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*Enhancing Shared Prosperity through Equitable Services (ESPES) Program*

*Second Additional Financing (P176354)*

**TECHNICAL ASSESSMENT - ADDENDUM**

*April 2021*

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**(A) Background and Contextual Analysis**

1. **Ethiopia’s decentralized administrative structure involves regions, zones, and woredas (districts), and the constitutional and legal framework commits the government to maintain the integrity and capacity of decentralized administration down to the woredas.** As per the existing revenue and expenditure assignments, the revenue powers devolved to lower government tiers are not commensurate with their expenditure responsibilities. Specifically, sub-national government taxes and revenues account for about 29.9 percent of general taxes and revenues, but sub-national expenditures amount to 54.4 percent of general government expenditures. In the context of pronounced vertical fiscal imbalance, decentralized expenditure patterns are subsidized transfers from the federal government, mainly the General-Purpose Grant (GPG) aka block grants, to meet their expenditure responsibilities.

2. **The woredas rely on these transfers to deliver basic services, defined as education, agriculture, health, water and sanitation and rural roads.** This administrative and financial structure has supported a steady and impressive increase in basic services throughout the country. The federal government uses an allocation formula approved by the House of Federation to distribute GPG to regions, which regions then allocate to woredas also based on agreed formulae. Federal transfers to regions through the GPG have increased dramatically in recent years, from US\$3.1 billion in FY15 to US\$4.6 billion in FY20. All regions except the Addis Ababa city administration receive GPG allocations, which support the functioning of more than 1,000 woredas. In total, therefore, the GPG benefits an estimated 110 million people across Ethiopia. Roughly 80 percent of the GPG is consumed by salaries paid to service delivery staff, including teachers, agriculture extension workers and health extension workers (HEWs). Given the progressive nature of this spending, the basic services are considered the “pro-poor” sectors by the Ministry of Finance (MoF) and these sectors have been receiving greater allocation of the spending at all levels of government (Federal, regional and woreda level).

3. **Spending on basic services is mainly financed from the GPG, which in turn is mainly financed from tax revenue.** While indirect tax revenues account for over 70 percent of federal tax revenue, direct taxes account for over 70 percent of regional revenue generation. As per the existing revenue assignment, tax on international trade, personal incomes from federal and international employees, profit taxes from federal government owned enterprises are the major sources of revenue for the federal government. Regional level individual profit taxes, agricultural land use fee and income taxes are under the jurisdiction of the regional governments. Federal and regional governments have concurrent (joint) power to collect and share tax on profit, VAT/sales, excise and personal income taxes and on enterprises jointly established by the federal Government and Regional States, profits of companies and on dividends due to shareholders, and on incomes derived from large scale mining and all petroleum and gas operations as well as royalties on such operation.

4. **Issues on revenue sharing are raised on tax sources and tax bases that fall in the realm of concurrent revenue generation.** The concerns are regarding the mismatch of tax sources, tax bases and the sharing arrangements. Recently, the HoF have commissioned a study and changed the revenue sharing between the Federal and Regional governments. For instance, on VAT the revenue sharing is changed from 70-30 to 50-50 where the 50 percent share of regions is to distribute on the basis of equalization principle. This is reported to lead to reduction in the amount of the total grant available at federal level to transfer to regional states. As per information from the MoF, over the first half of 2020/21 (2013 EFY) the revenue sharing resulted in more than ETB 10 billion tax revenue going to regions and reduction in the resource available for the block grant by the same amount. This is estimated to pick to over ETB 15 billion by the close of the fiscal year. This implies lower rate of growth of the GPG from the current fiscal year onwards and the need to look into both GPG and regional revenue when analyzing decentralized spending on basic services.

5. **Ethiopia's constitution<sup>1</sup> and the proclamations thereof show the commitment of the Government to decentralization agenda. Decentralization in Ethiopia established initially nine regions and two city administrations<sup>2</sup>.** Sidama, which was one of the zonal administrations of the SNNPR has recently became the tenth Regional administration. The Constitution provides expenditure and revenue assignments to the Federal and Regional Government administrative structures, where subnational Governments have the responsibility to provide basic services for communities in their constituencies.

6. **The inter-Governmental-Fiscal Transfer system of the Government is governed by the GPG transfer formula issued by the House of Federation.** Regional Governments receive and use the GPG as allocated by the formula. On top of the federal block grant allocation, regions have the authority to generate revenues to fulfill their expenditure assignments. In turn woredas, which are the third tier of Government structure, receive block grants from their respective regional governments and spend to fulfill the provision of primary basic service deliveries at the grassroots level.

7. **The Enhancing Shared Prosperity through Equitable Services (ESPES) is the Bank's largest PforR operations in Ethiopia contributing to the Federal block grants.** The objective of ESPES program is to improve equitable access to basic services and strengthen accountability systems at the decentralized level. The program supports service delivery for the entire population of Ethiopia with a focus on results in health, education, and agriculture services and strengthening the overall decentralized service delivery system. The ESPES focuses on leveraging the government's broad program of service delivery support to promote equity, enhance quality of and access to services, and to strengthen and institutionalize transparency and accountability systems.

8. **ESPES builds on three successive phases of Protecting Basic Services (PBS) programs between 2006-2018 that supported the GPG to regions and woredas for recurrent costs of basic service sectors.** As a result of the contentious 2005 general election and loss of lives in its aftermath, the Development Partners (DPs) had halted the provision of Direct Budget Support to the Government. To ensure that this did not unduly negatively impact the Government's financing of basic services, the DPs financed the PBS programs to support the delivery of basic services to the poor at subnational levels and introduce a strong focus on fiduciary, fairness, accountability and transparency. Specifically, this investment provided capacity building funds for PFM, procurement, M&E, FTA, GRM and SA, risk, and safeguards capacity

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<sup>1</sup> The Constitution of the Federal Democratic Republic of Ethiopia, 1995.

<sup>2</sup> The regions are: Afar, Amhara, Benishangul-Gumuz, Gambella, Harari, Oromia, SNNPR, Somali and Tigray and recently Sidama. The two City Administrations are Addis Ababa and Dire Dawa.

management. While the capacity building components of PBS 3 continued until 2018, ESPES PforR was approved in September 2015 followed by the ESPES 1<sup>st</sup> AF prepared in September 2017 and added an IPF component. ESPES continued to support the IGFT system to enable the delivery of basic services at the subnational level while building the capacity of the government system.

9. **Due to the support of the program to the Financial Transparency and Accountability (FTA) agenda, the government is now able to assign FTA focal persons in federal, regional and woreda finance offices.** These focal persons help facilitate budget literacy trainings, posting budget and expenditure information at finance bureaus and facilities (such as Health posts and schools) and creating awareness of the wider citizen on government budget and expenditure using creative information sharing mechanism. In the last ten years, more than two million people attended budget literacy training throughout the country.

10. **The program also plays a big role in strengthening the Grievance Redress Mechanism (GRM).** In partnership with the Ethiopian Institute of Ombudsman, it helped expand the opening of additional branch offices of EIO at the regional capitals and ensured their functionality through provision of office supplies and the necessary capacity building trainings. These branch offices have been instrumental in building the capacity of the regional level GRM offices established by the respective regional administrations. Currently more than 80 percent of woredas have GRM offices with two to four staff.

11. **Extensive research of this World Bank support for the Government's decentralized service delivery agenda shows the investment is efficient, cost effective and equitable.** The 2<sup>nd</sup> Additional Financing of ESPES is built on the success of the first additional financing, the original project, and the preceding PBS programs. A 2014 Poverty and Social Impact Analysis (PSIA) found that, for education, an increase of US\$1 per capita in spending by each woreda is associated with a 3.7 percent increase in the net primary enrollment rate within that woreda<sup>3</sup>. Every additional US\$1 of per capita spending by the woredas on health is associated with a 7.5 percent increase in the contraceptive prevalence rate and a 12.4 percent increase in deliveries by skilled birth attendants (two interventions that can reduce maternal mortality dramatically), as well as a 4 percent increase in antenatal care (which can reduce infant and child mortality significantly). And, for every additional US\$1 per capita spent, the probability that a field in a given zone will benefit from extension services increases by about 0.2 percent. The PSIA assessed equity at two levels and found that: the relative distribution of spending on woreda-level services is pro-poor, and the geographical distribution of resources by poverty level of the region/woreda favors poorer regions.

12. **A recent analysis<sup>4</sup> by Faguet et al (2020) implies that decentralization is improving performance in Ethiopia's public education and health sectors, specifically by raising enrollment rates in schools and increasing provision of antenatal care to pregnant women.** Evidence for this comes from regional-level panel estimates, as well as national-level time-series regressions. Health and education outcomes improve as total resource expenditures increase, as one would expect. But there is a separate effect of decentralization on net enrollment rate (NER) and ante-natal care (ANC) that arguably dominates the pure expenditure effect. The magnitudes are significant: the incremental effect of decentralizing health and education service provision to the mean woreda is an estimated 12.6 percent for ANC and 18 percent for

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<sup>3</sup> Khan, Q., Faguet, J-P., Gaukler, C., and Mekasha, W. "Improving Basic Services for the Bottom Forty Percent", World Bank. 2014.

<sup>4</sup> Jean-Paul Faguet, Qaiser Khan, and Devarakonda Priyanka Kanth (2020) Decentralization's Effects on Education and Health: Evidence from Ethiopia.

NER. The main channel for these improvements appears to be institutional, related to local control over education and health services, as opposed to local expenditures per se.

13. **Overall, the 1<sup>st</sup> Additional Financing of ESPES is progressing well toward achieving its PDO indicators and disbursement is on track.** Nine of the twelve PDO indicators are fully achieved, two are progressing on schedule and the status of one indicator, which deals with access to agriculture extension, is awaiting update from the implementing institution once monitoring can safely resume given COVID-19. With respect to achievement of DLIs, as of February 28, 2021, of the 40 total Disbursement Linked Results (DLRs), twenty five DLRs have been fully achieved while others are under review, not yet due and some are being restructured as they cannot be achieved because of the impact of COVID-19. Accordingly, disbursement is also on track with 99%, 82% and 29% disbursement from IDA-57160, IDA-61310 and 29% from IDA-2290 respectively as of February 28, 2021. The implementation capacity of MoF/COPCD has improved but cross sectoral coordination remains a challenge and in response COPCD is setting up a multisectoral taskforce to enhance coordination and joint monitoring of progress.

14. **The ESPES indicators focus on empowering frontline staff to reach households effectively.** Between 2015 and 2019, ESPES DLIs incentivized better training of health extension workers (HEW) and, in this period, the number of HEWs with Level 4 qualifications grew nearly eightfold, from 2,123 to 16,207. By 2020, 77 percent of grade 1-4 teachers in four targeted regions had diploma level qualifications, surpassing the target of 60 percent. Similarly, outcome linked disbursements helped expand agricultural services such that nearly 1 million more women connected with agricultural extension workers in 2019 as compared to 2015.

15. **The Program also has had tangible impacts on access to and quality of services and outcomes in health and education.** Between 2017 and 2019 in the bottom 20 percent woredas<sup>5</sup>, Penta-3 coverage has increased from 56 percent to 57 percent, girls' grade 8 completion has increased from 13 percent to 23 percent, and net grade 5-8 enrollment has increased from 17 percent to 28 percent.

16. **Citizen feedback shows gains in knowledge and perception of basic services as well.** Dissatisfaction with services decreased significantly over the period of PBS 3, from 67 percent in 2013 to 11 percent in 2017<sup>6</sup>. Understanding of local budgeting more than doubled, as did participation in the last 12 months in budget meetings. Ninety percent of citizens knew of a GRM in place for complaints and disagreements—a system resulting directly from dialogue around PBS and ESPES.

17. **However, despite these successes and significant investment in basic (education, health, agriculture, and WaSH) services, human development outcomes remain low.** The World Bank (2018) Human Capital Index (HCI) measured that expected productivity of a child born in Ethiopia today as a future worker is only 38% of what it could be with full Health and complete Education. Ethiopia's HCI is lower than the average for its region. Poor quality of services, inequitable access, demand side barriers, limited/poor capacities at decentralized levels, lack of cross-sectoral collaboration, recurring droughts and more recently conflict and violence, and the COVID pandemic are among the factors generally known to affect HD outcomes.

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<sup>5</sup> Lowest performing 20 percent woredas per agreed indicators as defined in ESPES program documents.

<sup>6</sup> Impact Assessment on Financial Transparency and Accountability (FTA) Implementation", BDS Center for Development Research 2009, 2013 and 2017

18. **Unfortunately, lack of adequate budget remains an issue.** Most of the spending at woreda level goes to non-discretionary spending (salary of teachers, HEWs, DAs, woreda water desk staff and rural road desks). At the same time, the continued investment on woreda basic service infrastructure (construction of additional schools/school blocks, health centers/health center blocks, farmer training centers, etc.) through Government-financed Sustainable Development Goals Fund require additional budget for recurrent allocations to make them operational. Yet, despite this, the 2020 MoF Cost of Basic Services Study shows that, despite the average historic 60 percent allocation, woredas still exhibit gaps in meeting their basic requirements and service delivery standards set by the Government.

19. **Additional analytics also point to several binding constraints in how services are planned, budgeted and delivered.** In coordination with Government and partners, the World Bank has led several key analytical analyses of binding constraints to service delivery in the decentralized system. These include the Rapid Woreda Institutional Assessment (2020), Review of Local Level Planning and Budgeting Processes in Ethiopia (2020), and Analysis of Human Development Delivery Systems in Lowlands of Ethiopia (2019). Together, they highlight several factors: lack of multi-sectoral coordination and integrated planning; lack of human capacity and lack of incentives and accountability systems to ensure results; poor planning, budgeting and resource allocation processes including mismatch between planning and budgeting; weak data collection and monitoring and evaluation systems; and shortcomings in the availability of supplies (books, drugs, materials, clean water, reliable electricity, etc.) especially in remote and pastoral areas.

20. **The ESPES PDO remains very relevant and the case for continued support to Federal block grants is very strong.** Given the above-mentioned gaps and challenges to service delivery and in the face of the macro-economic impact of the COVID-19 pandemic, the ESPES and its PDO is judged to be even more relevant the case for additional financing is very strong. As outlined in the Project Paper, the DLIs and DLRs for the 2<sup>nd</sup> Additional Financing are designed to address some of the binding constraints to decentralized service delivery, including adding new results areas within the basic services that have particular relevance in the COVID-19 recovery. The 2<sup>nd</sup> AF is further warranted to provide much needed resources to support the Government emergency response to the pandemic

21. **The institutional arrangements are also maintained given that implementation progress has remained Satisfactory or Moderately Satisfactory throughout the program period.** The main change under the ESPES 2<sup>nd</sup> AF is that MoF will convene an ESPES Task Force of all Implementing Partners monthly to discuss progress on DLRs, PAPs and the IPF component of the ESPES 1<sup>st</sup> AF. Under PBS, a similar task force was successful in the program's coordination efforts across sector ministries and agencies. The MoF will update the ToR from the PBS Task Force to provide clear objectives and responsibilities for the group.

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## *The Ethiopia Social Accountability Program*

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Ethiopian Social Accountability Program (ESAP) is built on the recommendation of WDR 2004 (Making Services Work for Poor People) that strengthening relationships of accountability—between policymakers, providers, and citizens—are required for legitimacy of government and to improve service delivery. Evaluation of the second phase of ESAP found increases in citizen participation in local committees and other policymaking venues; improvements in citizen satisfaction with the more immediate delivery of public service; and increases of more critical attitudes by citizens regarding more structural problems reflecting increased expectation and confidence to question the delivery of services.

Started in 2019, the third phase, ESAP 3, focuses on deepening and expanding Social Accountability while taking additional and more lasting steps toward institutionalization and sustainability. ESAP 3 undertakes activities with financing from a Multi-Donor Trust Fund (MDTF) and IDA.

With the MDTF resources, the program added additional 177 woredas and consolidated the earlier 230 woredas from phase 2, now reaching a total of 317 woredas throughout the country and mobilizing more than 100 local CSOs as facilitators of the program. The ESAP 3 target is 417 woredas. Moreover, in response to COVID-19, the ESAP 3 created a new innovative radio show, “Citizens on the Line” that gave an opportunity for people to call-in to talk with government officials about various topics related to the pandemic. The broadcast reach of the radio stations used is 729 woredas.

The IDA resource aims build the capacity of the government to take over the role of managing the Social Accountability as the MDTF’s Management Agency leave the woredas in phases. By establishing SA unit at the Ministry of Finance and recruiting regional SA team at each region, the government is expected to take over the first cohort of woredas at the end of 2021. This investment parallels the DLRs introduced through the ESPES 2<sup>nd</sup> AF on citizen engagement.

### **(B) Economic Analysis**

**22. There is a clear economic rationale for continued investment on basic services in Ethiopia with clear linkages to economic growth, human development and poverty reduction outcomes in the country.** Ethiopia has achieved robust growth of over 9 percent over the past decade and this was accompanied by significant poverty reduction outcome with poverty head count declining from 29.6 percent in FY2011 to 23.5 percent in FY2016<sup>7</sup>. This was reported to be the combined result of government investment on infrastructure and human development.

**23. Recent growth and poverty reduction outcomes are being challenged by the COVID-19 pandemic, ongoing conflict in many parts of the country, as well as natural disasters** (drought, flooding and locust infestations). The COVID-19 pandemic, in particular, slowed growth considerably in 2020 with initial estimates showing Ethiopia’s growth slashed by 3 percentage points from 9 percent to 6 percent.<sup>8</sup> In addition, the Ethiopian economy is negatively impacted by high inflation, which stood at over 20 percent currently, severe forex shortage and debt accumulation. Still, fiscal deficits remained modest

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<sup>7</sup> World Bank. 2020. Ethiopia Poverty Assessment: Harnessing Continued Growth for Accelerated Poverty Reduction. Washington DC. © World Bank.

<sup>8</sup> World Bank. 2020. “Covid-19: Potential Poverty and Social Impacts in Ethiopia and Policy Responses.” *Poverty and Equity Global Practice: Ethiopia COVID Response Notes*.

mainly due to tax collection and cautious expenditure management strategy. Although the tax take (tax/GDP ratio) is relatively lower compared to regional comparators, overall tax collection by the Government has been on increasing trajectory. For instance, domestic revenue of the Government increased by 16 percent in FY2020 compared to the preceding year. During the same period, Government expenditure increased by 18 percent thus contributing to only modest fiscal deficit. Government spending on basic services accounted for 60.4 percent of the total FY2020 budget compared to 59.4 percent in FY2019, depicting continued Government commitment on decentralized basic service delivery.

24. **Existing economic appraisal and cost effectiveness works suggest better returns to investment in decentralized basic service delivery.** The 2<sup>nd</sup> AF for ESPES will continue to support the deployment of key service delivery staff at woreda level, system strengthening and capacity building across all levels of Government. This is expected to lead to better service delivery at the local level and hence better social and economic outcomes. It will also generate efficiency enhancements in Government. Economic appraisal by the former Department for International Development (DFID) revealed that decentralized investment on basic services at woreda level will generate a return of US\$1.43 for every US\$1 invested. Although the recent service disruption due to conflict and COVID pandemic has implications on service delivery (such as internal displacements and temporary closure of service delivery facilities), these negative effects are believed to be short-lived and the overall benefits of this investment complemented by sectoral investments in health, education, agriculture and water is expected to outweigh the costs.

25. **The economic efficiency of decentralized spending is enhanced through strengthening fiduciary, governance, transparency and safeguard systems.** The systems building supported through the ESPES 2<sup>nd</sup> AF will continue to generate returns that justify the investment and those benefit-cost estimates continue to be valid. As noted above, key findings from the 2014 PSIA indicated that the GPGs are associated with a range of improved outcomes for the education and health sectors. As also noted above, research finalized in 2020 by Faguet, Khan and Kath reconfirm the cost effectiveness of decentralized basic service delivery in Ethiopia.