the Ministry of Revenues and developing proposals to improve the policy framework, in particular through the NMTR.

RM I / Tax Policy

In the area of tax policy, this CD project will increase the technical capacity of officials, regarding analyzing, evaluating and monitoring tax policy measures, including by improving the estimations of revenue potential and distributional impact, and tax gap analysis. CD activities will also focus on improving the government capacity on international tax issues, including designing a tax treaty policy (and strengthening the authorities' tax treaty negotiation skills), which will contribute to a more favorable and predictable environment for foreign direct investment.

Further, these activities will improve Ethiopia tax policy design, including the proposed MTRS measures.

The expected outcomes of the project include (i) improved structures and capacity related to tax policy advice and analysis, including organization of tax policy units, and building tax models or other tools for analysis and revenue forecasting, and (ii) increased economic efficiency by minimizing the economic distortions imposed by taxes or by using taxes to address externalities or market failures.

RM II / Revenue Administration:

Objective: Strengthening Management and Governance Arrangement

- CD will support development and implementation of the NMTRS and delivery of administration reforms with attention on improving capacity to reform through clear reform strategy and strategic management. CD will continue to assist the revenue administration to balance reform management and delivery of the immediate revenue needs of the country with clear monitoring and evaluation structures.

Objective: Strengthening core tax administration

- CD will assist the authorities in establishing digital tax and customs administration systems, strengthening excise tax administration, and developing the capacity of operational processes to improve compliance in the core compliance areas and high-risk sectors. Attention will be paid to improved data gathering and analysis for compliance risk management, with particular attention on large taxpayer segments in key sectors, and high net wealth individuals Improving tax risk management performance.

Table 1. Summary of Objectives covered by the Proposal

Component	Module	Objective
Revenue	RM I / Tax Policy	• Improve Tax Policy design • Strengthen Policy Monitoring, Evaluation, and Institutions
	RM II / Revenue Administration	• Strengthened Revenue Administration Management and Government Arrangements • Strengthened Core Tax Administration

B. Country Engagement

Ethiopia has benefited from two consecutive FAD Capacity Development (CD) projects. The Tax Policy and Administration Topical Trust Fund (TPA-TTF), from FY15 to FY17, and the Revenue Mobilization Thematic Fund (RMTF) CD project, from FY18 to FY24, supported a series of reforms in tax policy and core tax administration functions and revenue administration management and governance arrangements. As a result, the authorities have developed a National Medium-term Revenue Strategy which is due to be submitted for Cabinet approval early in 2024 to harness the falling revenue capacity.

C. Delivery Modalities

The CD delivery will mainly be in-person activities due to the low capacity of the country, necessitating a more hands-on approach. Virtual deliveries will be used to provide efficiencies to on the ground support, including pre-engagement meetings and post follow-up meetings. The following CD activities will be delivered as a package:

- **Headquarters-led (HQ) missions and staff visits** to provide strategic recommendations, conduct regular follow-ups, assess progress, inspect STX work, coordinate with other TA providers, and adjust reform implementation plans.
- **Peer-to-peer learning and bench-marking visits** will be provided for the MoRs to benchmark with other revenue administrations in the region and beyond, including in-country or regional workshops on areas of common interest.
- **Short-term expert (STX)** visits to help implement the recommendations delivered by the HQ missions; a limited number of STXs will be assigned to provide specialized assistance in specific areas of revenue administration like digitalization and the taxation of mineral wealth and international transactions.
- **Long-term experts (LTX).** The revenue administration module will continue benefiting from the support of an LTX regionally based focused on the development and implementation of the NMTRS, which was previously funded through the RMTF. From FY25, a proposed regional tax policy resident advisor will complement these efforts to provide timely support for tax policy implementation and build in-house capacity on tax policy analysis and design.¹

¹ Both regional revenue administration and tax policy LTXs will support several East African countries, including Ethiopia, Kenya, and Rwanda and may be expanded to other countries in future proposals.

D. Coordination / Cooperation

The Ethiopia Ministry of Revenues and the Ministry of Finance are currently receiving FAD CD on tax, customs, and PFM through AFRITAC East (AFE). An LTX funded under the RMTF and based at AFE is providing support to countries in East Africa who are developing and implementing the MTRS, including Ethiopia. Appropriate linkages with the existing CD programs are defined using the IMF's result-based management (RBM) framework. When designing specific country-based activities and workplans, this program will seek to define the emerging challenges in an integrated and coordinated manner. CD will be coordinated with other FAD divisions such as PFM, Expenditure Policy and Climate Policy as needed, with consultation with the AFR country team on program priorities.

Currently His Majesty's Revenue and Customs (HMRC) and Foreign, Commonwealth and Development Office (FCDO-UK) are providing CD support to the MoRs in implementing aspects of the tax administration reforms through the Tax Transformation Office (TTO), including procurement of a new ITAS. The World Bank has launched a new Domestic Resource Mobilization, Governance Global Practice Project which will also support the development and implementation of the new ITAS. This CD will be coordinated with the Gov-Tech CD that is supporting IT enhancements in developing countries in Africa, to ensure alignment. MoRs is also receiving support in DRM from the African Tax Administration Forum and the European Union. Project managers will continue to seek collaboration with the other CD providers in the respective areas to ensure regular exchange of information and discuss areas of support.

Most of the development partners meet with the authorities under the PFM Working Group where fiscal issues are discussed. The IMF Resident Representative assists FAD by setting up meetings with donors during major CD deliveries in the country, and in coordinating TA delivery with AFR country program work. Coordination of the NMTRS has been led by the Ministry of Finance (MoF) in collaboration with the MoR. In addition, CD through the RMTF assisted the MoR setup a structure for the MoR to co-chair with FCDO, the CD coordination meetings with development partners. The project managers will seek to expand this coordination with the authorities, especially through the implementation of the NMTRS.

IV. RISK ASSESSMENT AND MITIGATION

General or Module	Description	Probability	Impact	Mitigation Measures
External climate/conditions				
General	The security situation and effects of the world economic and security conditions pose a risk to DRM efforts.	Medium	Medium	Ensure sufficient flexibility in program execution and allow for ability to adjust activities in the case of adverse events.
Political Support				
General	Coordination between Ministry of Finance and Ministry of Revenues on MTRS has improved.	High	Medium	Seek support from the country team to coordinate meetings between MoRs and MoF and engage staff in both Ministries to ensure government ownership of reforms with the big picture in mind.
Management and Technical Staff Support and Commitment				
Tax Policy (RM I)	Low commitment of management and staff in finance ministry to adopt and implement tax reform measures.	High	High	Engage with senior management and technical staff pro-actively to strengthen their capacity to manage reforms for achievement of desired strategic outcomes.
Resource Adequacy				
Tax Policy (RM I)	Insufficient technical capacity; human resources necessary to make use of new tools.	High	High	Ensure CD plans include sufficient capacity building and training elements (including train-the-trainers approach) and prioritize CD to priority or highest risk areas where resources are limited.
Revenue Administration (RM II)	Minister of Finance showed commitment to supporting implementation of ITAS.	Medium	Medium	Continue providing CD support and engaging authorities in a coordinated way.
Other risks				
General	Delays in putting in place active and effective governance structures for NMTRS between Ministry of Finance and Ministry of Revenues are a threat to the country's DRM efforts.	High	High	Engage the IMF Resident Representative and other DPs to assist in coordinating between the MoF and MoRs to ensure timely implementation of the NMTRS.
General	Overlaps may arise as multiple donors are providing technical assistance on fiscal risk topics and gaps.	Medium	Medium	Take an active role in engaging with other donors, especially the World Bank, to ensure support is well coordinated.

V. CD DELIVERY PLAN COUNTRY LEVEL

Table 2. Summary of Indicative CD Delivery

CD Modalities (Remote or Field-based CD)	Total for FY24	Total for FY25	Total for FY26	Grand Total
RM I / Tax Policy				
FB HQ-led CD Mission	-	1	-	1
STX Visits	-	1	-	1
LTX Regional Advisor Visits	-	-	1	1
RM II / Revenue Administration				
HQ-led CD mission	1	1	1	3
STX visits	-	2	2	4
LTX Regional Advisor Visits	1	1	1	3
Staff or other visit	-	1	1	2
Interactive Learning	-	1	1	2

Note: LTX may participate in HQ led, STX visits. All costs associated are in reflected in the Regional LTX project proposal.

Table 3. First Year Workplan

Timing	CD Area	CD Delivery	Proposed Topics of CD
RM I / Tax Policy			
FY25 – Q2	In-depth mission	HQ (FB)	Training on revenue potential and tax gap analysis
FY25 – Q3	STX Visit (incl. LTX)	STX (FB)	CD on tax treaty policy
FY25 – Q4	LTX Visit	LTX (FB)	Follow up on development of revenue potential and tax gap analysis model
RM II / Revenue Administration			
FY24 – Q4	In-depth mission	HQ (FB)	TADAT Assessment
FY25 – Q1	STX Standard mission	1 STX (FB)	CRM Strategy
FY25 Q2	Interactive learning	1 STX (DS)	Virtual Training on CIPs
FY25 Q3	In-depth mission	HQ (FB)	NMTRS Implementation TADAT Follow up
FY25 Q4	STX Standard Mission	1 STX (FB)	Compliance Improvement Plan

VI. PROGRAM FINANCIALS

	FY24 Q4	FY25	FY26	TOTAL (USD)
Direct Delivery	179,355	531,754	379,686	1,090,795
Module RM I - Tax Policy	0	183,723	0	183,723
Module RM II - Revenue Administration	179,355	348,031	379,686	907,072
Module SM I - Spending Policy	0	0	0	0
Module SM II - Managing Public Finances	0	0	0	0
Subtotal	179,355	531,754	379,686	1,090,795
Trust fund management fee (7%)	12,555	37,223	26,578	76,356
TOTAL	191,909	568,977	406,264	1,167,151

The estimated budget for this three-year project is \$1,167,151, but endorsement is requested for \$760,886 through FY25. Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction.

ANNEX I. REVENUE MODULE I – TAX POLICY

A. Program Objectives

The objective of the program is to increase the technical capacity of officials in the tax policy area. In particular, CD activities will focus on:

- Training on revenue potential and tax gap analysis; and
- Training on tax treaty negotiation skills.

B. Expected Results (outcomes)

The project's expected outcomes are to increase the capacity of Ethiopian officials to negotiate bilateral tax treaties, to augment the current tax treaty network that consists of agreements with about twenty countries. Such treaties can contribute to providing a more favorable and predictable environment for foreign direct investment.

The project is also expected to provide tools for the authorities to estimate potential revenues and tax gaps, and to ensure the authorities have a good grounding in the use of these tools. The tools will contribute to more effective analysis of tax revenue analysis, supporting Ethiopia's medium-term revenue strategy.

C. Targeted Logical Framework - TAX POLICY

Objective	
Strengthen Policy Monitoring, Evaluation, and Institutions	
Outcome(s)	Indicator(s)
Improved structures (e.g., tax policy units) or capacity (e.g., models and tools) related to tax policy advice and analysis.	Improved models to evaluate tax policy adopted
	Models or tools developed or improved
Objective	
Improve Tax Policy Design	
Outcome(s)	Indicator(s)
Increased economic efficiency by minimizing economic distortions or addressing externalities or market failures	Regionally agreed measures to reduce tax policy distortions implemented.

ANNEX II. REVENUE MODULE II – REVENUE ADMINISTRATION

A. Program Objectives

The Revenue Administration Module aims to support the authorities in developing and implementing their NMTRS, with actions to mobilize domestic revenue. CD support aims to ensure the NMTRS revenue administration measures in tax and customs help deliver the revenue targets set to support the country's development goals.

In particular, CD activities will focus on:

- Strengthening leadership and management capacity for operational delivery and reform implementation.
- Building technical capacity for better compliance risk management in tax and customs.
- Developing core competencies in tax administration including data analytics and audit capabilities.

B. Expected Results

The CD will help the authorities finalize development of a medium-term revenue strategy supported by a detailed implementation plan and a monitoring and evaluation strategy to ensure delivery of the NMTRS targets and revenue growth. A compliance improvement plan will be developed to give focus on high risks in large and critical segments, especially those arising from taxation and management of international transactions and cross-border trade.

C. Targeted Logical Framework REVENUE ADMINISTRATION

Objective	
Strengthened revenue administration management and governance arrangements	
Outcome(s)	Indicator(s)
Capacity for reform increased due to clear reform strategy and a strategic management framework adopted and institutionalized.	Multi-year reform implementation plan, with supporting resource plan, adopted and well communicated.
Corporate priorities are better managed through effective risk management.	Improved identification, assessment, ranking and quantification of compliance risks (TADAT POA2-3)
	Better mitigation of risks through a compliance improvement program TADAT POA2-4)
Objective	
Strengthened core tax administration functions (SDG 17.1)	
Outcome(s)	Indicator(s)
Audit and other verification programs more effectively ensure accuracy of reporting	Appropriate range of tax audits and other initiatives used to detect and deter inaccurate reporting and fraud (TADAT 2015 POA6-16/TADAT 2019 POA6-19)