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Fiscal Policy Review of Arab States 2019

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ABSTRACT

The fiscal policy review of Arab States in 2019 provides important insights about overall domestic public resources in the region with a focus on fiscal policy reforms on taxation and the assessment of debt and external debt, foreign direct investments and overseas development assistance, as an important means of implementation of the 2030 Agenda for Sustainable Development. A major focus of the 2019 fiscal policy review is to create a baseline database on tax reforms undertaken by Arab States during the 2010-2018 period, covering personal income tax, corporate income tax, capital gains and dividends, property tax, value added tax and general sales tax. The role of tax expenditure provisions and recent subsidy reforms across the region, as part of fiscal consolidation efforts, are discussed briefly in this review as well. The main objective of the review is to assess the efficiency and progressivity of fiscal policy reforms initiated by the Arab States toward expanding their fiscal space. This fiscal review is first in the series following the ESCWA 2017 flagship report "Rethinking Fiscal Policy for the Arab Region".

The findings of the review suggest some important trends in fiscal space across the region, taking into account the diversity of the country clusters by main source of public revenues: first, oil-rich countries that rely mainly on hydrocarbon base revenues; second, oil-poor middle income countries that rely mainly on taxes; and third, the low income countries that have a lower economic base and rely heavily on development assistance. The Arab region has witnessed significant economic and political shocks along with falling oil prices that have had a continuous downward effect on economic growth and buoyancy of revenues starting with global economic downturn in 2008 and extending until 2018. This period has been a decade of losses across the three clusters of countries, albeit with differences specific to countries within each cluster.

In oil-rich countries, fiscal policy reforms have targeted diversifying the revenue base, whereas in the oil-poor middle income countries, the focus of reforms has been to expand the tax base and undertake fiscal consolidation through subsidy reforms. Questions remain, however, regarding the effectiveness and distributional consequences as major fiscal policy reforms have targeted indirect taxes rather than through income or wealth tax reforms. The trends in vulnerabilities to debt and external debt, reduced concessional borrowing and subdued inflow of foreign direct investments on several reform efforts remain worrisome in terms of expanding fiscal space. Furthermore, the low share of development assistance to sectors that impact the achievement of Sustainable Development Goals (SDGs) the most, such as health, education, water supply and sanitation, and productive sectors, put economic progress and the progress of the SDGs in the region at risk, especially in the low income countries.

Acknowledgement

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Abbreviations

CIT	Corporate Income Tax
DAC	Development Assistance Committee
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
GCC	Gulf Cooperation Council
HICs	High-income countries
IMF	International Monetary Fund
JD	Jordanian dinar
LICs	Low-income countries
MICs	Middle-income countries
OR	Omani riyal
OECD	Organisation of Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
ODA	Overseas Development Assistance
PIT	Personal Income Tax
SDGs	Sustainable Development Goals
UNCTAD	United Nations Conference on Trade and Development
ESCWA	United Nations Economic and Social Commission for Western Asia
VAT	Value Added Tax
WoRLD	World Revenue Longitudinal Data set

Introduction

The report of the United Nations Economic and Social Commission (ESCWA) in 2017 on "Rethinking fiscal policy for the Arab region" highlighted the importance of fiscal policy in connecting development aims with achieving the sustainable development goals (SDGs). It advocated for a course correction in fiscal policy in the choices made in mobilizing and spending resources, since how domestic resources are used is central to building sustainable fiscal space to implement the SDGs.

The Fiscal Policy Review of Arab States 2019 is first in an annual series[1] to provide important insights about overall domestic public resources (SDG 17) in the region with a focus on fiscal policy reforms on taxation, assessment of debt and external debt, foreign direct investments and overseas development assistance, as an important means of implementation of the 2030 Agenda. A major focus of the fiscal policy review 2019 is to create a baseline database on tax reforms undertaken by Arab States during the period 2010-2018. The annex provides tax reforms by country for various types of taxes, covering personal income tax, corporate income tax, capital gains and dividends, property tax, value added tax and general sales tax. Estimates of tax expenditures are often not calculated but they have a strong impact on fiscal space. Across the region, data are not adequate to assess the magnitude of the significant tax expenditure provisions. The report synthesizes tax expenditure provisions to briefly discuss the broad types present in the region and presents an estimate for each country. Fiscal reforms across the region have targeted subsidy reforms in recent years, mainly as part of fiscal consolidation efforts, which is discussed briefly in the review as well. The main objective of the report is to assess the efficiency and progressivity of fiscal policy reforms initiated by the Arab States toward expanding their fiscal space.

The report uses national tax laws and budget statements (Ministry of Finance), investment laws (relevant ministries/investment authorities) as well as International Monetary Fund (IMF) World Revenue Longitudinal Data set (WoRLD), World Economic Outlook, the World Bank's World Development Indicators, International Debt Statistics, and the Organisation of Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) databases in assessing various indicators that contribute to an in-depth analysis of the role of fiscal policy in harnessing domestic public resources in the Arab region. Cross-border issues such as illicit financing flows, trade and technology transfer and public-private partnerships are other important aspects of domestic public resources but are not solely determined by fiscal policy and hence are beyond the scope of this paper.

The review paper took into consideration the period between 2005 to the latest year of data availability. The mid-2000s were years of high and relatively stable growth in the Arab region (on average 7.7 per cent during 2004-2006) and oil prices were on an increasing trend during the 2000s until the global economic crises of 2008. The proposition in this report is to examine the revenue trends from the good years of growth until the latest year of available data, when several parts of the region were subject to conflicts and crises situations. The tax laws, budget statements and investment laws were reviewed, and timeline of reforms were created from the year 2010 until the latest available information (see the annex). Since fiscal reforms took centre stage after 2010, the year 2010 is considered as a baseline.

[1] A baseline assessment of domestic public resources in the Arab region was presented to the Inter-agency Task Force on Financing for Development in 2016. See Sarangi and El-Ahmadieh, 2017.

Countries across the region share some common concerns and achievements. However, the region is diverse in terms of the source of domestic public revenues, which is the basis for classification of countries into clusters, as noted in the 2017 report "Rethinking Fiscal Policy for the Arab region".[2] **The first cluster** of countries, the oil-rich high- and middle-income countries, referred as oil-rich countries, in short, draw their major source of revenue from oil and gas, although there are wide variations in fiscal space within this group. These countries include: Algeria, Bahrain, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia and the United Arab Emirates. Bahrain and Oman have much larger fiscal constraints than Qatar or the United Arab Emirates. Iraq and Libya have additional concerns as conflict-affected countries. That said, the one common element for the cluster from a fiscal perspective is reliance on revenues from oil and gas.

The second cluster of countries, the oil-poor middle-income countries,[3] referred to in short as oil-poor countries, includes Egypt, Jordan, Lebanon, Morocco, the State of Palestine, the Syrian Arab Republic and Tunisia. They rely on a mixture of revenue sources, mainly from taxation, and face more constraints on fiscal space than the oil-rich countries as well as growing public debt burdens in some cases. They host the region's largest share of middle-income people, so meeting their aspirations, including through opportunities for decent work, is a key concern. Other development challenges in recent years comprise high unemployment, increasing poverty and lack of adequate social protection. The Syrian Arab Republic and the State of Palestine have additional concerns as conflict-affected countries.

The third cluster of countries, the low-income countries, comprises Comoros, Djibouti, Mauritania, Somalia, the Sudan and Yemen.[4] They have high levels of poverty and significant development challenges as well as severely constrained fiscal space. As least developed countries, they depend on grants, particularly overseas development assistance (ODA), and external debt as their major sources of finance. They require significant support to develop institutional capacity, including to implement the SDGs. Somalia, the Sudan and Yemen are conflict-affected and face additional concerns.

I. Trends in total revenues: Arab region versus other regions in the world

Total revenues of the Arab region, as share of gross domestic product (GDP) on average, was 28 per cent in 2017, as compared to 36 per cent in advanced economies and 44 per cent in the European Union (figure 1).[5] The share of revenues to GDP declined from nearly 42 per cent in 2012 to 28 per cent in 2017. Over the past decade, the trend for the region shows large swings compared to advanced economies or any other region in the world. The swings are mainly influenced by the fluctuations in revenues of the oil-rich countries, which is strongly associated with international oil

[2] ESCWA, 2017.

[3] The Syrian Arab Republic has a relatively large oil sector, but its contribution to gross domestic product (GDP) is not large enough to qualify the country as oil rich. Furthermore, its oil revenues are not sustainable in the long term. Lebanon's discovery of oil deposits could make it potentially oil-rich in the near future, but at present the country does not report any revenue from oil and gas.

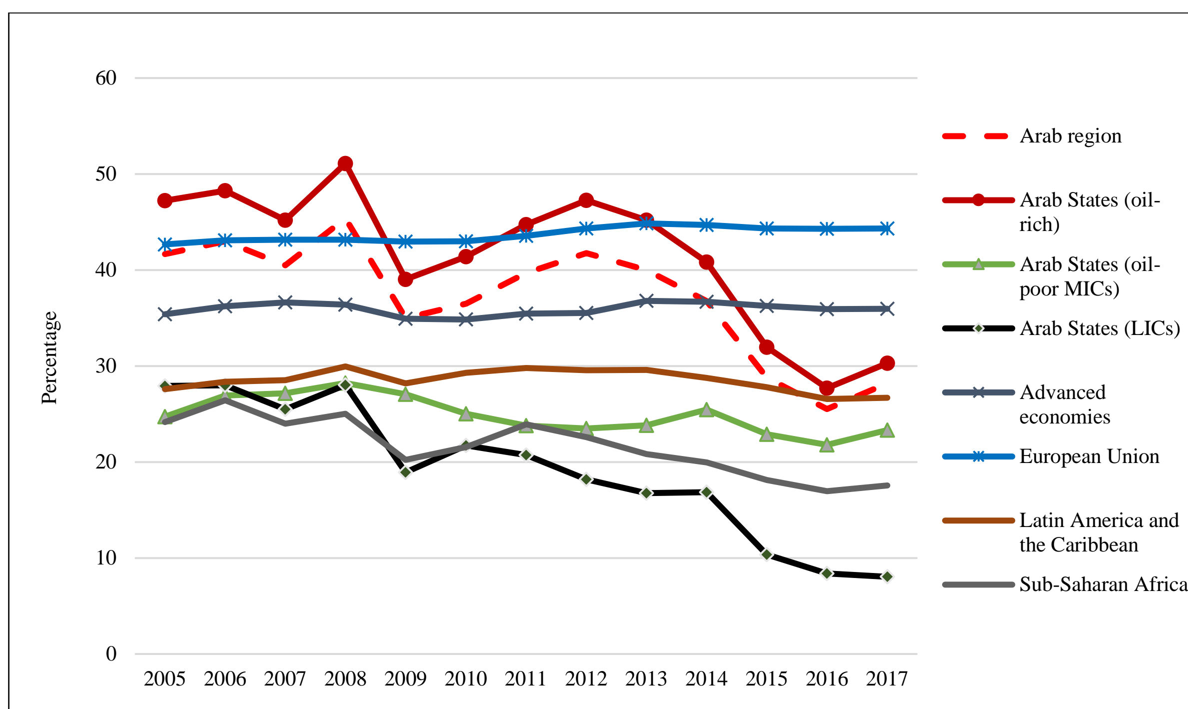
[4] The major source of revenue of Yemen is currently the oil sector. However, the country faces severe development challenges, which supersede the available fiscal space that can be derived from oil. Oil reserves also may be exhausted in the short or near medium term.

[5] The regional categorization in this graph follows that of the IMF World Economic Outlook regions. The Arab region and subregions are author's categorization as mentioned in the text.

prices.[6] The 2014 plunge in oil prices and its slow recovery has led to significant reduction in oil revenues, which is reflected in the decline in revenues to GDP share for the oil-rich countries, as well as for the region as a whole. Therefore, the volatility in revenues in the Arab region is quite apparent as compared to the other regions of the world.

The region is quite diverse in terms of mobilizing revenues, as noted earlier. The disparities in average revenue to GDP between oil-rich and the oil-poor middle-income and low-income countries are stark. For the oil-poor middle-income countries (MICs), the share of revenues to GDP is about 23.3 per cent in 2017, up from 21.8 per cent reported in 2016 (figure 1). For the low-income countries (LICs), the share of revenues to GDP is only 8 per cent in 2017, which is on a declining trend over time largely due to decline in revenues in the Sudan and Yemen in recent years. As noted, the share of revenues mobilization to GDP is low in the MICs and LICs than most regions in the world.

Figure 1. Total revenue across regions in the world
(*Percentage of GDP*)



Source: Author's calculation based on IMF, 2019f; IMF, 2019g.

Note: Regional and subregional aggregates are weighted averages. Revenues also include grants in case of low- and middle-income countries. The MICs do not include the Syrian Arab Republic due to lack of data.

There is, however, variation across the countries within any of the three clusters of countries in the region. We discuss the variations in revenues and their composition for each cluster of countries separately later in the paper.

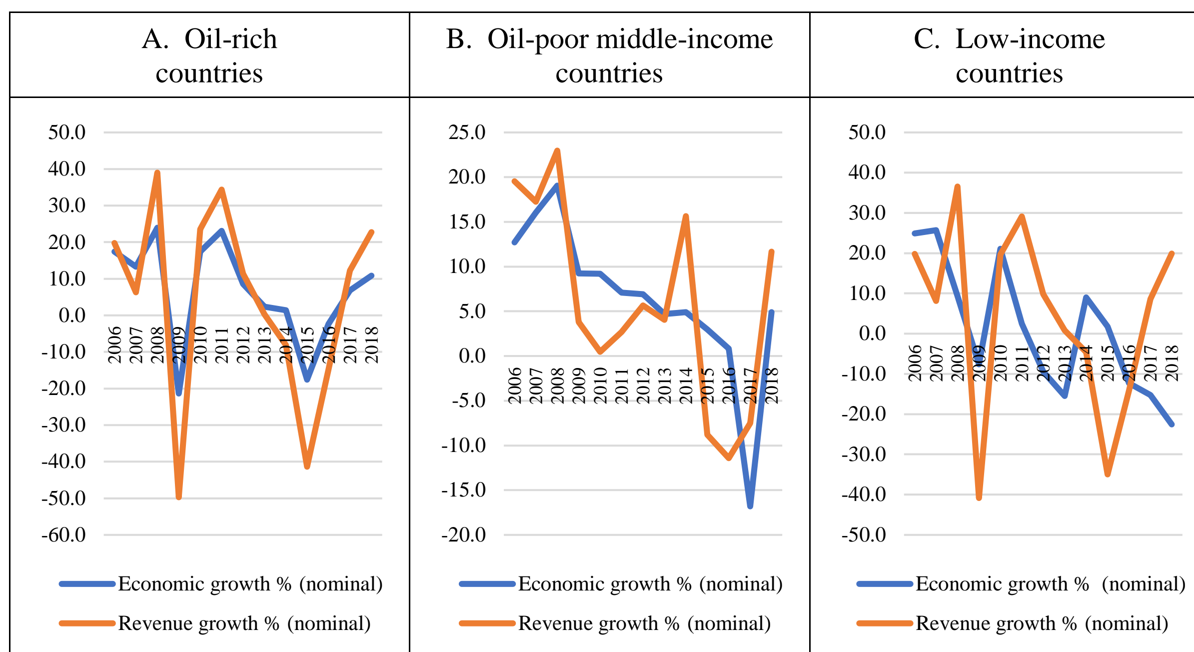
[6] In fact, considering 20 observations from the period 1994 to 2014, the correlation coefficient between international oil price (Europe Brent Spot Price FOB US dollars per barrel) and the ratio of total revenue (excluding grants) to GDP is 0.82, showing high association between their movements.

II. Economic growth and revenues buoyancy: a decade of losses (2008-2018)

Starting with global economic slowdown in 2008, the Arab region has witnessed significant economic and political shocks in many parts of the region that has a continuous downside effect on economic growth. The figure 2 tracks economic growth and revenues trends across the three country clusters in the region. In the oil-rich countries, the plunge of oil price in 2009 had a significant negative effect on growth and revenues. The impact was for a short duration: growth revived with rise in oil prices in 2010. Since 2014, the downside effect of the oil price plunge on growth and revenues has been much longer lasting, and growth has yet to recover. Following the Organization of Petroleum Exporting Countries (OPEC) decision on production cuts,there were some signs of improvement in oil prices during 2017 and 2018, but the recovery in prices has been slow and unpredictable.[7]

The oil-poor middle-income countries have continuously faced decline in economic growth since the global economic slowdown in 2008, followed by crisis in several parts of the region, including Tunisia, Syrian Arab Republic and Egypt. Other countries in the region also got adversely affected due to regional conflicts and population displacement and migration. As the figure 2 shows, nominal growth of GDP declined from the peak of 19 per cent in 2008 to -16 per cent in 2017. Economic growth in low income countries fluctuated with an overall declining trend as well. Overall, the region has not been able to recover from a declining trend of growth during 2008-2018. Consequently, it lost significant revenues, whether in the form of oil revenues in the oil-rich countries, or tax revenues that would have been generated following the pre-2008 trends.

Figure 2. Public revenues dried up as economic growth declined continuously across the oil-rich or oil-poor countries in the region, 2008-2018



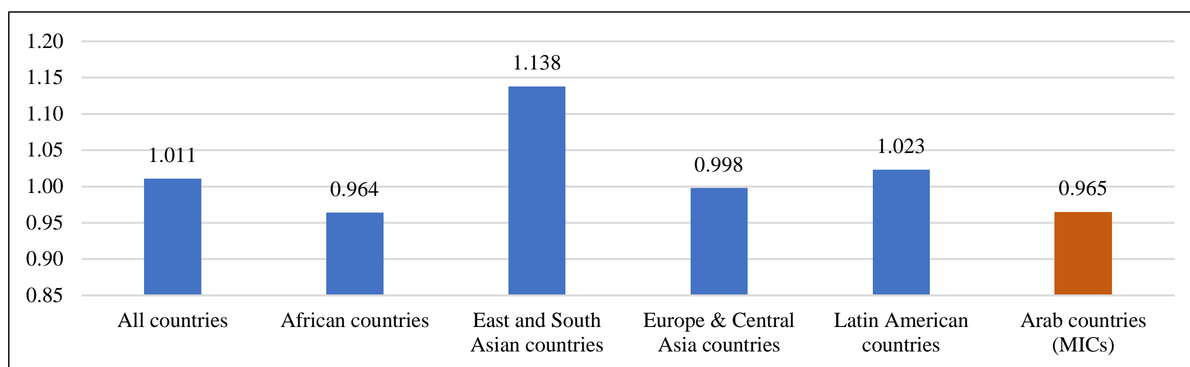
Source: Authors' calculation, based on IMF, 2019a.

[7] ESCWA, 2019.

A simple analysis of buoyancy of tax revenues for the oil-poor middle-income countries show that most countries in the region have tax buoyancy amounting to less than one.[8] It essentially implies that growth in GDP will not appropriate growth in revenues proportionately. Morocco, Lebanon and Tunisia have a greater than one tax buoyancy, indicating better response of revenues to economic growth. For these countries, the low performance of economic growth has a major impact in harnessing revenues.

A comparison of tax buoyancy estimates across regions of the world, based on panel data of 49 countries spanning the years from 1990 to 2018, indicates lower performance of Arab region as against most other regions (figure 3). Tax buoyancy is slightly above one for all countries, on average, in the sample. East and South Asian countries, Latin American, and Europen and Central Asian countries have tax buoyancy of one or greater than one.[9] For the middle-income Arab countries, the tax buoyancy is less than one, as well as for Africa. Lower than one tax buoyancy shows that tax revenue collection is not proportionate with economic growth. This is a typical phenomenon of countries where parts of the economy are informal in nature. The large informal nature of economies in the Arab region are well known, and therefore the less than one tax buoyancy is not a surprise.

Figure 3. Buoyancy of tax revenues



Source: Authors' calculation.

With low performance of growth and revenues, the gap between expenditure and revenues, as share of GDP, has increased over time. Figure 4 shows the widening gap between expenditure and revenues across oil-rich, oil-poor middle-income and low-income countries. The oil-rich countries used to have surplus revenues up until 2014. Thereafter, they started running deficits as revenues became less than expenditures (figure 5). The middle countries used to run deficits, which widened over time, especially between 2008 and 2016. While they improved fiscal balances slightly during 2017 and 2018, on average they were still at -7 per cent in 2018. The deficits in low-income countries have widened as well, particularly due to the Sudan, which is running a high and increasing fiscal deficit and where public debt reached above 212 per cent in 2018.

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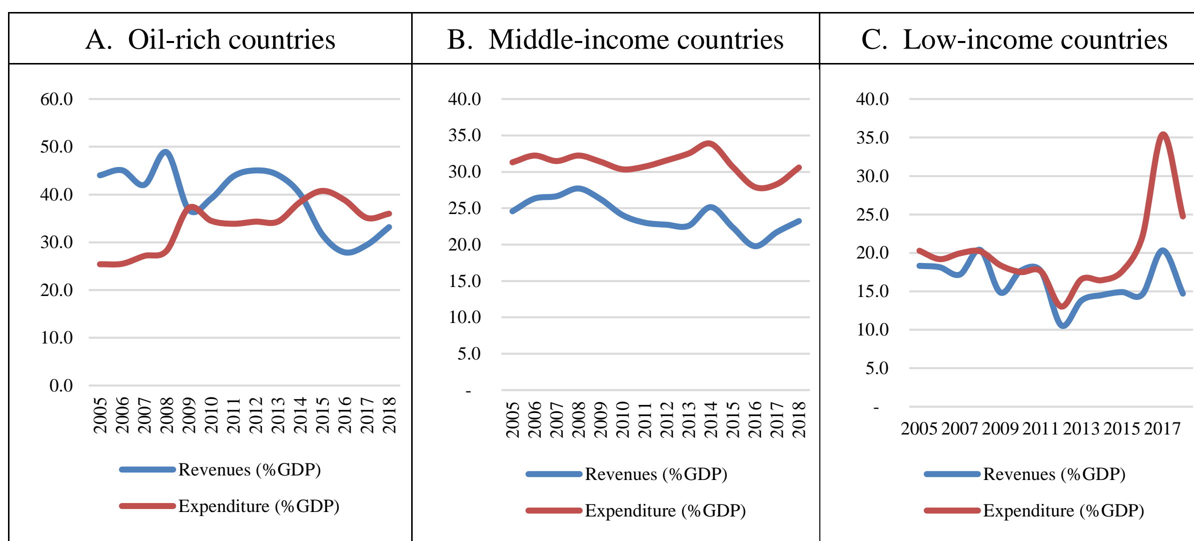
[8] ESCWA, 2017; Sarangi and El-Ahmadieh, 2017.

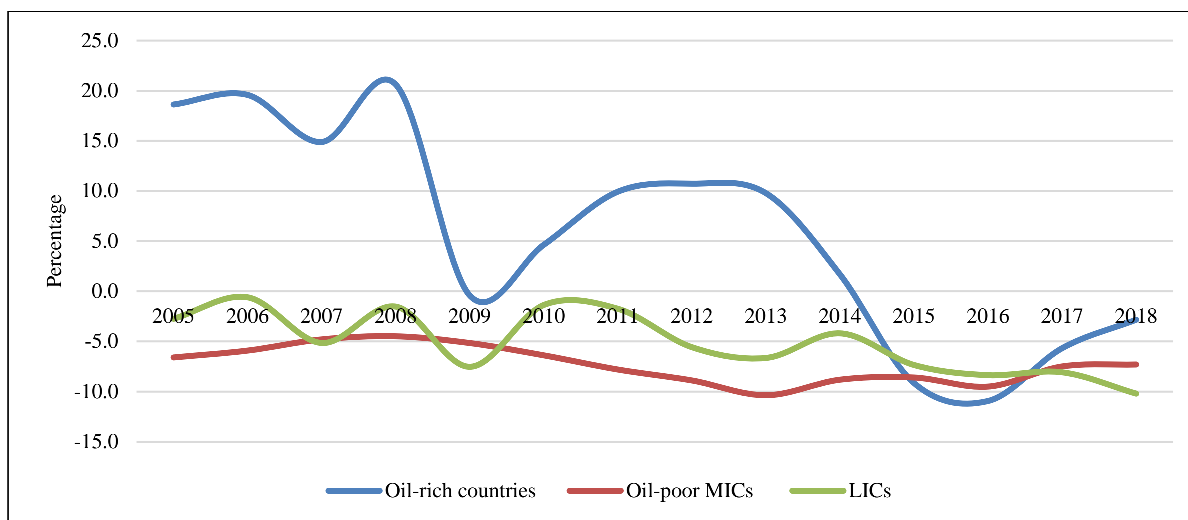
[9] The tax buoyancies are calculated using nominal values in this sample. There is evidence from other studies that tax elasticity estimates are often neutral to changes in inflation rates (Deli and others, 2018). We have also tried the estimates, for individual countries in the region, by using inflation deflators, and we found similar results. The changes in the coefficients are not significant.

Figure 4. The expenditure-revenue gap widened across the region



Source: Authors' calculation, based on IMF, 2019a.

Figure 5. Fiscal balances declined across the region
(Percentage of GDP)



Source: Authors' calculation based on IMF, 2019a.

Subsidy reforms in the Arab region as part of fiscal consolidation effort

As fiscal deficit remains high, many countries in the region have started cutting expenditures, particularly subsidies, as part of reform efforts for fiscal consolidation. Since 2015, prices of energy products increased in Gulf Cooperation Council (GCC) countries to reduce the subsidies. For some GCC countries such as United Arab Emirates, prices have been raised to the extent that fuel price gaps are totally eliminated. For other GCC countries, such as Bahrain, Kuwait, Oman, Qatar and Saudi Arabia, the price gaps were reduced. Similarly, higher electricity tariffs were also implemented in most oil-rich countries, including GCC countries and Iraq, to reduce a potential decrease in consumption or

an increase cost recovery. Algeria introduced higher taxes on gasoline and diesel and a higher VAT rate by 2 percentage points; VAT increased for both electricity and gas.[10]

Oil-poor middle-income countries have undertaken substantial adjustments in their energy prices as well. Morocco and Jordan resorted to the use of local price adjustments, thus eliminating all fuel subsidies, while others, such as Egypt, the Sudan and Tunisia, adopted some ad hoc discretionary reforms in local prices without full indexation to international prices. Regarding electricity and natural gas subsidies, Jordan is the only country which eliminated them totally – although it kept subsidies for the most vulnerable groups by a small margin equal to 0.1 per cent of GDP, while the other oil importers undertook more gradual medium-term reforms (with the exception of Lebanon). In fact, Egypt undertook gradual adjustments from 2013 and 2015 and plans more increases in tariffs throughout the next five years, while Tunisia implemented one-time tariff increases in both 2012 and 2013. The Tunisian authorities, aiming to reduce energy subsidies to shield the budget from oil price increases, implemented an ad hoc price increase of 3 per cent on average for the three main fuel categories in December 2017 and applied four more price adjustments in 2018.

Table 1. Status of energy reform in the Arab region

	Petroleum	Natural Gas	Electricity	Measure to protect the Poor? (Y/N)	Midium-term plan? (Y/N)
Oil-rich countries					
Algeria	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Yes	No
Bahrain	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Reform initiated, subsidies remain	No	Yes
Iraq	Reform initiated, subsidies remain	No specific measure	Reform initiated, subsidies remain	Yes	Yes
Kuwait	Reform initiated, subsidies remain	No specific measure	Reform initiated, subsidies remain	No	Yes
Oman	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Reform initiated, subsidies remain	No	No
Qatar	Reform initiated, subsidies remain	Subsidies eliminated	Reform initiated, subsidies remain	No	No
Saudi Arabia	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Yes	Yes
United Arab Emirates	Subsidies eliminated	No specific measure	Reform initiated, subsidies remain	No	No
Oil-poor countries					
Djibouti	No specific measure	No specific measure	No specific measure	No	Yes
Egypt	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Yes	Yes
Jordan	Subsidies eliminated	Subsidies eliminated	Subsidies eliminated	Yes	Yes
Lebanon	Subsidies eliminated	Subsidies eliminated	Reform initiated, subsidies remain	No	No
Mauritania	Subsidies eliminated	Reform initiated, subsidies remain	Subsidies eliminated	Yes	Yes
Morocco	Subsidies eliminated	Reform initiated, subsidies remain	Subsidies eliminated	Yes	Yes
Sudan	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Reform initiated, subsidies remain	Yes	Yes
Tunisia	Reform initiated, subsidies remain	Reform initiated, subsidies remain	No specific measure	Yes	Yes

Legend: Subsidies eliminated; Reform initiated, subsidies remain; No specific measure

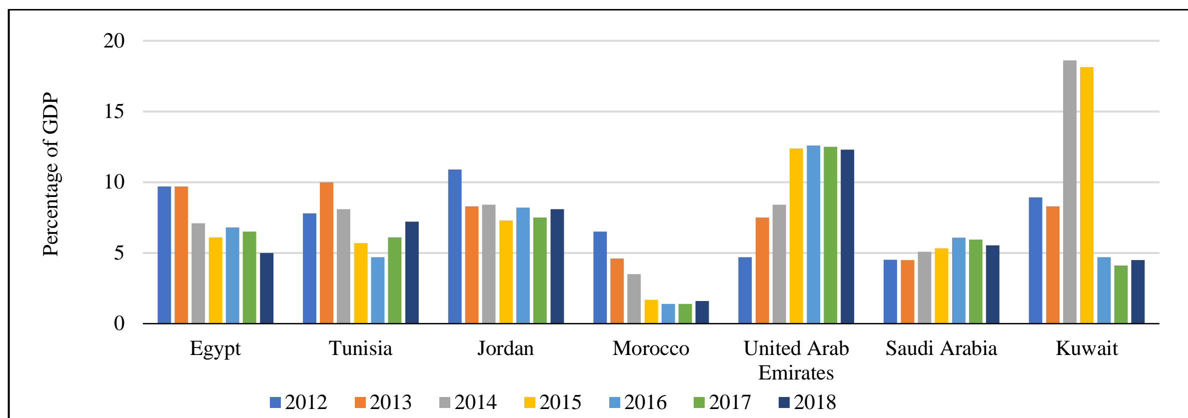
Source: Authors compilation, 2019 and IMF, 2017a.

Figure 6 presents the subsidies expenditure, as a share of GDP, over the past years between 2012 and 2018. For the oil-rich countries in the sample, expenditure on subsidies, as share of GDP, remained stagnant or reduced since 2015, following the fall of oil revenues. For the middle-income countries, the expenditures on subsidies in 2018 was much lower than in 2012 in all countries in the sample, including Egypt, Jordan, Morocco and Tunisia. There are challenges in comparability of data on subsidies for

[10] ESCWA, 2019; IMF, 2017a

Tunisia, where the subsidies expenditure data includes subsidies and transfers. Transfers include several social protection measures for Tunisia.

Figure 6. Subsidy expenditure, as a share of GDP, reduced across countries



Source: Authors compilation, based on data from IMF Article IV, respective countries, respective years.

III. Tax reforms in oil-rich countries: diversifying revenues is a key goal

The oil-rich countries heavily rely on hydrocarbon sector for public revenues.[11] The tax component of total revenue, as a share of GDP, is negligible in most oil-rich countries, which varies from 1 per cent in Bahrain to 4.6 per cent in Qatar in 2017 (figure 7A). United Arab Emirates and Algeria are exceptions that show relatively high percentage of taxes to GDP, but most taxes are collected from hydrocarbon-based industries. Since the major source of revenue in the oil-rich countries is oil and gas exports, their revenues are affected by fluctuations in international oil prices or sales affected by global demand situations at times of economic crises such as the global economic slowdown of 2008 or due to production being affected by political conflicts and crises situations.

The low price of oil since 2014 has hit the fiscal balance in all the oil-exporting countries negatively. They have incurred budget deficits since 2015, as revenues have fallen short of expenditures (figure 7B). Prior to 2014, the oil-rich countries had balanced or surplus budgets. With increasing fiscal deficit in several oil-rich countries, these countries are increasingly borrowing by issuing sovereign bonds in international capital markets in order to meet the public expenditure needs, in addition to introduction of new policy measures such as introduction of excises and VAT, reduction of energy subsidies and cut in capital expenditures. Reducing reliance on hydrocarbon sector is the prime objective of most oil-rich countries, particularly after 2014.

A well-strategized revenue diversifying framework is thus a priority for these countries in order to sustain fiscal spending levels in the medium and long term. For instance, the GCC member States have signed a "Common Excise Tax Agreement of the States of the Gulf Cooperation Council" to implement excise taxes as a part of revenue diversification reform plan. Excise tax shall be imposed on goods that are harmful to human health and to the environment, as well as on luxury goods. The excise tax was introduced as of 2017 in United Arab Emirates, Saudi Arabia and Bahrain followed by Qatar

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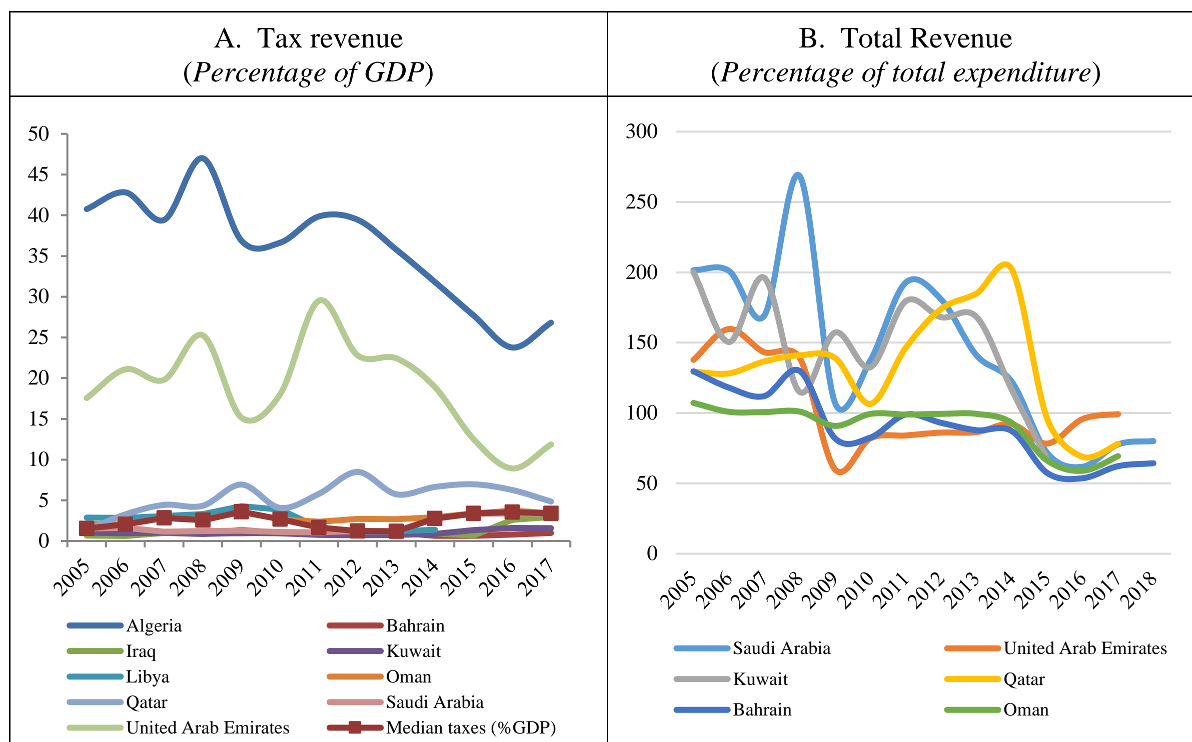
[11] Sarangi, 2016; ESCWA, 2017.

and Oman in 2019. Carbonated drinks will be subject to 50 per cent levy and tobacco products and energy drinks to a 100 per cent levy. In 2019, United Arab Emirates and Saudi Arabia expanded excise taxes whereby a 100 per cent levy will also be imposed on electronic smoking devices and tools along with their liquids, and a 50 per cent levy on any product with added sugar or other sweeteners.

Figure 7. Taxes and total revenues in Arab oil-rich countries

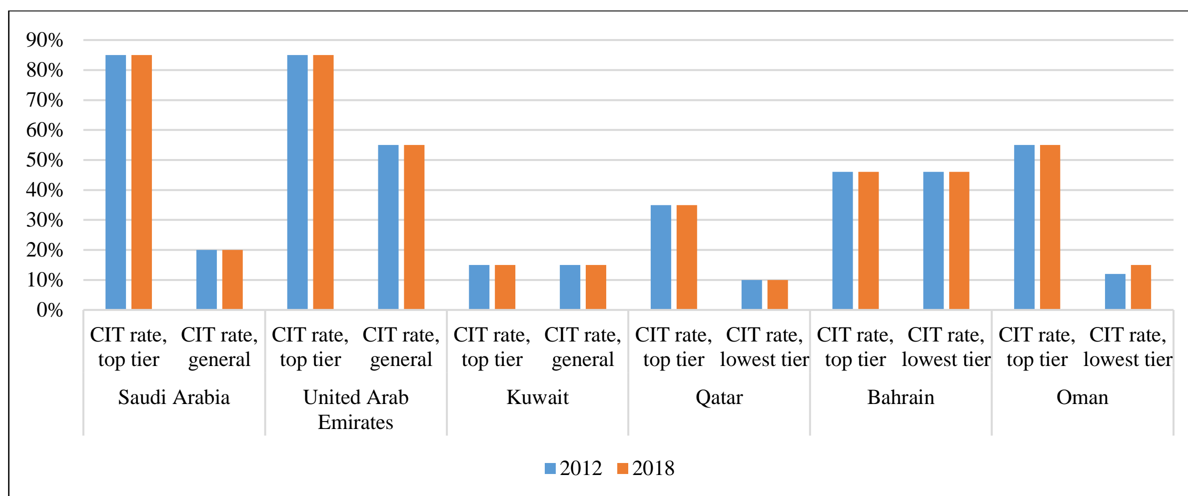


Source: IMF, 2019b; national data from ministry of finance of respective countries, respective years.

Another agreement signed by GCC member States is the "Unified VAT Agreement to implement Value Added Tax". In January 2018, United Arab Emirates and Saudi Arabia were the first to implement a VAT rate followed by Bahrain in January 2019. Unless the supply of goods and services falls within a category that is specifically exempt or is subject to the zero rate, VAT will apply at the standard rate of 5 per cent. As for Kuwait, Qatar and Oman, introduction of the VAT is still under review and the implementation has not taken place yet.

In GCC countries, employed individuals' wages, salaries and allowances are not subject to tax. Reform of Corporate Income Tax (CIT) has been considered in few countries, such as Oman and Qatar. In 2017, Oman suspended exemptions for businesses with net income less than 30,000 Omani riyals (OR) and imposed a new flat CIT rate of 15 per cent instead of 12 per cent applied on net profits of businesses (except petroleum sector) (figure 8). Similarly, in 2018, Qatar imposed a higher CIT rate of 35 per cent on petrochemical industries, which makes it at par with the tax rate of extraction of natural resources sector. The effectiveness of these measures in mobilizing tax revenues are yet to be assessed as data are not available. At present, the tax basket of revenues does not show any significant improvement for the oil-rich countries, except for United Arab Emirates which introduced VAT in 2018.

Figure 8. Corporate tax rates in GCC countries have remained unchanged in most cases



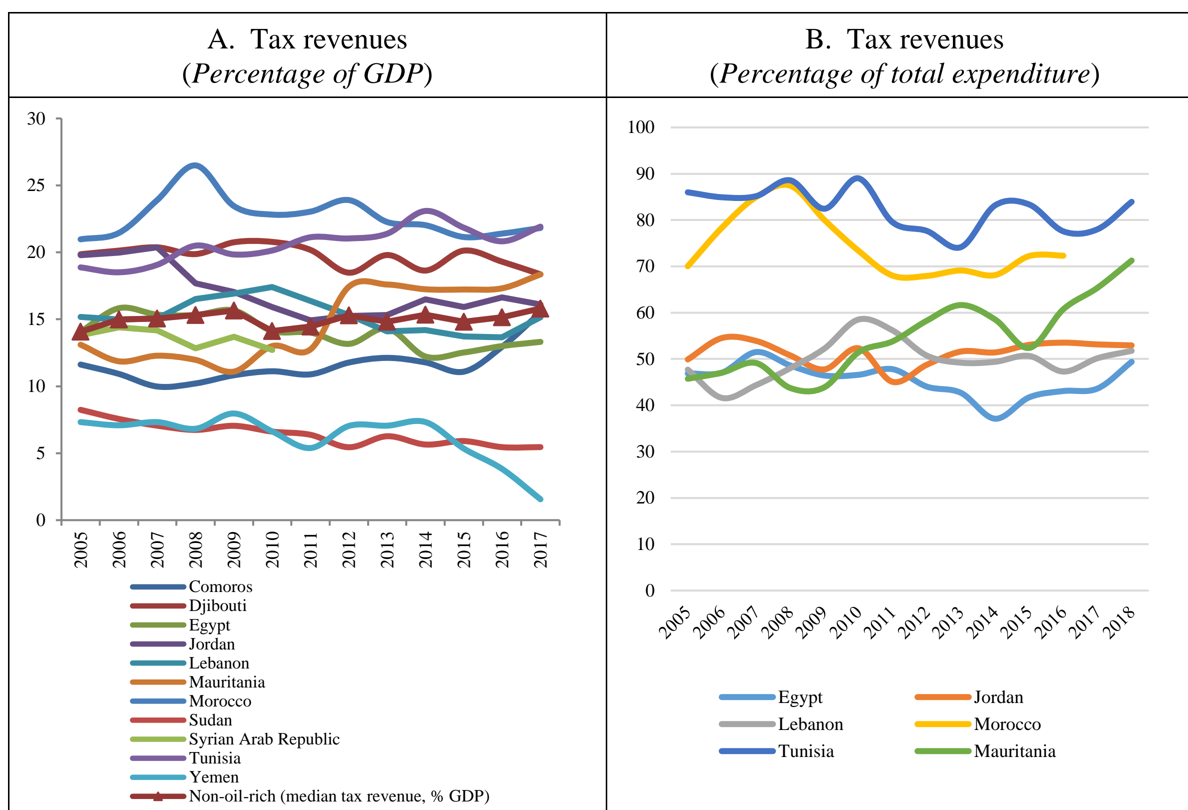
Source: Authors compilation from Ministry of Finance, official gazettes and relevant tax authorities of respective countries, Saudi Arabia, United Arab Emirates, Kuwait, Qatar, Bahrain, and Oman with respective years (see tax reforms timeline in the annex).

IV. Tax reforms in oil-poor middle-income countries: improving progressivity remains a challenge

The oil-poor countries mainly rely on taxes for public revenues. The mobilization of taxes, as share of GDP, are lower in most of these countries than the world average. For instance, the median taxes to GDP for the oil-poor MICs and LICs is 15 per cent in 2017 (figure 9A), as compared to 25 per cent for Europe or 18 per cent for all MICs in the world. In the Sudan, the share of tax to GDP was less than 6 per cent in 2017. It used to be similar in Yemen, but since the conflict, taxes to GDP declined to 1.6 per cent in 2017. Morocco and Tunisia are good performers in the region, where tax to GDP is around 22 per cent. In other MICs, tax to GDP is around 15 per cent. From 2016 to 2019, several countries in the region have noted increase in tax revenue due to the series of reforms undertaken. The annex presents these reforms, which will be discussed in the following paragraphs, in greater detail.

Taxes, as share of total expenditure, varies widely across the countries. Tax revenues constitute about 84 per cent of total expenditure in Tunisia and about 70 per cent in Morocco in 2018. For Egypt, Jordan and Lebanon, taxes constitute only about half of the total expenditure (figure 9B). As such, public budgets continue to be in deficit in the middle-income countries.

Figure 9. Tax revenues in oil-poor countries



Source: IMF, 2019b; national data from ministry of finance of respective countries, respective years.

Disaggregation of total taxes into its components indicates that indirect tax constituted the main source of tax in all the tax systems of oil-poor middle-income countries.[12] In some cases, such as in Jordan, indirect taxes constitute around 70 per cent of total tax revenue in 2018 (figure 10). Furthermore, most countries show increasing share of indirect taxes in the total tax revenue during the period 2010-2018. The share of income tax in total tax revenue remained low in Jordan (4.5 per cent) and Lebanon (6.2 per cent) in 2018 although these have improved slightly over time. In Egypt, it remained around 11 per cent. Morocco and Tunisia have shown some increases in share of income tax, which reached 20.5 per cent and 25.3 per cent respectively in 2018. The high and increasing share of taxes being mobilized from goods and services indicates the regressive nature of taxes in most countries, rather than becoming more progressive as a result of reforms. A recent study on tax incidence analysis in Jordan shows that the lower 40 per cent of the population end up paying a larger share of budget in terms of indirect taxes as compared to the higher decile groups.[13] Additionally, evidence on implementation of VAT across the countries suggests that multiple tax exemptions and rates often reduce equity in the administration of VAT and burdens the poor and the middle class more than the richest sections of population.[14]

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[12] Data on disaggregation of taxes for low-income countries is not available.

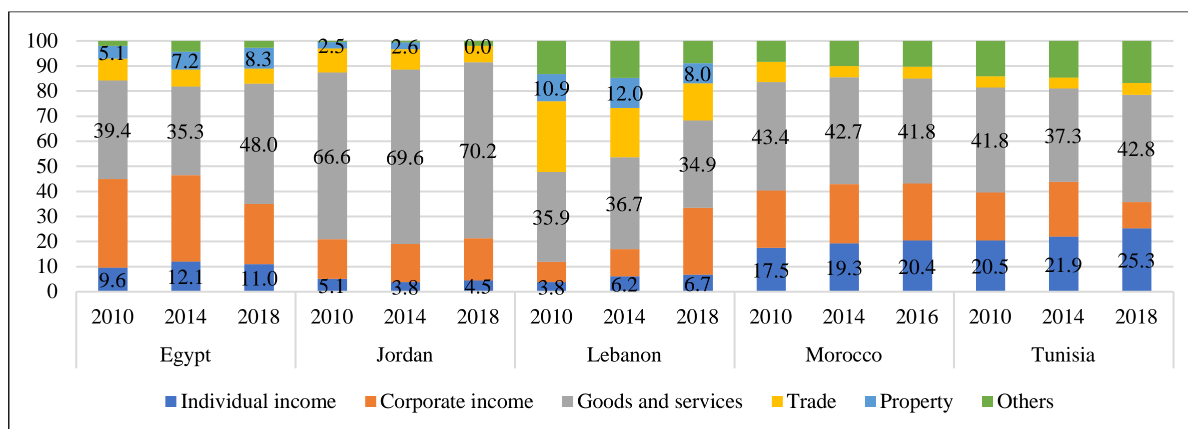
[13] Sarangi, Bhanumurthy and Abu-Ismail, 2015.

[14] ESCWA, 2017.

In addition to low significance of income tax in most countries that rely on taxes, wealth tax constitutes a negligible share of total tax revenue. Among the three countries in figure 10, Egypt and Lebanon have relatively higher share of earnings from property tax, which is about 8 per cent of the total tax revenues in 2018. Studies indicate that the region has a high concentration of wealth among the top 1 per cent of people,[15] and the share of middle class population is shrinking.[16] This evidence suggests that property tax can be considered a useful tool of correcting imbalances in Arab societies, and it can be a major potential source of revenue. Globally, taxes on property form around 7 per cent of total tax revenue, which is much higher than the average in Arab countries.

Figure 10. Composition of tax revenue in selected oil-poor countries

(Per cent share)



Source: Author's calculation, based on data from ministry of finance of respective countries.

Note: Property tax in Morocco and Tunisia were not available. The category "others" includes property tax.

1. *Recent tax reforms: improving progressivity remain a challenge*

Arab countries have systematically low tax collection rates relative to the size of their economies, and little attention is paid to ways of improving taxation systems to raise more revenue or to improve fairness in tax systems.[17] Historically, the oil-rich countries largely rely on oil revenues and the oil-poor countries rely on tax revenues as major sources of their revenue. On average, taxes in GDP in the oil-rich countries of the region are 7.3 per cent in 2017 while that in the oil-poor countries of the region is 13.7 per cent in 2017. The median tax revenue as a share of GDP is 15.8 per cent in 2017, which is lower than the median for the middle-income countries and much below the median of the developed countries in the world. In the Arab region, the exceptions are Morocco and Tunisia, where the share of taxes in GDP is about 22 per cent in 2017.[18]

Amid low oil prices, high debt and rising expenditure needs for meeting the aspirations of people during recent years, public budgets across the Arab region have come under heavy pressure. Therefore, several Arab governments have undertaken tax reforms over the past five years, mostly focussing on

[15] Alvaredo, Assouad and Piketty, 2018.

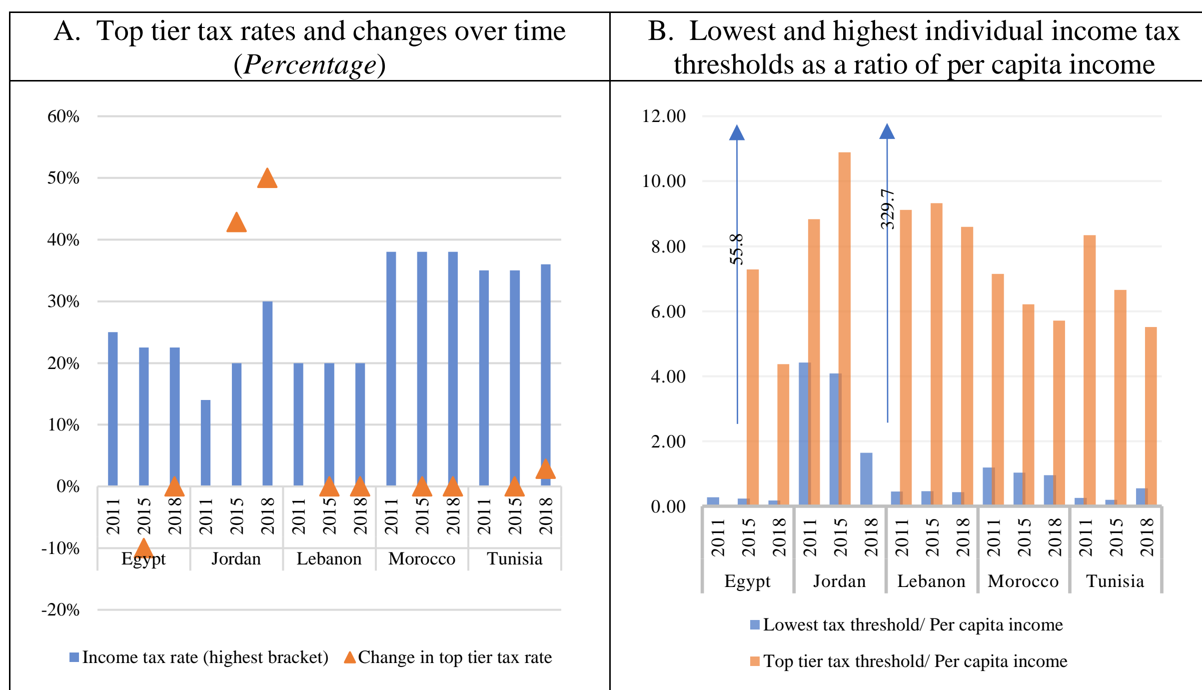
[16] ESCWA, 2014.

[17] ESCWA, 2017.

[18] Based on data from IMF, 2019b.

income tax and taxes on goods and services such as VAT, with the aim of raising revenues. We analyse these reforms in the perspective of their progressivity and revenue-raising potential.

Figure 11. Reforms in individual income tax



Source: Authors' compilation from Ministry of Finance, official gazettes and relevant tax authorities of respective countries: Egypt, Jordan, Lebanon, Morocco and Tunisia, respective years.

Note: The arrow for Egypt shows the top tier tax threshold to GDP per capita ratio in 2011; the arrow for Jordan shows the top tier tax threshold to GDP per capita ratio in 2018.

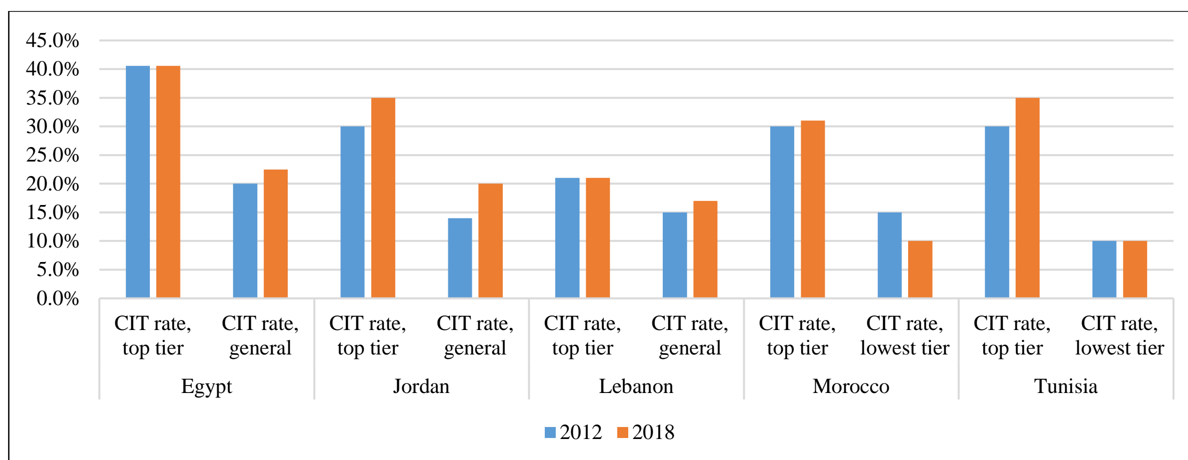
Since 2010, the top tier tax rates have not changed for a majority of the region's middle-income that rely most on tax resources, except for Jordan and Egypt. In Jordan, the top tier tax rate increased from 20 to 30 per cent during 2015 and 2018. In Egypt, there was a decline in top tier tax rate during 2011 (25 per cent) and 2015 (22.5 per cent) and the rate remained unchanged after that (figure 11A). However, there have been efforts to expand the tax base to harness more revenues from individual income tax. This can be seen in the declining ratio of top tier tax thresholds to per capita income between 2011 and 2018 (figure 11B). The ratio declined for most countries, except for Jordan where a new upper threshold is introduced during 2018. The new threshold went up to 1,000,000 JD from the previous 20,000 JD and the tax rate for the top tier went up to 30 per cent. Interestingly, the bottom threshold in Jordan also reduced during the same period, from 12,000 JD in 2011 to 5,000 JD in 2018. In terms of the ratio of bottom threshold to per capita income, most countries show a declining trend, except for Tunisia.[19] The declining ratio is indicative that more people at the lower end of income, who were exempted previously, would have come to the tax bracket. The impact of these changes on expenditure and poverty is yet to be assessed as detail records of tax are available. In general, the significant reductions in the ratio of top tier tax threshold to per capita income tend to show that more people at

[19] In Tunisia, the ratio was lowest among all countries and the ratio of bottom threshold to per capita income went up between 2015 and 2018. This is due to upward revision of the bottom threshold, giving tax exemptions to individual incomes at the lower end of income distribution.

relatively higher end of income are in the top tier tax bracket. However, there are significant differences across countries. For instance, this ratio is 1.65 times the per capita income in Jordan, while it is 0.17 in Egypt.

Furthermore, there are also reforms in corporate tax rates in several countries. General corporate tax rate increased in Egypt, Jordan and Lebanon, while top tier corporate tax rate increased in Jordan, Morocco and Tunisia (figure 12). Overall, there are efforts to improve tax revenues from corporate tax reforms.

Figure 12. Corporate tax rates in oil-poor middle-income countries of the region



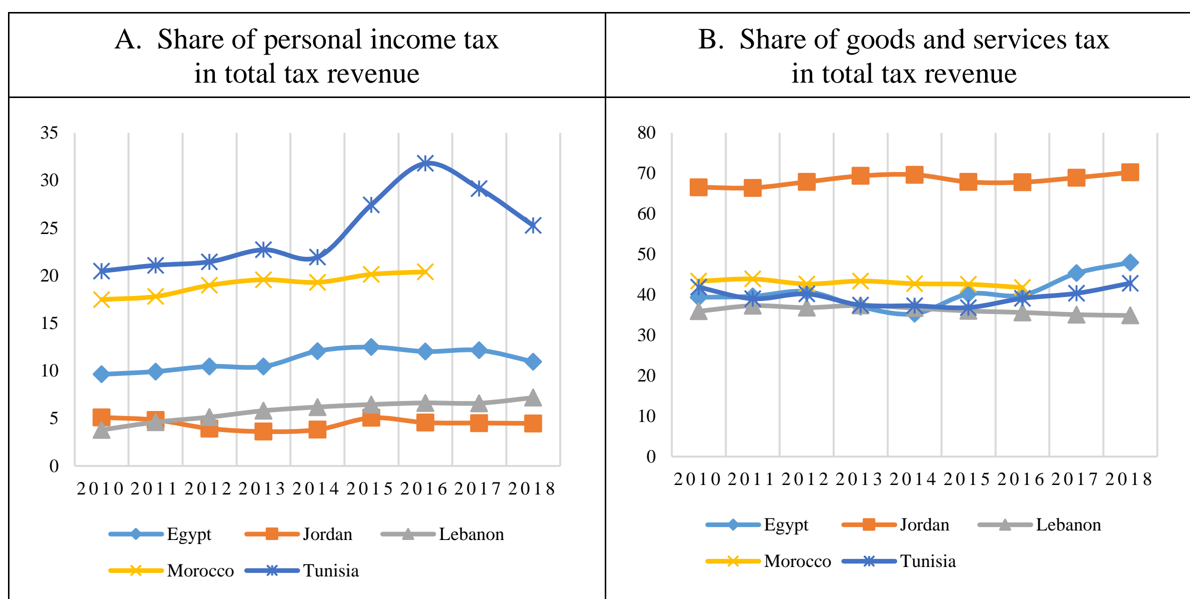
Source: Authors' compilation from Ministry of Finance, official gazettes and relevant tax authorities in respective countries: Egypt, Jordan, Lebanon, Morocco and Tunisia, respective years (see the annex for country-wise tax reforms).

Furthermore, the question remains as to how effective these changes have been in improving tax collections. The share of income tax to total tax revenues increased in case of Lebanon and Tunisia, although there is a big gap in income tax share itself between the two countries (figure 13A). Jordan and Egypt, where several changes in top tier tax rate and bracket were introduced during 2015 to 2018, did not register any significant change in the share of tax collections from individual income. For Morocco, updated data on individual income tax is not yet available, but there seems to be an upward trend share of personal income tax to total tax revenues from data until 2016.

Several of these middle-income countries have also introduced reforms in goods and services tax, including introduction of value-added tax (VAT) or upward revision of VAT. Until 2015, Egypt had a goods and services tax rate (GST) of 10 per cent. In 2016, Egypt implemented a VAT system instead of a GST. The general VAT rate was 13 per cent in 2016 which increased to 14 per cent in 2017. Tunisia increased VAT rate by 1 percentage point for all VAT slabs in 2018.[20] Lebanon decided to increase VAT from 10 to 11 per cent in 2017 and implemented it in 2018. The introduction of VAT in Egypt has led to significant increase in share of goods and services tax in total revenues since 2016. In Tunisia too, the continuous increase in the share is reflected upon the rising VAT (figure 13B).

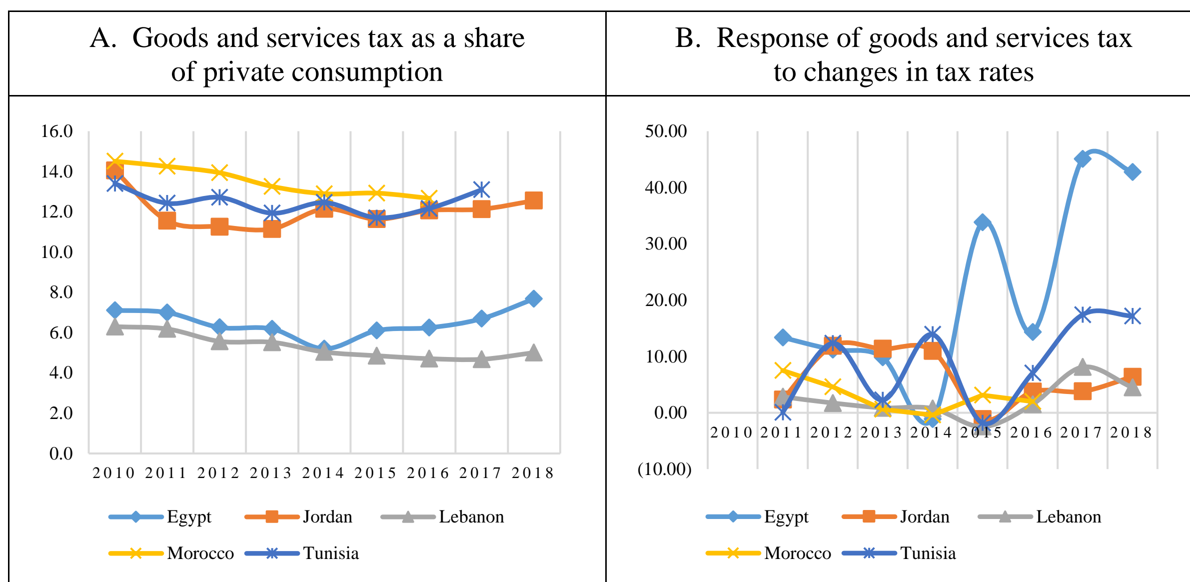
[20] Goods and services taxed at a rate of 6, 13 and 17 per cent previously are taxed at a higher rate of 7 ,14 and 18 per cent respectively as per classification of goods and services. Information about the classification of such goods and services in Tunisia is available in the annex.

Figure 13. Changes in tax collections – tax on income and goods and services



Source: Ministry of Finance Budget Reports and Publications for Jordan, Lebanon, Morocco, Tunisia. Central Bank of Egypt statistics; IMF, 2017b; Article IV Egypt.

Figure 14. Mobilization of goods and services tax



Source: Ministry of Finance, official gazettes and tax authorities Egypt, Jordan, Lebanon, Morocco and Tunisia, respective years.

In Lebanon, the share of GST declined in 2018 as compared to 2017, despite increase in the VAT rate, mainly due to reduction in economic activities. However, the share of goods and services in total private consumption shows an increase, which would be mainly due to increased VAT and excise tax (figure 14). The share of goods and services tax as a share of private consumption is low in Lebanon and Egypt as compared to that of Jordan, Morocco and Tunisia. In Tunisia, taxes constituted between 12 to 14 per cent of private consumption, while it was only 5 per cent in Lebanon

(which has an 11 per cent VAT) and 7.7 per cent in Egypt (which has a 14 per cent VAT) in 2018. Tax exemptions from VAT and tax evasion need to be examined to better understand the lower collections of taxes in such cases. In Jordan, the share of goods and services tax constitutes about 12.6 per cent of private consumption and 70 per cent of total tax revenue. High reliance of tax revenue on goods and services is indicative of a regressive tax system, as the burden lies more on the poor and middle class. Therefore, there is scope to improve fairness and equity in tax systems.[21]

2. *Tax expenditures distort expected revenue collections*

Tax expenditures have been a major aspect of fiscal policy and budgeting and are usually implemented with the goal of reducing the tax burden to encourage economic development, growth and prosperity. The major definition of a tax expenditure is the tax revenues lost due to provisions by a government which allows an individual or corporation subject to tax to pay a significantly smaller amount of taxes or, in some cases, none. The OECD provides a definition which is the costs in revenues produced by the preferential treatment to certain economic activities.[22] It is often not easy to have a common definition of tax expenditures due to complexity of provisions introduced by various national budgets.

There are several different types of tax expenditure provisions, with each having a different impact on the economic groups affected by it. One form of a tax expenditure is an *exemption*. Taxpayers exempted from tax have no tax levied on them and do not have to pay a tax that would usually have been paid if not for the exemption. *Deductions and exclusions* are two other forms of tax expenditure. According to the Tax Policy Center, an example of each would be the deduction of mortgage income on homes and the exclusion of interest on bonds.[23] *Reduced rates* are a form of tax expenditure where the taxpayer pays a decreased tax rate instead of the full rate. *Incentives* are also tax expenditures to encourage and promote economic activity and production in certain industries; such incentives involve reduced tax rates or deductions for corporations involved in these industries. *Special economic zones* are also a form of tax expenditure used to promote economic development within a specific area or region of a country. Corporations that operate in these zones benefit from tax exemptions and deductions which make it less costly than operating in areas subject to taxes.

Several OECD countries report tax expenditures on a regular basis, either annually or in their budgets.[24] However, there is no specific international standard reporting that can compare tax expenditure across countries. Improving tax expenditure reports and standardizing their measurements is important to better understand the associated costs. For Arab States, none report costs of tax expenditure in budgets or in annual reports. Several countries use tax expenditure provisions (table 2). A study of tax expenditures in Morocco suggests that the total cost of tax expenditures was about 34.6 billion dirham or 3.8 per cent of total output in 2014 (box 1). These costs are significant and should be estimated at the time of setting the provisions. Without an assessment of tax expenditure, the provision of exemptions, incentive or any form of tax expenditure often makes it difficult to assess the total expected tax revenues. Assessing tax expenditures by various types of taxes also informs the distributional consequences of tax expenditures.

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[21] ESCWA, 2017.

[22] Council on Economic Policies (CEP), 2018.

[23] Tax Policy Center, 2019.

[24] CEP, 2018.

Table 2. Types of tax expenditures in the middle-income Arab countries: some examples

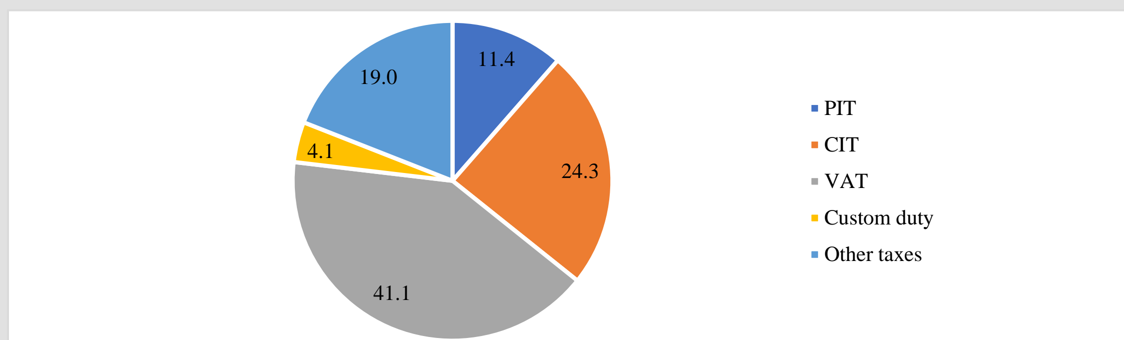
Type of tax expenditures	Country (type of tax)
Exemptions	Egypt (PIT, Property); Jordan (PIT); Lebanon (CIT); Morocco (PIT and VAT); Tunisia (PIT)
Deductions and exclusions	Egypt (PIT); Lebanon (CIT); Morocco (PIT); Tunisia (PIT)
Reduced rates	Egypt (VAT); Jordan (GST); Lebanon (VAT for several products); Morocco (VAT); Tunisia (CIT)
Incentives	Egypt (CIT); Lebanon (CIT); Morocco (CIT); Tunisia (PIT, Property)
Special economic zones	Jordan (CIT); Morocco (CIT)

Note: PIT, personal income tax; CIT, corporate income tax; VAT, value added tax.

Box 1. Tax expenditures in Morocco are as high as 17 per cent of total tax revenues

Tax expenditures constitute a significant share of revenues in Morocco. According to an estimate by the total tax expenditures in Morocco were about 34.6 billion dirham or 3.8 per cent of total output in 2014 (Kassim and Mansour, 2017),The tax expenditure report of Morocco is fairly detailed, and each tax expenditure is explained together with its legal provision, beneficiary, objective and the sectoral decomposition. For the year 2014, 74.6 per cent of the total number of identified tax provisions were evaluated – 300 out of a total of 402. The definition of the benchmark tax system contains the tax rates and tax bases for each category of taxes but it does not include the tax unit and tax period. The chart shows that more tax expenditures are related to the VAT than any other type of tax while the real estate sector benefits the most from tax expenditures.

Share of tax expenditures by type of taxes, Morocco 2014



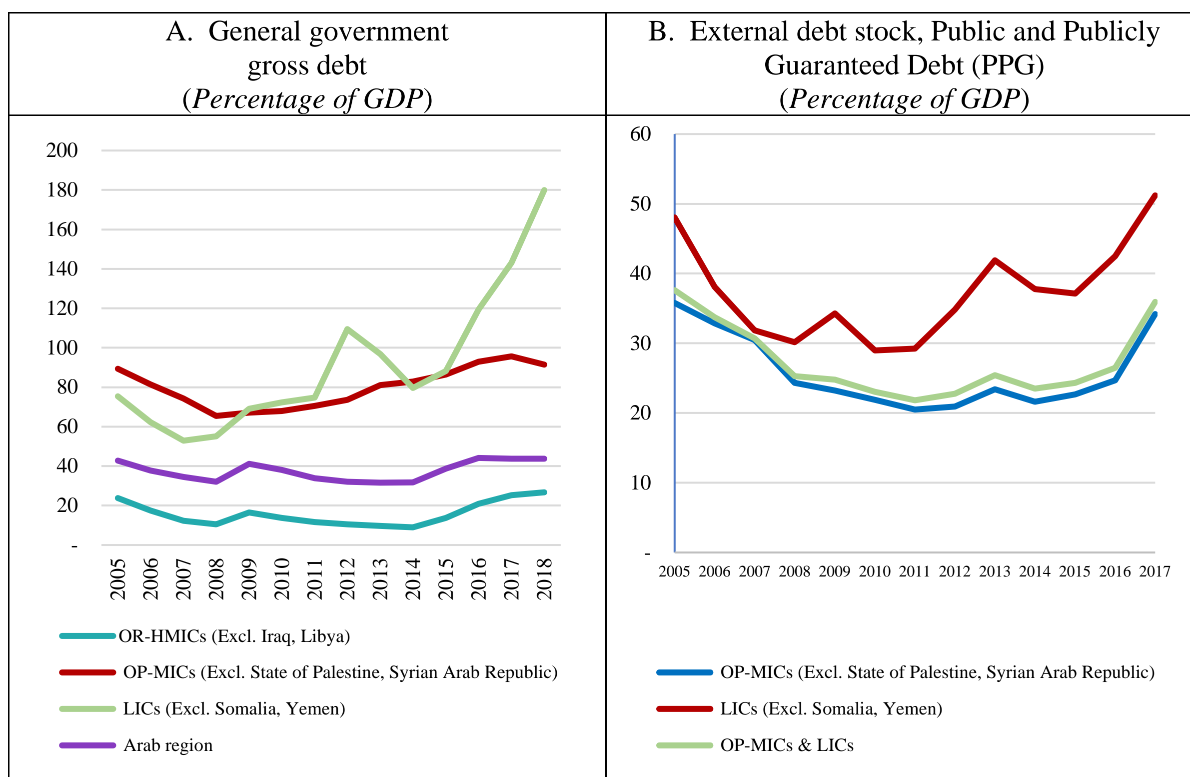
Source: Kassim and Mansour, 2017.

V. Growing debt vulnerabilities in the Arab region

1. *Rising debt constrains fiscal space for development financing*

The ability to manage public budgets to support economic and social investments varies significantly across the oil-rich and oil-poor countries in the Arab region. Public debt-to-GDP ration is low in the oil-rich countries but in some cases like Bahrain, public debt, as a share of GDP, is touching 95 per cent. Oman, Libya, Iraq have accumulated significant amount of public debt. However, they are relatively better off than the oil-poor middle-income countries in the region. The average debt-to-GDP ration is 91 per cent for the MICs as compared to 26 per cent of the oil-rich countries.

Figure 15. Public debt



Source: Authors calculation, based on World Bank, 2019; ESCWA, 2017.

In the oil-poor middle-income countries,[25] debt as a share of GDP has risen continuously since the global economic crisis in 2008 (figure 15). Debt-to-GDP ratio has reached 157 per cent in Lebanon and 94 per cent in Jordan in 2018, while it was reduced slowly in Egypt to reach 92 per cent in 2018. A lax approach to fiscal policy rules and discretionary increases in government expenditures are major drivers of rising fiscal deficits and debt in the region.[26] Fiscal deficits and current account deficits have increased, as discussed in this paper in the first section, financed through borrowing in foreign currency. On average, the current account deficit of oil-poor middle-income countries stands at 6.5 per cent of GDP in 2018. This situation has forced middle-income countries such as Egypt, Jordan, Morocco and Tunisia to borrow from the IMF under the Special Borrowing Arrangement, and thereafter, in 2016 from the Extended Fund Facility. Lebanon has become highly vulnerable to public debt and is facing an economic recession, while tackling public protests that are calling for change of government (box 2).

The average debt-to-GDP ratio has been increasing to 180 per cent of GDP in the LICs. It is mainly driven by skyrocketing debt in the Sudan, which reached 212 per cent in 2018, also due to significant depreciation of Sudanese currency (36 per cent). Alongside the Sudan, Mauritania's debt-to-GDP ratio is about 85 per cent.

[25] They include Egypt, Jordan, Lebanon, Morocco and Tunisia.

[26] Sarangi and El-Ahmadieh, 2017; ESCWA, 2017.

In addition to high and rising general government gross debt, the external borrowing part of debt stock and associated debt servicing, poses further challenges for most Arab countries. For the oil-poor middle-income countries, the weighted average of total external debt-to-GDP has increased from about 28 per cent in 2011 to 34 per cent in 2017, as per the latest available data.[27] The total external debt for the MICs reached 56 per cent in 2017, compared to 38 per cent in 2015, which shows that private external debt has increased rapidly during this period. The share of public and publicly guaranteed external debt has come down from about 72 per cent of the total external debt in 2015 to 61 per cent in 2017 in the oil-poor MICs. The increasing external debt share of GDP has consequently led to an increasing share of debt services to GDP in recent years, especially for the MICs who have to spare nearly 25 per cent of their export earnings as external debt service in 2017.

For the low-income countries, external debt (PPG) increased to 51 per cent of GDP in 2017 and private external debt was negligible. About 99 per cent of the total external debt stock in 2017 was in the form of PPG debt. The average share of PPG external debt to GDP increased to 36 per cent in 2017 from about 25 per cent in 2013. The debt relief to Comoros brought its external debt down from 40.5 per cent of GDP in 2012 to 18.5 per cent in 2013. Since then, no other country in recent years has received debt relief, although the Sudan is eligible for it.[28] The public external debt is closely associated with financing the current liabilities and implicit subsidies incurred by large public sector and State-trading enterprises. The high share of external debt in PPG also indicates that the capacity of the private sector in leveraging external financing is limited or negligible.

2. *Rising non-concessional external debt*

The concessional[29] part of external debt is minimal for middle-income countries (figure 16). The MICs have reported a consistent decline in concessional external debts as a share of total public and publicly guaranteed external debt. For instance, in Jordan concessional loans as a share of PPG external debt declined from 70 per cent in 2008 to less than 29 per cent in 2017. A similar stark decline occurred in Egypt. It implies that rate of interest of borrowing is going up. Since concessional funds are not easily available to middle-income countries anymore, governments have relied on non-concessional external loans. Between 2012 and 2017, long-term public and publicly guaranteed external debt as a share of GDP increased in Egypt, Jordan, Morocco and Tunisia.[30]

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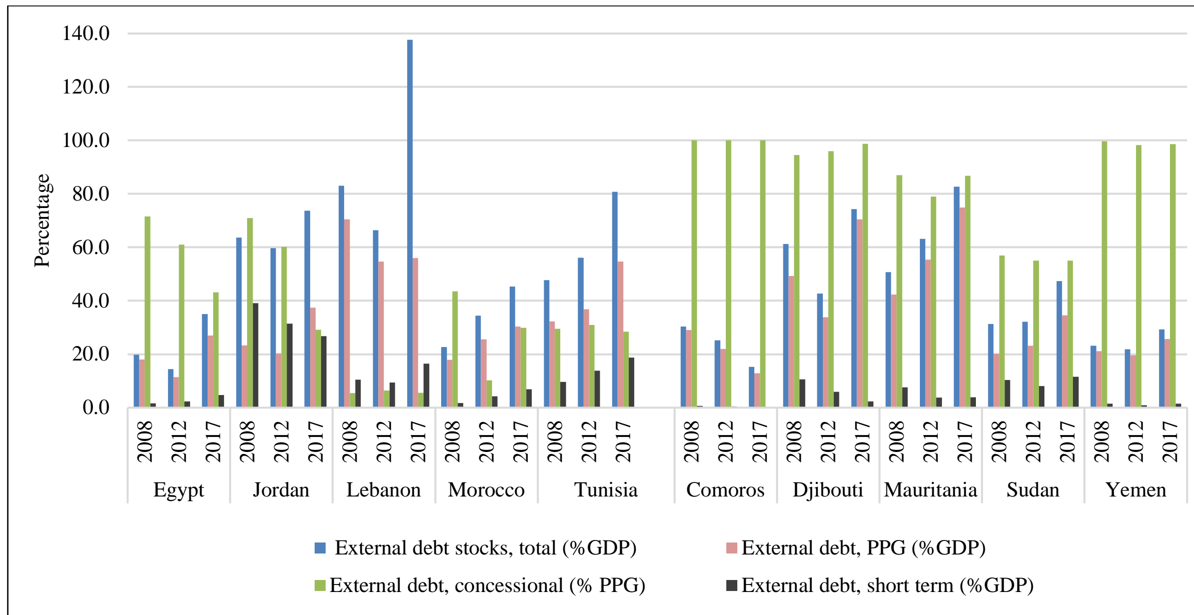
[27] External debt total refers to debt owed to non-residents repayable in currency, goods or services. Total external debt is the sum of public, publicly guaranteed and private nonguaranteed long-term debt, use of IMF credit and short-term debt.

[28] The Sudan is eligible for the Highly Indebted Poor Countries (HIPC) Initiative assistance, but still has to meet certain requirements to reach the decision point.

[29] Concessional debt is defined as loans with an original grant element of 25 per cent or more. Concessional external debt conveys information about the borrower's receipt of aid from official lenders at concessional terms as defined by the Development Assistance Committee (DAC) of the OECD (World Bank, 2017a).

[30] Long-term external debt is defined as debt that has an original or extended maturity of more than one year and that is owed to non-residents and repayable in currency, goods or services.

Figure 16. External debt profile
(*Percentage of GDP*)



Source: Authors calculation updating data, based on ESCWA, 2017.

Box 2. Lebanon must consider a course correction in fiscal policy response to public debt

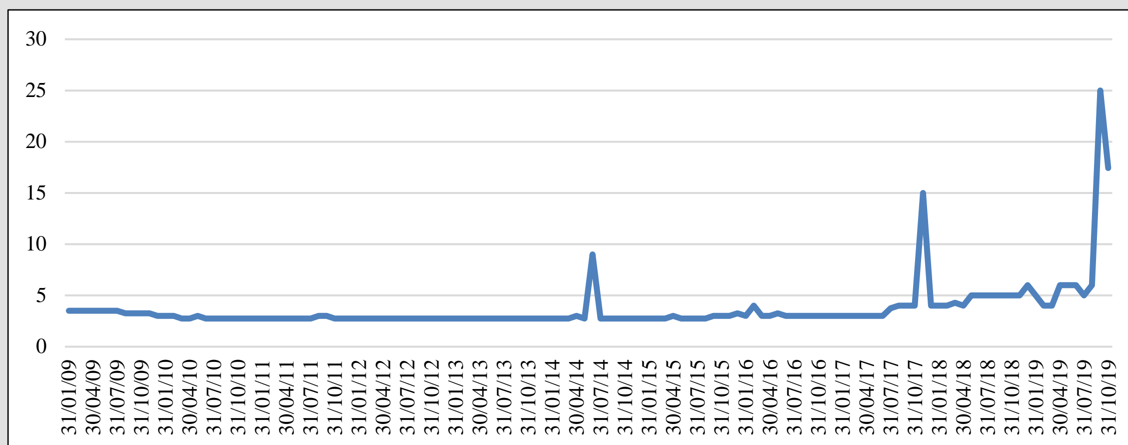
Reducing public debt is a major challenge to bring macroeconomic stability in Lebanon. With an economy of about $56.6 billion, gross public debt stands around $85 billion. The debt-to-GDP ratio persists on an unsustainable path, at 157 per cent of GDP in 2018. Total foreign debt amounted to $33.7 billion in 2018, most of which belongs to Eurobond ($31.5 billion). Historically, the government has a high level of dependency on external debt of which 90 per cent consist of Eurobonds.

The electricity sector is a major component of the country's public debt. One of the main challenges is largely subsidized electricity tariffs, while the power prices have remained unchanged over the past few years despite higher fuel prices. Electricity subsidies have contributed to more than 50 per cent of the accumulated Lebanese debt since 1992. About 15 per cent of Government's budget are electricity subsidies (Bouri and El Assad, 2016); according to the World Bank estimates, half of the fiscal deficit in 2014 were losses of Electricité du Liban (World Bank,2014).

In 2018, the budget deficit increased to 11 per cent of GDP, up from 8.6 per cent in 2017. The increased deficits put pressure on the government to undertake significant fiscal reforms to reduce the budget, which is a precondition for accessing $11 billion from international donors, committed in the Conférence économique pour le développement, par les réformes et avec les entreprises (CEDRE) conference in 2018. The 2019 budget promised to reduce deficits to 7.6 per cent of GDP, despite the increase in the costs of servicing the public debt, as interest payments constitute almost half of the government expenditures and almost 9 per cent of GDP. The decrease in budget deficit was proposed by significantly decreasing capital expenditures and with newly implemented tax provisions in 2018, such as raising VAT rate from 10 to 11 per cent. Furthermore, pressure of improving revenues was so much that in mid-2019, there were additional new tax measures proposed, which led to significant resentment among the people and consequently led to massive public protests in end October 2019.

Tight monetary policy conditions and a high savings rate, coupled with laxity in fiscal rules, have weakened growth and public finance. During the 2019, interest rates on 1-year deposits increased to reach 12 per cent on deposits in Lebanese pounds (LL) and 8 per cent (and even higher for large deposits) on dollar deposits. The interbank interest rate, or the federal funds rate, has been on an increasing trend since the past three years. After public protests in Lebanon in October 2019, the interbank rate jumped to 25 per cent by end November 2019 (figure below). The interest rate and growth differential (IRGD) has remained positive, up to 5 per cent, in recent years, implying that the cost of serving the debt is much higher than the earnings being weakened by slow growth. Addressing public debt becomes unsustainable and leads to further accumulation of debt.

Federal funds rate (*percentage*)



Since the last quarter of 2019 and after the massive protests in Lebanon demanding better fiscal, monetary and social policies, as well the fight against corruption, the country has been experiencing harsh economic conditions and liquidity problems. Although the Central Bank did not impose capital controls, Lebanese banks introduced capital controls on their foreign currency reserves, especially the dollar. In a country where imports reached $19.9 million in 2018 while exports were $2.9 billion, dollar liquidity problems negatively affected businesses (through imports) and consumers (higher prices) as well threatening food security in the country. Consequently, Lebanon continues to face a weakened dollar to the Lebanese pound peg in a parallel market; loss of revenues and closure of businesses; loss of public confidence in economic prospects; the downgrading of credit ratings; a decrease in the amount of remittances sent; and the pressure of liquidity in Lebanese banks.

In December 2019, the Central Bank issued a circular ordering banks to lower interest rates to a maximum of 5 per cent on the dollar and 8.5 per cent on the Lebanese pound on new deposits as a form of intervention in the market. However, some serious fiscal reforms in harmony with the monetary policy should also be adopted in Lebanon in order to build public confidence and improve transparency in public finance management.

Improve tax progressivity, not more taxes on goods and services: Increasing tax revenues is essential but that doesn't essentially mean higher taxes on goods and services where the middle class and the poor bear a higher burden than that of the rich. Instead, the focus should be on introducing more progressivity in taxation and improving tax compliance, as argued by the ESCWA Rethinking Fiscal Policy for the Arab Region report (ESCWA, 2017). In the past, Lebanon has not been successful in strongly improving the share of income tax in total revenues. In fact, the share of income tax has remained largely sluggish and low, at around 7 per cent in 2018. Mobilizing higher revenues has mainly been realized through raising taxes on goods and services, such as VAT. At this juncture, there is a strong need to improve progressivity in income tax rather than resorting to further rises in goods and services tax. For instance, the top tier tax rate in Lebanon is only about 20 per cent as compared to 35 per cent in Tunisia and 38 per cent in Morocco.

Improve tax compliance, ensure tax filing by all citizens: Even with existing tax rates, there is scope to improve tax resources by improving tax compliance. It is noted that the burden of tax on the top rich is lower than the burden of tax on the middle class in Lebanon (ESCWA, 2017). One such measure of improving compliance is to ensure that all citizens fill tax returns even though they may not have to necessarily pay taxes. It would help improving transparency albeit there are some costs to be borne in the beginning to reform processes for tax filing.

Implement CEDRE by channeling resources to productive investments: Show seriousness in governance reforms beginning with an access to information law that would allow open access to data as well as more regular surveys to assess the social impact of economic policies. CEDRE implementation should be overseen by a group of independent technocratic experts with no political affiliations who can ensure funds are directed to strategic projects to resolve priority issues such as infrastructure bottlenecks.

Implement financial sector reforms: The banking sector needs to enhance corporate governance by implementing the Basel Committee guidelines, taking into consideration the specificities of the Lebanese economy. The monetary regime needs to be revisited to support macroeconomic stability.

Gradually shift to debt stabilizing fiscal policies: Lebanon's debt has skyrocketed over the years, and the economy has not been able to ensure enough primary balances to stabilize debt. The required debt-stabilizing primary balance ratio has remained much higher than the actual primary balance ratio to GDP, suggesting that interest rates have remained below economic growth rates (Sarangi and El-Ahmadieh, 2017). While the economy is continuing with such a situation, further debt (bond issue) with promise of higher interest rates would increase vulnerabilities to external debt.

Assess expenditure switching policies: Abolish/reduce all unnecessary governmental expenditures to reduce costs and divert public expenditures to productive and social investments. This would require a monitor of social expenditures linked with the macroeconomic strategies and reforms discussed above. ESCWA new tool on "Social Expenditure Monitor for Arab States" is supporting member States in the area of budget and fiscal policy reform, which can be useful to Lebanon as well (ESCWA, 2019).

VI. Investment promotion efforts: how efficient to attract FDIs?

The inflow of foreign direct investment (FDI) to productive sectors is an important means of implementation to accelerate the SDGs targets, especially in improving access to energy for all (target 7.B.1), improving resilient infrastructure (target 9.A.1, 11.C.1) and to improve productive capacity of countries that helps reducing inequality among countries (target 10.B.1).

Countries in the Arab region have undertaken several policy reforms in order to achieve higher integration with the global economy and attract more foreign direct investment (FDI). Reducing trade barriers by making free trade agreements, adopting standards of treatment and international practices and making bilateral investment treaties are part of investment and trade promotion measures. Here we focus on reforms in investment laws that contribute to attracting FDI. In the past ten years, these reforms were mainly aiming at lowering the cost of starting a business.[31] For instance, many Arab countries eliminated or reduced the minimum capital requirements for investments such as Algeria, Jordan, Morocco and the GCC countries. Others, such as Egypt, and the United Arab Emirates, facilitated registration processes. Several countries, such as Kuwait, Morocco and Saudi Arabia, modernized their registrations and payment methods while Egypt, Oman and Qatar implemented one-stop shops.

Fiscal incentives, including tax holidays, have been introduced in different Arab countries (such as United Arab Emirates, Kuwait, Egypt, Lebanon, Morocco, Libya, Jordan, Algeria, and the State of

[31] OECD, 2018a.

Palestine) during the 2010s. The tax holidays vary between 5 and 20 years, depending on the specific industry.[32] Exemptions of indirect taxes in specific economic sectors, in the cases of Bahrain and Lebanon, or in specific economic zones, like in Egypt or Jordan, were permitted. Other countries such as Tunisia have been allowing the exemption of reinvested profits from corporate taxation while others such as Jordan are offering exemption of foreign personnel from income taxes and social security contribution.

Investment reforms were also enacted to boost the business environment. Firstly, all GCC countries updated their investment and corporate laws where they are now allowing up to 100 per cent foreign ownership in several sectors of their economy.[33] In fact, Saudi Arabia, United Arab Emirates, Qatar, Bahrain, Oman and Kuwait have enacted new investment laws that permit foreigners to own companies in several industries such as manufacturing, renewable energy, administrative services as well as information and communication. Several countries have also amended or created new laws to attract and retain FDI. According to OECD, Egypt carried out multiple reforms over the past few years. It presented a new industrial licensing law, bankruptcy law, amendments to companies' law, and established a movable collateral registry.[34] Egypt also amended its investment law which reestablished the private free zone and provided tax exemptions, a unified customs rate as well as free lands.[35] In Jordan, reforms were enacted to support small and medium enterprises. In fact, a new credit bureau was established as well as a new insolvency law. Also, access to finance was eased through the creation of a secured transactions law. Jordan also revised its investment law in 2014 and reviewed its list of investment restrictions. Morocco, which created the National Committee for the Business Environment in 2009, has seen the introduction of multiple horizontal reforms aimed at improving the business and investment climate in the country. It also introduced a new finance law in 2019 which included a number of tax developments such as changes to income tax for corporations and self-employed individuals, real estate investment. Given these reforms, we analyse the trends and patterns of FDI into the region as an important means of achieving the SDGs, as mentioned above.

1. *FDI inflow declined sharply*

Foreign direct investment inflows to the Arab region have witnessed a decline in their total value as well as in their share of GDP and gross fixed capital formation (GFCF) for most Arab States over the last ten years (table 3). FDI inflow witnessed a strong decline since the global economic slowdown in 2008, followed by political instability in parts of the region (figure 17). In 2008, FDI inflow was $88 billion, which decreased to $25 billion in 2015, and thereafter it has slowly risen to $31 billion in 2018. The inflow of FDI between 2008 and 2018 increased for Morocco and Oman, while it declined for all other countries. For instance, Saudi Arabia witnessed a sharp decline in its FDI inflow from $39 billion in 2008 to merely $3.2 billion in 2018. Its FDI, as a share of GDP, reduced from 7.59 per cent to only 0.41 per cent between 2008 and 2018. Also, its FDI shares of GFCF dropped from 33 per cent to only 1 per cent in 2017. Among the middle-income countries in the region, Lebanon witnessed a sharp decline in FDI inflow which reduced from $4 billion in 2008 to $2.9 billion in 2018. FDI, as a share of GDP or as a share of GFCF, dropped by more than half that of 2008. In Jordan, FDI inflow dropped from $2.8 billion to $0.9 billion. Its FDI share of GDP declined by 80 per cent and its FDI, as a share of GFCF, declined to half that of 2008. Overall there was a sharply declining trend in FDI inflow until 2016 for most countries in the region. Thereafter, it has slowly picked up, but it is far from recovery of its peak in 2008.

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[32] IEMS, 2013.

[33] Price Waterhouse Coopers, 2019.

[34] OECD, 2018a.

[35] Price Waterhouse Coopers, 2019.

2. *FDI inflow remain skewed toward specific countries as well as sectors*

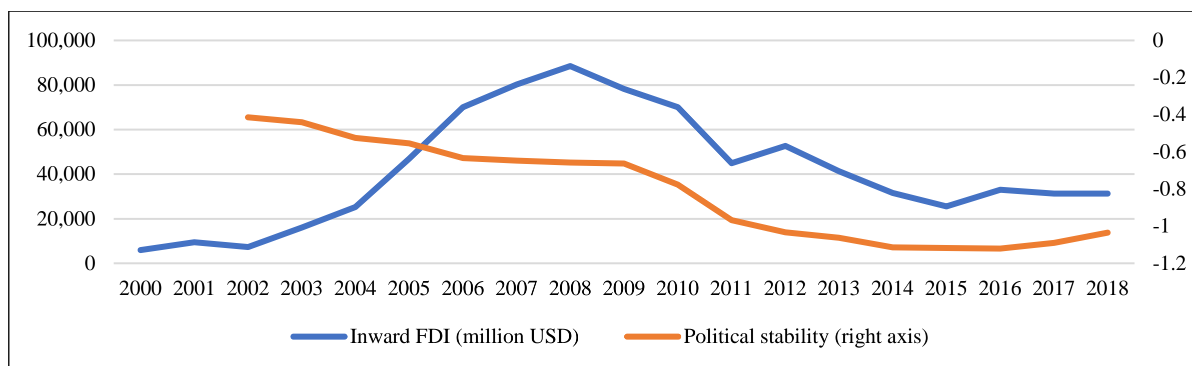
Moreover, foreign direct investment has been skewed toward specific countries as well as sectors. GCC countries attracted almost half of the FDI inflows over the 2000s and these investments have been highly concentrated in extractive industries (figure 18). Natural resources processing attracted a big share of FDI in Western Asia as well as North Africa. According to United Nations Conference on Trade and Development (UNCTAD) 2019 World Investment Report, in Saudi Arabia the company Total signed a contract with Saudi Aramco to develop a petrochemical complex in Jubail in a project worth $9 billion. In Egypt, foreign direct investment was skewed towards the oil and gas industry, as significant discoveries of offshore gas reserves attracted investments from multinational enterprises, and the country became a net exporter of gas in January 2019.

3. *FDI remains concentrated into extractive industries, which are highly capital intensive and have less employment generating effects*

FDI in the GCC countries from 2010 until 2018 has been mainly concentrated in the oil sector as well as real estate, as figure 17 reveals. This is different than previous years where the majority of flows were focused in services and tourism sectors. Hence, foreign direct investments in the past decade reaching the tradable sectors have been very limited since they are mainly being captured by the capital-intensive extractive industries. Since most FDI are going to extractive industries, which are highly capital intensive, these FDIs also have less employment-generating effect.

There are only few projects in non-extractive sector that attracted FDI. For instance, Algeria received significant investment in the automotive industry in 2018. The Automobile company, BAIC International, opened a manufacturing plant in Algeria, with an investment of more than $100 million. The Algerian Investment Council has also approved to set up manufacturing plants for Hyundai and Ford. In the United Arab Emirates, investments were directed to a wide range of sectors, including as digital technologies. In Bahrain, manufacturing companies such as American Company International and Ariston Thermo Group established new facilities in the Bahrain International Investment Park.[36] The region requires these kinds of investments to accelerate diversification and employment generation.

Figure 17. FDI inflow
(million USD)

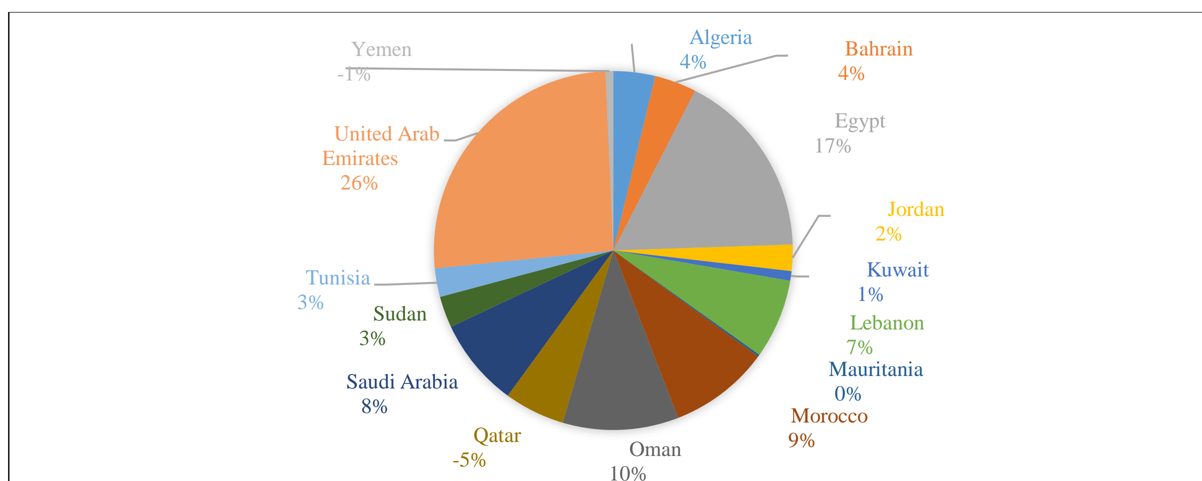


Source: Calculations based on data from World Bank, 2019, for political stability and UNCTAD, 2019, for FDI inflow.

[36] UNCTAD, 2019a.

In summary, despite efforts made to encourage foreign direct investment in Arab countries, more reforms are needed in order to further catalyse investment in the region and create an investment friendly environment. This FDI should be directed towards non-oil tradable sectors. This would allow further economic diversification and employment generation in the region.

Figure 18. Per cent of total FDI inflows in 2018



Source: UNCTAD, 2019.

Table 3. Foreign direct investment inflow

	Total (*Current million USD*)			Percentage of GDP			Percentage of GFCF		
	2008	2012	2018	2008	2012	2018	2008	2012	2017
Algeria	2 631.71	1 499.45	1 506.32	1.54	0.72	0.84	5.26	2.33	1.78
Bahrain	2 638.30	1 545.21	1 515.16	10.26	5.03	3.94	29.72	18.72	15.55
Egypt	9 494.60	6 031.00	6 797.60	5.76	2.18	2.72	25.85	14.84	24.86
Jordan	2 826.26	1 548.31	949.86	12.73	5.01	2.25	45.41	23.09	24.99
Kuwait	-5.95	2 872.58	345.54	0.00	1.65	0.25	-0.02	13.61	1.00
Lebanon	4 002.06	3 111.31	2 879.83	13.69	7.03	5.07	49.82	28.62	24.31
Mauritania	342.77	1 388.59	70.76	8.50	26.54	1.33	24.20	52.75	26.24
Morocco	2 487.09	2 728.36	3 640.38	2.69	2.78	3.08	7.81	8.52	8.61
Oman	2 952.00	1 365.41	4 190.51	4.85	1.78	5.07	15.83	8.21	14.88
Qatar	3 778.63	395.88	-2 186.26	3.28	0.21	-1.14	7.97	0.78	1.50
Saudi Arabia	39 456.00	12 182.00	3 208.81	7.59	1.66	0.41	33.29	7.43	0.91
Sudan	1 653.12	2 311.00	1 135.79	2.58	3.73	2.77	14.30	13.86	4.23
Tunisia	2 758.62	1 603.19	1 035.94	6.15	3.56	2.59	26.03	15.82	11.17
United Arab Emirates	5 062.97	9 566.65	10 385.29	1.58	2.55	2.45	7.16	12.25	11.77
Yemen	1 554.62	-531.00	-282.10	5.11	-1.66	-0.68	29.10	-9.11	-4.23

Source: UNCTAD, 2019.

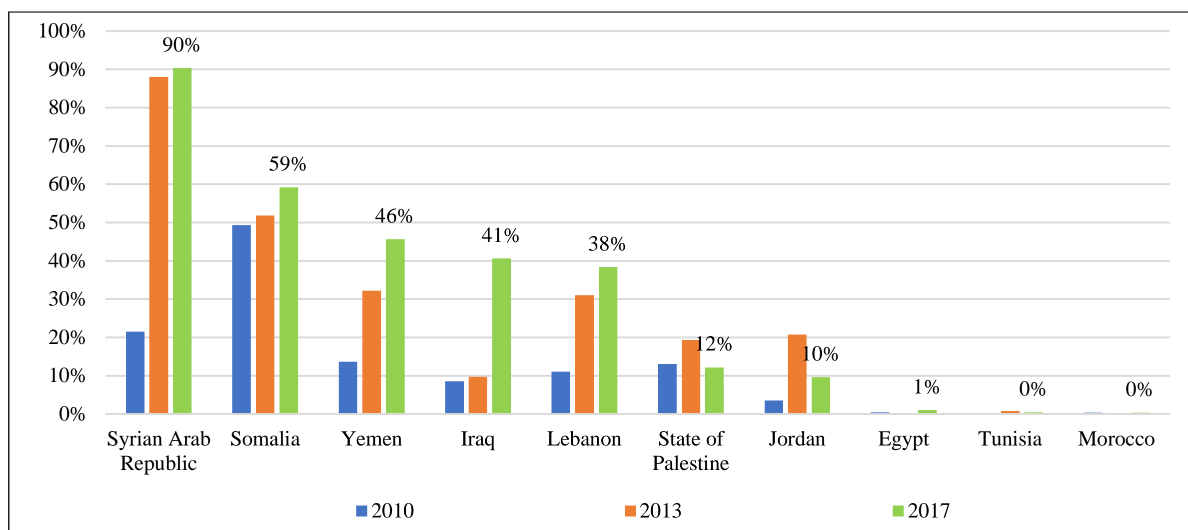
4. *ODA is essential for SDGs, sectors and for the low-income countries*

ODA is a critical means of implementation for several SDGs targets.Total ODA provided to Arab countries (excluding Arab donors), has steadily increased since 2011, following years of sharp decline during 2008-2010. In 2017, total ODA in the Arab region was $33.95 billion, which is the peak within the past decade. The total ODA received by Arab countries from all sources is 17.7 per cent of total ODA extended to developing countries in 2017.

5. *ODA increased to conflict-affected countries*

However, the increasing trend of ODA to the region is largely influenced by in-country "refugee" costs and humanitarian aid channeled to the countries affected by conflicts (figure 19). For instance, about 90 per cent of ODA to the Syrian Arab Republic was humanitarian aid. Among the least developed countries (LDCs), Somalia and Yemen received a higher inflow of ODA in the past five years, a large part of which was humanitarian aid. In contrast, ODA to the Sudan has declined significantly during the past decade. ODA to the middle-income countries of the region, including Egypt, Jordan, Morocco and Tunisia, appears to have increased during the past five years compared to the period 2010-2011, but aid flow has remained volatile, fluctuating from one year to another. The inconsistency in the flow of ODA remains a major concern, in addition to the fact that developed countries need to keep their commitment of 0.7 per cent of gross national income (GNI) to disburse as ODA to developing countries.

Figure 19. Humanitarian aid as percentage of total ODA disbursed (10 largest Arab recipients from all donors)



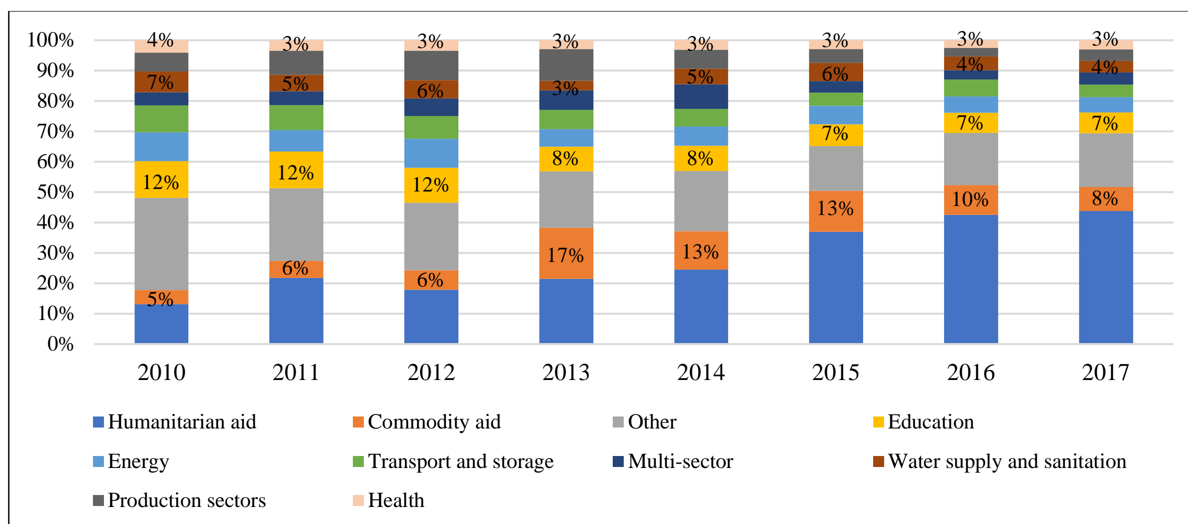
Source: OECD, 2019.

6. *ODA is essential means in sectors that impact the SDGs*

In the region, the share of ODA to education sector has declined over the years, and was only about 3 per cent in 2017. The share of ODA to health sector, water supply and sanitation remain negligent, declining to 3 per cent and 4 per cent, respectively, in 2017. Together water supply and sanitation, education, health and commodity aid accounted for only 22 per cent of total ODA in 2017 (figure 20). ODA share to the production sector declined over the years as well. These trends are

worrisome and can hamper the progress of several SDGs of the region, considering that significant resources are needed in these sectors to improve the quality of public services and improve access to the poor in order to make the societies more inclusive and sustainable.[37]

Figure 20. ODA disbursements (percentage distribution) from all donors to Arab countries, by sector



Source: OECD, 2019.

VII. Conclusions

The fiscal policy review in the Arab region 2019 provides important insights about overall domestic public resources in the region with a focus on fiscal policy reforms on taxation, assessment of debt and external debt, foreign direct investments and overseas development assistance, as an important means of implementation of the 2030 Agenda. A major focus of this fiscal policy review 2019 is to create a baseline database on tax reforms undertaken by Arab States during the period from 2010 to 2018. The annex provides country-wise reforms for various types of taxes, covering personal income tax, corporate income tax, capital gains and dividends, property tax, value added tax and general sales tax. The role of tax expenditure provisions and recent subsidy reforms across the region, as part of fiscal consolidation efforts, are discussed briefly in this review as well. The main objective is to assess the efficiency and progressivity of fiscal policy reforms initiated by the Arab States toward expanding their fiscal space. This fiscal review is first in the series following the ESCWA 2017 flagship report "Rethinking Fiscal Policy for the Arab Region".

The region is diverse in terms of the main sources of public revenues, which breaks into three distinct clusters of countries: first, oil-rich countries who rely mainly on hydrocarbon-based revenues; second, oil-poor middle-income countries who rely mainly on taxes; and third, the low-income countries who have a lower economic base and rely heavily on development assistance. The clusters are not homogenous, as there are differences among countries within each cluster.

[37] Sarangi and others, 2018.

The findings of the review suggest that, starting with global economic slowdown in 2008, the Arab region has witnessed significant economic and political shocks that have had a continuous downward effect on economic growth and buoyancy of revenues up until 2018. It has been a decade of losses in growth and public revenues, driven by long episodes of falling oil prices or crisis in several parts of the region. The fiscal space across the countries has been eroded, which compelled significant reforms to mobilize revenues and tailor expenditures. The budgets of oil-rich countries, which had higher revenues than expenditures in the pre-2014 period, have developed deficits. Hence reliance on oil revenues will no longer earn sustainable fiscal space. Reforms in the oil-rich countries are guided by the key goal of diversifying the sources of revenues.

Tax buoyancy of middle-income countries in the region, who rely heavily on taxes, is low on average, as compared to other middle- and high-income regions of the world. High debt and widening deficits in these countries have called for deepening tax reforms. Efforts in mobilizing revenues have largely relied on increasing taxes on goods and services through increased VAT or GST. Other important and recent reforms have focused on broadening the tax base through reducing the top tier income tax thresholds and also the bottom exemption level incomes, as well as corporate tax reforms. Most of these tax reforms across countries tend to burden the poor and the middle class more than that of the richest sections of population. Assessing wealth of richest sector and the potential of wealth tax is still unexplored.

Furthermore, the effectiveness of the tax reforms in improving tax collections is not clear. Most of the major reforms were undertaken during the past two to three years and the data have not yet established any significant trend change. However, we do see that many countries in the region have improved tax revenues as a share of GDP, including in Egypt, Jordan, Lebanon, Morocco and Mauritania. Reforms in the area of income tax area improved its share in total tax revenues in case of Lebanon, Morocco and Tunisia. Reforms in VAT certainly improved tax collection as a share of private consumption, but prevailing tax exemptions and tax evasions tend to undermine the overall tax collections. There is a much greater need to improve tax compliance in both direct and indirect taxes. Improving tax buoyancy is also possible by channeling higher social investments into quality public services, which brings more buy-in from the middle class (box 3).

Inflow of foreign direct investment (FDI) to productive sectors is an important means of implementation to accelerate the SDGs targets. Several investment and regulatory reforms have been undertaken to attract FDI inflow into the region. In 2008, FDI inflow was $88 billion, which decreased to $25 billion in 2015, and thereafter has slowly increased to $31 billion in 2018. However, it remains skewed toward specific countries as well as sectors. FDI remain concentrated in the extractive industries, which are highly capital intensive and have less employment-generating effects. There are only few projects in non-extractive sector that attracted FDI. More reforms are needed in order to further catalyse investment in the region and create an investment-friendly environment, build resilient infrastructure, improve productive capacities, economic diversification and employment generation in the region.

ODA is an essential means that impacts sectors and the SDGs, particularly for low-income countries that have narrow fiscal space. The share of ODA to sectors such as water supply and sanitation, education, health and commodity aid accounted for only 22 per cent of total ODA in 2017. ODA share to the production sector declined over the years as well. Furthermore, in recent years most of the ODA is channeled to humanitarian aid. These trends are worrisome and can hamper the progress of several SDGs of the region, especially in the low-income countries that have a low productive base,

considering that significant resources are needed in the sectors such as health, education, water supply and sanitation.

Box 3. Tax buoyancy improves with higher social investments, more than that of growth

Based on panel data spanning the period from 1990 to 2018 from 49 countries, we observed the following estimates of tax buoyancy. In finalizing the fixed effect estimates, we carried out robustness checks and controlled for performance score on control of corruption (as a measure of economic governance), different fiscal rules (binary) including an expenditure rule, revenue rule, debt rule and budget balance rule, and interacted the binary variables with social investments. We refer to "social investment" as public expenditure in health, education and housing, which are essential for building human capital.

The fixed effect estimates in the table below shows that higher social investments tend to increase tax revenue mobilization. The coefficient is higher for social investment than that of economic growth indicating that tax collections tend to be higher in countries that have higher social investments even if they have same economic growth.

Another interesting point is that a revenue rule combined with higher social investment tends to increase tax revenues. A revenue rule alone doesn't improve revenues, rather it tends to reduce tax revenues. A balanced budget rule and a debt rule also do not tend to have any significant impact on tax revenues. These results intuitively make sense. A focus only on revenues will lead to resentment or tax evasion unless accompanied by expenditures on quality public services. Importantly, an expenditure rule tends to have no significant effect on improving tax revenues. Expenditure rules on cutting expenditures will not help growth nor generate more revenues. Therefore, setting medium-term frameworks for revenues along with monitoring social expenditures are essential to mobilize fiscal space as well as efficient budget decisions. ESCWA social expenditure monitor (SEM) is forwarding this agenda to support its member States in the area of budgeting and fiscal policy reform that supports growth, revenues and effectiveness of social expenditures (ESCWA, 2019).

Fixed effect estimates (N=49; i=29)

	Ln (tax revenues)
Ln (GDP)	0.375 (13.11)**
Ln (social investment)	0.588 (22.62)**
Governance (control of corruption index)	0.000 (0.01)
Fiscal rule (expenditure): 0;1	0.095 (0.60)
Fiscal rule (revenue): 0;1	-1.014 (2.23)*
Fiscal rule (budget balance): 0;1	-0.048 (1.75)
Fiscal rule (debt): 0;1	0.048 (1.62)
Interaction of social investment and fiscal rule on expenditure	-0.003 (0.45)
Interaction of social investment and fiscal rule on revenue	0.038 (2.09)*
_cons	0.881 (3.28)**
R^2	0.96
N	803

Note: * $p<0.05$; ** $p<0.01$; t-statistics in parenthesis.

Annex

Tax reform timeline in Arab States (2010-2018): Country-wise illustration

Cluster 1. Oil-rich countries – GCC countries and Iraq

Figure A.1. Major tax reforms in PIT, CIT and property tax in GCC countries

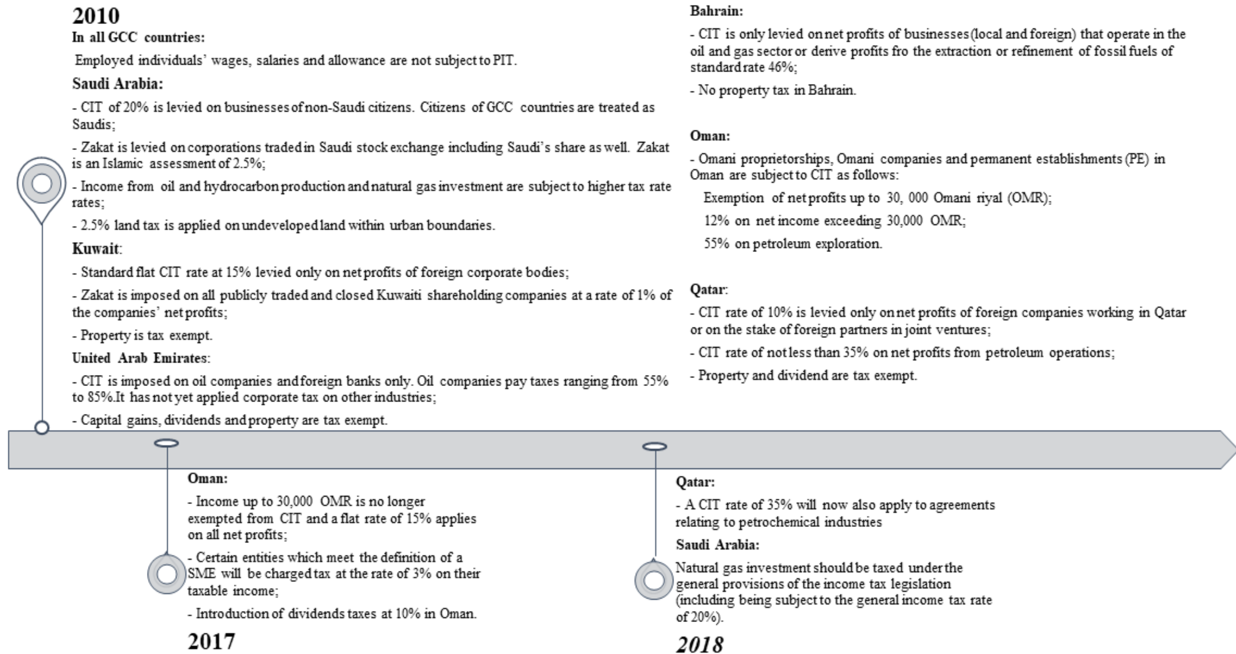
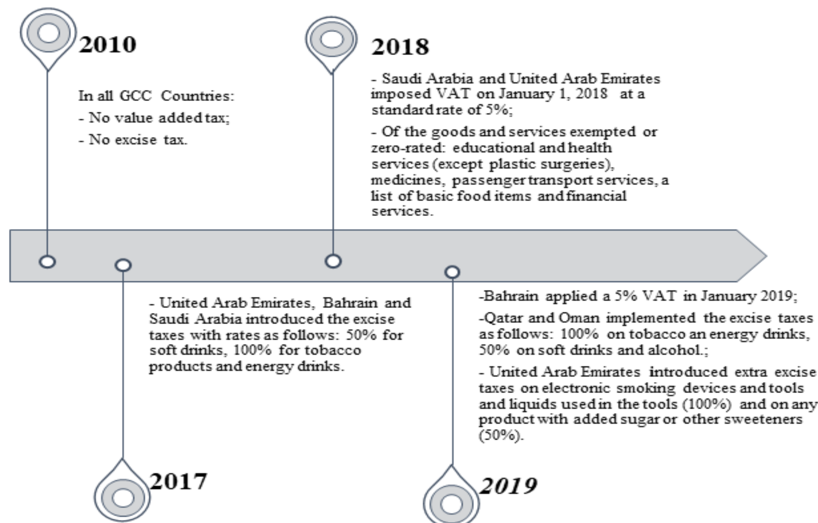


Figure A.2. Introduction of value added and excise taxes in some GCC countries



Iraq

Figure A.3. Major PIT reforms in Iraq

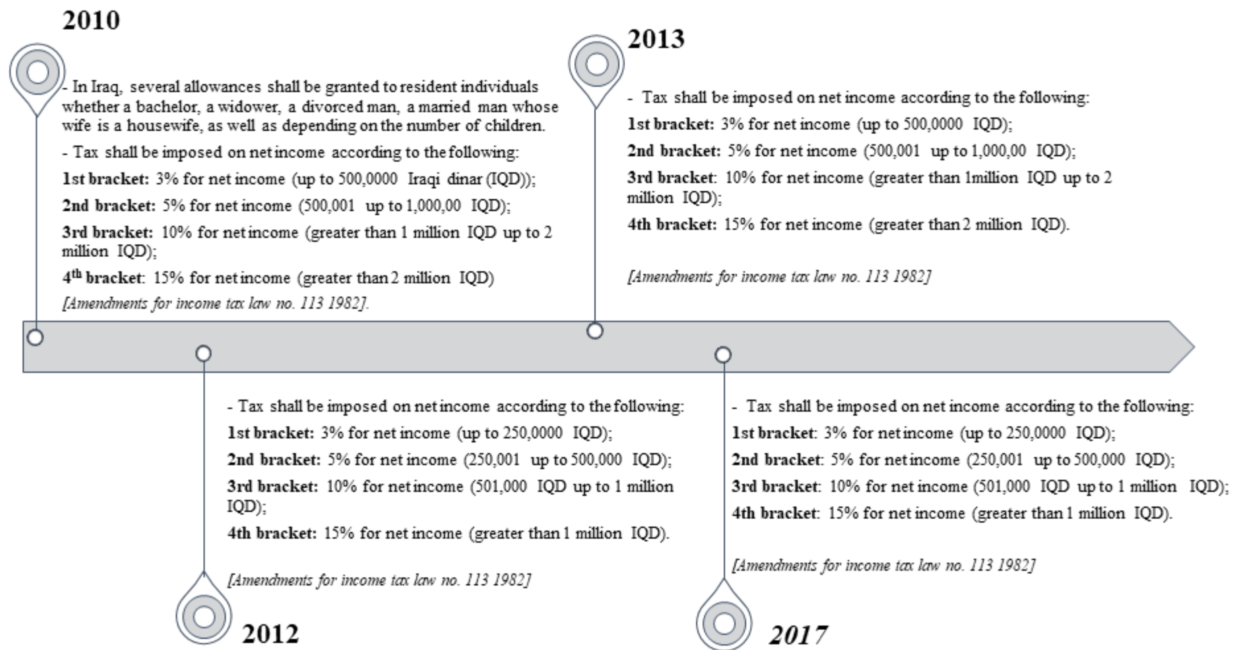
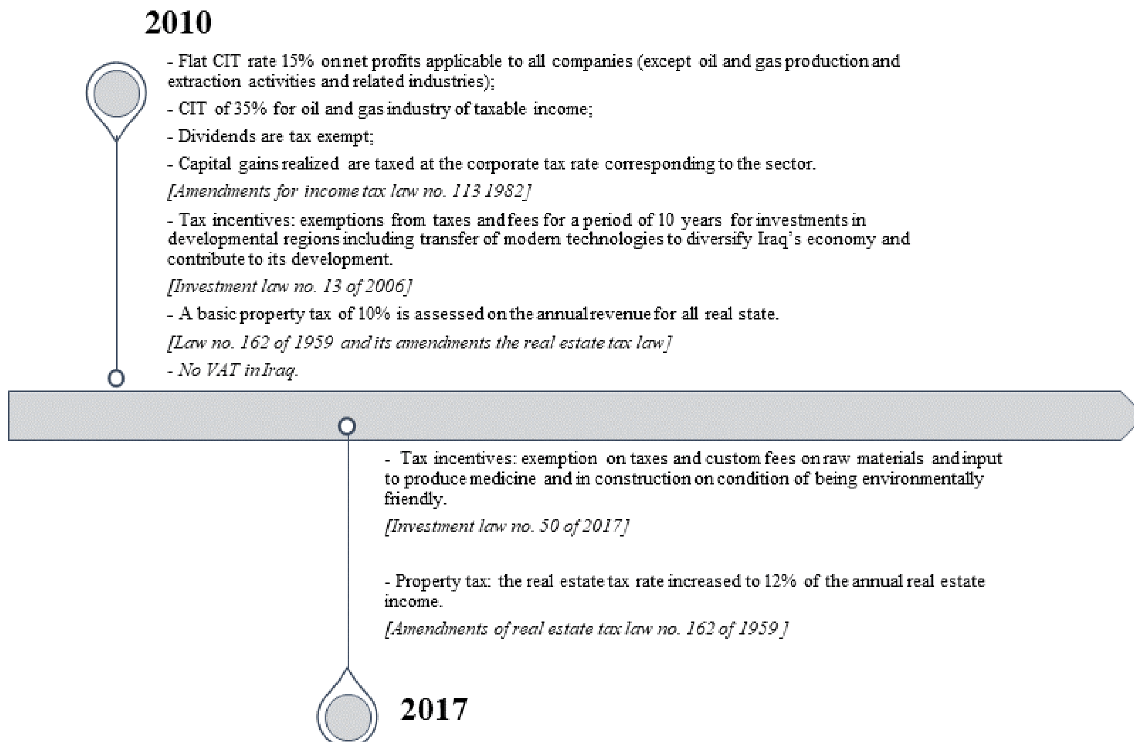


Figure A.4. Major CIT, property and VAT reforms and tax incentives in Iraq



Cluster 2. Oil-poor middle-income countries

Egypt

Figure A.5. Major PIT reforms in Egypt

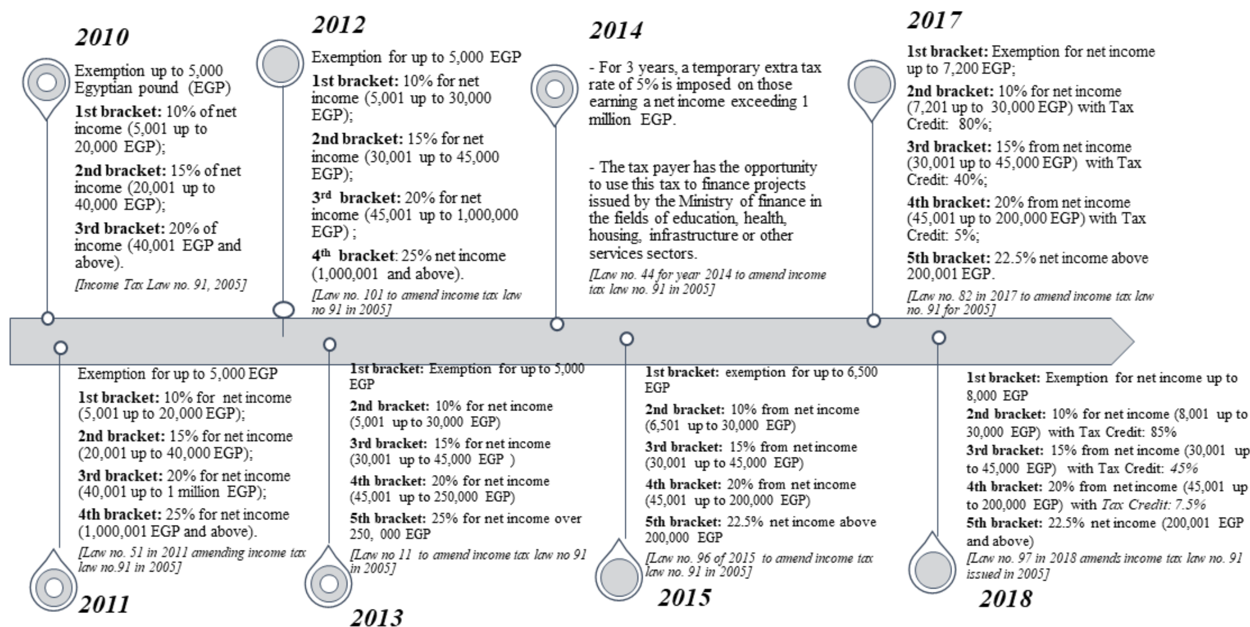


Figure A.6. Major CIT reforms and Tax incentives in Egypt

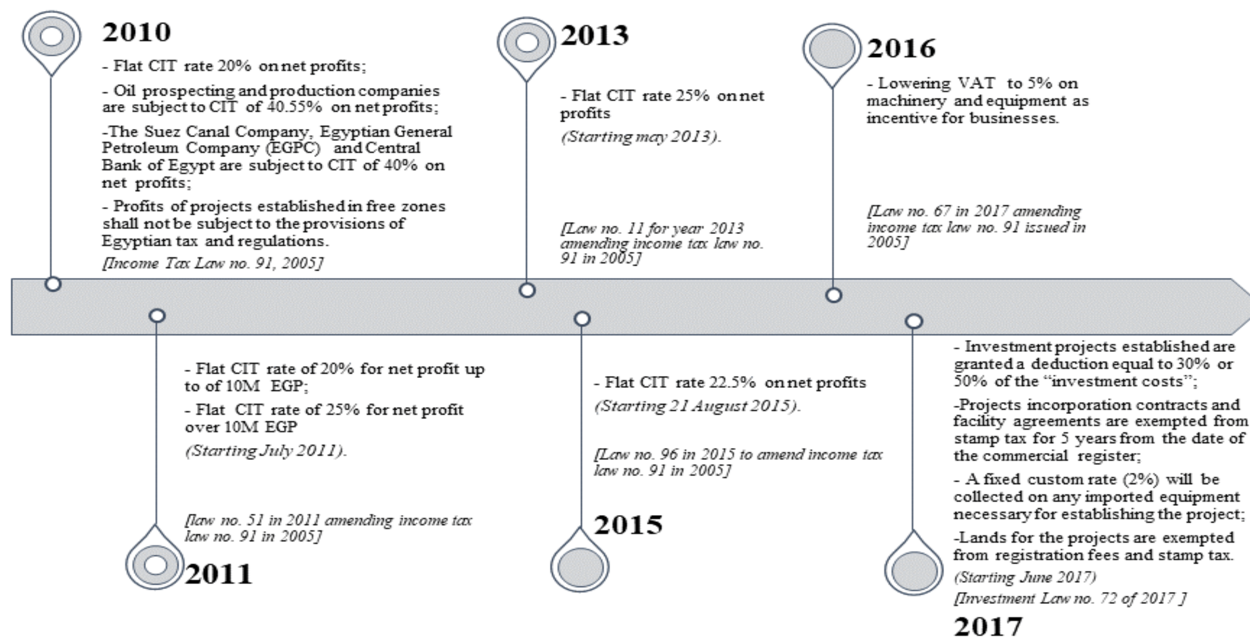
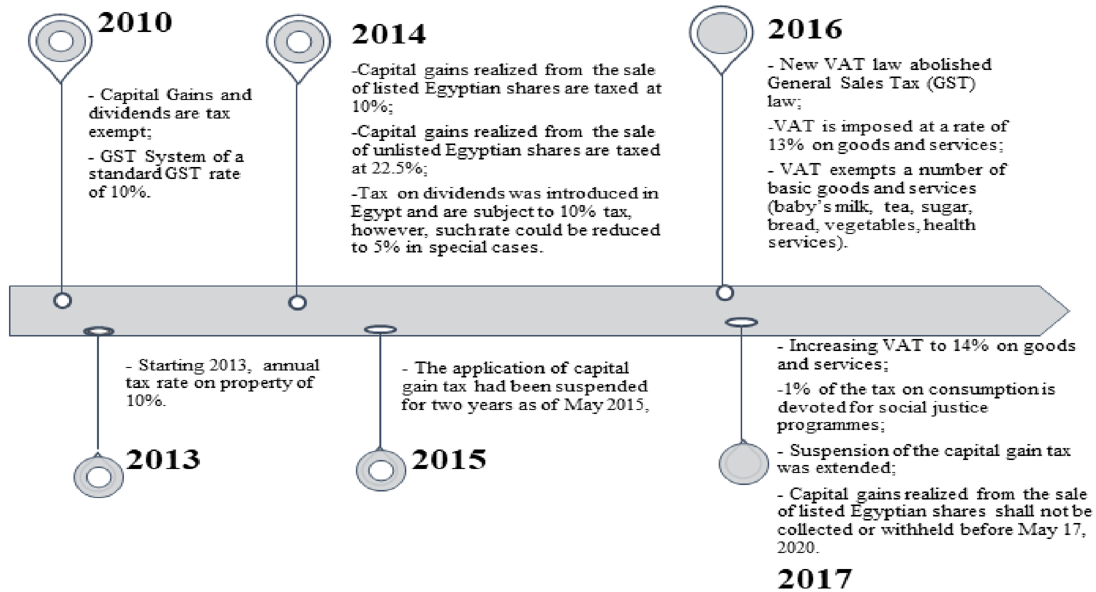


Figure A.7. Major capital gain, dividend, property tax, VAT and GST reforms in Egypt



Jordan

Figure A.8. Major PIT reforms in Jordan

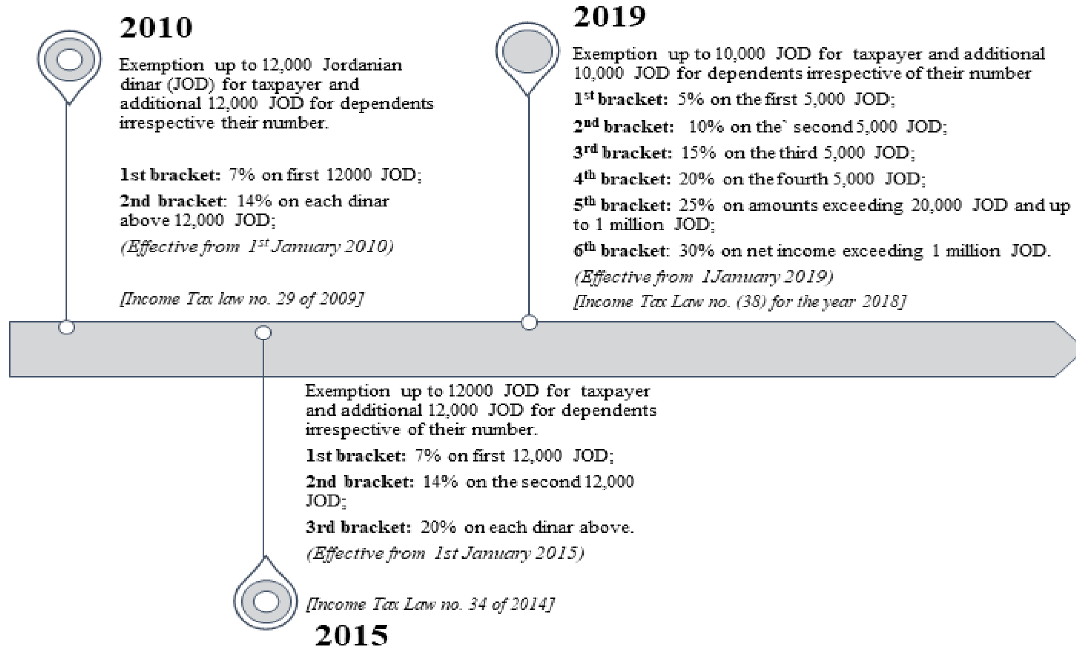


Figure A.9. Major CIT reforms in Jordan

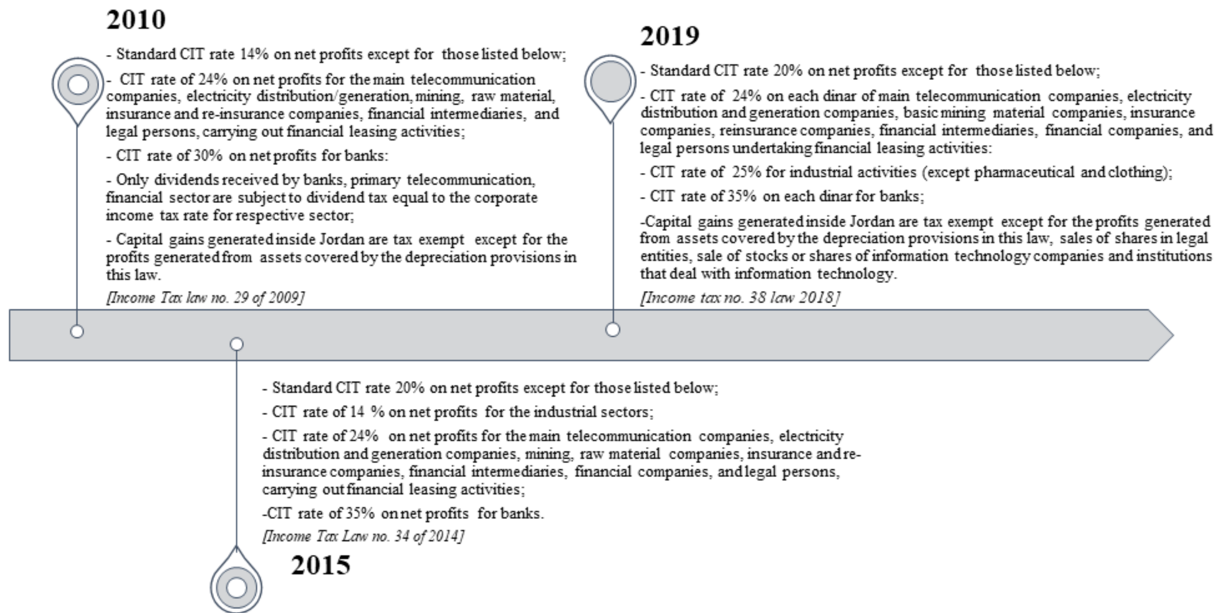
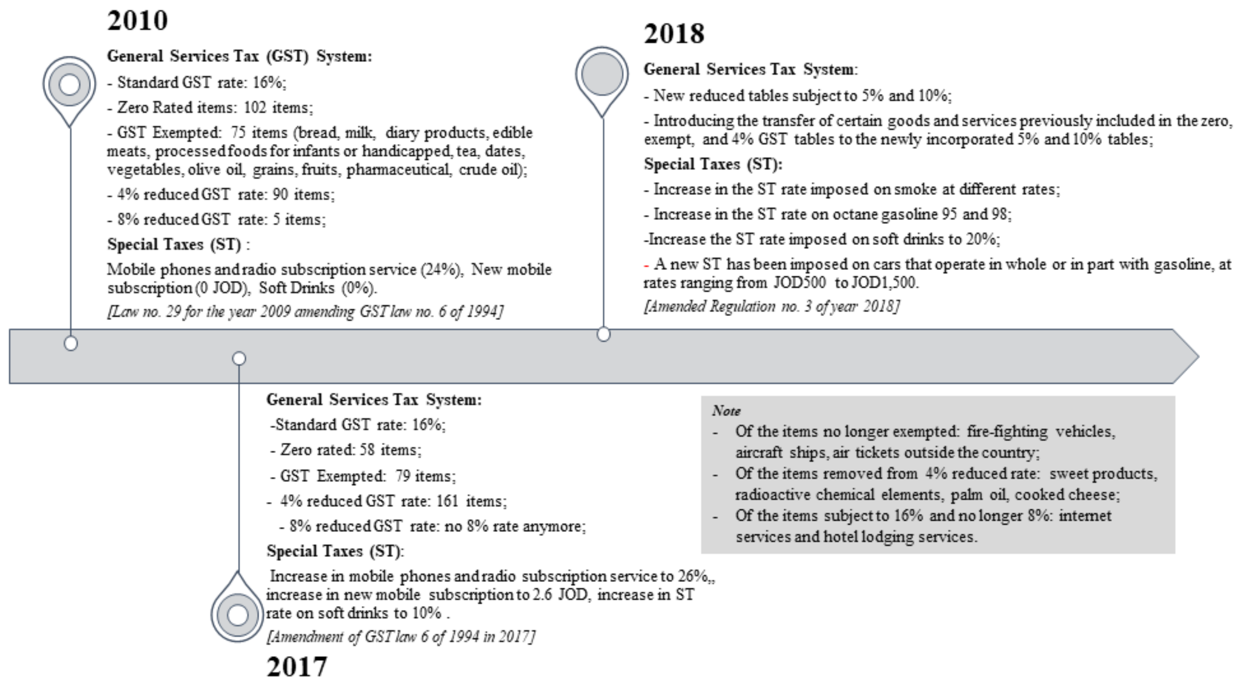


Figure A.10. Major GST and ST reforms in Jordan



Note: The main difference between zero-rated and exempted items is that the suppliers of zero-rated items can still reclaim all their input VAT, but the suppliers of exempt items are either not registered for VAT or if they are, cannot reclaim their input VAT.

Lebanon

Figure A.11. Major PIT reforms in Lebanon

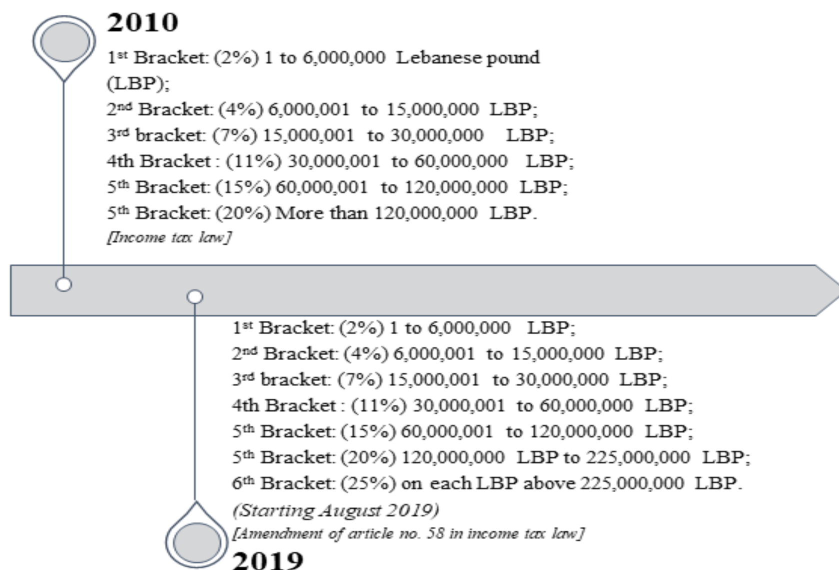


Figure A.12. Major CIT reforms and Tax incentives in Lebanon

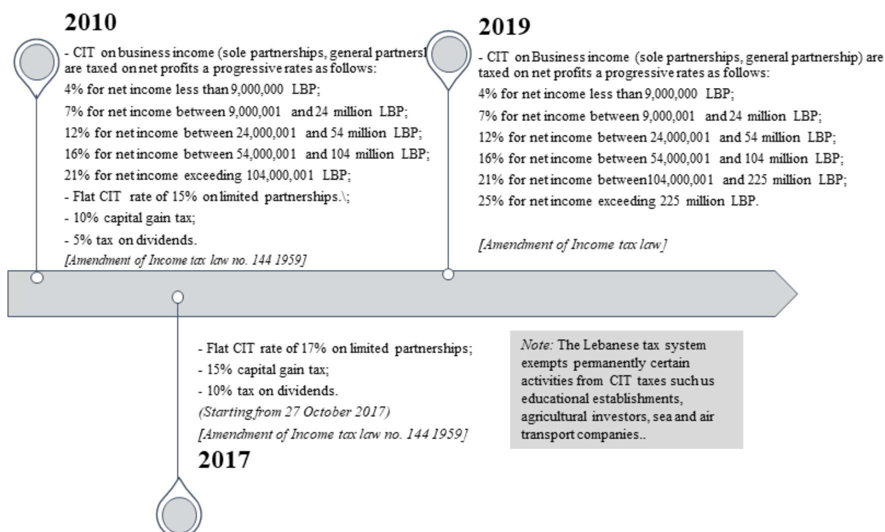
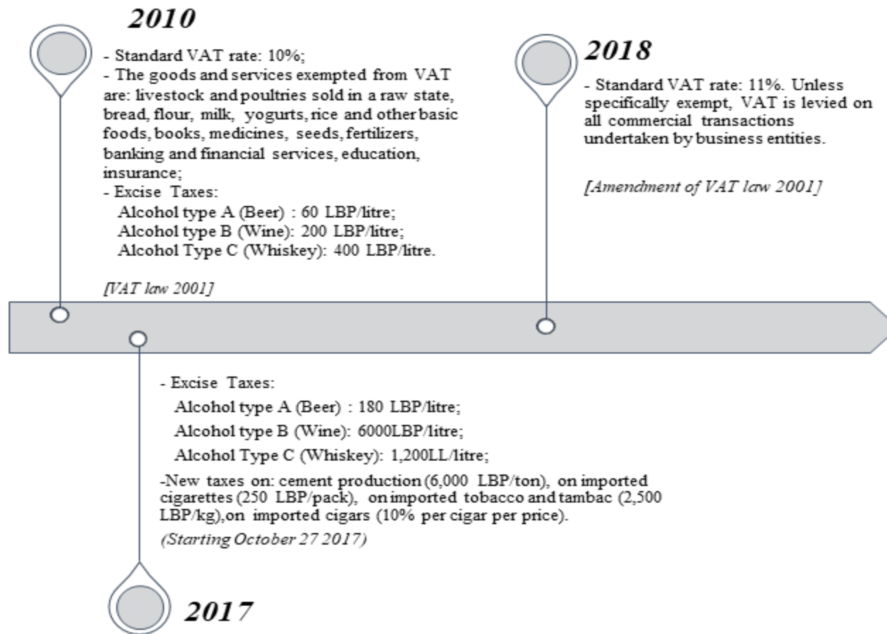


Figure A.13. Major VAT and Excise Tax reforms in Lebanon



Morocco

Figure A.14. PIT in Morocco

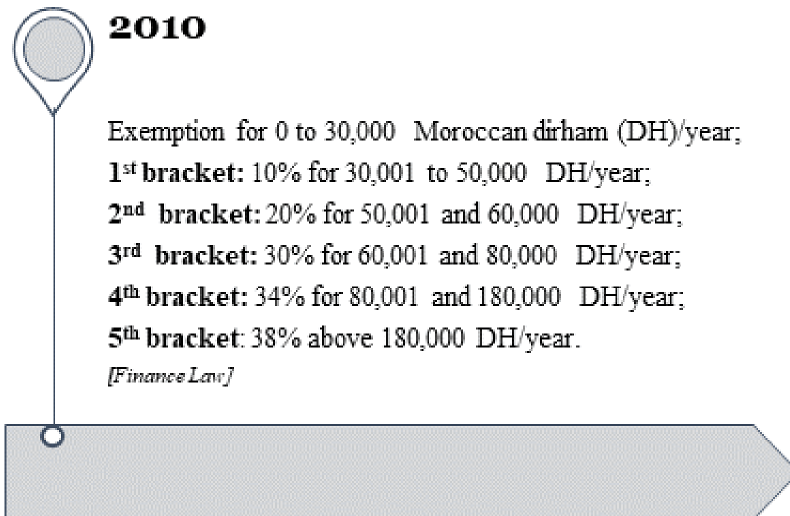


Figure A.15. Major CIT reforms in Morocco

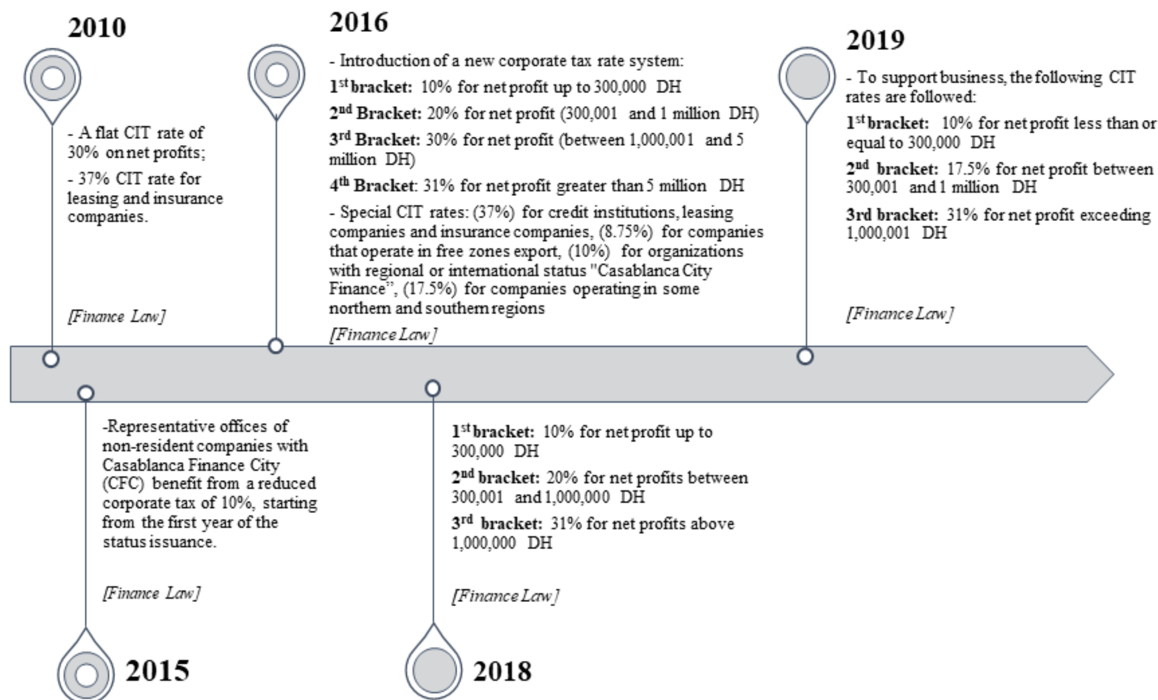


Figure A.16. Tax incentives in Morocco

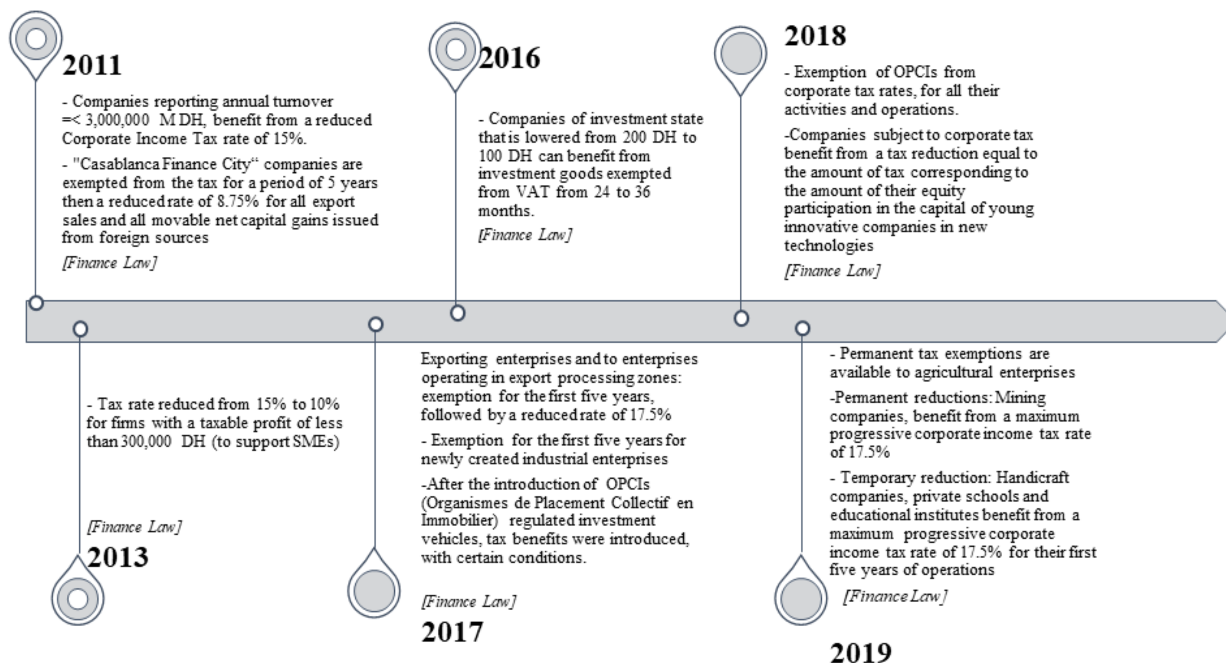
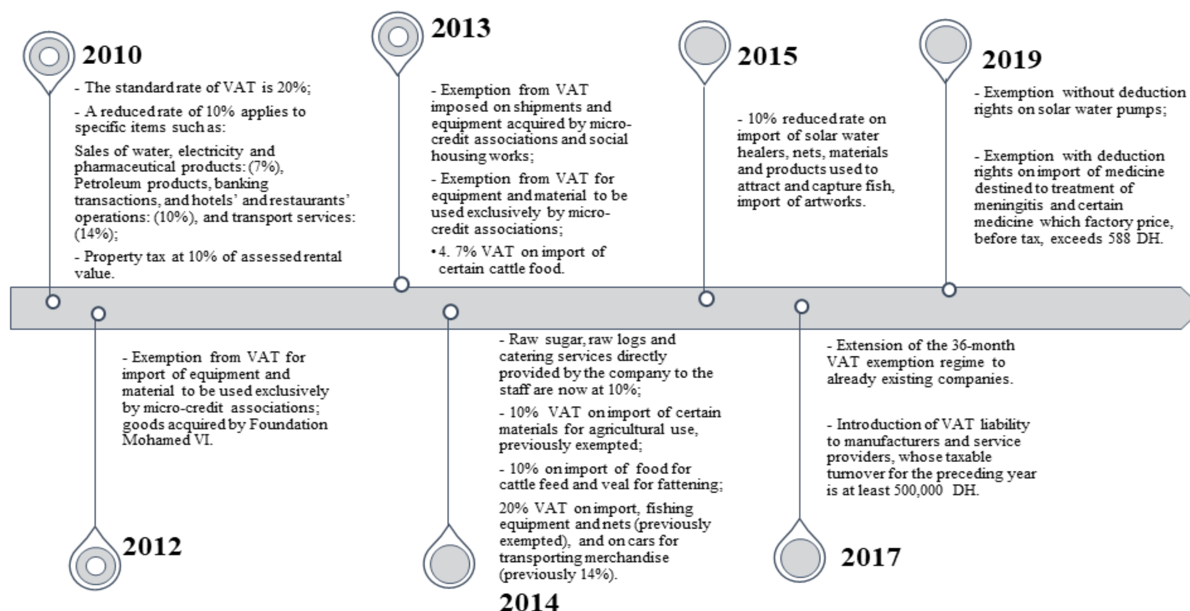


Figure A.17. Major VAT and property tax reforms in Morocco



Tunisia

Figure A.18. Major PIT reforms in Tunisia

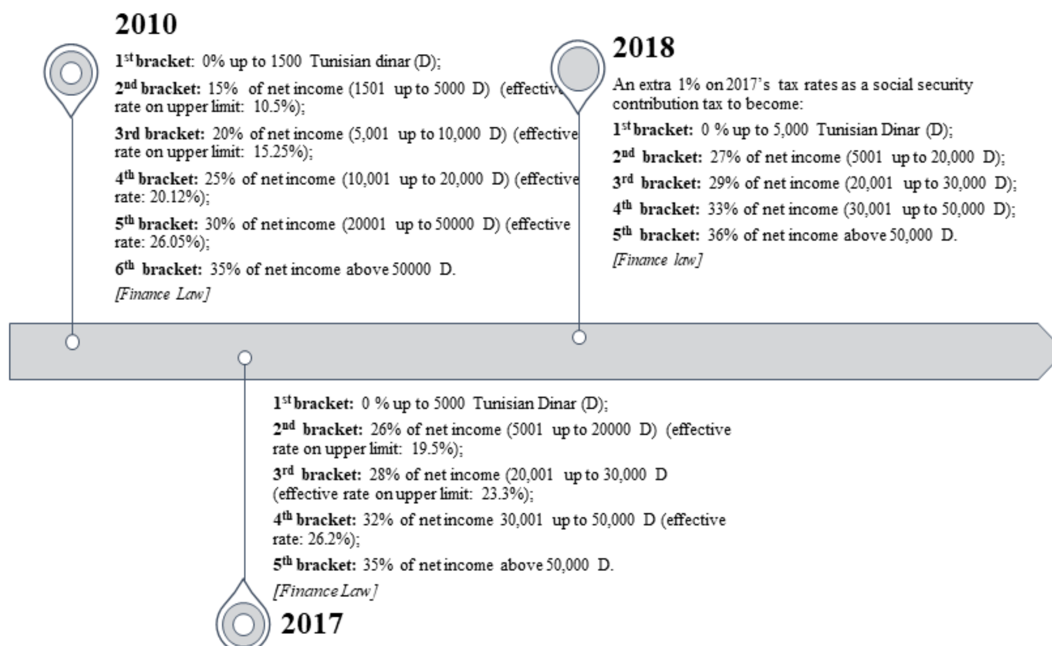


Figure A.19. Major CIT reforms in Tunisia

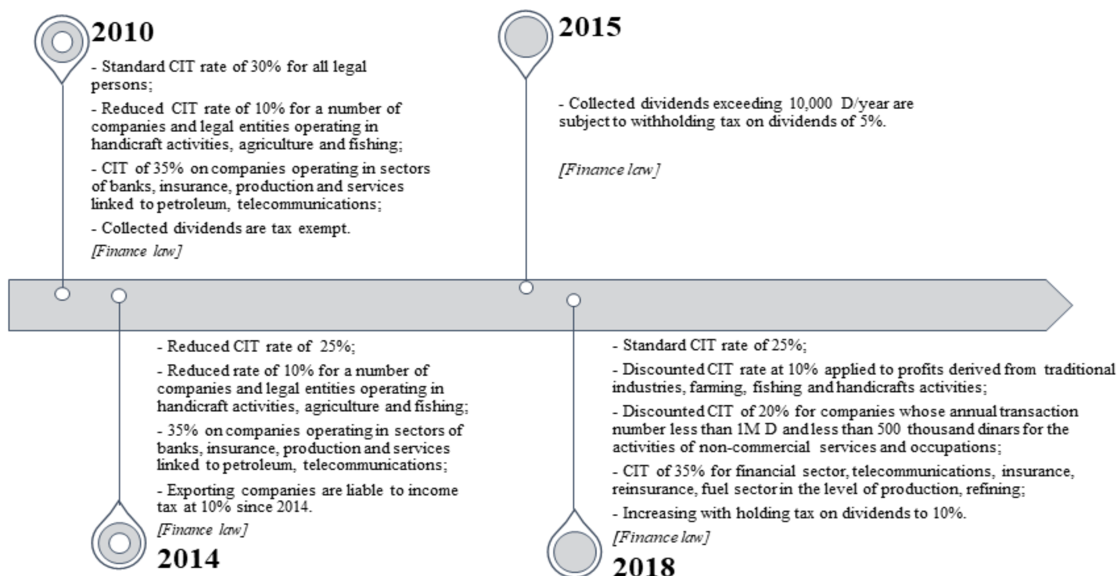


Figure A.20. Tax incentives to support investment in Tunisia

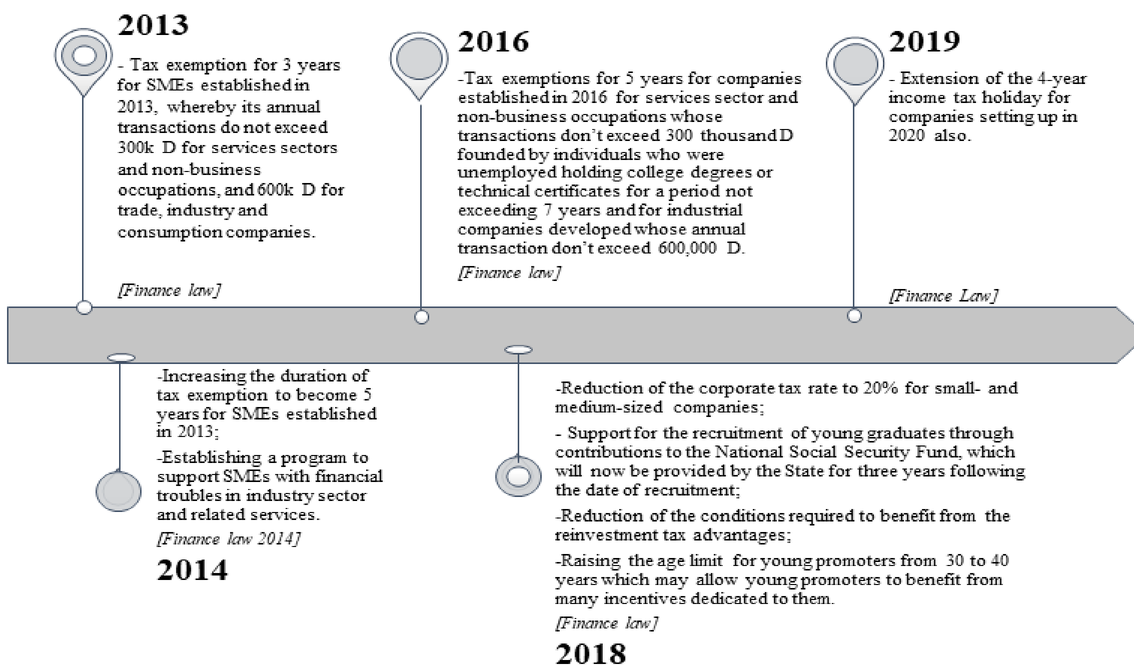
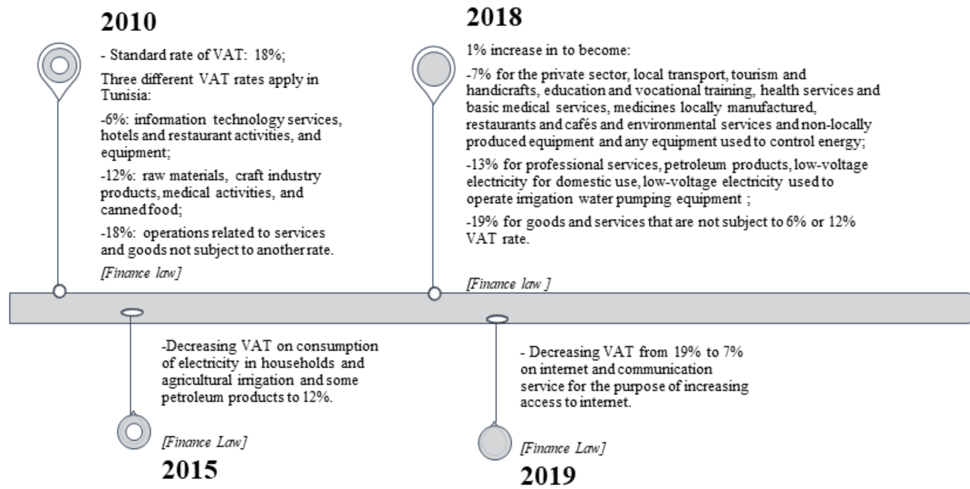


Figure A.21. Major VAT reforms in Tunisia



Cluster 3. Low-income countries

Mauritania

Figure A.22. Major PIT reforms in Mauritania

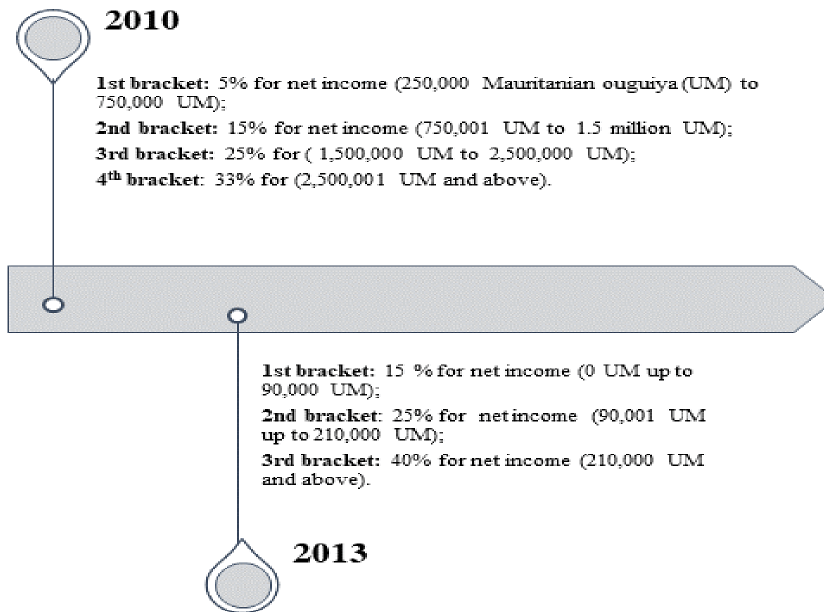


Figure A.23. Major CIT reforms and tax incentives in Mauritania

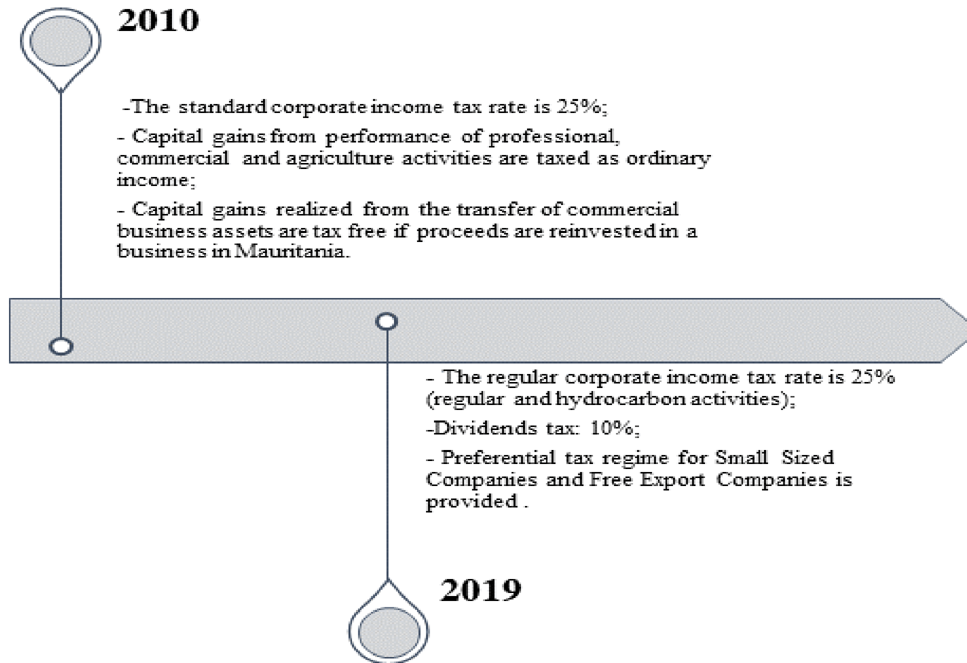
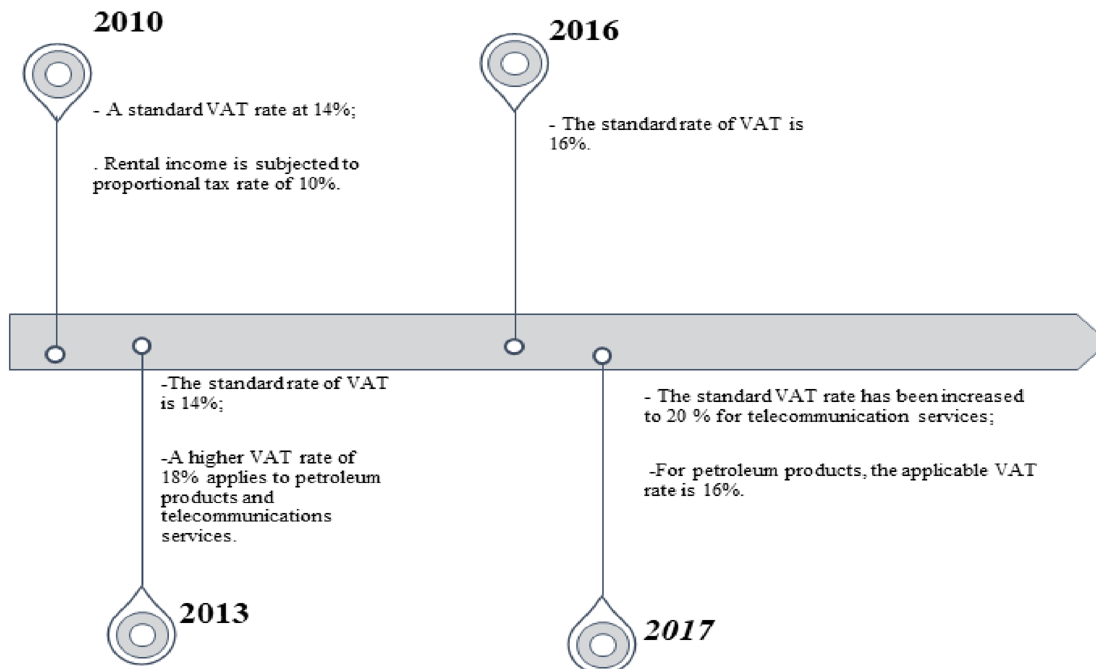


Figure A.24. Major VAT reforms in Mauritania



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