FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

National Medium-Term Revenue Strategy (NMTRS)

FY 2024/25 to FY 2027/28

August 2024

Addis Ababa

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ACRONYMS

AfCFTA	African Continental Free Trade Agreement
AfDB	African development Bank
ASYCUDA	Automated System for Customs Data
BEPS	Base Erosion and Profit Shifting
CSOs	Civil Society Organizations
eCMS	Electronic Customs Management System
FY	Fiscal Year
IT	Information Technology
LTO	Large Taxpayers Office
MAT	Minimum Alternative Tax
MEFF	Medium-Term Macro-Economic and Fiscal Framework
MoF	Ministry of Finance
MoPD	Ministry of Planning and Development
MoR	Ministry of Revenue
NBE	National Bank of Ethiopia
NMTRS	National Medium-Term Revenue Strategy
OECD	Organization for Economic Cooperation and Development
SOEs	State-owned enterprises
SSA	Sub-Saharan Africa
TADAT	Tax Administration Diagnostic Assessment Tool
WTO	World Trade Organization

Acknowledgment

This National Medium-Term Revenue Strategy was prepared by a joint team from the Ministry of Finance and Ministry of Revenue and supported by the World Bank, Institute for Fiscal Studies IFS/TaxDev and United Nations Economic Commission for Africa (UNECA).

We thank the IMF Technical Assistance (TA) team for the training and workshop organized, supporting materials provided was crucial in equipping the MoF and MoR committee constituted to prepare this NMTRS independently. Besides, the IMF TA was valuable insights provided during the preparation by providing constructive feedback and input of this NMTRS at different stage. Similar appreciation goes to IFS/TaxDev, the World Bank and UNECA for their crucial feedback. The IFS/TaxDev has played decisive role during the preparation from inception to the final stage of the NMTRS. We also appreciate the collaboration with other governmental institutions at federal, regional and city administration levels.

1. INTRODUCTION

A Medium-Term Revenue Strategy (MTRS) is a key component of economic planning and development in any economy, particularly in low-income countries. A well-designed revenue strategy will help the government reduce its dependence on foreign aid and ensure fiscal sustainability, thereby promoting economic growth and development. The process involves outlining the various measures to be taken to reform tax policy and improve tax administration, with a view to enhancing and strengthening revenue collection efforts. It provides a framework for generating sustainable revenue streams for the government to finance various public services, infrastructure development and poverty reduction efforts. It also provides certainty to taxpayers, investors, and the public about the policy reform direction, which facilitates planning, long-term investment, and provision of public goods. In addition, it will help to better match revenue and expenditure, which tend to be planned in the medium term.

The National Medium-Term Revenue Strategy (NMTRS) sets out the Government of Ethiopia's revenue mobilization strategy for the period spanning from FY 2024/24 to FY 2027/28, aligning with the 10-year development plan. This strategy proposes a comprehensive set of tax policies and administrative measures aimed at simplifying the tax system and fostering a more favourable environment for private investment, thereby bolstering Ethiopia's global and regional competitiveness. It sets out a reform agenda aimed at improving the overall domestic resource mobilization, reversing the declining trend in the tax-to-GDP ratio, and achieving an additional 6.9% of GDP in tax-to-GDP ratio by the end of the NMTRS period.

The NMTRS offers estimates of the revenue impact associated with each tax policy and tax administration measure. Tax policy measures, aimed at broadening the tax base and simplifying the tax system, are expected to raise approximately 3% of GDP. Similarly, tax administration measures, primarily focusing on enhancing tax administration and service delivery at the federal, regional and city administration revenue bureaus are anticipated to generate an additional revenue of 2.9% of GDP. The macroeconomic reform including the foreign exchange reform is expected to raise additional 1% of GDP.

Effective implementation of the NMTRS necessitates a clear roadmap and coordinated efforts among various stakeholders, each with well-defined roles and responsibilities. To achieve this, the strategy has identified key stakeholders and outlined their respective responsibilities. The Ministry of Finance will spearhead the coordination of NMTRS implementation through a well-resourced collaborative endeavour and will take the lead in monitoring and evaluating the processes.

2. SITUATIONAL ANALYSIS

The NMTRS is grounded in the global and local economic context, which is reviewed in the following section.

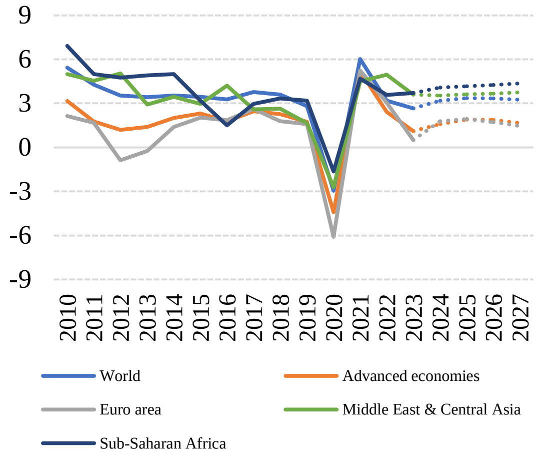
2.1. Global economic outlook

In recent years, the global economy has been hugely impacted by the COVID-19 pandemic and the ongoing war in Ukraine. The COVID-19 pandemic and the measures that countries implemented to contain the spread of it substantially disrupted global supply chains. In 2020, all regions experienced GDP contraction (see figure below). The global economy contracted by nearly 3%, with falls of 6.1% in the Euro area, 4.4% across all advanced economies, and 1.6% in sub-Saharan Africa. The strict lock-down measures that governments instituted, especially in advanced economies, contributed to the severe economic contraction. Sub-Saharan African (SSA) countries experienced contraction but not to the magnitude observed in other regions.

Almost all regions recovered quickly from the COVID-19 pandemic in 2021. The global economy expanded by 6.0%, all advanced economies by 5.2%, and Sub-Saharan Africa registered a 4.7% growth in 2021. The easing of COVID-19 lockdown measures and the vaccine rollout contributed to the recovery, especially in advanced economies. The tightening of global finances, supply chain disruptions in the aftermath of the war in Ukraine and weaker global growth had a negative impact on SSA's economic performance (AfDB, 2023).

Starting in 2022, the Ukraine war has had a huge impact on the global economy, exacerbating the energy and cost of living crisis across the world. The global economy grew by 3.2%, the euro area by 2.2% and SSA by 3.7%. The economic outlook in many regions is relatively weak, given the ongoing war in Ukraine, tightening global financial conditions and volatile commodity prices (IMF, 2022; see figure above). However, the GDP growth projection for SSA is relatively strong compared to other regions. The region is projected to grow by 3.7% in 2023 and by more than 4% in 2024.

Figure 2.1. Real GDP growth for selected regions and the outlook (%)- 2010 to 2027



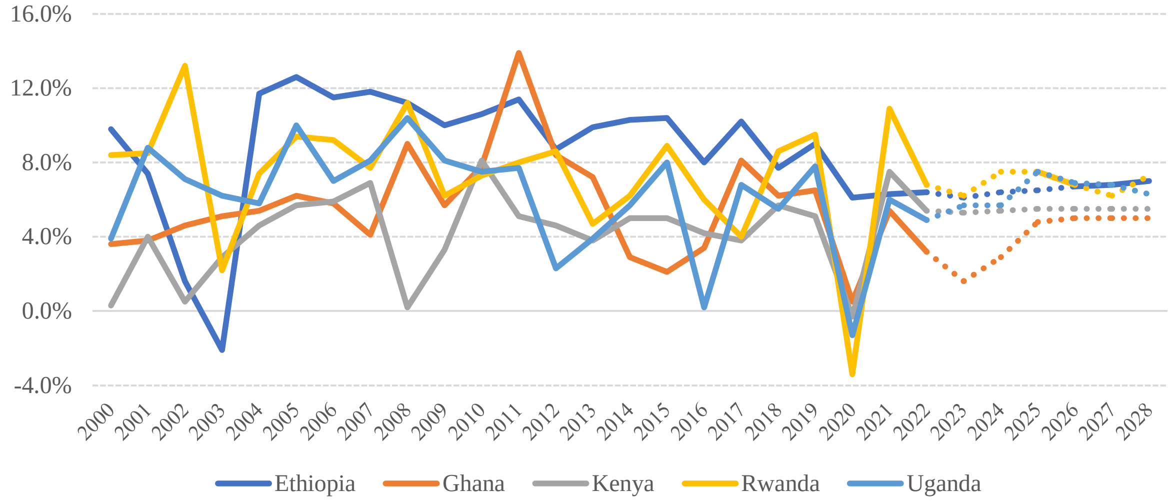
Note: dotted lines represent IMF projections
Source: IMF World Economic Outlook Database (2023)

2.2. Ethiopian economic outlook

Over the last two decades, Ethiopia had impressive economic growth (especially between 2004 and 2019). During this period, Ethiopia was one of the fastest-growing economies in the region with annual average GDP growth of 10.3%. However, since 2020, growth has slowed down due to a multitude of factors including the conflict in the north, drought in the southern and eastern parts of Ethiopia, the COVID-19 pandemic, and the war in Ukraine.

Following the COVID-19 pandemic, growth throughout the region was weak. In Ethiopia, GDP growth was registered at around 6% in 2020. This still is relatively robust compared to the other countries in the region. Kenya and Rwanda experienced GDP contraction in 2020 (IMF, 2023). In 2021, the recovery was quick in all other countries in the region. But Ethiopia continued to register pandemic-level growth, mainly due to the outbreak of the civil war in the north, and partly due to the drought in some parts of the country.

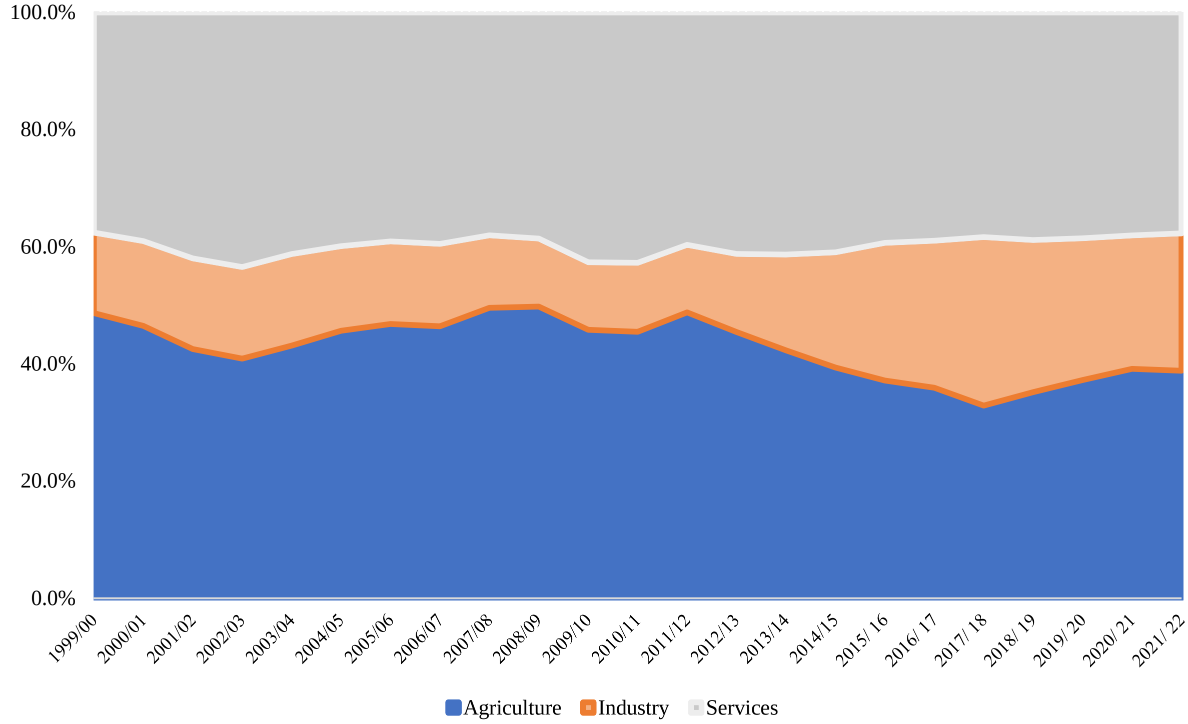
Figure 2.2. Real GDP growth (%) and the outlook for Ethiopia and selected SSA countries - 2010 to 2027



Note: the dotted lines indicate the IMF projection.
Source: International Monetary Fund (2023).

Agriculture is the biggest economic sector in terms of contribution to the overall GDP and employment, while the industry sector (which includes manufacturing, construction, and electricity) still contributes the smallest share. In the early 2000s, the contribution of agriculture fell, while that of the service sector grew. This coincided with the expansion of the financial sector. In FY 2002/03, the service sector briefly overtook the agriculture sector in terms of contribution to GDP. But then after FY 2003/04 up until FY 2013/14, the agriculture sector's contribution grew, overtaking the service sector again. This increase in the contribution of agriculture to GDP was driven by higher agricultural prices rather than by higher productivity. During this time, the industry sector contribution driven mainly by the construction sector exhibited relatively robust growth, its share increasing from 11.5% of total output in FY 2011/12 to 28.8% in FY 2017/18. In the last five years, however, the industry sector's contribution has fallen. Similarly, in terms of employment, agriculture employs almost two-thirds (64%) of the workforce, while industry employs only 10% and services around 26% in 2021 (World Bank, 2023).

Figure 2.3. GDP contributions by sectors at current prices (in %)- FY 2014/15 to FY 2021/22

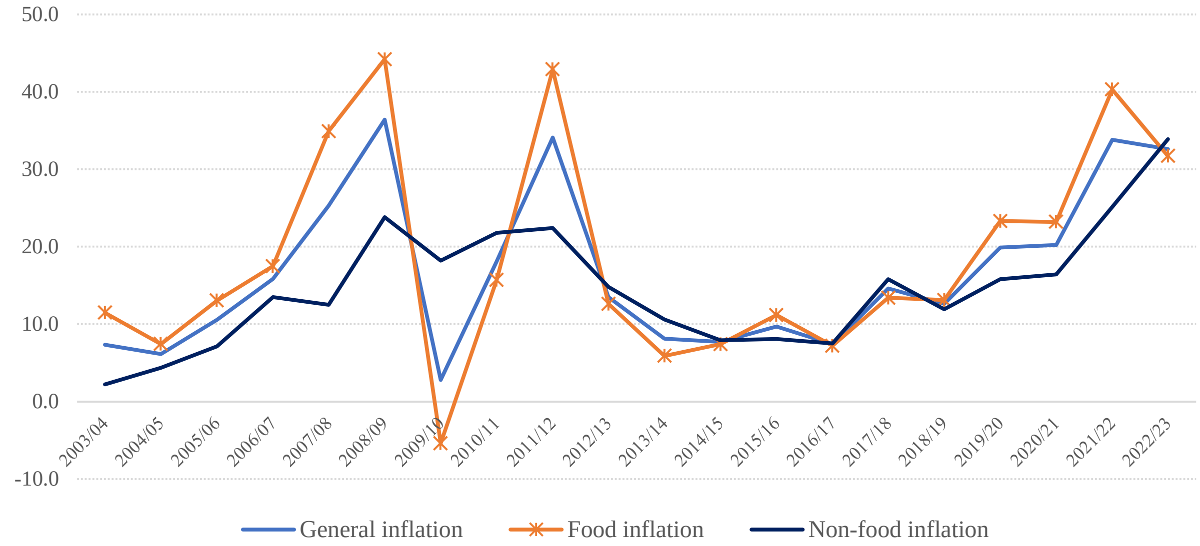


Source: Ministry of Planning and Development.

This growth has been accompanied by falling absolute poverty in the country. Recent studies show that the absolute poverty headcount ratio (measured at $2.15 a day at 2017 PPP) fell substantially from 69.2% in 1995 to 27% in 2015 (World Bank, 2023).

Yet the economy still faces many challenges including persistently high inflation, growing income inequality, high public sector debt, high unemployment, severe foreign exchange shortages, and a weak export sector. High inflation, which disproportionally impacts wage earners in urban areas, remains the key economic challenge facing the country. In FY 2021/22, general inflation was above 27%, while food inflation was around 32%. This is the highest inflation registered in the country in a decade. This has been exacerbated by the COVID-19 pandemic, drought in some parts of the country, and the conflict in the north, which substantially disrupted domestic supply chains. Income inequality as measured by the Gini coefficient increased from around 0.3 in 1999 to around 0.35 in 2015 (World Bank, 2023).

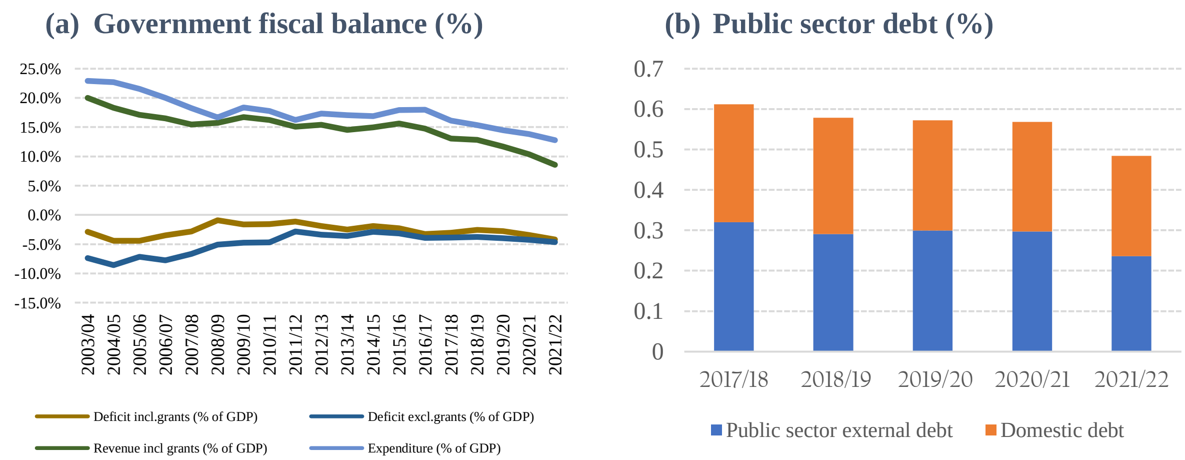
Figure 2.4. Annual inflation in Ethiopia (%)- FY 2003/04 to FY 2021/22



Source: The National Bank of Ethiopia.

The overall government fiscal balance had shown improvement between FY 2003/04 and FY 2010/11. But since then, the country's fiscal balance has deteriorated. During this period, both revenue collections including grants and expenditure have fallen relative to GDP. Expenditure as a share of GDP was 22.9% in FY 2003/04 but has fallen to 12.8% in FY 2021/22. Likewise, revenue including grants dropped from 20.0% of the overall GDP in FY 2003/04 to 8.5% of GDP in FY 2021/22. The overall fiscal balance showed relative improvement in the early 2000s. The deficit including grants, for example, fell from 2.9% in FY 2003/04 to 0.9% in 2008/09. However, from FY 2008/9 onwards, the fiscal deficit increased again, reaching above 4% in FY 2021/22.

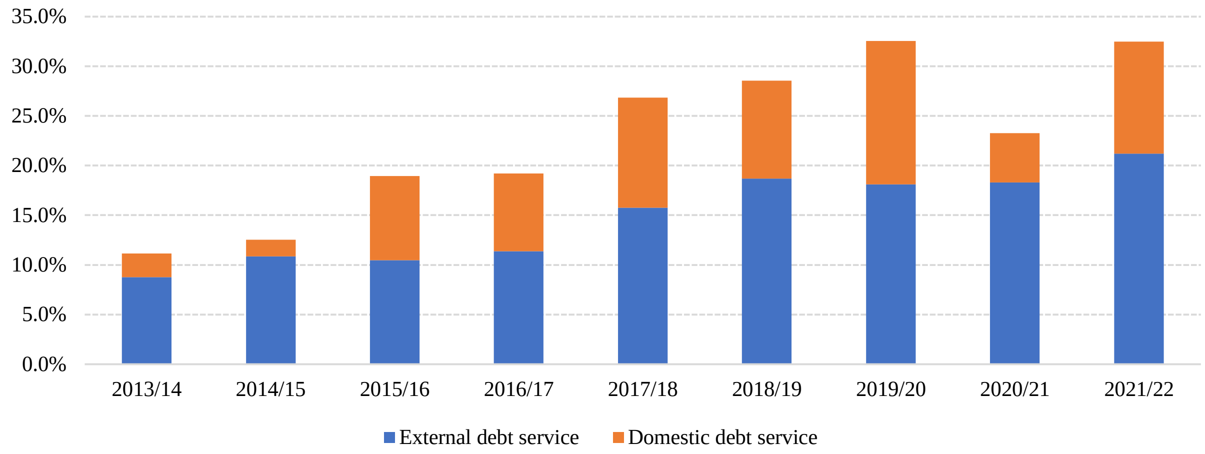
Figure 2.5. Government fiscal balance and public sector debt (as % of GDP)



Source: The Ministry of Finance and the Ministry of Planning and Development.

In recent years, Ethiopia has grappled with a significant accumulation of public sector debt, primarily fuelled by a widening fiscal deficit. Despite recent improvements, the country continues to contend with relatively high levels of public sector debt, positioning it within the IMF's high debt vulnerability category. However, there has been a modest reduction in Ethiopia's total public sector debt over the past five years, declining from over 60% in FY 2017/18 to below 50% in FY 2021/22. This decline is particularly notable in external debt. It reflects, in part, the prudent fiscal measures implemented by the government in the last two years under the Home-Grown Economic Reform I (HGER I), including a notable reduction in commercial borrowing. Additionally, persistent high inflation has contributed to this trend.

Figure 2.6. Public sector debt servicing (as % of revenue excluding grants)- FY 20213/14 to FY 2021/22



Source: Ministry of Finance, Tax Policy Department

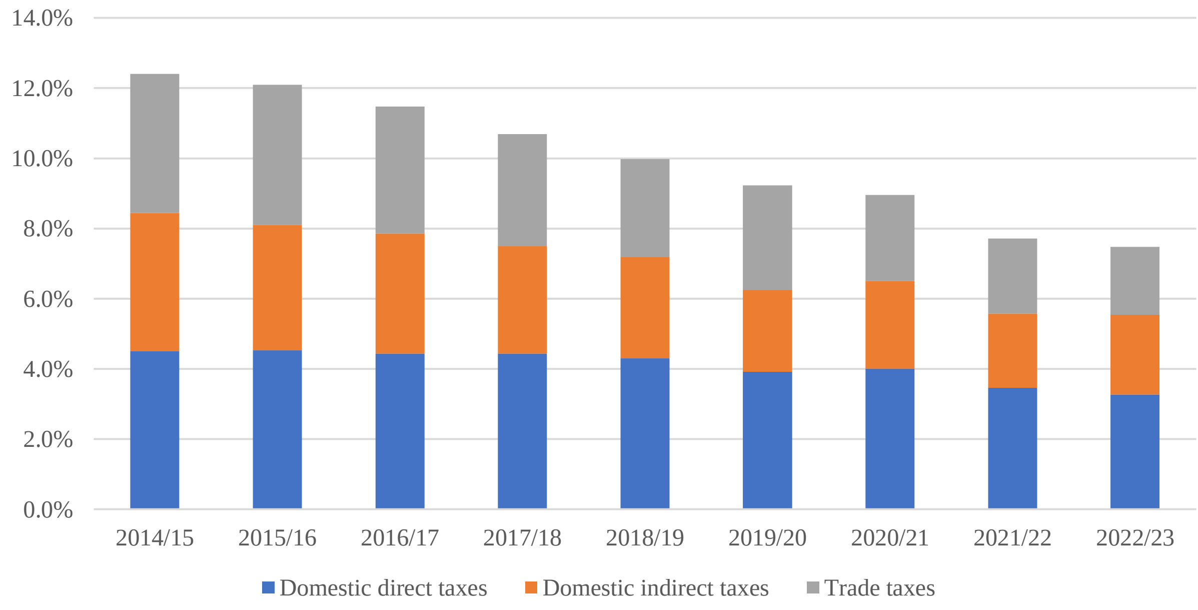
Public debt servicing as a percentage of revenue excluding grants has exhibited a steady rise from FY 2013/14 to FY 2019/20, experiencing a decline in FY 2020/21 (driven by domestic debt servicing costs) before rising once more in FY 2021/22. Over this period, external debt service has notably increased, surging from 8.8% of revenue in FY 2013/14 to 21.2% in FY 2021/22. This escalation in external public sector services could potentially impact total government expenditure.

2.3. Recent tax revenue performance

The tax-to-GDP ratio has exhibited a continuous decline since FY2014/15, falling from 12.4% to 6.8 % in FY2022/23. This decline persists despite improved revenue collections in nominal terms, indicating a slower growth in revenues relative to GDP. Notably, the decrease in the tax-to-GDP ratio is evident across all tax types. This trend is considerably below the IMF's recommended minimum tax-to-GDP ratio of 15%, essential for securing resources to fulfil state functions. Urgent action is imperative from all stakeholders to reverse this downward trajectory and ensure the provision of critical minimum public services.

Analysis reveals that domestic direct taxes constitute the most significant tax type, contributing around 44% of overall taxes in FY2022/23, followed by domestic indirect taxes at 30.4% and all trade taxes (including excise and VAT on imports) at 25.8%. Although all tax types have witnessed nominal year-on-year increases over the past eight years, the share of domestic direct taxes in total tax revenues has notably increased by nearly 9 percentage points. On the other hand, the shares of both domestic indirect and international taxes (in the total tax revenue) have declined during this period from 31.7% and 31.9% in 2014/15 to 25.8% and 30.4% in 2022/23 respectively. .

Figure 2.7. Ethiopia's overall tax composition (as % of GDP)- FY 2014/15 to FY 2022/23

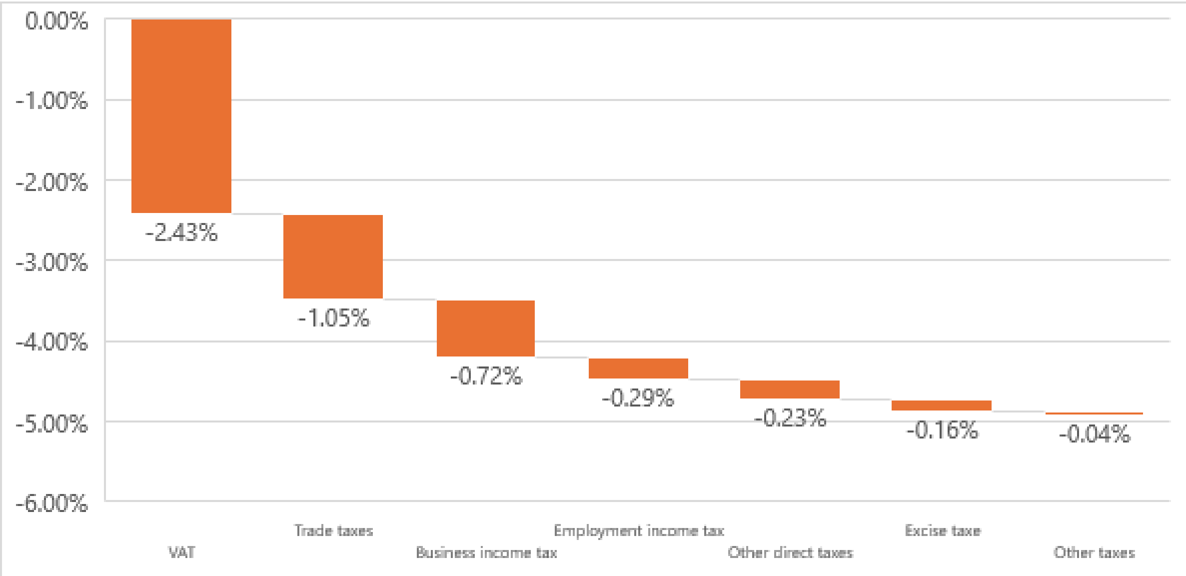


Note: 'Trade tax' includes both import VAT and excise on imported goods.

Source: Ministry of Finance staff computation, Tax Policy Department.

The decline in the tax-to-GDP ratio between 2014/15 and 2022/23 is mainly due to VAT, followed by trade taxes and business income taxes. During this period, VAT alone fell by 2.43% of GDP, trade taxes by 1.05% and business income taxes by 0.72% of GDP.

Figure 2.8. Change in tax-to-GDP ratio between FY 2014/15 and FY 2022/23



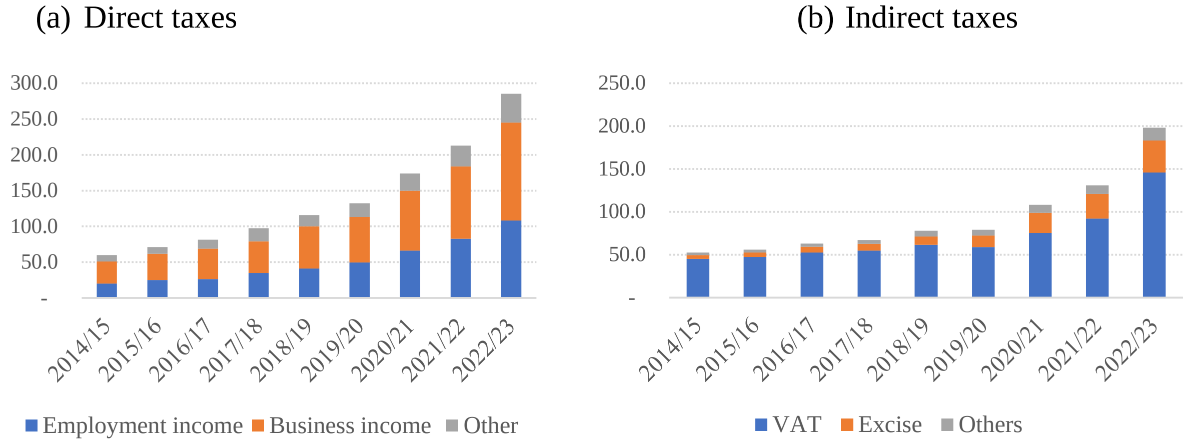
Note: Business income tax refers to income tax on incorporated and unincorporated businesses. Trade taxes only include customs and surtax, with VAT on imports classified under VAT, and excise on imports classified under excise. Other direct taxes refer to taxes on rental incomes, dividends, capital gains, royalties, withholding taxes on imports, interest income taxes, agricultural income tax and urban/rural land value tax.

Source: Tax Policy Department, Ministry of Finance

Domestic direct taxes

Business income taxes stand out as the most significant direct tax type, followed by employment income tax. The share of other direct taxes on interest income, royalties, dividends, and capital gains remains marginal. In FY ,2022/23 total domestic direct tax collections amounted to approximately ETB 285 billion, equivalent to 3.3% of GDP. Of this, business income tax collections accounted for over 44%, amounting to ETB 126. billion, while employment income tax constituted 38%, totalling ETB 108 billion. Other direct taxes collectively contributed less than 18% of the total domestic direct taxes collected.

Figure 2.9. Domestic tax collections by types (in ETB Billions)-FY 2014/15 to FY 2021/22



Source: Ministry of Finance staff computation, Tax Policy Department.

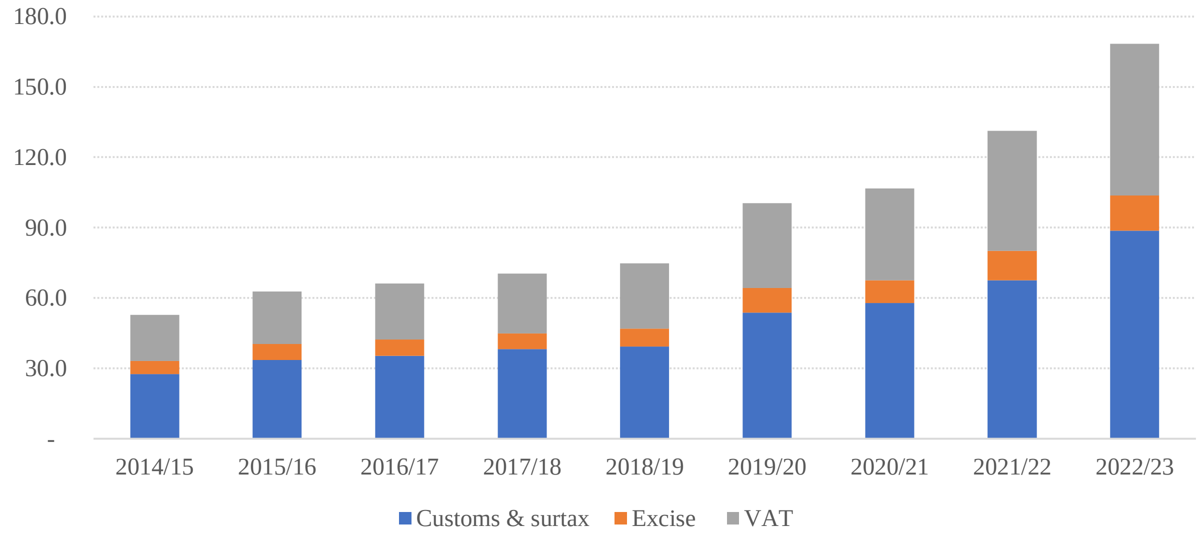
Domestic indirect taxes

VAT on local goods and services stands as the predominant contributor to domestic indirect tax collections. In FY 2022/23, VAT on local goods and services accounted for close to 74% of total domestic indirect taxes, amounting to ETB 146 billion. Excise tax from local goods constituted 19% of the total, equivalent to ETB 37 billion, while other domestic indirect taxes contributed less than 8%, equating to ETB 15 billion., in FY 2022/23, excise tax collections on local goods experienced a 30% nominal increase, rising from ETB 29 billion in FY 2021/22 to ETB 37 billion in FY 2022/23.

Trade taxes

Customs duty and import tax collections in FY 2020/21 were impacted by the COVID-19 pandemic. Compared to the preceding FY, total customs duty and import tax collections saw only a nominal 6% increase, corresponding to a notable 16.5% decrease in real terms in 2020/21. Then, amid the conflict in the north, customs duty and import tax collections increased by 23% in nominal terms (which corresponds to a 7.9% decline in real terms) in 2021/22. In FY 2022/23, the total trade tax collections grew by around 28% in nominal terms. Excise tax collections from imported goods increased by only less than 20% which translate to a real decrease. In terms of composition, customs duties and surtax together are the most important trade taxes, followed by VAT on imports.

Figure 2.10. Trade tax compositions (in ETB Billions)-FY 2014/15 to FY 2022/23

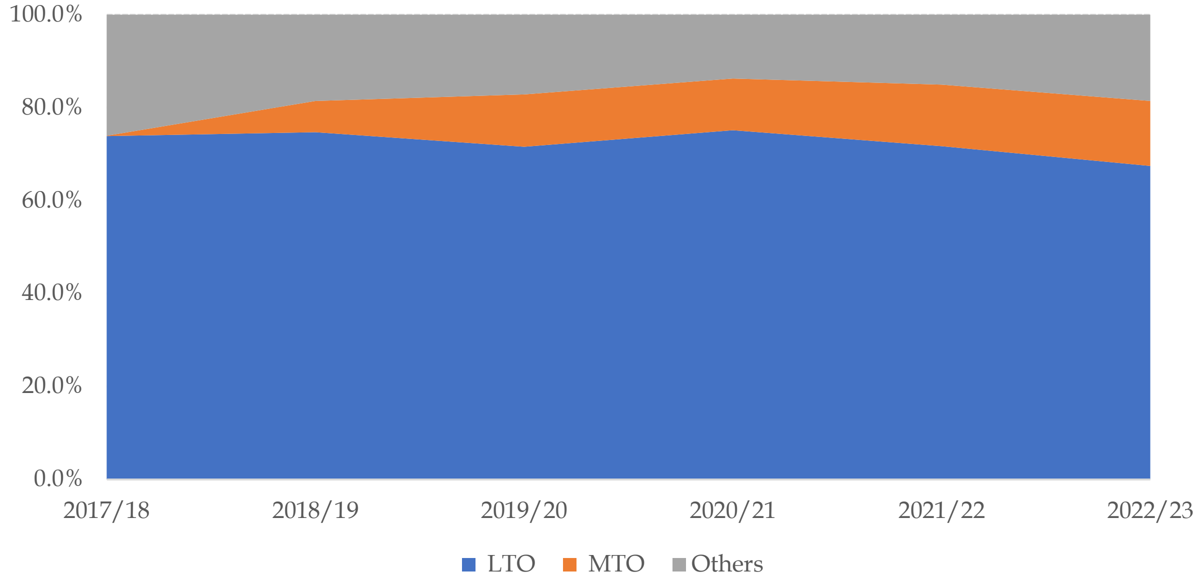


Source: Ministry of Finance staff computation, Tax Policy Directorate.

Tax collections by tax offices.

The Ministry of Revenue has established tax offices across the country to facilitate tax compliance. As part of the ministry's restructuring efforts, Large Taxpayers Office (LTO) and Medium Taxpayers Office (MTO) were established to cater to the needs of large and mid-sized corporate taxpayers. Recent data indicates that these specialized offices play a key role in revenue collection at the federal level. In FY 2017/18, the LTOs accounted for 73.9% of all federal tax collections, while MTOs and the regular small taxpayer's office collected 0.1% and 26.9% respectively. By FY2022/23, the dominance of LTOs persisted, albeit with a slight decrease, as they collected 67.4% of federal taxes. Meanwhile, MTOs and regular small taxpayer offices collected 14.0% and 18.6% of federal taxes, respectively. This data shows the significance of specialized tax offices, particularly LTOs, in contributing to federal tax revenue collection. Their tailored approach to serving large and mid-sized corporate taxpayers has proven effective in streamlining tax administration and enhancing compliance efforts.

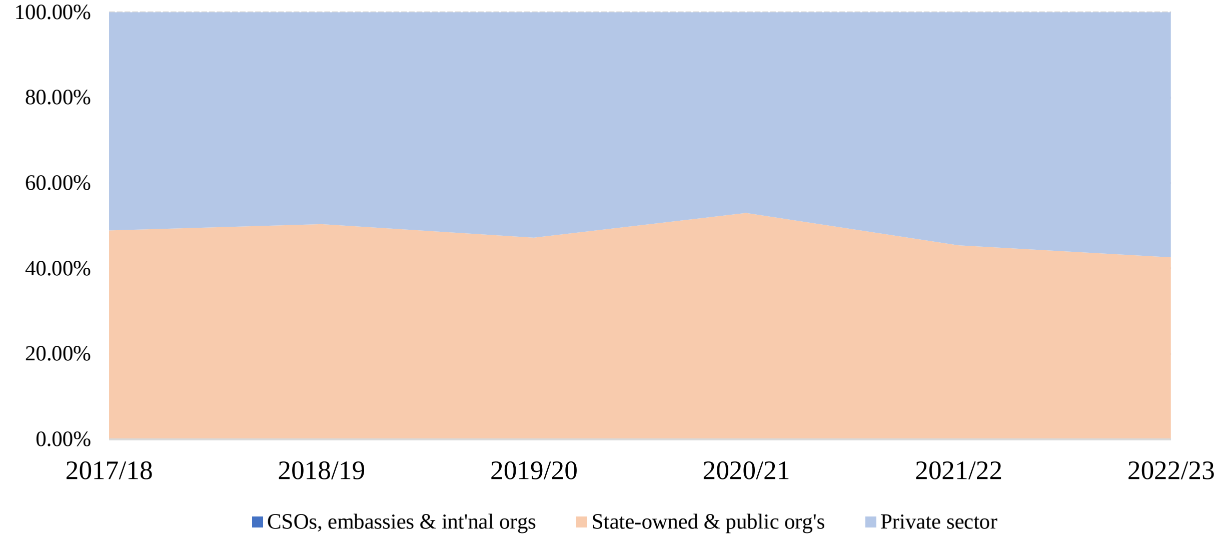
Figure 2.11. Federal tax collections by branch offices (in %)-2017/18 to 2022/23



Note: The FY 2022/23 collection is only for the 11 months (excluding the June 2023 collections).
Source: The Ministry of Revenue.

Tax revenue collected by LTOs accounted for the largest share of tax revenue collected by the federal government. Of the total tax revenue collected by LTOs, tax revenue from state-owned enterprises (SOEs) accounts for a significant proportion. In FY2017/18, SOEs and other public institutions contributed about 49% of total LTO tax collections, while the private sector, including civil society organisations (CSOs), contributed 51%. This has changed slightly in recent years, with state-owned enterprises and other public institutions contributing 42.6% and the private sector contributing around 57.4%. As can be seen from the figure, the contributions of CSOs to the overall tax collections at LTO is negligible.

Figure 2.12. LTO tax collections by sector (% of total tax collected by the LTO)- FY 2017/18 to FY 2022/23

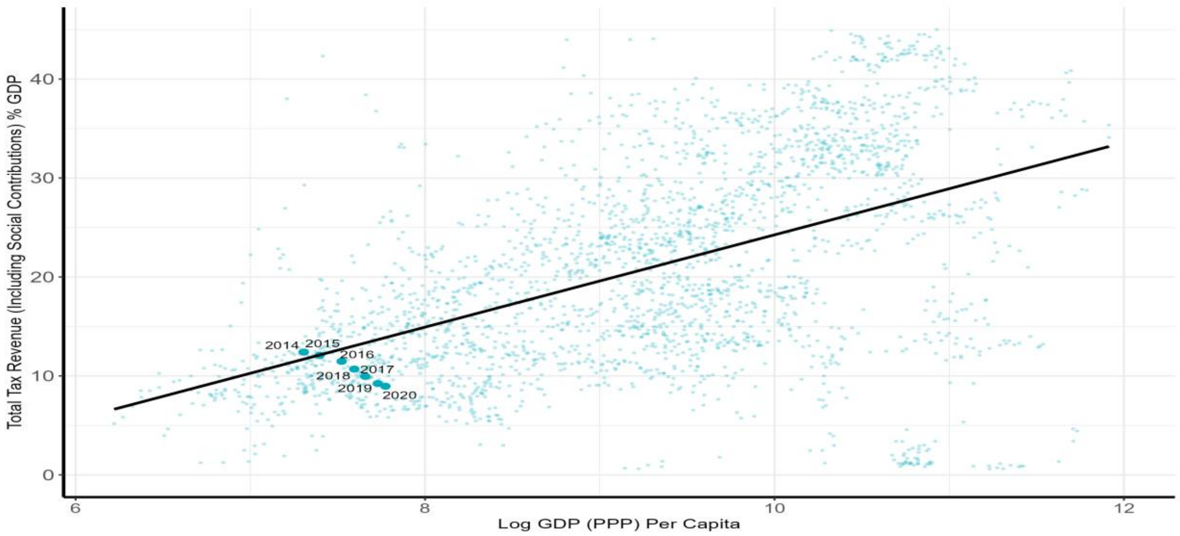


Note: The FY 2022/23 collection is only for the 11 months (excluding the June 2023 collections).
Source: The Ministry of Revenue.

2.4. Cross-country comparisons: How does Ethiopia compare with other countries?

Ethiopia's tax-to-GDP ratio continues to lag significantly behind the Sub-Saharan African average and is on a declining trajectory, as depicted in the figure below. The graph illustrates that Ethiopia's tax-to-GDP ratio, excluding social security contributions, now falls well below the average for countries with similar per capita income levels.

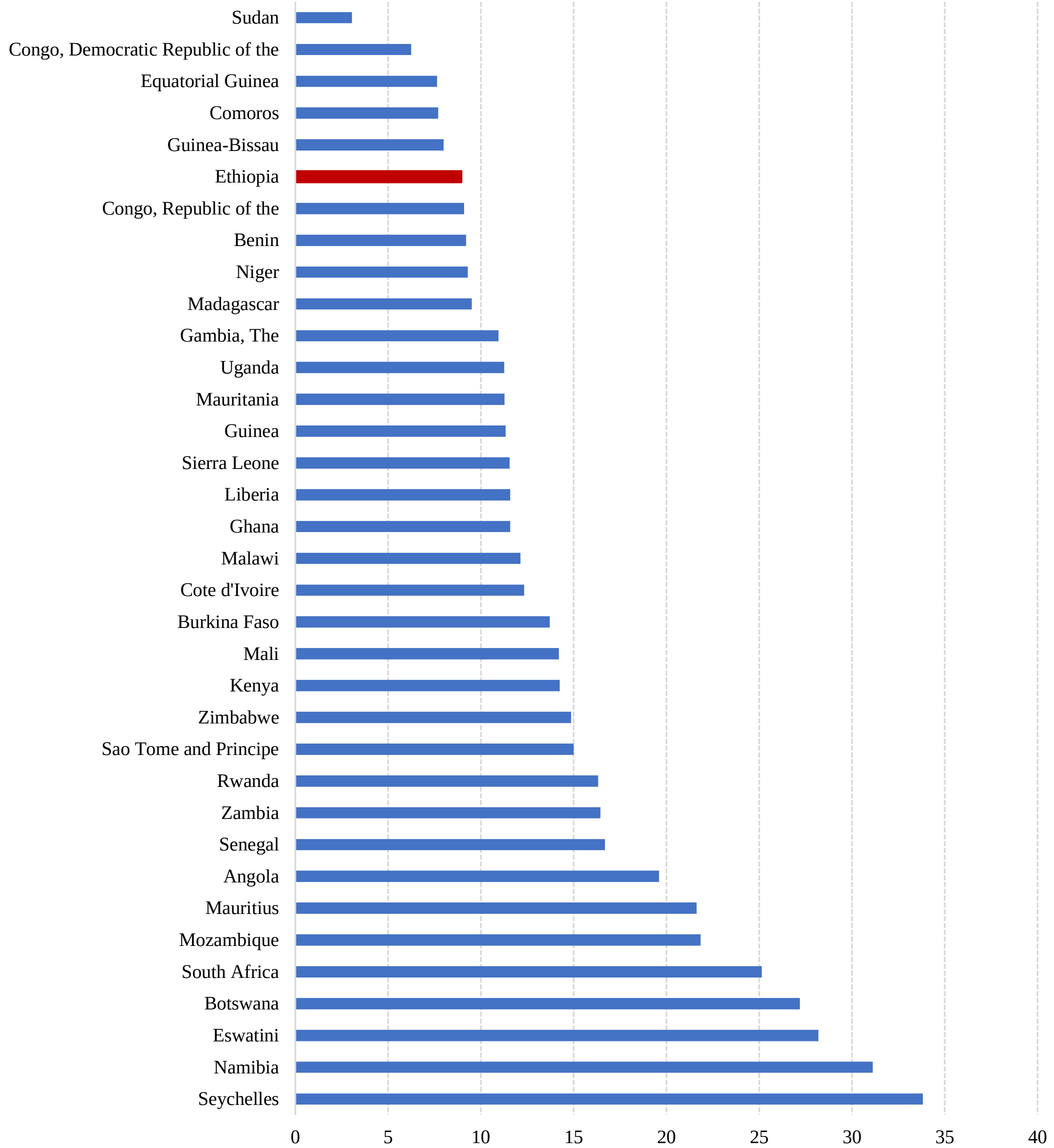
Figure 2.13. Tax-to-GDP ratio Vs per-capita income



Source: Institute for Fiscal Studies (IFS) analysis based on UNU-WIDER Government Revenue Dataset.

In 2022/23, the latest FY, the tax-to-GDP ratio was around 6.8%, which is comparable only to resource-rich and fragile economies in the region like the Democratic Republic of Congo, the Republic of Congo, and Equatorial Guniea (see figure below). Neighbouring countries like Kenya, Uganda, and Rwanda have a higher tax-to-GDP ratio than Ethiopia. Kenya, for example, collected around 14% of its GDP in taxes in 2020.

Figure 2.14. Tax-to-GDP ratio for SSA Countries including Ethiopia in 2020

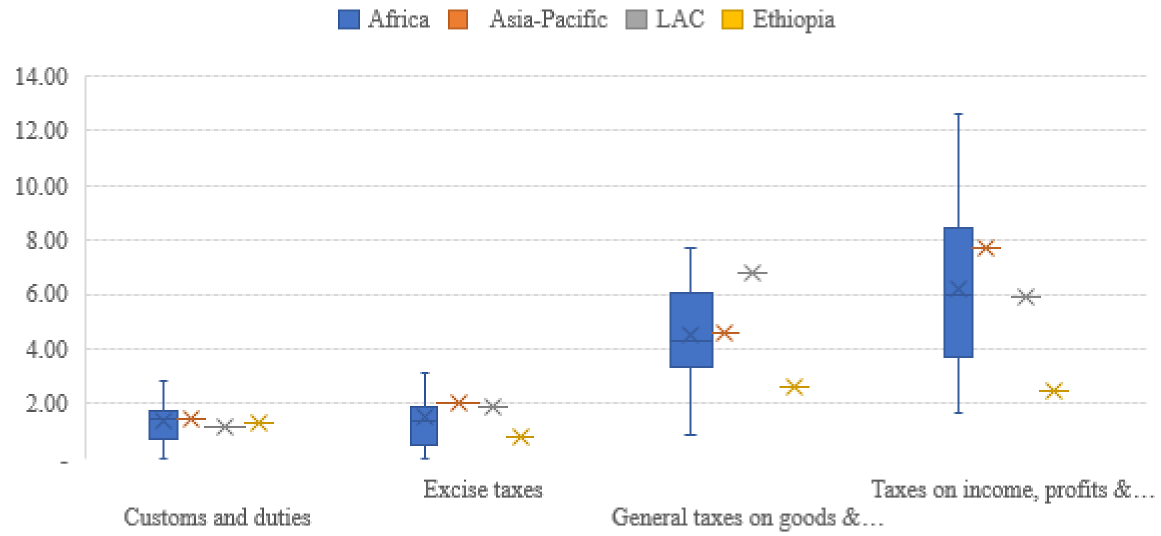


Note: The Ethiopian tax-to-GDP ratios are for 2020/21.

Source: UNU-WIDER Government Revenue Dataset.

As shown in the figure below, Ethiopia's tax composition differs from that of other African countries. Taxes on income, profits and capital gains (excluding payroll taxes) account for only 2.5% of GDP in Ethiopia, compared with an average of 6.2% for the African continent, 7.7% for Asia-Pacific and 5.9% for Latin America and the Caribbean. Ethiopia also raises less revenue than other African countries from excise duties and general taxes on goods and services. Customs duties and import levies, on the other hand, raise almost the same amount (as a percentage of GDP) as in the other regions.

Figure 2.15. Tax compositions (as % of GDP) for Ethiopia Vs other regions in 2020



Note: For LAC and Asia-Pacific, the numbers represents the averages, and the whiskers show the mean

Source: UNU-WIDER Government Revenue Dataset.

2.5. Challenges to Domestic Resource Mobilization (DRM) in Ethiopia

Structure of the economy

Despite recent improvements in the contribution of services and industry to total GDP, agriculture, which is largely exempt from income tax, remains the main economic activity. It contributed more than 39% of the country's GDP in 2021/22, while the service and industry sectors contributed around 38% and 24% respectively. In terms of employment, agriculture continues to absorb a significant portion of the labor force. In 2021, it employed around 64% in Ethiopia, while in Kenya and Rwanda, it only employed 33% and 55% respectively (World Bank, 2023). To have a good understanding of the share of agriculture in the Ethiopian economy, it is better to compare the share of agricultural value added in the total gross domestic product (GDP) of Ethiopia with some other African economies. The contribution of agriculture to the overall economy, as measured by the ratio of agricultural value added to GDP, is highest in Ethiopia at over 37.57% in 2020/21. However, the agricultural value added to GDP ratio for other African countries is less than 30%, with the lowest agricultural value added to GDP ratio being recorded in Zambia at 3%. Similarly, the contribution of agriculture in some African countries such as Senegal (15%), Cameroon (17%), Kenya (22%), Malawi (23%), Uganda (8%), Rwanda (24%) and Tanzania (26%) is much lower than the share of agriculture in the Ethiopian economy (World Bank, 2022).

In an economy where agriculture is a key economic sector, tax collection could be challenging. Coupled with this, the Ethiopian economy is characterized by high informality. World Bank estimates for Ethiopia indicate that the informal sector contributed around 34% of GDP in 2018. Various empirical studies show that the structure of the economy and the degree of informality are key factors affecting domestic revenue mobilization (Besley and Persson, 2014; Kibret, 2016, McNabb et al., 2021). Such businesses are often unregistered for tax purposes and difficult to tax or administratively costly for the tax authority.

Weak administrative capacity

Ethiopia's tax administration ranking in the latest TADAT assessment failed to meet the minimum standard for most indicators, despite recent efforts by the government to improve the tax administration system. In almost all Performance Outcome Areas (POAs), Ethiopia was rated D, reflecting the weak administrative capacity of the Ministry of Revenue. This may be one of the challenges in fully implementing the various tax policy and administrative measures envisaged in the MTRS and thereby improving domestic resource mobilization. In many low-income countries, fair and efficient tax policies may fail to raise more revenue or effectively address the broader economic situation because the tax administration is unable to implement the policies properly (Vehorn, 1997). In addition, the Ministry of Finance and the Ethiopian Customs Commission have high staff turnover, which hampers the proper implementation of the various tax policies.

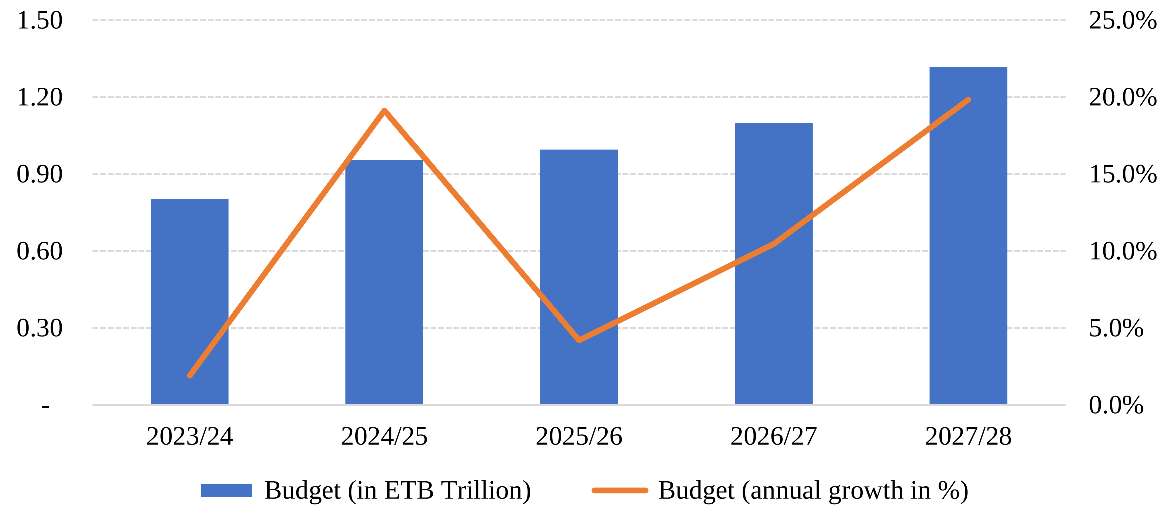
Persistently high inflation

Persistently high inflation could affect both the collection and composition of tax revenues through various mechanisms. Since most taxes are not inflation-indexed, inflation has a direct impact on the entire tax system. A typical example is "bracket creep", where inflation pushes wage earners into higher tax brackets. Although high inflation with a fixed nominal threshold could lead to an increase in real tax revenues and marginal tax rates, higher inflation could also lead to an increase in tax evasion (Beer, 2023). Similarly, since some types of taxes, such as VAT, are levied on nominal value and apply to taxpayers with a given registration threshold, persistently high inflation could push small taxpayers into the VAT system with marginal revenue gains, creating administrative costs for the tax authorities and compliance costs for businesses.

3. RECENT TAX POLICY & ADMINISTRATIVE MEASURES

The government plans to tighten fiscal policy during the NMTRS period in view of the growing debt service burden of the public sector in the coming years. Nevertheless, the federal government's expenditure plan is projected to increase from ETB 0.8 trillion in FY 2023/24 to ETB 1.3 trillion in FY 2027/28 per the Medium- Term Macro-Economic and Fiscal Framework (see figure below). It is therefore crucial for the government to improve its domestic resource mobilization efforts and meet its expenditure needs through a comprehensive tax policy and administrative measures.

Figure 3.1. Medium-term macroeconomic and fiscal framework (MEFF) federal government spending plan



Source: Ministry of Finance, Fiscal Policy Department.

3.1. Recent Policy Measures

The Ministry of Finance has introduced a series of comprehensive tax reforms, especially in the last four years. Tax policy reforms are usually initiated by the Ministry of Finance in consultation with the relevant stakeholders, including the Ministry of Revenue. The key policy and administrative measures over the last four years are presented in the Appendix.

3.1.1. Border *franco-valuta* and tariff exemptions

To facilitate trade in the border areas, the Ethiopian government allowed *franco-valuta* trade in selected border areas. The scheme allowed businesses to import goods without getting foreign exchange permits from or without opening a Letter of Credit, Cash Against Documents, or Telex Transfer at the National Bank of Ethiopia. It played a critical role in promoting cross-border trade among communities. However, in recent years the scheme has become administratively challenging for the Customs Commission. And many key stakeholders including regional states have not fully cooperated with the Customs Commission to properly monitor the scheme. This has paved the way for illegal trade in these border areas, which threaten the country's overall trade and revenue collections. It was estimated that the scheme was costing the government around 0.22% of GDP per year. It also raised issues of fairness and equity in some areas. Therefore, recognising these issues, the government scrapped the scheme in 2017.

3.1.2. VAT Reforms

The compulsory VAT registration (i.e. ETB 0.5 million) had not been revised for almost fifteen years, despite persistently high annual inflation. This had brought many small businesses into the VAT system and increased the administrative costs for the tax authority, and the tax compliance costs for these businesses. Recognising this, the Ministry of Finance revised the VAT registration threshold from ETB 0.5 million to ETB 1 million in 2018 (Circular T/K/Q/5/161).

In 2019, the Ministry of Finance introduced another VAT regulation, which revised the VAT withholding rates. Prior to 2019, VAT withholding agents were required to withhold and remit to the Ministry of Finance 100% of the VAT payable on their procurement. However, in 2019, the withholding rate has been changed to 50%. It requires withholding agents to withhold only 50% of the VAT payable on their procurement, while suppliers keep the remaining 50% and remit it to the Ministry of Revenue.

3.1.3. Excise tax reform

In 2020, the MoF introduced the Excise tax Proclamation (Proclamation No. 1186/2020) replacing the previous proclamation (Proclamation No. 307/2002), which had been in place since 2003. This reform introduced various changes, including a change of the tax base for locally produced goods from the ‘production cost’ to ‘ex-factory prices’ (the tax base for imported goods remained the CIF value plus customs duty payable). The reform also introduced a wide range of changes related to the administration of the excise tax. These included:

- Taxpayers must get a permit from the tax authority to import or locally manufacture goods that are subject to excise tax.
- Excise duty rates for certain products have been reduced to offset the impact of the change in tax base from ‘production cost’ to ‘ex-factory prices’. For example, textile and garment products were subject to 10% before but are now subject to 8% excise tax. Similarly, powder soft drinks were taxable at 40% but are now taxed at 25%. The new law also raised the maximum applicable excise tax rate on certain imported items, mainly on old vehicles, from 100% to 500%.
- Additional goods have been included in the excise tax base (which were not subject to excise previously). For example, tractors and three-wheeler motor vehicles are now subject to rates of up to 400% and 405%, respectively, depending on age and engine power, and some luxury items like human hair and wigs are now subject to 40% excise tax.

3.1.4. Customs Reform

In September 2021, the Ministry of Finance introduced a comprehensive customs reform. It was mainly aimed at simplifying the customs tariff book (which had not been reviewed for over two decades) and shifting the tariff burden towards final goods and away from raw materials and intermediate goods. In line with the government’s industrial policy, the Ministry of Finance exempted capital and investment goods (especially machinery) from the payment of customs duty and other import taxes. The reform changed the previous customs duty rate structure from 0%, 5%, 10%, 20%, 30%, and 35% to 0%, 5%, 15%, 25%, and 35% based on the value addition. Raw material and capital goods attract lower duty rates while final goods attract higher duty rates of up to 35%. This was aimed at simplifying the country's customs system as per the recommendations of the World Customs Organization.

Previously, in its effort to promote the local manufacturing sector, the government used to grant preferential customs duty treatment to selected local producers through the second schedule scheme. The scheme was effective in terms of promoting local production and attracting foreign direct investment. However, it created a huge administrative burden for the Customs Commission, as well as distortions in the economy. Therefore, recognizing these issues, the Ministry of Finance removed the second-schedule scheme altogether from the tariff book. However, selected local manufacturers continue to enjoy duty-free or preferential customs treatment when they import raw materials, capital, and investment goods. This reform was a revenue-raising measure.

3.1.5. Surtax Reform

When the surtax was introduced in 2007, it was a temporary measure to be levied on all imports with a small number of exemptions, including for petroleum products and fertilisers.[1] It was aimed at raising revenue to finance the government's effort to address the rising cost of living in 2007 and 2008, especially in urban areas. However, it has remained a key part of the tax system, raising around 20% of the foreign trade tax revenue for the government until FY 2020/21.

Along with customs reform, the Ministry of Finance implemented a reform of surtax in September 2021, which is intended to be the first step towards phasing out surtax entirely. In the first phase, the Ministry of Finance exempted all imported items with a customs duty rate of 15% or less from the payment of surtax. These exempted imports are mostly raw materials, strategic imports such as capital goods, or intermediate imports. This has simplified the customs and import tax system.[2] The reform is a revenue loss measure.

[1] Import Surtax, Council of Ministers Regulation No. 133/2007. Available at https://www.2merkato.com/images/downloads/regulation_133_2007.pdf

[2] Imports with a customs duty rate above 15% are generally subject to a 10% surtax. However, there are certain imports, mainly within the garments and textiles category, that are subject to 25% customs duty but exempted from the payment of surtax altogether.

3.1.6. Centralization of the tax exemptions

In its effort to promote industrialization, the Ethiopian government grants tax exemptions to various entities including foreign investors, civil society organizations, and private investors. The tax exemptions were administered by more than 35 government ministries/entities including the regional government without much coordination, which resulted in substantial revenue loss for the government. In addition to that, it also paved the way for corruption. So, it was necessary to centralize the administration of the exemption process. In May 2021, the Ministry of Finance started administering the exemption process. By doing so, the Ministry of Finance coordinates and harmonizes the exemption process. It has also started monitoring and evaluating the tax exemption system. In 2021/22, the Tax Policy Department produced a comprehensive assessment of the tax expenditures arising from these exemptions which fed into the rationalization of the tax incentives. One typical example being the removal of customs duty and import tax exemption privilege granted to importation of pickup trucks for investors.

3.1.7. Rationalization of tax incentives

Aimed at rationalizing the investment incentives, a new investment incentives regulation (Council of Minister Regulation No. 517/2022) was introduced in 2022. The regulation clearly listed the investment incentives and the eligible sectors by geographic areas. As part of this reform, some incentives such as the duty-free importation of pick-up trucks for investors and civil society organizations were removed.

The rationalization of incentives included the removal of employment income tax exemptions for expatriates. The incentive was aimed at promoting the transfer of knowledge to domestic workers and fostering the development of local talent. Export companies were permitted to hire expatriates, with employment income tax exemptions granted to these individuals. While this initiative initially succeeded in addressing the domestic skills gap and facilitating knowledge transfer, it inadvertently created a disincentive to hire local talent. Recognizing this unintended consequence, the government decided to remove these incentives.

3.1.8. Social Welfare Levy

As the country reeled from the conflict and the impact of the COVID-19 pandemic, it was key to mobilize more domestic resources earmarked for the rehabilitation and reconstruction of infrastructure like schools, health centres, etc. Hence in 2022, the Council of Ministers approved a regulation (Regulation No. 519/2022) to levy a social welfare levy on all imports (except a few exempted imported items/entities such as persons and organizations with diplomatic privileges, and goods which are subject to the surtax levied under Import Surtax Council of Ministers Regulation No. 133/2007) at the rate of 3% on the CIF value in addition to any other customs duties and taxes collected under applicable laws. Since it came into effect in FY 2022/23, the government raised more than ETB 6.3 billion (or less than 0.1% of GDP).

Chart 1: Summary of tax policy reforms and revenue implications (in ETB)

Source: Tax Policy Department estimates

3.2. Recent tax administrative measures

Ethiopia's tax administration system is based on a self-assessment system combined with tax enforcement tools. As a result, taxpayers are encouraged to assess their taxes, file their returns in a timely manner and pay the taxes due to the tax administration in a timely manner as stipulated in the tax laws.

Ethiopia currently has a federal structure where taxation and expenditure are decentralised. In principle, decentralisation of public services to regional states is a feature of the federal government, which leads to decentralisation of expenditure - this in turn requires decentralisation of revenue administration, as a result of which the federal government and regional states/city administrations have their own tax administration to manage taxpayers under their jurisdiction.

The Ministry of Revenue is the result of a series of institutional reforms undertaken by the government. The Ethiopian Revenue and Customs Authority (ERCA) was established in July 2008 by merging the Ministry of Revenue, the Ethiopian Customs Authority and the Federal Inland Revenue Authority into a single administration /Proclamation No. 587/2008/. Currently, again based on the general reforms of the federal government institutions, the Ethiopian Revenue and Customs Authority has undergone another phase of reform that led to the tactical separation of the customs administration from the coalition and resulted in the establishment of two legal entities, namely the Ministry of Revenues (MOR) and the Customs Commission (Proclamation No 1097/2018). The Ministry of Revenues has the mandate to supervise and control the newly established Customs Commission.

3.2.1. Major Tax and Customs Administration Reform measures

The Ministry of Revenue is overhauling the tax administration system to improve service delivery, increase compliance, enforce tax laws and sustainably increase revenue collection. In recent years, the Ministry of Revenue has implemented the following administrative measures:

A) Tax administration reforms

- Issuance and implementation of various directives to streamline tax processes and encourage compliance, including penalty waivers, estimated assessments, and tax payment extensions.
- Introduction of measures such as self-assessment amendments, taxation of income after business termination, and tax clearance services.
- Implementation of risk-based VAT refund systems and taxpayer identification number (TIN) systems with biometric verification to reduce fraud.
- Adoption of e-filing, e-payment systems, and cash register machines to digitize processes and enhance revenue collection.
- Strategies to improve compliance, including risk-based audits, taxpayer education, and dialogue forums with stakeholders.
- Establishment of specialized units for debt management, large taxpayers, and tax offices across the country.
- Initiatives to raise public awareness about taxation and enhance customer service through regular reviews of customer charters and training programs for staff.

- Modernization efforts such as upgrading IT systems, introducing electronic invoicing, and implementing data warehouses for better tax enforcement.
- Introduction of reward schemes for taxpayers and employees to promote voluntary compliance and productivity.

b) Major Customs administration reforms

- Upgraded its customs management system to the Electronic Customs Management System (eCMS) from ASYCUDA.
- Strengthened the Customs Valuation System (ECVS) to combat under-invoicing and simplify clearance processes.
- Introduced deferred payment, advance ruling, and consolidated/deconsolidated systems for faster cargo clearance.
- Reduced document requirements for imports and exports.
- Implemented cargo-scanning machines, tracking systems, and Authorized Economic Operators program.
- Introduced pre-arrival clearance and one-stop shops within industrial parks.

4. NMTRS POLICY & ADMINISTRATIVE INTERVENTIONS

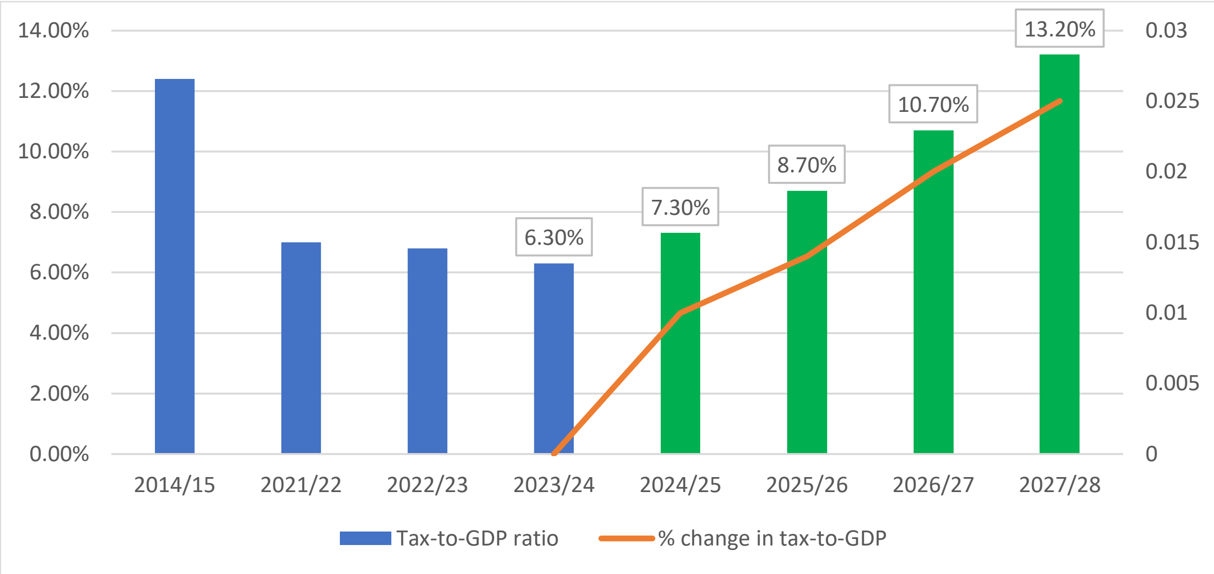
The NMTRS aligns with the country's fiscal policy direction outlined in the 10-year development plan, aimed at bolstering tax collection and base broadening to reduce external dependence. The overarching objective of the NMTRS is to realize the country's tax revenue potential while ensuring the sustainability of its public finances. The NMTRS sets out the following specific objectives:

1. **Reversing the falling tax-to-GDP ratio:** Coordinated policy and administrative measures will be implemented to reverse the declining tax-to-GDP ratio. By the end of the NMTRS period, the target is to achieve a tax-to-GDP ratio of approximately 13.22%.
2. **Broadening the tax base:** Introducing new taxes such as property and vehicle taxes will contribute to broadening the tax base, thereby enhancing revenue generation.
3. **Improving tax compliance:** Enhanced enforcement and improved service delivery to taxpayers are pivotal in fostering better tax compliance.
4. **Bringing the informal sector into the tax net:** Efforts will be made to reduce the level of informality in the country by bringing the informal sector into the tax net, consequently expanding the tax base.
5. **Ensuring the efficiency and fairness of the tax system.** This involves continuous evaluation and refinement of tax policies and procedures to ensure that the tax system operates efficiently and fairly for all stakeholders.
6. **Maintaining vertical and horizontal harmonization of the tax system**: This aims to maintain consistency and coherence in tax policies and regulations both vertically across different levels of government (national, regional, local) and horizontally among various types of taxes (e.g., income tax, indirect taxes, property tax).

These objectives will be realized through the reinforcement of tax policy and the enhancement of compliance and administrative capacity. This comprehensive approach is envisaged to enhance the investment climate, stimulate private sector development, and foster greater equity and fairness within the tax system.

The NMTRS outlines a holistic strategy encompassing broader tax policy reforms and administrative measures to be implemented between FY 2024/25 and 2027/28.

By the end of the NMTRS period, tax policy and tax administration reforms are expected to raise an additional 6.9 percentage points (in the country's tax-to-GDP ratio), bringing the country's tax-to-GDP ratio to 13.2%. Of additional tax revenue, tax policy measures (outlined in detail below) will raise the tax-to-GDP ratio by 3 percent of GDP while tax administration measures will lead to an additional 2.9 percentage points. The foreign exchange reform and the broader macroeconomic economic reform is expected to raise additional 1% of GDP by the end of the strategic period. **Figure 4.1. Projections of the tax ratio as a percentage of GDP under NMTRS**



Note: The blue bars show the actual tax-to-GDP ratio while the green bars show the projections under the NMTRS. It is also worth noting that the 2023/24 figures are based on the IMF projections.

Source: Ministry of Finance, Tax Policy Department estimates

BOX: Guiding principles of the NMTRS

The key guiding principles of taxation underpin the proposed policy reforms in the NMTRS. These include:

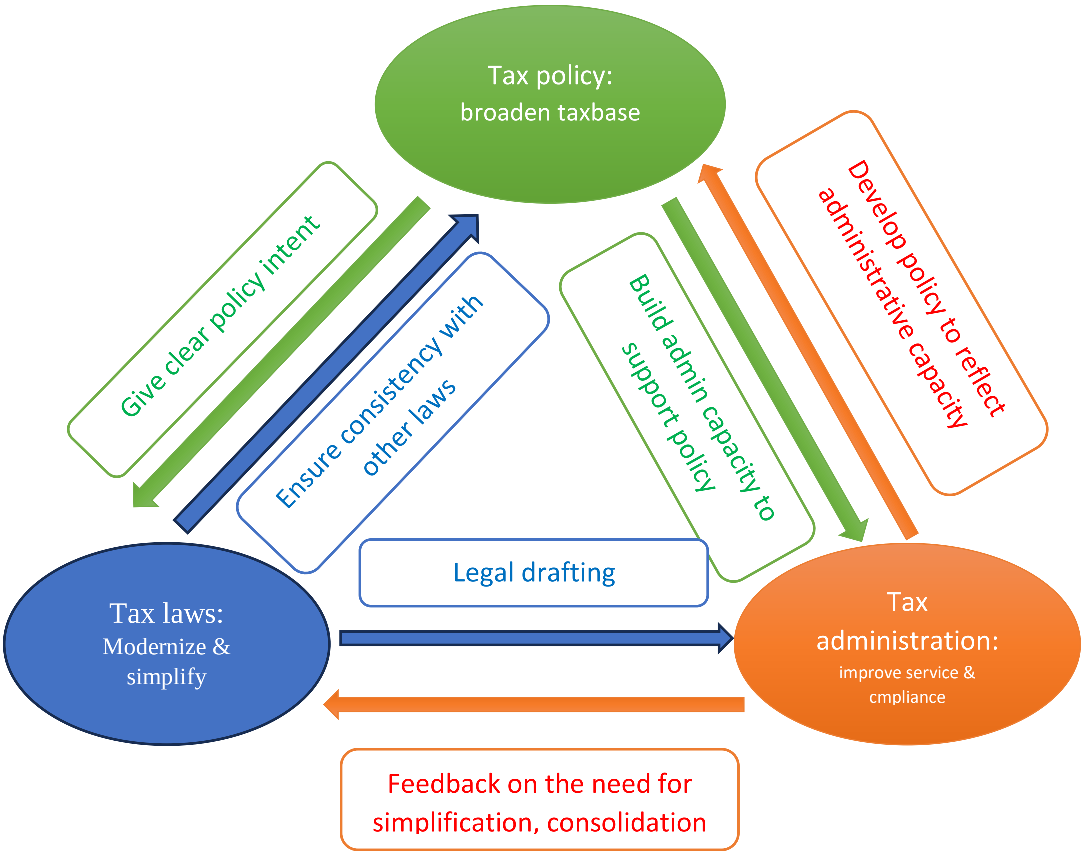
- **Neutrality**: The tax system should treat similar activities in similar ways. Such a system minimizes the economic distortions that could arise from peoples' choice and behaviour.
- **Simplicity**: A simple and transparent tax system that imposes minimal administrative costs on the tax authorities and compliance costs on taxpayers is a key feature of a good tax system. A lack of simplicity and neutrality paves the way for tax avoidance and tax evasion.
- **Progressivity**: The system as a whole needs to ensure both horizontal equity (similarly situated individuals in the income distribution face similar tax burden) and vertical equity (where those who earn more pay more).
- **Feasibility**: The design of taxes should take into account the administrative capacity of the tax authority for effective implementation and collection of tax revenues.

- **Flexibility/Dynamic**: The tax system must adapt to the current economic reality by means of periodic policy reforms.

4.1. Approaches to the NMTRS

In many low- and middle-income countries (LMICs), well-designed and efficient tax policies can fail because the tax administration may not be able to implement them properly (Vehorn, 1997). These interdependencies and linkages between the different elements of the tax system aim to create a business, investment, and tax environment with clear policies that support national development and social objectives and encourage investment. By considering tax policy, administrative capacity, and legal frameworks in tandem, governments can create an environment conducive to effective tax governance. This integrated approach enhances the likelihood of successful policy implementation, facilitates compliance, and supports sustainable revenue generation, ultimately contributing to broader socioeconomic development objectives. The following diagram outlines the interaction between the three key components in the policymaking and implementation cycle:

Figure 4.2. Policy and administration interactions



Source: Adapted from the Papua New Guinea MTRS (2018-22)

4.2. Tax policy reform measures

During the last six years, a series of policy reforms (including the excise tax, customs, and surtax reforms) have been implemented aimed at tapping the remaining revenue potential and simplifying the overall tax system. To ensure the full implementation of the policy reforms, a ministerial committee was set up in FY 2019/20 comprising the ministers from the Ministry of Finance, the Ministry of Revenue, Ministry of National Planning and Development, as well as the Governor of the National Bank of Ethiopia and the Commissioner of the Ethiopian Customs Commission. The reforms have simplified the tax system and improved revenue collections. Nonetheless, the tax-to-GDP ratio continues to decline, suggesting a need for further comprehensive tax policy reform. Hence in the next four years, i.e. FY 2024/25 to FY 2027/28, various policy reforms will be implemented with the aim of raising the tax-to-GDP ratio by 30% by the end of the NMTRS implementation period, i.e. FY 2027/28.[3]

Income tax reforms

In 2016, the income tax was reformed, introducing various changes to the income tax system including the PIT rate structure and exemption thresholds, and revising the annual turnover threshold for presumptive tax system up from ETB 100,0000 to ETB 500,000. But still, there are key policy and administrative issues requiring further reforms in line with the economic and social dynamics of the country. The following are the key reform areas in relation to the income tax:

- **Revisiting the existing schedular tax system:** The current schedular income tax framework treats various income sources disparately, impacting the system's progressivity and fairness. Individuals with identical income levels (and corresponding ability to pay) may face significantly different tax burdens due to varying tax rates and limited deductions or exemptions for certain income categories. Moreover, the classification of diverse income sources under a schedular system imposes a substantial administrative burden on tax authorities. Additionally, the schedular tax system is susceptible to tax planning strategies employed by taxpayers. To address these challenges, a shift towards a global tax

[3] The IMF in 2019 estimated that the average additional spending to achieve the SDGs in five key areas (education, health, roads, electricity and water) in low-income countries by 2030 is 15.4 (Gasper, 2019).

system is planned. This transition aims to create a more uniform and equitable tax regime, where all income sources are treated consistently, ensuring fairness, and reducing tax planning opportunities. This reform is slated to be implemented in the FY2027/28.

- **Rationalizing tax exemptions and incentives**: In its effort to attract foreign direct investment and promote exports, the government has put in place various incentives including income tax exemptions and tax holidays. Owing to the growing revenue costs for the government and the need to ensure transparency of the whole incentive structure, to improve the efficiency of the incentive structure and the whole tax system, the tax exemption and incentive scheme will be rationalized. This will also help align our incentive structure with the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS).
- **Simplifying the presumptive tax regime**: Ethiopia currently applies a presumptive income tax regime for small and micro enterprises classified as 'Category C'. The current presumptive tax regime has a multi-rate turnover-based system making it administratively cumbersome for the regional tax bureaus and creating substantial compliance costs for taxpayers. The Ministry of Finance will work with the regional tax bureaus to simplify the system by reducing the number of tax rates. This is aimed to be a revenue-neutral reform.
- **Introducing a Minimum Alternative Tax (MAT)**: The introduction of MAT is poised to play a pivotal role in tackling tax evasion and avoidance among corporations, thereby empowering the government to bolster its CIT revenue. Currently, businesses benefit from numerous deductions under the standard business income tax, leading to potential reductions in tax liabilities and posing risks to revenue collection. even with rationalizing tax incentives, it may be necessary to grandfather some existing incentives which could delay some increases in revenues. To mitigate these risks and enhance tax compliance, the government will institute a minimum alternative tax framework. This measure aims to effectively counter tax avoidance strategies employed by corporations. Implementation of this reform is scheduled for the FY2027/28.
- **Revisiting the double taxation avoidance treaties**: Currently, Ethiopia has double taxation agreements with different countries with significant implications on revenue collections. . Hence in the next four years, the government will identify priority existing agreements for renegotiation and initiate negotiations to ensure

that all these agreements benefit the country New double taxation agreements will be negotiated based on the national policy framework, and the double taxation avoidance treaty model will be revisited in line with the OECD and UN Model. This reform is expected to be a revenue neutral reform.

- **Reforming the personal income tax**: The marginal PIT rates and the exemption thresholds will be revised in line with prevailing inflation. Currently, the PIT has six marginal rates, and the PIT-exempted threshold has not been changed since 2016 despite the high inflation rate. The reform will reduce the number of marginal rates and increase the exemption thresholds. This is intended to ensure that the PIT rates are in line with the inflation rate and reduce bracket creep. This will result in a revenue loss of around -0.1% of GDP. It will be implemented in FY 2024/25.
- **Reforming the withholding rates (WHR):** Currently, the income tax system employs three withholding rates i.e. 5%, 10%, and 15% which are applied to various income sources. As part of the broader income tax reform, all tax rates on income sources subject to final withholding taxes, such as interest income, dividends, royalties, and undistributed profits, will be revised. This policy adjustment is scheduled to take effect in FY 2025/26 and is projected to generate an increase of 0.1% of GDP in revenue.

Property taxation

Regional and local governments have been grappling with significant financing shortfalls, a challenge exacerbated in recent years by both conflict and the COVID-19 pandemic. Considering these pressing fiscal constraints, it is imperative to explore a range of financing mechanisms, with particular emphasis on property taxation. Presently, local governments derive revenue from lease fees on urban land sales and urban land use fees for longstanding land possession.

- **Formalizing the property tax regime**: Recognizing the acute funding requirements of local administrations, the federal government, in collaboration with regional authorities, is poised to introduce a property tax framework aligned with the existing land lease fee structure. This revamped system will feature two key components: urban building taxation and land use fees. The building tax will be levied based on the market value of structures, ranging from 0.2% to 1%, contingent on the building's location and purpose. Meanwhile, land use fees will be determined by the assessed value of land, also ranging from 0.1% to 1%. Upon the completion of the NMTRS, this reform is projected to yield a 0.3 percentage point increase in the tax-to-GDP ratio. Implementation of this initiative is slated for the fiscal year 2024/25. The reform will be rolled out in phases across the country.

Motor vehicle circulation

Currently, the government levies various taxes and duties on the ownership and purchase of vehicles. However, the existing duties and taxes do not raise the much-needed revenue and are not targeted at addressing environmental concerns. Thus, there is a need to explore other taxes on vehicle, such as the annual circulation tax.

- **Reforming the motor vehicle circulation taxation**: This will be implemented in FY 2025/26 and is expected to generate additional revenue of 0.2% of GDP by the end of the NMTRS. This reform is also planned to be rolled out in phases.

VAT and ToT reforms

Despite the growing importance of Value Added Tax (VAT) and Turn Over Tax (ToT) for the regional and federal government in terms of revenue collections, there has not been much change to these taxes in line with the economic dynamics. One of the key features of VAT is that it is in principle broad-based, affecting all final consumption. Reduced rates, zero-rating, and exemptions, especially for basic food items, are widely used throughout the world to increase the progressivity of VAT. They do, however, present the risk of eroding the tax base unnecessarily as they cannot be targeted. The reform will be implemented in FY 2024/25. The reforms, with potential additional tax revenues of 1.1% of GDP, includes the following:

- **Rationalizing VAT exemptions and zero-ratings/removing VAT exemptions:** The current VAT exemption system applies to a wide range of goods, including basic food items. Such exemptions are granted mainly on distributional considerations. However, recent empirical work shows that the presence of the informal sector in low-income countries reduces the distributional benefit of such exemptions. So, the Ministry of Finance will assess the effectiveness of exemptions in terms of their distributional impact with a view to rationalizing the exemptions. In addition to this, the government will set up a mechanism for refunding VAT to the poor including a cash transfer mechanism on the expenditure side of the budget.

- **Revising the VAT registration threshold:** Due to persistently high inflation, small businesses previously exempted from the VAT regime end up in the VAT system. The Ministry of Finance will revise the compulsory VAT registration threshold in line with the prevailing inflation rates.
- **Simplifying the tax system for small businesses:** Currently, micro and small businesses exempted from the VAT are required to pay ToT in addition to the presumptive income tax. This is administratively costly for the tax authority. Based on a detailed assessment of the tax systems for micro and small businesses, the Ministry of Finance will be simplifying the tax regime for such small businesses by abolishing ToT and revising the presumptive tax rates to make up for the potential revenue loss that could arise from the removal of the ToT.

Excise tax reforms

Although there have been several excise tax reforms in recent years, further reforms are necessary in the light of changes in economic dynamics. During the NMTRS period, the government will introduce the following excise tax reforms with total expected additional revenues of 0.8% of GDP:

- **Amending the excise tax laws**: During the NMTRS period, there will be regular revisions of the excise tax proclamation. The amendment is expected to raise tax revenue by around 0.1% of GDP by the end of the NMTRS period.
- **Introducing excise management system (EMS)**: The government will introduce an electronic excise management system (such as stamp, tracking and tracing system) to support the proper implementation of the excise tax law and reduce the illegal trade of excisable items/goods. The system will help consumers and law enforcement agencies to easily identify excisable goods. The Ministry of Finance will procure system-implementing agencies. This will raise additional revenues around 0.3% of GDP when it comes into effect in 2024/25.
- **Adjusting the specific excise tax rates:** The specific excise rates applied to locally produced products such as tobacco and tobacco products, alcohol and alcoholic products will be revised in line with the rate of inflation since they were last revised and revised regularly in line with inflation going forwards. By the end

of the NMTRS, this reform will bring in around 0.1% of GDP. This will come into effect in 2025/26.

- **Fully apply the excise tax on fuel:** the statutory excise tax rate of 15% will be fully applied on fuel. This is expected to raise around 0.3% of GDP by the end of the NMTRS implementation period.

Trade tax reforms

Over the past five years, the Ministry of Finance has undertaken a series of revisions to Ethiopia's tariff book. In September 2022, a significant reform was introduced, which included several key changes: reducing the number of tariff bands from 6 to 5, eliminating the complex preferential customs and import tax scheme (second-schedule scheme), phasing out the surtax on all imports with a customs duty rate of 15% or lower, and aligning the applied tariff rates based on value addition. The following trade tax reforms are planned for implementation during the NMTRS period:

- **Simplifying the tariff regime**: Despite recent reforms, Ethiopia's tariff bands remain complex. As part of the NMTRS, efforts will be made to reduce the number of tariff bands to four. This reform aims to align the tariff structure with that of the African Continental Free Trade Agreement (AfCFTA), of which Ethiopia is a signatory. Harmonizing the tariff structure with the AfCFTA involves identifying sensitive sectors/products that may require additional tariff protection. Consequently, the government will undertake to identify these sectors/products during the NMTRS period. Additionally, it will monitor the full implementation of the agreement and assess the revenue implications thereof. It is expected that this reform will be revenue neutral.
- **Phasing out the surtax on imports**: Surtax was introduced temporarily in 2007 but has remained in place for over 15 years. The Ministry of Finance removed the surtax payment on goods with a customs duty rate of 15% or lower in 2022. In the NMTRS period, the surtax will be phased out altogether from the tax system. This reform will result in a revenue loss of 30%.
- **Rationalizing the import tax exemptions and incentives**: To attract FDI, foster industrialization via import substitution, and stimulate exports, the government has implemented various tax incentives for local manufacturers, notably import tax exemptions on capital goods and raw materials. However, the current framework

for import tax exemptions necessitates ongoing assessment against stated objectives. Hence, the Ministry of Finance will undertake a comprehensive evaluation of these exemptions and incentives in the forthcoming years. Based on this evaluation, the Ministry aims to streamline and rationalize the existing exemptions, anticipating a revenue increase equivalent to 0.30% of GDP by the conclusion of the NMTRS period.

Table 4.1.: Summary of the policy measures to be implemented in FY 2023/24 to FY 2027/28

TAX POLICY REFORMS	BASE YEAR	IMPLEMENTATION PERIOD				CUMULATIVE CHANGE
	2023/24	2024/25	2025/26	2026/27	2027/28	2023/24 to 2027/28
TAX POLICY & THE BROADER MACROECONOMIC REFORM INCLUDING THE FOREX REFORM	**0.360**	**1.00**	**2.60**	**3.6**	**4.00**	**4.00**
1. FOREX REFORM & ECONOMIC RECOVERY	**0.00**	**0.20**	**0.40**	**0.80**	**1.00**	**1.00**
2. TAX POLICY REFORM	**0.10**	**0.80**	**2.20**	**2.80**	**3.00**	**3.00**
2.1. Income tax reforms	**0.00**	**0.00**	**0.40**	**0.40**	**0.60**	**0.60**
Revisiting the schedular tax system	0.00	0.00	0.00	0.00	0.00	0.00
Rationalizing income tax exemptions and holidays (e.g. Minimum Alternative Tax)	0.00	0.00	0.40	0.40	0.60	0.60
Simplifying the presumptive tax regime	0.00	0.00	0.00	0.00	0.00	0.00
Revisiting the double tax agreements	0.00	0.00	0.00	0.00	0.00	0.00
Reforming the personal income tax rate structure	0.00	-0.10	-0.10	-0.10	-0.10	-0.10
Reforming the withholding rates to offset PIT	0.00	0.10	0.10	0.10	0.10	0.10
2.2. Property tax reforms	**0.00**	**0.10**	**0.20**	**0.30**	**0.30**	**0.30**
Formalizing property tax	0.00	0.10	0.20	0.30	0.30	0.30
2.3. Motor vehicle circulation tax	**0.00**	**0.00**	**0.10**	**0.20**	**0.20**	**0.20**

Reforming the motor vehicle circulation taxation	0.00	0.00	0.10	0.20	0.20	0.20
2.4. Excise tax reform	**0.00**	**0.40**	**0.40**	**0.80**	**0.80**	**0.80**
Introducing excise management system	0.00	0.30	0.30	0.30	0.30	0.30
Revising the excise tax rates	0.00	0.00	0.00	0.10	0.10	0.10
Revising specific excise tax rates (in line with inflation)	0.00	0.10	0.10	0.10	0.10	0.10
Fuel (15% on budget, i.e. EPSE full cost recovery)	0.00	0.00	0.00	0.30	0.30	0.30
2.5. VAT Reform	**0.00**	**0.30**	**1.10**	**1.10**	**1.10**	**1.10**
VAT on services: removal on exemptions of selected transportation, utilities	0.00	0.30	0.40	0.40	0.40	0.40
VAT exemptions: processed foods and beverages, including Sugar	0.00	0.00	0.10	0.10	0.10	0.10
VAT exemptions: items to be identified	0.00	0.00	0.10	0.10	0.10	0.10
Applying the statutory VAT on fuel	0.00	0.00	0.50	0.50	0.50	0.50
2.6. Customs duty and import tax reform	**0.36**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Simplifying the tariff regime	0.00	0.00	0.00	0.00	0.00	0.00
Phasing out the surtax on imports	0.00	0.00	0.00	-0.30	-0.30	-0.30
Rationalizing the import tax exemptions	0.00	0.00	0.00	0.30	0.30	0.30
Introducing Social Welfare Levy	0.360	0.00	0.00	0.00	0.00	0.00

Note: The tax revenue figures shown (as a percentage of GDP) indicate the cumulative tax revenue expected from each policy reform in each period. The shaded areas indicate the timing of the reforms to be implemented.

4.3. Tax administration reform measures

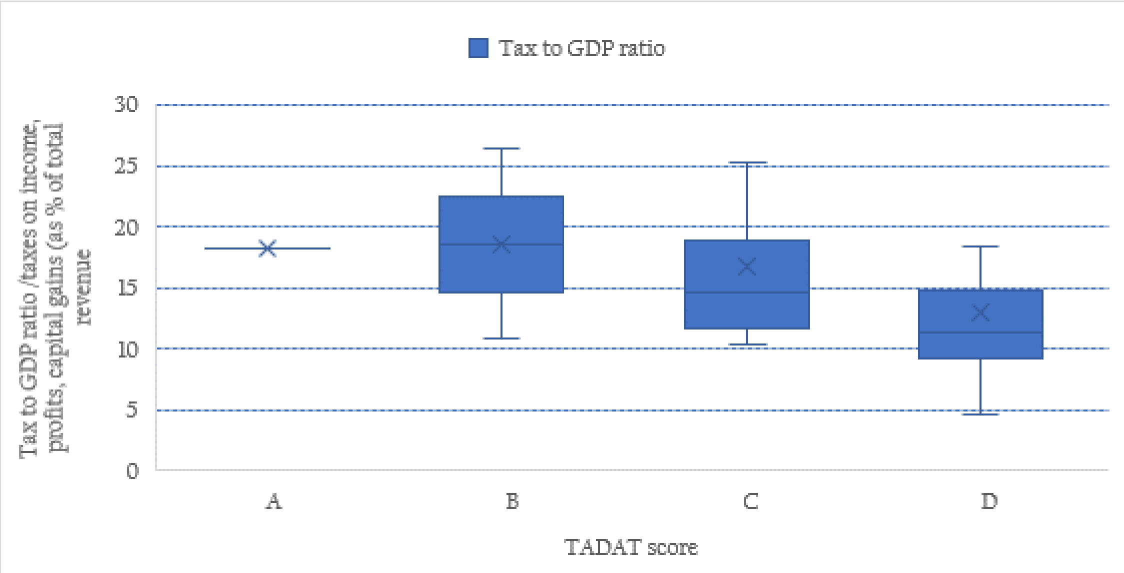
Modern tax administrations attempt to collect adequate revenue while keeping tax administration and compliance costs low and treating taxpayers fairly. The most cost-effective systems are those that convince many taxpayers to meet their tax obligations voluntarily so that tax officials can concentrate on relatively small numbers of non-compliant taxpayers. Features of the tax administration that encourage compliance include a service-oriented attitude that educates and assists taxpayers in meeting their obligations, effective audit programs and consistent use of penalties as strong deterrents to non-compliance, and transparent administration of the tax laws that are viewed as honest and fair (Okello, 2014).

A recent 2016 Tax Administration Diagnostic Assessment Tool (TADAT) report for SSA countries indicates that countries with low TADAT scores and weak tax capacity have a low median tax-to-GDP ratio of around 11.3%, while countries with high TADAT scores and high tax capacity perform well in terms of tax-to-GDP ratio. This points to the importance of improving the tax capacity and the overall tax administration system. The latest available TADAT rankings show an average ranking of D for Ethiopia indicating the low tax capacity. This could partly explain the low tax-to-GDP ratio. Therefore, improving tax capacity through a comprehensive implementation of tax administrative measures could be key to increasing overall tax collections. Recent estimates show that improving Ethiopia's TADAT ranking from 'D' to 'C' alone could lead to a 2.3 to 7.2 percentage point increase in the tax-to-GDP ratio (Acedo *et al*, 2022). This implies that implementing comprehensive tax administrative measures could bring substantial improvement in the country's tax-to-GDP ratio, in addition to the increases attributable to tax policy measures. Reversing the recent decline in tax-to GDP ratio requires comprehensive administrative measures.

Table 4.2. Interpretation of the TADAT scores

TADAT scores	Interpretations	Score ranges
A	Meets or exceeds good international tax administration practices	4.00
B	Sound tax administration practices that are a rung below good practices	3.00 to < 4.00
C	Fundamental tax administration practices are in place	2.00 to < 3.00
D	Fundamental tax administration practices are not in place	1.0 to < 2.00

Box 1.1. TADAT scores and tax-to-GDP ratio for SSA countries[4]



Note: The whiskers show the average tax-to-GDP ratio by country's TADAT score. The graph shows the tax-to-GDP ratio by TADAT score. As can be clearly seen, countries with a low TADAT score, i.e. D, have on average a lower tax-to-GDP ratio, while countries with a higher TADAT score have on average a higher tax-to-GDP ratio.

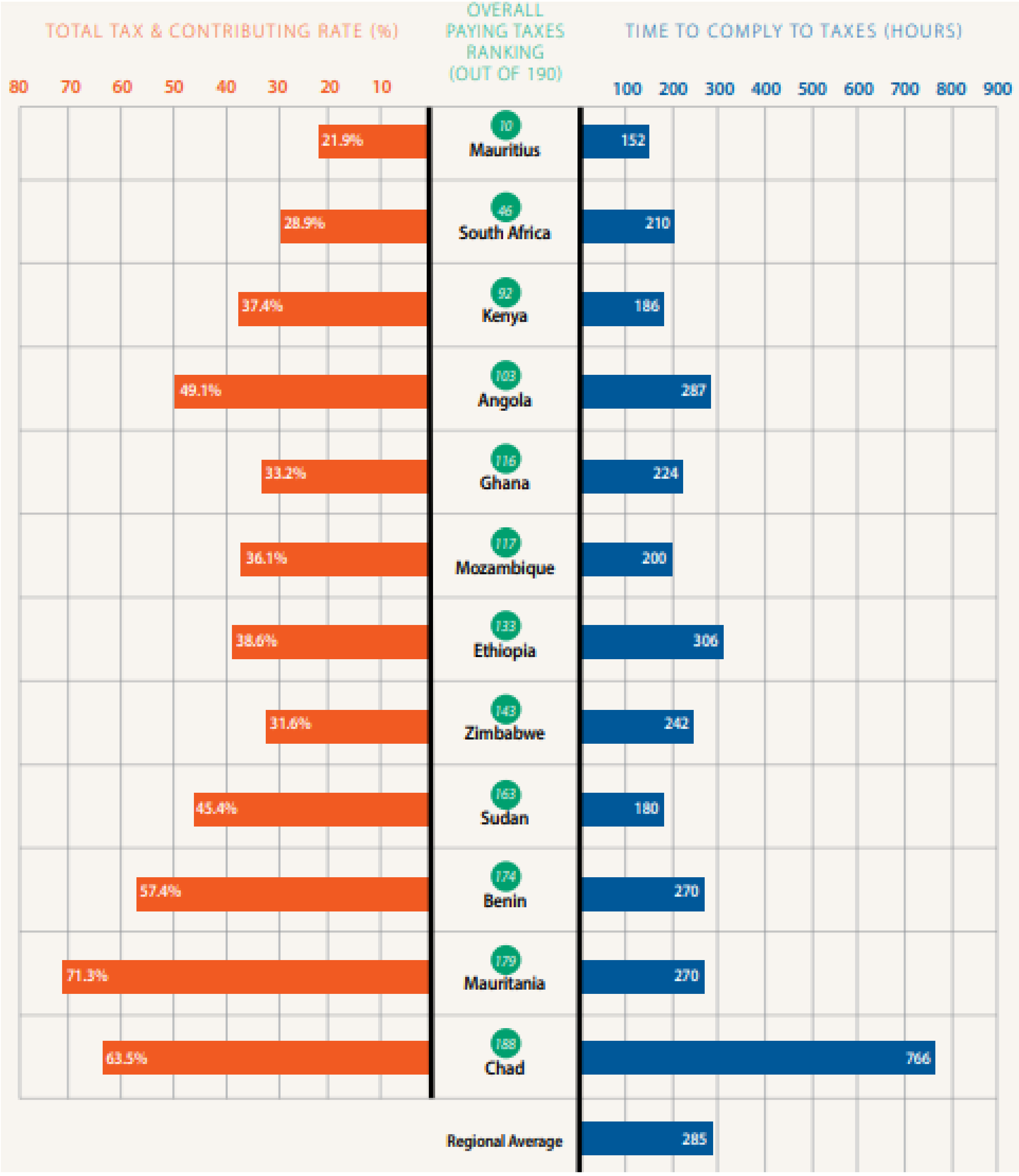
Source: Acedo *et al* (2022)

Total tax rate measures the amount of taxes and mandatory contributions payable by businesses after accounting for allowable deductions and exemptions as a share of commercial profits. Taxes withheld (such as personal income tax) or collected and remitted to tax authorities (such as value added taxes, sales taxes or goods and service taxes) are excluded.

[4] The TADAT framework assesses tax administration performance across nine critical areas known as Performance Outcome Areas (POAs): integrity of the registered taxpayer base, effective risk management, supporting voluntary compliance, timely filing of tax declarations, timely payment of taxes, accurate reporting in declarations, effective tax dispute resolution, effective revenue management, and accountability and transparency.
TADAT scores are categorized as follows:

A: Strong performance (meets or exceeds international good practice)
B: Sound performance (healthy level of performance but below international good practice)
C: Weak performance (relative to international good practice)
D: Inadequate performance (requirements for a C rating or higher are not met)

Figure STATUS OF TAX ADMINISTRATION INDICATORS FOR SELECT COUNTRIES, 2018



Source: FISCAL POLICY FOR FINANCING SUSTAINABLE DEVELOPMENT IN AFRICA, UNECA (2019)

The first two-year period of the NMTRS will focus on implementing the administrative reforms changes. Focused tax and customs compliance initiatives have the potential to improve revenue performance in a significant way. Building on the MoR's ongoing reforms and plans, comprehensive measures aimed at improving the tax capacity will be implemented during the NMTRS period. These include:

- **Establishing a reform administering unit at the MoR**: To ensure effective implementation of the reform measures across Directorates/Units and regional revenue bureaus, the Ministry of Revenue in collaboration with the regional revenue bureaus will set up a reform unit accountable to the Minister with the role of administering, monitoring, and assessing the implementations of the reforms set out in this Strategy and coordinating the various units within the Ministry of Revenue. Without a dedicated reform unit, it would be challenging to coordinate the implementing Directorates within the Ministry of Revenue, as the reforms will be implemented by various units.
- **Conducting regular self-assessments of the tax authority's digitisation process using standard tools such as the OECD Digital Transformation Maturity Model.** This will ensure that the tax authority and the respective regional tax offices respond to changes in the way taxpayers interact with each other and do business. It will also improve the interaction between taxpayers and tax authorities. Therefore, the Ministry of Finance and the regional tax offices will conduct such a self-assessment at the beginning of the NMTRS and at the end of the NMTRS period.
- **Conducting TADAT assessment:** The Ministry of Revenue will collaborate with other pertinent line ministries to undertake baseline and endline Tax Administration Diagnostic Assessment Tool (TADAT) evaluations. Subsequently, the Ministry of Revenue will regular produce a comprehensive report based on these assessments.
- **Improving the IT and data management system**: Maintaining complete and accurate taxpayer data is crucial for effective tax administration. Such a system enables tax administrators to easily cross-check third-party information about taxpayers and improves the flow of information across different government agencies. However, the data management system at the Ministry of Revenue and regional states' revenue bureaus is poor. This has often resulted in inconsistent numbers across various entities within the Ministry of Revenue. It has also been practically impossible for the tax authority/revenue bureaus to fully utilize the available third-party data for cross-checking purposes. Hence it is critically

important for the tax authorities at different levels to improve the data management system through digitization of the system. This will enhance the Ministry's ongoing efforts to create digital identities for taxpayers, further improve service delivery and tax compliance, and also reduce the administrative cost for the tax authorities/bureaus. During the NMTRS period, the Ministry of Revenue will digitize the data management system and integrate all the systems across branches. This will also involve automating the whole tax and customs administration systems (including *iTAS*, data warehouse, e-invoice, CRM technology updating). Digitizing the customs management system will also be part of this reform. The Ethiopia Customs Commission successfully transitioned its customs management system from Automated System for Customs Data (*ASYCUDA*) World to Electronic Customs Management System (*eCMS)*. In the next five years, the Customs Commission will digitalize the valuation and the tariff classification process to ensure transparency. It will also fully operationalize an electronic cargo tracking system in selected key trade corridors. This is a real-time mechanism to establish the location of goods in transit at any time, track those tampering with Customs seals, and those engaged in off-route diversion of goods. This will reduce diversion of goods in transit and put an end to the high risks encountered in escorting cargo. Since this digitization and automation requires huge financial investments not only on the technology but also on the human resources, the Ministry of Revenue and the Ethiopian Customs Commission will mobilize the required finances from international development partners.

- **Improving existing taxpayer touchpoints:** To facilitate effective engagement, tax administrations need to move from paper-based systems to websites and portals, establish proactive mechanisms to support taxpayer engagement, and promote inclusiveness and accessibility. A multi-functional and easily accessible website has been established by both the Ministry of Revenue and the Ethiopian Customs Commission. However, most regional tax offices do not have a functioning website. This can sometimes cause friction between tax officials and taxpayers. By expanding e-services at all levels during the NMTRS period, the government, together with development partners, will facilitate the transition from paper-based interaction to more transparent interaction. This will help the tax administration at all levels to be more responsive and proactive in supporting taxpayer engagement. It will also increase awareness and capacity to support inclusiveness and accessibility. In this regard, the ministry intends to establish additional taxpayer touchpoints; these will include call centres, regularly updated websites, electronic services, and face-to-face interactions.

- **Instituting a dynamic computerized risk management system**: An effective risk management system will be key to systematically identifying, assessing, and mitigating risks through a clear compliance improvement plan. This will help the tax authority/bureaus to target those high-risk taxpayers for further tax audits. The Ministry of Revenue has been applying a risk management system. However, the latest available TADAT score shows that Ethiopia fails to meet the minimum standard in relation to risk management mechanisms. The Ministry of Revenue and the respective regional states' revenue bureaus will modernize and computerize the risk management system, and adopt (by customizing to the local situation) effective risk management systems from other successful countries with similar development levels. Similarly, the Ethiopian Customs Commission will strengthen customs compliance through such a computerized risk assessment. As the volume of imports increases, the customs commission needs to strengthen its customs management through a comprehensive risk-based assessment.
- **Making the Audit, Risk, and Intelligence Directorates independent from each other**: Currently, the Risk, Audit and Intelligence Directorates interfere with each other's work, affecting the effectiveness of audits and risk assessments. So, the Ministry of Revenue will restructure these three Directorates as separate and independent from each other with clear and well-defined roles and responsibilities. This will reduce interference and improve the independence of each Directorate.
- **Strengthening the revenue management within the revenue authorities including the regional revenue bureaus:** In close collaboration with the Ministry of Finance, the Ministry of Revenue and the regional revenue bureaus will put in place a mechanism to account for, monitor and analyse revenue collections. This requires strengthening the human capital and the necessary infrastructure including the ICT within the Ministry of Revenue/regional revenue bureaus and the Ethiopian Customs Commission. It has been challenging to strengthen the human capital of the Ministry due to a high rate of turnover.
- **Preparing a human resource development strategy:** It has been challenging to retain and attract a well-qualified and disciplined work force due to low incentive structures and a lack of clear career development. The Ministry of Revenue will

prepare a human development strategy outlining career development paths for its employees. This Strategy will help switch from unplanned to ongoing processes for recruitment and workforce planning based on a comprehensive need assessment. This will ensure that the Ministry could retain and attract a well-qualified work force.

- **Introducing excise stamps, and tracking and tracing mechanisms:** The excise tax law requires that local producers of excisable goods put excise stamps on their goods. During the NMTRS period, the Ministry of Revenue in collaboration with other stakeholders will introduce the excise stamp and ensure the proper implementation by taxpayers.
- **Improving voluntary compliance**: A recent assessment of tax revenue collection indicates that compliance varies substantially by sector and tax type. The construction sector, for example, is one of the sectors with significantly poor compliance. Similarly, VAT compliance is weaker than compliance with other taxes. Therefore, the Ministry of Revenue will improve voluntary compliance by targeting these sectors and tax types through taxpayers' education.
- **Establishing a national fair-market value institution/structure**: Valuation for tax and customs purposes has been an issue at the Ministry of Revenue, regional revenue bureaus and the Ethiopian Customs Commission, creating loopholes for corruption and bad practices. To address this, the Ministry of Revenue in collaboration with the regional bureaus will establish an independent national fair market institution with the role of setting out a fair market value for any taxable transactions across the country for tax purposes.
- **Setting up a government & and state-owned enterprises taxpayers' office (SOETO) or a tax unit under each tax office (SOETU):** Currently, the LTO branch collects the bulk of its taxes from state-owned enterprises and public institutions. In FY 2021/22, more than 45% of the LTO collections came from these state-owned enterprises and public institutions. Therefore, the Ministry of Revenue will set up a taxpayers' office for these enterprises. These taxpayers do not need much investment in terms of human resources from the tax authority. So, having a dedicated tax office for these agencies and enterprises could help the LTO redirect its limited human resources to the private large taxpayers. If establishing SOETO is going to be challenging for any reason then establishing SOETU unit under respective tax offices is important.

- **Introducing a data management policy/manual**. With increasing digitization, tax administrators collect, process, and analyse bulk data. To maximize the value of such bulk data for policy and administration, tax administrations need to put a system and policy to share such bulk data effectively and responsibly with other agencies. This system will outline the overall data management including data entry, and quality, and responsibility of different entities/units within the Ministry of Revenue. It will help guide tax and customs data flow across the Directorates/Units within the Ministry of Revenue or Ethiopian Customs Commission and even the data sharing with other entities including regional revenue bureaus.
- **Setting up an institutionalized inter-ministry/agency/bureaus communication mechanism**: One of the biggest challenges across the different branches and regional revenue bureaus is the lack of clearly defined roles, as well as different tax administration systems. This makes the tax administration system unharmonized and sometimes conflicting. Hence the Ministry of Revenue will take the lead in setting up institutionalized communication channels across the MoR's branches, regional revenue bureaus, and with other line Ministries. This will help harmonize the tax administration systems across the country (including between the Ministry of Revenue and the respective regional bureaus). It will also address overlapping duties and responsibilities of the Ministry of Revenue's Headquarters and its branches. This will also help to institutionalize the relationship between the Ministry of Revenue and the Ministry of Finance.
- **Restructuring and strengthening of the 'Tax Administration and Research Department' within the Ministry of Revenue**: This unit will play a pivotal role in conducting routine annual analyses of tax administration, audits, risk management, and other related aspects, all in alignment with the fundamental principles of taxation.

These administrative measures are expected to improve the country's TADAT ranking and enhance its digital transformation maturity, consequently enhancing overall revenue collection. Similarly, customs-related initiatives are poised to ameliorate the country's business climate and facilitate the unhindered movement of goods across borders to their designated destinations. Ethiopia currently occupies the 98th position in the latest available global ranking of border management efficiency and transparency.

These reforms are poised to positively influence the country's standing in customs administration. With regard to revenue generation, these measures are expected to contribute approximately 2.9 percent of GDP by the conclusion of the NMTRS period. Further specifics regarding the timing of each administrative measure can be found in the accompanying table.

Table 4.3 : Summary the tax administrative measures to be implemented in FY 2023/24 to FY 2027/28

TAX ADMINISTRATION MEASURES	BASE YEAR	2023/24	2024/25	2025/26	2026/27	2027/28	20223/24 to 2027/28
1. TAX ADMINISTRATIVE MEASURES	**0.00**	**0.00**	**0.20**	**0.60**	**0.90**	**1.20**	**2.90**
Establishing a reform administering unit at the MoR							
Conducting regular self-assessments of the tax authority's digitisation maturity level							
Conducting Two TADAT assessment and ensuring at least average one rank higher from first assessment rank result							
Conducting readiness to manage international tax risks using the Framework for International Tax Administrative Strengthening (FITAS) tool kit							
Build Compliance Risk Management (CRM) Framework							
Improving the IT and data management system (iTAS, Introduce e-Audit, e-Risk Assessment, etc)							
Improving existing taxpayer touch-points							
Instituting a dynamic computerized risk management system							
Making the Audit, Risk, Intelligence, and Investigation independent from each other							
Strengthening the revenue management within the revenue authorities including the regional revenue bureaus							
Preparing a human resource development strategy							
Introducing excise stamps, and tracking and tracing mechanisms							

TAX ADMINISTRATION MEASURES	**BASE YEAR**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**20223/24 to 2027/28**
Improving voluntary compliance							
Establishing a national fair-market value institution/structure							
Setting up a government & and state-owned enterprises taxpayers' office (SOETO) or SOETU							
Introducing a data management policy/manual							
Setting up an institutionalized inter-ministry/ agency/ bureaus communication mechanism							
Upgrading the existing sales registration machine technology in order to send detailed sales and purchase real time data to the tax administration server							
Introduce data science to develop effective and timely services and interventions							
Re-structure the Research Department upgrading it to Domestic Taxes and Customs Tariff Institute to improve and harmonise the Tax Administration system (Federal, Regional, City Administration etc). This may include the existing Regional Support Department of MoR.							
Develop a strategy to harmonize vertical and horizontal tax administration (Federal with Regions with City Administration and Regions with Regions with City Administration etc). This may include helping regions and city administrations to evaluate their system applying TADAT, Digitization Maturity, CRM, etc.							

4.4. Non-tax revenue reform measures

To sustainably enhance non-tax revenue collections and improve the administration of such revenues, the government will implement the following measures:

- **Regularly revising fees and charges**: the Federal government in collaboration with the respective regional or local governments will revise the fees and charges in line with the prevailing inflation regularly. This will help local governments deliver public service delivery.
- **Strengthening the monitoring and reporting system:** the government will implement mechanisms to strengthen the reporting and the monitoring of non-tax revenues through the applications of information technology system like IFMIS.
- **Improving the effective management of state-owned enterprises**: Implementation of measures to enhance the administration and management of state-owned enterprises to ensure their viability.
- **Revise equity shares in natural resource exploration and extraction:** revision of existing equity shares in natural resource exploration and extraction activities.
- **Identifying other potential non-tax revenue sources**: the government will conduct comprehensive studies to identify potential non-tax revenue sources.

5. SUCCESS FACTORS & IMPLEMENTATION RISKS

5.1. Success factors

Political Will at all levels

Successful implementation of the NMTRS requires strong political will at all levels of government and clearly defined roles among the different government institutions.

- **Leadership at higher level:** Political commitment at higher levels, including the Prime Minister's Office, will be crucial to the proper implementation of the measures set out in the NMTRS. The Ministry of Finance will play a pivotal role in coordinating government institutions for NMTRS implementation.
- **Policy Implementation:** Clear roles will be defined, with the Ministry of Finance implementing policy measures, and the Ministry of Revenue and regional tax bureaus overseeing tax administrative measures.

External Support

Well-targeted donor support, especially on capacity building will be critical for the full implementation of the NMTRS.

- **Capacity Building:** Well-targeted donor support is crucial, particularly in capacity building for tax policy and administration. This support enhances the capacity to execute policy and administrative measures. In addition, donors could contribute to capacity building in implementation, monitoring, and evaluations of the NMTRS itself.
- **Multilateral Institutions:** Institutions like the IMF and World Bank can provide invaluable support through experience sharing and promoting best practices in revenue mobilization.

Taxpayers

- **Engagement:** Taxpayers' cooperation is vital for the success of the NMTRS. Engaging taxpayers throughout the implementation process ensures their involvement and strengthens compliance.

Opening of the economy

- **Economic Reform:** The government's privatization program aims to foster a competitive market structure, attract foreign investment, and stimulate private sector growth. This initiative enhances revenue collection by encouraging private investment and economic expansion.

5.2. Implementation risks

External Shocks

- **Global Shocks:** Events like the AfCFTA and Ethiopia's accession to the WTO present both opportunities and risks. Success depends on the country's ability to transform its economy to capitalize on opportunities while mitigating threats.

Weak IT infrastructure

- **Infrastructure Lag:** Despite recent progress, Ethiopia's IT infrastructure lags behind, potentially hindering the digitization of tax administration. Addressing this gap is crucial for efficient tax management.

Macroeconomic Imbalance

- **High public debt:** Public debt remains high, with increasing debt service obligations. This poses challenges to revenue targets and expenditure plans outlined in the NMTRS.
- **Foreign exchange shortages:** Shortages in foreign exchange could also impact NMTRS plans, highlighting the importance of sound economic management and resilience-building measures.

By addressing these success factors and implementing mitigation strategies for implementation risks, Ethiopia can enhance the effectiveness of the NMTRS and achieve its revenue mobilization goals in alignment with broader development objectives.

6. NMTRS ROADMAP, MONITORING, & EVALUATION FRAMEWORK

6.1. NMTRS Roadmap

The roadmap for implementing the NMTRS serves as a systematic and adaptable plan designed to guide the implementation process over the medium term. Recognizing the dynamic and iterative nature of policy formulation and execution, this roadmap offers a structured approach to planning and executing various activities. It aims to:

- **Identify Key Activities:** The roadmap outlines the essential activities necessary for the successful implementation of the NMTRS, providing clarity on the steps required to achieve its objectives.
- **Track Progress:** By establishing clear milestones and monitoring mechanisms, the roadmap facilitates the tracking of progress toward NMTRS implementation. This enables stakeholders to gauge the effectiveness of interventions and make necessary adjustments as needed.
- **Ensure Coordination:** Systematic coordination of stakeholders across all government levels is prioritized within the roadmap. By fostering collaboration and communication among relevant actors, it ensures alignment of efforts and enhances the overall effectiveness of implementation.
- **Address Challenges and Opportunities:** The roadmap helps stakeholders anticipate potential challenges and opportunities associated with NMTRS implementation. By identifying these factors early on, stakeholders can proactively plan to mitigate risks and capitalize on opportunities, thereby enhancing the likelihood of success.

Overall, the roadmap provides a structured framework for navigating the complexities of NMTRS implementation, setting out a coordinated and adaptive approach that maximizes the strategy's impact on revenue mobilization and national development goals.

Key steps in the implementation of the NMTRS

The key steps needed to implement the NMTRS are as follows:

a) Stakeholder mapping

Stakeholder mapping is the first step in the implementation of the NMTRS. The Ministry of Finance and the Ministry of Revenue will take the lead in ensuring that each of the stakeholders including taxpayers and development partners contribute to the implementation of the NMTRS. Therefore, it is important to map out the various stakeholders and identify the roles and responsibilities of each stakeholder. The table below shows the stakeholders matrix in the implementation of the NMTRS.

Table: Stakeholders mapping

	Stakeholders	**Roles in the implementation of the NMTRS**
1.	Government	▪ The government will be coordinating and leading the implementation of the NMTRS. To do that, the government has already set up a clear governance framework showing the roles and responsibilities of the various government entities including regional states.
2.	Business community (chamber of commerce and sectoral associations)	▪ As one of the key stakeholders in the implementation of the NMTRS, the government will engage the broader business community by providing regular and timely information regarding the broader economic benefits of the NMTRS, and work with them to address any concerns they might have on the Strategy.
3.	Civil society organizations (CSOs), and opposition political parties	▪ Civil society organizations are one of the key players in the preparation and implementation of NMTRS. Various consultative meetings with relevant CSOs will be organized to receive feedback on the proposed policy and administrative reforms in the next five years. ▪ This will ensure that CSOs hold the government accountable for the implementation of policy measures as set out in the NMTRS. Second, CSOs could also contribute to the monitoring and evaluation of the NMTRS and the impact assessment of the reforms.
4.	All development partners	▪ The government recognizes the critical roles that international development partners could play in effectively implementing the NMTRS through capacity developments to the various implementing entities and financing some of the key measures. Hence, the government will provide development partners with regular updates on the NMTRS. To do that, the government will be organizing various platforms including donor coordinating forums.

Note: The Stakeholders matrix will be updated as NMTRS progresses

b) Communicating the Strategy

To ensure the effective implementation of the NMTRS, the government will prepare a clear communication strategy outlining the broader objective, target audiences, communication channels, frequency of communication, and evaluation mechanisms. This will allow the government to garner broader public support. The key elements of the Communication Strategy for NMTRS are as follows.

i. **Objective:** The communication strategy aims to build broader public understanding and support for the National Medium-Term Revenue Strategy (NMTRS). It also aims to create public awareness on tax policy and administrative change.

ii. **Audiences**: The target audiences of the NMTRS are the general public, taxpayers/business community, international development partners, civil society organizations, and various government entities.

iii. **Communication channels**: various and accessible communication channels including social media, press releases, public events, and town hall meetings using local languages will be employed to communicate the NMTRS to the public.

iv. **Frequency**: Regular and timely updates on the NMTRS will be provided through the identified communication channels. On top of that, town hall meetings and public events will be held twice a year.

v. **Evaluating the communication strategy**: Continuous evaluation of the communication strategy will be conducted based on a set of criteria including awareness of the NMTRS among the target audience. This will be help to revise the communication channels and the overall communication strategy.

c) Implementing the Strategy

This step is where the Strategy comes into effect. The sequences of actions at this stage are as follows:

- **Expert-level meeting:** Immediately following the publicization of the NMTRS, expert-level meetings will be convened to facilitate coordination among different stakeholders. These meetings will serve to align activities and establish a collaborative approach to implementing the strategy within the agreed-upon timeline.
- **Stakeholder meetings:** Regular stakeholder meetings will be organized to coordinate activities across various stakeholders. These meetings will enable coordination of efforts and provide a platform for regular reporting and review of activities, typically on a quarterly basis.
- **Assigning responsibilities:** Clear reporting and communication mechanisms will be established to assign specific responsibilities to each stakeholder. This ensures accountability and clarity in roles and tasks assigned to various parties involved in implementing the NMTRS.
- **Legal drafting:** The drafting of necessary legal frameworks and regulations will be undertaken to support the implementation of the NMTRS. This involves ensuring that the legal framework aligns with the objectives and strategies outlined in the strategy document.
- **Cabinet & parliamentary approval:** The proposed legal drafts will undergo review and approval processes within the cabinet and parliament to formalize the legal framework required for implementing the NMTRS.
- **Training:** Comprehensive training programs will be conducted both within the revenue administration and externally to build capacity and ensure understanding of the new policies and administrative measures introduced under the NMTRS. This training may overlap with the communication strategy to ensure consistent messaging and understanding.
- **Planning for system changes:** Necessary changes to existing systems and processes will be planned and implemented to accommodate the requirements of the NMTRS. This may involve updates to technological infrastructure, software systems, and operational procedures within the revenue administration.
- **Facilitating regular reviews:** Baseline, mid-term, and end-term reviews of the NMTRS will be conducted at predefined intervals to assess progress, identify challenges, and make necessary adjustments to ensure the strategy's effectiveness. These reviews will inform decision-making and help maintain alignment with the overarching goals of the NMTRS.

6.2. Monitoring and evaluation framework

Setting out a robust monitoring and evaluation framework is critical to ensure the effective implementation of the NMTRS. The monitoring and evaluation plan serves as the foundation for systematically measuring progress and assessing the impact of the NMTRS. The key objectives of the monitoring and evaluation plan are as follows:

1. **Track progress:** The plan facilitates tracking the implementation progress of activities outlined in the NMTRS, ensuring that milestones are met within the designated timeline.
2. **Inform stakeholders:** Regular monitoring and evaluation activities enable the dissemination of progress updates to various stakeholders involved in the NMTRS, fostering transparency and accountability.
3. **Assess strategies and processes:** Through systematic evaluation, the plan assesses the effectiveness of strategies, systems, and processes implemented under the NMTRS, identifying challenges and areas for improvement.
4. **Promote collaboration:** The sharing of progress reports among implementing agencies fosters collaboration and coordination, facilitating a cohesive approach to NMTRS implementation.

As part of the broader monitoring and evaluation framework, a dedicated monitoring and evaluation committee is established, led by the Ministry of Finance. The committee's responsibilities include:

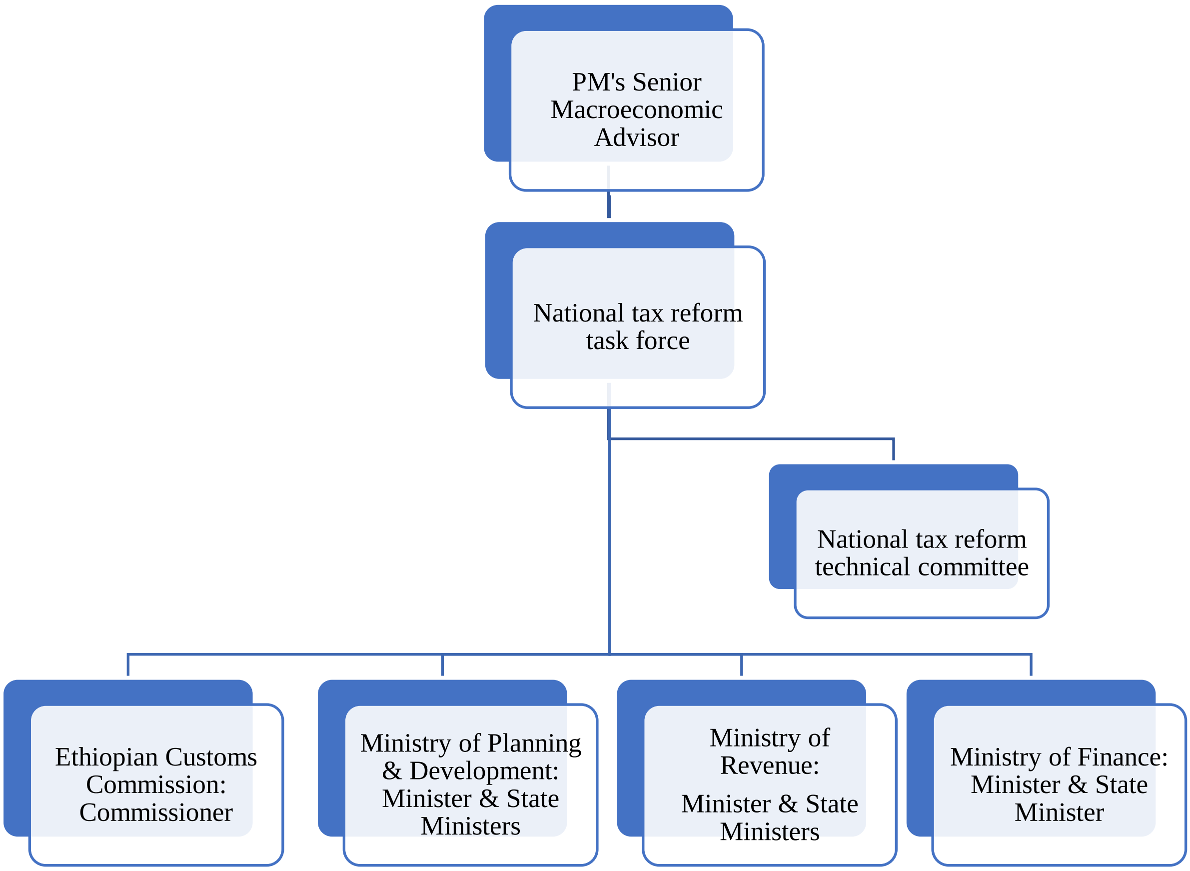
- Conducting monitoring and evaluation activities to assess the progress and impact of the NMTRS.
- Providing support to implementing agencies on strategy implementation and policy measures.
- Organizing regular review meetings with stakeholders to discuss progress and address challenges.
- Producing periodic reports detailing the findings of monitoring and evaluation activities.
- Facilitating the smooth implementation of the NMTRS by coordinating efforts across various stakeholders.

6.3. NMTRS Governance and Management structures

To ensure the proper implementation of the NMTRS and to coordinate efforts effectively, a clear governance structure with well-defined roles for different government institutions called National Tax Reform Taskforce (NTRTF) has been established by a letter reference number 00.30.888/1 written on July 18, 2024 by the Prime Minister Office (PMO). This governance structure consists of three distinct committees operating at different levels of government:

- **Expert Group:** Comprising experts from key government entities such as the Ministry of Finance, the Ministry of Revenue, the Ethiopian Customs Commission, and the Ministry of Planning and Development, the Expert Group leads the development of the NMTRS. This group is responsible for organizing stakeholder engagement platforms, gathering feedback and inputs for the strategy, and coordinating reform efforts across government agencies. Additionally, it monitors and evaluates the implementation of proposed reforms. The Expert Group holds fortnightly meetings to discuss key challenges and progress in reform implementation and prepares regular progress reports for the Technical Committee.
- **National Tax Reform Technical Committee:** The Technical Committee is chaired by Tax Policy Department of the Ministry of Finance. Members of the technical committee are of heads of departments, directors, and deputy commissioners from the Ministry of Finance, the Ministry of Revenue, and the Ethiopian Customs Commission. This committee assesses the reports submitted by the Expert Group and makes recommendations to the Ministerial Committee on key policy issues. The Technical Committee convenes monthly to review progress and provide guidance on implementation.
- **National Tax Reform Taskforce:** At the highest level of the governance structure, the Taskforce is chaired by Senior Macroeconomic Advisor to the Prime Minister. The taskforce comprises Ministers and State Minister from the Ministry of Finance, the Minister and State Ministers of Ministry of Revenue, Minister and State Minister of the Ministry of Planning and Development, and the Commissioner of the Ethiopian Customs Commission. This committee receives policy recommendations from the Technical Committee and makes decisions that do not require parliamentary approval. For decisions requiring parliamentary approval, the Ministerial Committee submits them to the Council of Ministers and, if approved, forwards them to Parliament. The taskforce convenes twice a year to review progress and make strategic decisions.

Figure 6.1. NMTRS Governance Structure/Framework



7. CONCLUSION

Ethiopia has experienced impressive economic growth, especially during the period 2004-2019, with average annual GDP growth exceeding 10%. Over this time, Ethiopia was one of the fastest growing economies in the region with average annual GDP growth of 10.3 per cent. However, since 2020, there has been a slowdown in growth due to a variety of factors such as conflict in the north, drought in the south and east of Ethiopia, the COVID-19 pandemic and the war in Ukraine. Growth was weak across the region following the COVID-19 pandemic. In Ethiopia, GDP growth was recorded at around 6% in 2020. This is still a relatively robust performance when compared to the other countries in the region. In 2021, the recovery was rapid in all other countries in the region. However, mainly due to the outbreak of civil war in the north and partly due to the drought in some parts of the country, Ethiopia continued to grow at pandemic levels.

However, the economy still faces a number of challenges, including persistently high inflation, growing income inequality, a high level of public sector debt, high unemployment, a severe shortage of foreign exchange and a weak export sector. High inflation, with a disproportionate impact on wage earners in urban areas, is still the country's main economic challenge. This was compounded by the COVID-19 outbreak, drought in some parts of the country and the conflict in the north, which severely disrupted domestic supply chains.

A clear strategy for sustainable sources of domestic financing is needed to meet the country's growing expenditure needs. To achieve this, the Government has initiated this NMTRS covering the period FY 2023/24 to FY 2027/28. The strategy adopts a holistic approach by integrating tax policy, tax administration and the legal framework. Hence, the NMTRS identifies the key policy and administrative measures to be implemented over the next four years.. The policy measures are aimed at simplifying the tax system and broadening the tax base, while the administrative measures are aimed at modernizing the tax administration and improving tax compliance and reducing tax evasion and tax avoidance.

The main policy measures include the reform of the personal income tax system, the introduction of a minimum alternative tax (MAT) for corporations and the rationalization of tax exemptions. It also includes the reform of excise duties, VAT and customs regulations. While the administrative measures include digitizing the administrative system, improving data management, expanding taxpayer touch points, and implementing the risk management system. On the revenue side, the policy measures are expected to generate about 4% of GDP by the end of the NMTRS period, while the administrative measures are expected to generate about 2.9% of GDP. The country's TADAT score and Digital Transformation Maturity Model will also improve as a result of these administrative measures.

In order to implement all these measures effectively and in a coordinated manner across the different agencies/ministries, the government has established a clear governance structure with clearly defined roles and responsibilities. The Expert Group, comprising experts from the Ministry of Finance, the Ministry of Revenue, the Ethiopian Customs Commission and the Ministry of Planning and Development, will be responsible for operationalizing the various interventions, coordinating the government agencies/ministries and monitoring and evaluating the interventions. This group will report to the Technical Committee, which will review the expert group's reports and proposed actions before forwarding them to the Ministerial Committee. The Ministerial Committee then reviews the proposed measures and actions. If the measures require parliamentary approval, it forwards them to the Council of Ministers and then to the Parliament.

Key success factors and implementation risks have been identified in the strategy. The political commitment, the support of donors and taxpayers, and the ongoing privatization process are identified as success factors. Implementation risks include external shocks, limited IT infrastructure at the Revenue Authority, macroeconomic imbalances and limited buy-in by different stakeholders, including the private sector.

Appendix

Appendix 1: Summary of tax policy reforms in last five years

	Policy measures	Timing	Impact	Revenue implication
1.	Border *franco-valuta* and tariff exemptions	2017	▪ To facilitate the cross-border trade, the government permitted traders in selected border areas to import goods through the *franco-valuta* scheme, where importers were not required to get bank permit to import goods. ▪ The reform was effective in promoting cross-border trade ▪ However, it was administratively cumbersome and costly for the government. It was estimated that the government lost ETB 4 billion annually. ▪ But in 2017, the scheme was removed	▪ Revenue raising reform
2.	VAT threshold reform	2018	▪ The compulsory VAT registration threshold was ETB 0.5 million until 2018, which was not revised in line with the prevailing inflation for more than 15 years. ▪ This threshold brought small businesses into the VAT system. ▪ So, in 2018, the VAT compulsory threshold was revised to ETB 1 million.	▪ Revenue-reducing reform
3.	VAT withholding change	2019	▪ Before 2019, withholding agents were required to withhold 100% of the VAT payable from their purchase/procurement and remit to the Tax Authority. ▪ In 2019, a new regulation was enacted changing the withholding rates from 100% to 50%. Withholding agents are now required to withhold only 50% from their purchase or procurement, while the suppliers are required to collect the remaining 50% VAT payable and remit to the tax authority.	▪ Revenue-neutral reform

	Policy measures	Timing	Impact	Revenue implication
4.	Excise tax reform	January 2020	▪ Broadened the tax base (bringing more excisable items into the excise tax net); ▪ Simplified the tax base for locally produced goods (changing it from the cost of production to ex-factor prices); ▪ Raised more government revenue from locally produced goods, while reducing the excise tax import tax collections in 2020/21.	▪ Revenue-raising reform
5.	Customs duty reform	September 2021	▪ Simplified the customs duty by reducing the customs duty bands from 6 to 5; ▪ Removed the second schedule from the tariff system;	▪ Revenue-neutral reform
6.	Surtax reform	September 2021	▪ Removed the surtax on all imports with customs duty of 15% or lower; ▪ Eased the import tax burden on importers; ▪ Resulted in revenue loss for the government;	▪ Revenue-reducing reform
7.	Centralization of the tax exemptions	May 2021	▪ Previously, tax exemption was administered by different government agencies creating inconsistent administration. ▪ In May 2021, the government centralized the administration at the Ministry of Finance ▪ The reform improved the overall administration of the exemption process;	▪ Revenue-raising reform
8.	Rationalizing the tax incentives	2022	▪ The reform made it clear which sectors are eligible and also removed certain incentives which are costly for the government (like duty free importation of pickup trucks for investors and CSOs).	▪ Revenue-raising reform
9.	Social welfare levy	August 2022	▪ It imposes a 3% levy on all imports (on the CIF value of imports) ▪ Raised more government revenue (making up the revenue loss from the surtax reform).	▪ Revenue-raising reform