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Poverty, Inequality, and Social Protection in Ethiopia, a Policy Brief by *Dejene Mamo Bekana**

Abstract

In this brief commentary the author argues that social protection is not a useful approach to addressing poverty and inequality in low-income countries like Ethiopia. Instead, the author suggests focusing on wealth creation and the capability development approach to poverty reduction. To achieve this, the author proposes targeted state investment expenditure to enhance the productive capabilities of the economically vulnerable population. Besides, the social protection system should prioritize the design and implementation of livelihood improving investment programs, as in-kind or cash transfer support is not sustainable given the elevated level of economic vulnerability. The effectiveness of Ethiopia's social protection system lies on improving coverage, targeting deserving individuals, and sustainable financing solutions.

Keywords: Poverty, Inequality, Social Protection

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Introduction

Ethiopia has experienced robust economic growth in the past two decades, with an average growth rate of about 9.6% between 2004 and 2022[1]. The annual economic growth rate has consistently been above 7% except for the last three years (2020:6.1%, 202:5.6%, and 2022:5.3%) (World Bank, 2023). However, the recent economic growth has faced significant challenges, both nationally and internationally.

Political instability resulting from a civil war in the northern part of the country and unrest elsewhere has disrupted economic activities and limited mobility, among other consequences. Moreover, the surge in global prices of basic commodities, such as oil, gas, and fertilizers, has impacted economies worldwide, including Ethiopia, which relies on the global market for these commodities. As the IMF (2022) states, "Economic growth and inflation were adversely impacted by internal conflict, drought, and the effects of Russia's invasion of Ukraine on commodity prices." Despite the economic growth, the Ethiopian economy has not undergone transformation, and poverty and inequality persist.

There is substantial evidence supporting the existence of rising inequality and slowly declining multidimensional poverty. Although multidimensional poverty has decreased over time, it remains at an elevated level. On the other hand, Ethiopia's GDP per capita has been steadily increasing over the past two decades (see Figure 1). The figure clearly demonstrates that the growth rate of GDP per capita in the country is robust and persistent. For example, it has risen from as low as $281.52 in 2004 to $857.32 in 2022. This indicates that the Ethiopian economy is performing well. However, the challenges of rising inequality and high multidimensional poverty continue to be significant socio-economic challenges.

The Gini index, which measures inequality at the aggregate level, score ranges between 0 and 1(with zero representing perfect equality and 1 representing perfect inequality) (Solt, 2020). It increased from 29% in 2004 to 35% in 2016. This rise in the Gini index, despite Ethiopia's robust economic growth, clearly demonstrates the lack of fair distribution of the economic growth dividend. The income share held by the lowest

[1] Own calculation based on World Bank (2022).

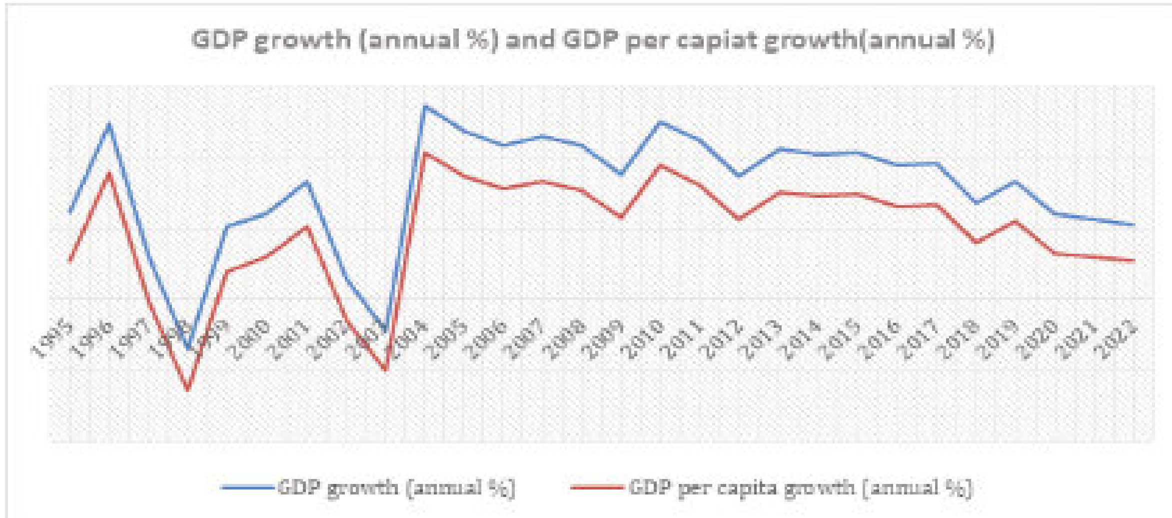

Figure 1 GDP growth (annual %) and GDP per capita growth (annual %)
Source: Author tabulations using data from using data from World Development Indicators (2022).

quantiles of the income group has been declining, while the income share held by the highest income quintile is growing[1]. This indicates that that the rich are getting richer, while the poor are getting poorer. Figure 2 provides unmistakable evidence of wealth concentration among few dominant individuals and businesses. The figure demonstrates that inequality is rising in terms of both disposable income and market income. Market income inequality is based on the income of households before taxes and government transfers, while disposable income inequality is based on the income available after taxes and government transfers. However, the poverty headcount ratio at national poverty lines (% of population) has decreased from 38.7% in 2004 to around 23.5 % in 2019. The current poverty rate in Ethiopia (23.5%) is almost half of the African average, which is approximately 43%.

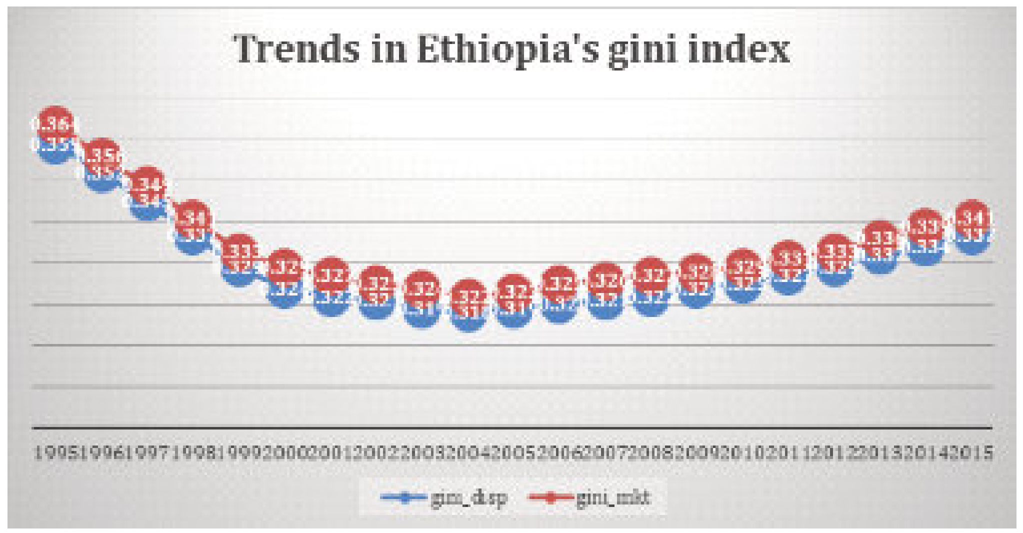

Figure 2: Trends in Ethiopia's Gini Index
Source: The Standardized World Income Inequality Database, Versions 8-9, Harvard Dataverse, V10, 2019

[1] World Inequality Database (2022). World Inequality Database. http://wid.world. Accessed 26 June 2023.

In Ethiopia, there has been slow but consistent progress in reducing extreme and absolute poverty over the years. As mentioned earlier, 23.5% of the Ethiopian population lives below the national poverty line. Additionally, as of 2021, Ethiopia ranks 175th out of 196 countries on the Human Development Index (HDI) (UNDP, 2022).

Although there has been significant decline in headcount poverty at the national poverty line, multidimensional poverty remains high in Ethiopia. The multidimensional poverty index is 0.367, and the headcount multidimensional poverty rate was around 68.7% in 2019(Alkire et. al., 2023a). In comparison, the sub-Saharan African average in the same year was 49.5%. This indicates that Ethiopian policy makers need to intensify their efforts to reduce multidimensional poverty and reach the level of the sub-Saharan African average. Although recent evidence shows decline in the headcount of multidimensional poverty (83.5% in 2011, 77.4% in 2016 and 68.7% in 2019), there is still significant regional variation in multidimensional poverty.

Evidence points to significant cross-regional differences in multidimensional poverty in Ethiopia (Alkire et. al., 2023b). For example, the top three regions that experienced the highest level of multidimensional poverty include the Somali region (90%), Afar region (84.7%) and Oromia region (71.5%). The three regions that experienced the lowest incidence of multidimensional poverty include Addis Ababa City (11.5%), Dire Dawa (33.3%) and Harari (46%). Furthermore, the incidence of multidimensional poverty for rural parts of the country is double that of their urban counterparts. Urban multidimensional poverty incidence stands at 39.2% of the urban population in 2019, while it stands at 79.7% for rural areas. This evidence implies that a comprehensive rural development strategy is essential to significantly reduce multidimensional poverty in the country. This is particularly important because about 80% of the Ethiopian population live in rural areas of the country.

Poverty is often believed to be the outcome of poor investment in human capital development (Barro and Lee, 2018; C. Moyo et al., 2022), negative discrimination (Ahmed et al., 2021) and injustice in the design and/or implementation of social policy (Shepherd, 2011). For instance, gender inequality in Ethiopia is one of the major social challenges. In 2021, Ethiopia's gender inequality index stands at 0.921, signifying slow progress in gender parity achievement. Besides, the human development report indicates that the gender index is greater for males than for their female counterparts. Moreover, there is convincing evidence supporting of a significant gender gap in asset ownership in Ethiopia (Ethiopian Statistics Service, 2023).

Ethiopia provides diverse types of social protection schemes to deal with poverty and inequality. The National Social Protection Policy of the country adopts a lifecycle approach to protect the poor and vulnerable people. Ethiopia's social protection policy has four areas of focus: 1) Social safety net (especially for children, the elderly, and people with disabilities); 2) Livelihood and employment schemes; 3) Social insurance and 4) addressing inequalities in access to basic services.

However, social protection coverage is still limited. The proportion of the population covered by at least one social protection benefit (excluding health) is about 7.4 % (ILO, 2021). The social protection coverage for the most vulnerable portion of the society is exceptionally low (*Ibid*). Social protection coverage for the unemployed is 0%, while the coverage for persons with severe disabilitiesis about 1.3%. Similarly, the social protection coverage for the old age group stands at 3.9%. Furthermore, the working age population

covered by the pension scheme is 6.2%. The universal health service coverage stands at 39%. Only 3.2% of vulnerable persons are offered protection through social assistance.

The core functions of social security (i.e., old age, disability, maternity, and health) in Ethiopia are based on contribution, while social assistance is non-contributory cash transfer or in-kind support. In 2020 Ethiopia's expenditure on social protection programs is about 0.7% of its GDP. The budget is lower compared to low income and middle-income countries that allocate 7% to almost 9% of their GDP to social protection initiatives. Similarly, it is much lower than the African average which is 3.8%. Overall, available evidence indicates that social protection in Ethiopia is characterized by limited coverage, poor targeting of the needy and inadequate financing.

Ethiopia has made considerable improvements in strengthening its social protection system, yet issues remain. A case in point is the lack of social protection schemes for unemployment. The level of poverty and vulnerability in Ethiopia requires a larger fiscal outlay on social protection; the fiscal gap is especially pronounced in social assistance and employment programs. Currently, only 15% of social assistance programs are financed with domestic resources. In this regard, well organized, properly targeted, and fiscally sustainable social protection initiatives have a far-reaching positive impact in the improvement of the social protection landscape in the country.

Policy Issues and Recommendations: What Has Been Done? And What Can Be Done?

Dealing with poverty and inequality is a daunting task, particularly for low-income countries, like Ethiopia. The following policy options can be sought to address these fundamental socio-economic challenges.

First, the emphasis should be on wealth creation rather than redistributive fiscal policy. Evidence shows that social protection programs have not contributed to food security and poverty eradication. For example, Lemma and ve Cochrane (2020), state "The broadening of social protection programs is a response to the failure of the emergency aid approach that help curb famine but failed to contribute to household food security and poverty alleviation" (p1).

This means that the development policy needs to prioritize wealth creation through investment to boost the productive capacity of the poor in both urban and rural areas. While redistributive fiscal policy is often seen as a solution to poverty and inequality, it is only effective in economies with accumulated wealth. Without accumulated wealth, a redistributive fiscal policy proposal is meaningless. In the absence of accumulated wealth, redistributive fiscal policy cannot address the vulnerabilities of the poor in the society. Figure 3 provides empirical evidence that redistributive fiscal policy is more effective in rich countries compared to poor countries. The social protection spending of a rich country, as a percentage of its GDP, is greater than that of the poor country. The figure clearly demonstrates that rich countries allocate a larger portion of their GDP per capita towards social protection programs compared to poor countries.

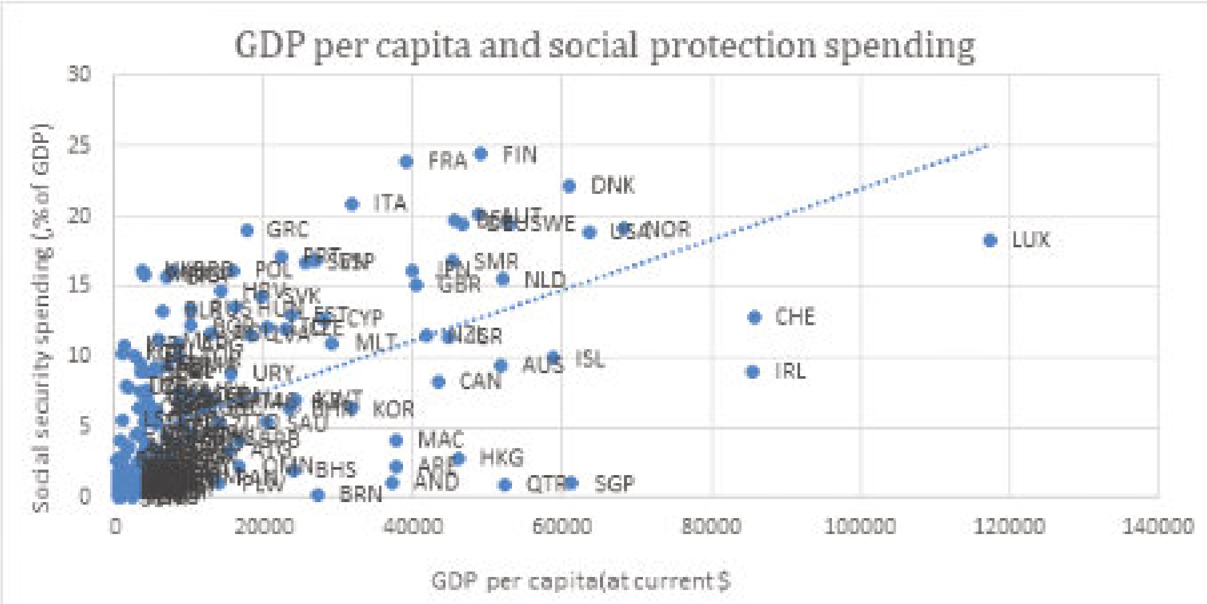

Figure 3: GDP per capita vs. social protection spending excluding health.
Source: Wold Development Indicators and International Labour Organization, 2020

As wealth and capital accumulation is improved, redistributive fiscal policy can play a role. If taxation is based on the ability to pay approach, the government can generate more tax revenue as the economy progresses. However, taxing the wealthy alone may not achieve the objective of redistributive policy. It is essential to have targeted expenditure policies that enhance the productivity of the economically vulnerable segment of society in the long term. In rural areas, a clear rural development strategy that diversifies household income sources is necessary. Additionally, the introduction of scalable technologies to enhance productivity in crop production and livestock development is crucial. In urban and semi-urban areas, focusing on the development of micro- and small-scale enterprises that benefit low-income households is essential. Technical and financial assistance for small scale start-up businesses can be helpful.

Second, the state should increase investment in areas that significantly reduce the cost of doing business, such as infrastructure and human capital development. Investment plays a key role in economic development, and for investment to thrive, the cost of doing business must be minimized. An economy with prohibitive costs cannot attract capital investment. Reinforced investment in infrastructure development (transport, energy, communication) and human capital development can significantly reduce the cost of doing business. Infrastructural development increases mobility and enhances integration between primary producers, manufacturers, and product markets. Human capital development improves the quality and quantity of skills available, thereby enhancing production efficiency for the private sector (Elena Pelinescu, 2015).

2021a; 2021b). For example, in 2020, the country's human capital index stood at 38 percent, much lower than the well-performing African countries like Seychelles (63 percent), Mauritius (62 percent), Kenya (55 percent), Algeria (53 percent) and Tunisia (52 percent) (see Figure 5).

Expenditure on education is crucial for human capital development (Shafuda and De, 2020; Linhartová, 2020; Mustafa M. Alalawneh, 2020; Samina et al., 2023). The World

Bank report indicates that Ethiopia's average government spending on education as a percentage of GDP was around 4.5 percent in 2019, slightly higher than the sub-Saharan African average of 4.3 percent. Ethiopia also allocates more than 20 percent of its annual national budget to education spending (UNESCO, 2021). However, evidence shows that the average education spending as percentage of GDP in Ethiopia has been declining since 2017(5. Six percent in 2017, 5.1 percent in 2018 and 4.5 percent in 2019) (see figure 4).

Figure 4 below illustrates the trend in gross fixed capital formation as a percentage of GDP for Ethiopia. It clearly shows a decline in fixed capital formation starting from 2016, indicating that the country is spending a smaller portion of its national income on fixed capital formation. Empirical literature consistently demonstrates the positive impact of fixed capital formation on a country's economic performance (Onyinye et al., 2017; Edward et al., 2020; Topcu et al, 2020). Therefore, Ethiopia needs to increase its spending on fixed capital formation to support sustainable economic growth and development

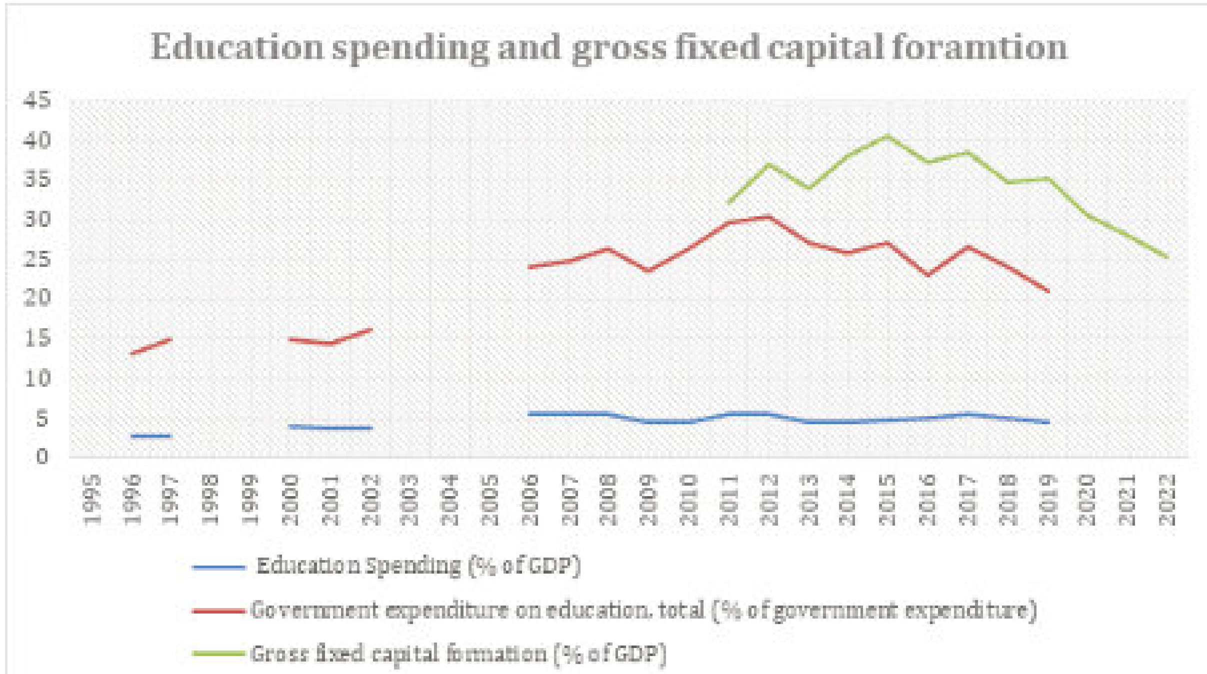

Figure 4: Education spending and fixed capital formation

Source: Author tabulations using data from using data from World Development Indicators (2022).

Third, enhancing the delivery of public goods and services is crucial. The quality and quantity of these goods and services provided by the state are essential for the functioning of civilization. However, Ethiopia's aggregate governance indicator scores reveal a weakness in delivering these essential public goods and services. The government's effectiveness in providing public goods in Ethiopia is extremely low. Corruption is widespread, and the rule of law is compromised. Regulatory quality is also lacking, and political instability and violence are prevalent. Additionally, there is a lack of voice and accountability. The country's aggregate score indicates a negative trend score over the period from 1996 to 2022, measured on a standard normal distribution scale of -2.5 to 2.5 units. Nonetheless, the effective delivery of public goods and services plays a significant role in improving the investment environment, and it is the responsibility of the state to provide them. Pure public goods and services, with their non-rival non-excludable nature, cannot be provided by the private sector primarily due to the free rider problem in their consumption (Varian, 1992).

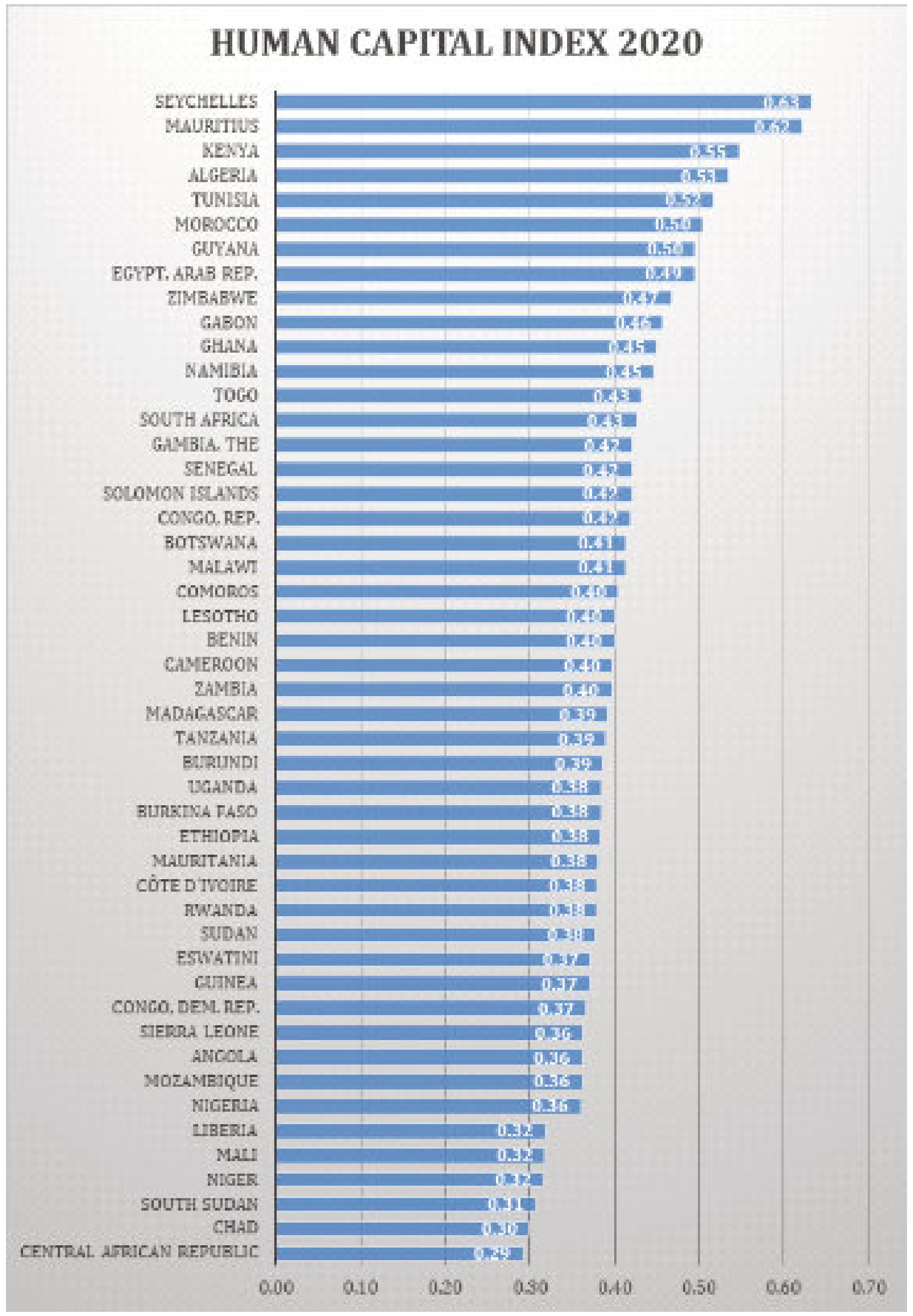

Fig 5: Human Capital Index in Africa in 2020
Source: Author tabulations using data from World Development Indicators (2022).

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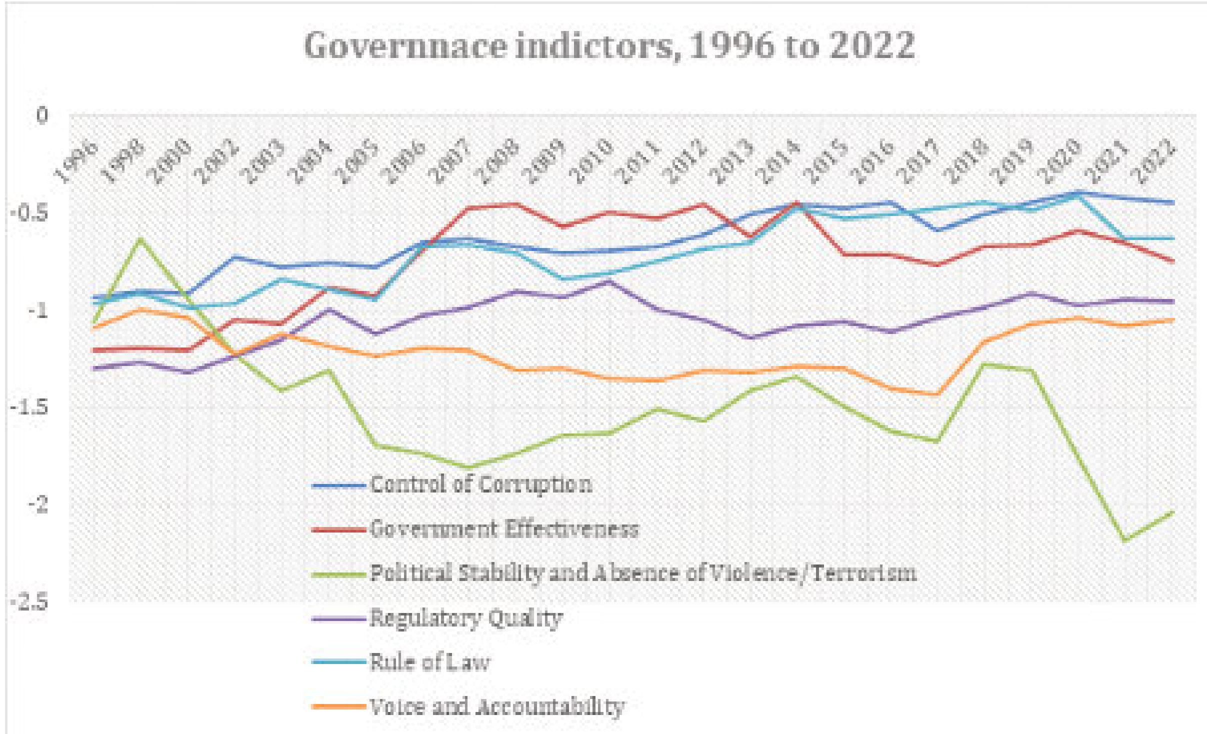

Fig 6: Governance indictors score
Source: Author tabulations using data from Worldwide Development Indicators (2022).

Consequently, the provision of these goods falls on the state. "The government plays a significant role in providing goods such as national defense, infrastructure, education, security, fire and environmental protection almost everywhere" (Reiss, 2021, p.1). However, public-private partnership arrangements could help in the production and distribution of these goods. By working in tandem with the private sector, the public sector can improve the effectiveness and efficacy of providing certain public and semi-public goods and services. Therefore, it is important to explore areas in which public-private partnership could enhance the delivery of public goods and services. Public-private partnerships have proven to be particularly useful in areas such as transportation services, power and energy development and distribution, water and wastewater services management, healthcare services, education services, and social infrastructure, among others.

Fourth, introducing well organized, properly targeted, and fiscally sustainable social protection initiatives has a far-reaching positive impact on improving of the social protection landscape in the country. As discussed in the previous section, Ethiopia's expenditure on social protection programs is meager, much lower not only than that of the low-income and middle-income countries but also below the African average of 3.8%.

The social protection system in Ethiopia is characterized by limited coverage, poor targeting of the needy and inadequate financing. There is strong empirical evidence that the social protection system in Ethiopia lacks effective targeting of the needy (Hoddinot et. al., 2013; Lemma and ve Cochrane, 2020). A social protection system is effective when it is based on properly targeting the extremely poor segment of society. Furthermore, the social protection system needs to emphasize the design and implementation of investment in livelihood improving programs, particularly for those who can work (Rachel et al., 2018). Cash transfers and in-kind support should be focused on the disabled and those lacking the capacity to participate in economic activities.

Conclusion

My policy suggestions as outlined in this policy brief are guided by the existing situations pertinent to poverty, inequality, and social protection in the country. Despite the profound difficulty in addressing poverty and inequality simultaneously, I believe that stakeholders will rise to the challenge. Over the last two and a half decades, Ethiopia has achieved enormous improvements in terms of economic growth and reduction in poverty levels. However, this economic growth has not alleviated poverty or transformed the Ethiopian economy. The level of multidimensional poverty remains strikingly high, and inequality is on the rise. This means that household economic vulnerability is high, and traditional social protection strategies are ineffective in dealing with poverty and inequality. The relevant policy options must be responsive to the existing context. Therefore, we must be perceptive about the magnitude of these socio-economic challenges.

First, the promotion of sustainable wealth creation is and must remain central to addressing poverty and inequality. Second, reinforcing investment in areas that significantly reduce the cost of doing business, such as infrastructure and human capital development, is crucial for private sector investment, which is essential for job creation and, therefore, poverty reduction can be attained. Third, avoiding bottlenecks in the delivery of public goods and services is important in creating an enabling environment for economic operators. Fourth, introducing well-organized, properly targeted, and fiscally sustainable social protection initiatives to support livelihood improvement for the deserving poor is essential.

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