UNIT THREE

ETHIOPIAN PUBLIC FINANCE

Budget in Ethiopia

The word now means, "Plans of government finances submitted for the approval of the legislature". The budget reflects what the government intends to do. The budget has become the powerful instrument for fulfilling the basic objectives of government. The budget covers all the transactions of the central government.

Budget is a time bound financial program systematically worked out and ready for execution in the ensuing fiscal year. It is a comprehensive plan of action, which brings together in one consolidated statement all financial requirements of the government. The budget goes into operation only after it is approved by the parliament. A rational decision regarding allocation of resources to satisfy different social wants requires considerable thinking and planning. Thus budget is an annual statement of receipts and payments of a government.

Functions of Budget

The functions of budget include the following:

- proper allocation of resources: - to relate expenditure decisions to specified policy objectives and to existing and future resources;
- to relate all major decisions to the state of the national economy;
- long term economic growth:- to ensure efficiency and effectiveness in the implementation of government programs;
- to facilitate legislative control over the various phases of the budgetary process.
- equitable distribution of income and wealth and
- Securing economic stability and full employment.

It implies that the objective of budget policy is to take corrective measures or to adopt regulatory policies to remove imperfection or inefficiencies of market mechanism. Besides, the objective of the budget policy is to make provision of social goods or the process by which total resources are divided between private and social goods. It means that the objective of budget policy is to ensure

equitable distribution of income and wealth. This may be termed as distribution function. Third objective of budget policy is to maintain a high level of employment, reasonable degree of price stability and an appropriate rate of economic growth.

To implement its economic functions government raises revenues through taxation. Fees and charges, and spend them on different programs and activities. This process of rising revenues and spending by government is performed through budgeting. Budget thus stands for the yearly plans/forecasts of government revenues and expenditures. The budgeting process starts from the initial stage of preparing the annual revenues and expenditures forecast and end at the stages of approval by the higher government body followed by its implementation.

The Concept of Budgeting in Ethiopia

The government budget represents a plan/forecast by government of its expenditures and revenues for a specified period. Commonly government budget is prepared for a year, known as a financial year or fiscal year. In Ethiopia the fiscal year is from July 7 of this year to July 6 of the coming year (Hamle 1-Sene 30 in Ethiopian calendar). Budgeting involves different tasks on the expenditures and revenues sides of government finance. On the side of expenditure, it deals with the determination of the total deals with the determination of the total size of the budget (i.e total amount of money for the year), size of outlays on different functions, and the magnitude of outlays on various activities; on the revenue side, it involves the determination of the size of the overall revenue and foreign aid.

Furthermore, budgeting also address the issue of the budget deficit (i.e. the excess of outlays over domestic revenues), and it's financing. Budgeting is not solely a matter of finance in the narrow sense. Rather it is an important part of government's general economic policy. Budget is not solely a description of fiscal policies and financial plans, rather it is a strong instrument in engineering and dynamiting the economy and its main objectives are to devise tangible directives and implement the long term, medium term, and annual administrative and development programs".

Budget Structures in Ethiopia

Budget structures are the formats that organize budget data. Budget data could be classified in different ways and for different purposes. In the early days, for instance, budget classification basically focused on providing a better understanding of the intentions and purposes of government for which funds were planned and to be spent. Later on, the budget structures started to be influenced largely by the issue of accountability. That is in addition to providing information on what the government proposed to do, the budget structures indicate the full responsibility of the spending agency. To this end the budget heads or nomenclatures the full responsibility of the spending agency. To this end the budget head or nomenclature of the budget are mostly mapped to each spending agency. This should not, however, imply unnecessarily extended and detailed structure (or mapping). Perhaps, due consideration must be taken to make the structure manageable and appropriate. The first classification of the budget is between revenue and expenditure.

Revenue Budget

It represents the annual forecast of revenues to be raised by government through taxation and other discretionary measures, the amount of revenues raised this way differ from country to country both in magnitude and structure, mainly due to the level of economic development and the type of the economy.

In Ethiopia, the revenue budget is usually structured into three major headings: **ordinary revenue, external assistance, and capital revenue**. Hence, the funds expected from these three sources are proclaimed as the annual revenue budget for the country. The revenue budget is prepared by the Ministry of Finance (MoF) for the federal government and by Finance Bureaus for regional governments.

Ordinary revenues include both tax and not tax revenues. the tax revenues being direct taxes (personal income tax, rental income tax, business income tax, agricultural income tax, tax on dividend and chance wining, land use fee and lease); indirect taxes (excise tax on locally manufactured goods, sales tax on locally manufactured goods, service sales tax, stamps and duty); and taxes on foreign trade (customs duty on imported goods, duty and tax on coffee export). Non tax revenues include charges and fees; investment revenue; miscellaneous revenue (e.g. gins); and pension contribution. The second major item in revenue budget is external assistance. It includes: cash grants, these are grants from multilateral and bilateral donors for different structural

adjustment programs; and technical assistance in cash and material form. The third item is capital revenue. This could be from domestic (sales of movable properties and collection of loans), external loan from multilateral and bilateral creditors mostly for capital projects, and grants in the form of counterpart fund.

Categories of Revenues to Government

- **Revenue on the basis of Nature**

The revenues on the basis nature can be classified as in the following table. Of these two types of classifications of revenues the classification of revenues based on the nature is considered as the ideal classification.

A. Tax Revenue

The revenue from tax includes the following.

I. Tax on Income

The Government imposes two types of taxes on income.

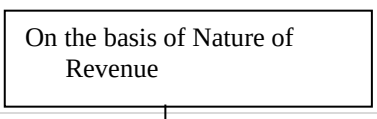
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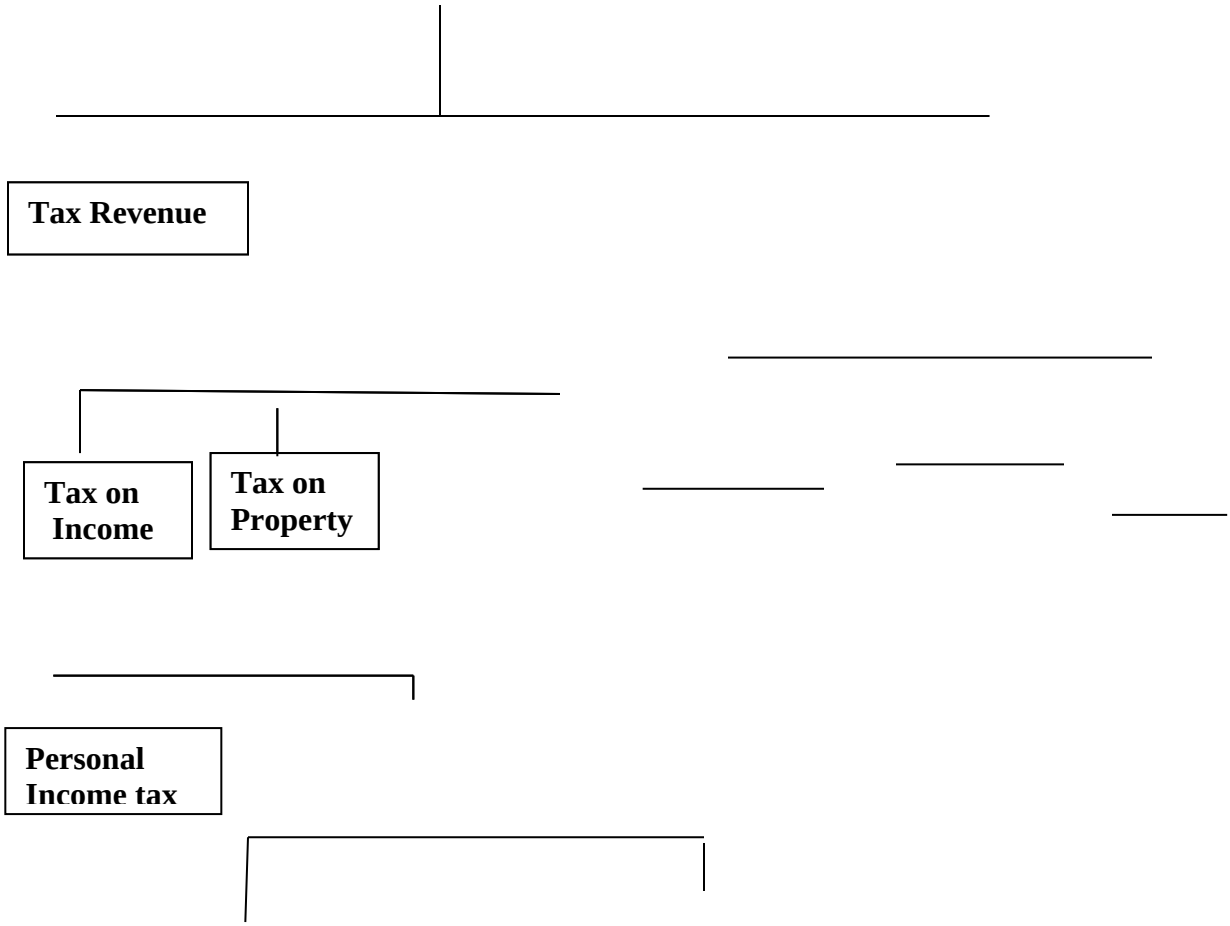
a) personal income, and
b) Corporation profits.

The personal income tax is levied on the net income of individuals, firms and other association of persons. The tax on the net profits of the joint stock companies is known as corporation tax.

II. Taxes on Property:

It is the tax revenue from properties including rental income tax land use tax etc.





III. Taxes on Commodities

The important taxes levied by the Government on commodities are:

a) Customs Duty,
b) Excise Duty,
c) Value Added Tax
d) Turnover Tax

- Customs Duty includes both import and export duties. These duties are le vied when the goods cross the boundaries of the country.

- Excise duties are levied on the commodities produced in the country. Excise duties now constitute the single largest source of revenue to the Union Government.
- Value Added Tax is levied by the Government on the commodities sold at specified percentage on the value of sales.
- Turnover Tax is levied by the Government on the sales which are not covered under Vat.

B. Non-Tax Revenues

The following categories of revenue are included under non-tax revenue.

❖ **Administrative Revenue**

It includes the following:

I. Fees

It is the compulsory payment made by the individuals who obtain a definite service in return. Fees are charged by the Government to bear the cost of administrative services rendered by it. These services are rendered for the benefit of general public. It includes court fee, registration fee, etc.

II. Licenses

A license fee is collected not for any service rendered, but for giving permission or a privilege to those who want to do a special or specified work. It is charged on the grounds of control of certain activities.

III. Fines and Penalties

Fines and penalties are imposed as a form of punishment for the mistakes committed such as violation of the provisions of law, etc. The basic aim behind them is to prevent the people from making mistakes. A fine is also compulsory like a tax, but it is imposed more as a deterent as a source of revenue.

IV. Forfeitures

Forfeiture means the penalty imposed by the courts on the persons who have not complied with the notice served by it or for the breach of contract or has failed to pay the dues in time, etc.

V. Escheats

The property of a person having no legal heirs and dying intestate, will be taken possession of by the Government that is, the Government can take over the property cannot be considered as a main source of revenue to the Government.

VI. Special Assessment

According to Prof. Seligman, special assessment means "a compulsory contribution levied in proportion to the special benefit derived to defray the cost of the specific improvement to property undertaken in the public interest ". Thus, it is a compulsory payment or contribution. It is levied in proportion to the special benefits derived to bear the cost of specific improvement to property. Whenever the Government has made certain improvements, somebody will bet benefited. For example, irrigation facility, road and drainage facility, etc.

Budget Deficit

A budget is considered as surplus or deficit according to the position of the revenue accounts of the government. Thus a surplus budget is one in which revenue receipts exceed expenditure charged to revenue account regardless of the gap in capital accounts; while a deficit budget is one in which expenditure is greater than current revenue receipts.

Budget deficit is the excess of total expenditure over total revenue of the government.

The deficit financing denotes the direct addition to gross national expenditure through budget deficits whether the deficits are on revenue or capital accounts". It implies that the expenditure of the government over and above the aggregate receipt of revenue account and capital account is treated as budget deficit of the government.

The meaning of deficit financing is different in different countries. In western countries, the budget gap, that is covered by loans is called deficit financing because, if the government borrows from the banks rather than from individuals the idle funds will be activated and there will be an increase in the total public expenditure and thus there will automatically be an deficit financing has been used in a different sense,. Here it is used to denote the direct addition to gross national expenditure as a result of budget deficit.

Thus deficit financing can be defined as "the financing of a deliberately created gap between public revenue and public expenditure". The government of Ethiopia has used deficit financing for acquiring funds to finance economic development. When the government cannot raise enough

financial resources through taxation, it finances its developmental expenditure through borrowing from the market or from other sources.

Methods of Financing Deficit

There are four important techniques through which the Government may finance its budgetary deficits. They are as follows:

A. borrowing from central bank

B. The running down of accumulated cash balances

C. The government may issue new currency

D. Borrowing from market or from external sources.

Under the first method, government borrows from central bank as per budgetary policy. In the second source, government spends from available cash balance. In the third measure, government issues new currency for financing deficit. The last method is that government borrows from internal and external sources to finance its deficit.

Objectives of Deficit Financing

1. Deficit financing has generally been used as a method of meeting the financial needs of the government in times of war, when it is considered difficult to mobilize adequate resources.
2. Keynes advocated deficit financing as an instrument of economic policy to overcome conditions of depression and to raise the level of output and employment.
3. The use of deficit financing has also been considered essential for financing economic development especially in under developed countries.
4. Deficit financing is also advocated for the mobilization of surplus idle and unutilized resources in the economy.

Pattern of Revenue Sharing

Ethiopia has chosen the federal structure in which a clear distinction is made between the union and state functions and sources of revenue, but residual powers, belong to the center, although the states have been assigned certain taxes, which are levied and collected by them, they also share in the revenue of certain federal taxes. In addition, the states receive grants-in-aid of their revenue from the federal government, which further increase the amount of transfers between the two levels of government. The transfer of resources from the central government to the states is an essential feature of the present financial system.

Distribution of Revenues between Central and States

The present federal fiscal system in Ethiopia is of a recent origin. The distribution of revenues between the centre and states is followed on the basis of "constitution of Ethiopia" and proclamation no.33/1992-proclamation "to define sharing of revenue between the central government and the national/regional self governments". The articles 96, 97, 98, 99 and 100 of the constitution of Ethiopia make a clear demarcation of areas where the central alone or state alone have authority to impose taxes. It contains a detailed list of the functions and financial resources of the center and states.

Basis for Revenue Sharing

The sharing of revenue between the central government and the National/ Regional governments shall take in to consideration the following Principles:

1. Ownership of source of revenue;
2. The national or regional character of the sources of revenue;
3. Convenience of levying and collection of the tax or duty;
4. Population, distribution of wealth and standard of development of each region;
5. Other factors that are basis for integrated and balanced economy.

Categorization of Revenue

According to "Constitution of Ethiopia" and Proclamation No.33/1992-Proclamation, revenues shall be categorized as Central, Regional and Joint. That is there are three lists given in the Articles. They are as follows:

A. Central List,

B. Regional List, and

C. Joint/Concurrent List

The important sources of revenue under "Constitution of Ethiopia" and The Proclamation No.33/1992-Proclamation "To Define sharing of Revenue between the Central Government and the National/Regional Self Governments" are explained below:

A. Central List

The sources of revenue are given under Federal/Central List are as follows:

I). Duties, tax and other charges levied on the importation and exportation of goods;

II). Personal income tax collected from the employees of the central Government and the

International Organizations;

III). Profit tax, Personal income tax and sales tax collected from enterprises owned by the Central Government. (Now sales tax is replaced with VAT and Turnover taxes).

IV) Taxes collected from National Lotteries and other chance winning prizes;

V). Taxes collected on income from air, train and marine transport activities;

VI). Taxes collected from rent of houses and properties owned by the central Government;

VII) Charges and fees on licenses and services issued or rented by the central Government;

B. Regional List

The following shall be Revenues for the Regions:

I). Personal income tax collected from the employees of the Regional Government and Employees other than those covered under the sources of central government.

II) Rural land use fee.

III) Agricultural income tax collected from farmers not incorporated in an organization.

IV) Profit and sales tax collected individual traders.

V) Tax on income from inland water transportation.

VI) Taxes collected from rent of houses and properties owned by the Regional Governments;

VII) Profit tax, personal income tax and sales tax collected from enterprises owned by the Regional Government:

VIII) With prejudice to joint revenue sources, income tax, royalty and rent of land collected from mining activities.

IX). Charges and fees on licenses and services issued or rented by the Regional Government;

C. Joint/Concurrent List

The following shall be Joint revenues of the Central Government and Regional Governments.

I. Profit tax, personal income tax and sales tax collected from enterprises jointly owned by the central Government and Regional Governments;
II. Profit tax, dividend tax and sales tax collected from Organizations;
III. Profit tax, royalty and rent of land collected from large scale mining, any petroleum and gas operations;
IV. Forest royalty.