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POLICY BRIEFS

Repercussions of Tax Policies in the Arab Region

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The Arab NGO Network for Development (ANND) has developed two new regional research papers that assess tax systems in a number of Arab countries under the economic and social justice perspective (especially in Lebanon, Egypt, Jordan and Palestine) and that of gender justice (in Lebanon, Egypt and Tunisia). These two studies complement ANND's research and advocacy efforts since about one and a half year in cooperation with Christian Aid and with the support of Ford Foundation on tax policies in the Arab region and their economic and social repercussions. These two pilot studies also complement a comparative study of tax systems in six Arab countries (Egypt, Jordan, Palestine, Lebanon, Tunisia and Morocco) prepared by ANND with the same partner in 2014.

ANND looks forward to the publication of these two updated regional reports as well as the national reports based on them in the next couple of weeks. It should be noted that the author of these two reports is Dr. Nasr Abdel Karim from Palestine. This summary presents the most prominent data and all findings mentioned in the reports and reflects the state of tax justice in the Arab world. It also shows how current policies hinder Sustainable Development Goals (2030 Agenda), especially Goal 10 (reducing inequality within and across countries) and Goal 5 (achieving gender justice and women empowerment).

The majority of tax systems in our Arab countries are characterized by stable and varied sources of financial revenues, but at lower levels than in other emerging market countries and developing countries. Moreover, tax systems suffer from a low level of escalation, do not support equal opportunities between firms, and are very complex, making tax administration harder. The multiplicity of tax exemptions and tax rates often limits justice in the management of these systems. The concentration of taxes on personal income and trade taxes reduces their ability to redistribute income, while wealth taxes, such as property taxes, only play a limited role in mobilizing the financial resources of these countries. Furthermore, tax burdens are not proportionately distributed to all economic activities and all segments of society, including men and women, due to the absence of necessary methods during policy development, such as gender responsive budgeting. This compounds the imbalance in gender justice.

Tax revenues in these countries reached an average of 13% of the Gross Domestic Product (GDP) in 2013-2016; the highest percentage was in Palestine, where it reached 23%, and the lowest was in Egypt with 11%. In Jordan and Lebanon, the figure was about 15%, which is below the average of 17% in emerging market countries and other developing countries. This indicates a breach of the basis of tax efficiency, and that the effort and tax burden are less than the latent or possible tax potential of the economies of these countries. These revenues have fluctuated around that level since 1990, while a clear upward trend has taken place in emerging market countries and other developing countries. Arab countries are similar in terms of the contribution of tax revenues to the financing of the budget's total public expenditures, reaching about 70%. The contribution of other non-tax revenues, either from public investments, natural resources or services fees, does not exceed 5% in Jordan and Palestine, and amounts to about 8% in Egypt and Lebanon. The rest of the public expenditure (budget deficit) is financed either through foreign aid or domestic and external borrowing (public debt). This explains the increasing size of public debt accumulated on these countries and the rising cost of its service over the years. In fact, as a result of lower revenues and increased spending, the budget deficit in most Arab countries increased. Thus, the total outstanding public debt (both domestic and external) increased in all Arab countries by about 14.2% in 2014, equivalent to $ 590.6 billion in comparison with $ 516.8 billion in 2012. Thus, the public debt as a percentage of GDP increased from 48% in 2012 to 52.2% in 2014. The increase in the size of public debt and the cost of its service in most Arab countries is one of the most important challenges that prevent us from achieving an acceptable level of sustainable development and justice. In some Arab countries, such as Jordan, Egypt and Mauritania, the public debt is close to 90% of the GDP, while it has exceeded recently 130% in Lebanon, making these countries fall in the so-called "Debt Trap".

Tax systems in our Arab region suffer from the following:

- **Dominance of indirect taxes over revenues:** Taxes on domestic trade of goods and services consisting of value added tax, excise taxes and purchase taxes represent the largest sources of tax revenues, averaging about 65% of these revenues, in line with the average of emerging market countries and developing countries. For Lebanon, unlike many countries, VAT is levied at a uniform rate of 10 percent imposed on the consumer, with exceptions including but not limited to basic foodstuff and education, as well as some luxuries since its adoption in 2002. In Palestine, the proportion of this unified tax on all goods and services without exception is 16%. In Egypt, a new VAT law was issued in September 2016 by the first elected Parliament after June 30, 2013, which raised the general tax rate from 10% to 13% and to 14% in 2017-2018. In Jordan, sales tax is applied uniformly to all goods.

- **Procurement and excise taxes are poorly designed and do not seek justice and provide limited revenues.**
- **Taxes on international trade have an uneven tariff structure:** Due to trade liberalization and the accession of most Arab countries to the World Trade Organization, the rate of customs duties in total tax revenues has fallen sharply and gradually in the past two decades. Trade liberalization has resulted in low tariff levels, declining prices of imported production inputs, expansion of export markets and increased exemptions. This constitutes an unequal basis for competition among companies in the region and weakens the effectiveness of international trade agreements. The average customs revenues of these countries from the domestic product are less than 2% and less than 8% of tax revenues.
- **The average contribution of corporate and individual income taxes is about one-third of the tax revenues in the countries under study:** The bulk of income taxes come from waged individuals (from the source) and not from companies. The largest contribution to income taxes is in Egypt, where it reaches about half, quarter in Lebanon, and about 15% in Jordan, and much less in Palestine with only 8%.
- **The revenues of personal income taxes are lower than those in emerging market countries and developing countries, and are often not very progressive:** The highest personal income tax rate in all four countries is lower than the average of emerging market countries and developing countries. In addition to the low level of the highest tax rates, the excessively high marginal tax income levels for the upper segments result in the exclusion of a large proportion of affluent households. For example, the minimum taxable income per year in Lebanon and Egypt is much lower than the average wage and the national poverty line, and is closer to them in Palestine, but much higher in Jordan. On the other hand, the tax base in Arab countries does not include capital profits and dividends, interest rates and real estate deals, which benefit the rich disproportionally. The region suffers from low tax compliance, in part due to the big size of the informal economy, the spread of cash payments for a part of the salaries, and weak technical and institutional capacities.
- **The tax base is not comprehensive** because an important part of the taxpayers who practice free professions remain outside the framework of tax follow-up and prosecution.
- **Corporate income taxes are applied at relatively moderate rates, but suffer from multiple tax rates and wide tax expenditures:** Over the past two decades, corporate income tax rates have fallen in all four countries. Today, the corporate income tax rate reaches in most sectors a maximum of 35% in Jordan, 25% in Egypt, and 15% in Lebanon and Palestine.
- These companies enjoy large tax exemptions and for many years, according to the laws encouraging investment, in addition to large deductions from their income to their expenses. These companies have a greater ability to manage their tax files than individuals due to their strong connections with political power circles, thus promoting tax evasion and avoidance.
- **Property taxes play currently a limited role in the four countries:** These taxes are applied in Palestine, Lebanon and Jordan, but not in Egypt; in all cases, their revenues are much lower than the average of emerging market countries and developing countries.
- **The problem of tax evasion and avoidance takes various forms** due to the absence of clear legal mechanisms, the lack of a smooth and fair tax system, the fragility of institutional and supervisory work in the absence of democracy, and the existence of laws that sometimes facilitate the process of evasion, especially those related to foreign investment.

Regarding gender tax justice, the problem begins with the stereotyping of male customs, traditions and mentality, which view men as heads of household and those who always feed their families. Women are considered housewives and personalities who are not economically independent, and their participation to political life and decision-making mechanisms is weakened. In general, the participation of women to the economic life is weakened; the participation rate to the labor force of Arab women is not more than 23% and women suffer from significant discrimination in the labor market. While this is the basis for weakening the status of Arab women in this field, women are also more affected by the phenomena of tax evasion and avoidance, the collection imbalance resulting from administrative corruption and the absence of modern techniques and methods. Women are the greatest beneficiaries of public services and are most likely to benefit children. But women are victims of unpaid labor (mostly at home) that is not taken into consideration even when calculating productivity rates. Arab working women are largely part of the informal and intermittent labor, especially in small and medium-sized enterprises that charge high costs for little profit. This harms women's access to adequate and decent social protection. Also, women are more affected by weak taxation and absurd and ill-considered forms of indirect taxes; and this is also because they tend more to spend on basic commodities, while Arab countries adopt for instance arbitrary tax increases to serve the public debt. All this, coupled with the inability of women to control their property and the impact of social injustice on gender inequalities, illustrates the "implicit discrimination" against women in tax systems, which is aggravated by the blatantly discriminatory laws and decisions.

Accordingly, we recall some facts and figures that reflect this reality, which primarily highlight the lack of gender responsive budgeting and of the different policies by responding to different or dissimilar needs of males and females, although this is an important tool to reduce gender inequality as it is the case in almost all Arab countries (as well as for other vulnerable and marginalized groups):

- In Lebanon, women's participation in the labor market is 27% compared to 73% for men (unpaid domestic care labor plays a role) and their participation to informal labor is 57%. The gender wage gap exceeds 27% and the unemployment rate among women is 18%. Lebanon suffers greatly from the phenomenon of "pink taxes" and arbitrary indirect taxes to mobilize resources and serve the debt. On the other hand, article 31 of the 1959 Tax Law states that a married man is entitled to tax deductions for his dependent wife and no more than five children, whereas a married woman can do so only if she can prove that she is the head of the household. Also, articles 625-622 of the Trade Law impose restrictions on the wife's property in the event of her husband's bankruptcy, but the reverse is incorrect.
- In Egypt, the debt ratio of GDP is 93.8%. The IMF's $ 12 billion loan to Egypt was accompanied by a significant increase in taxes on vital commodities (rice, sugar, etc.). On the other hand, women's participation to the labor force increased from 4.2 million in 2001 to 6.5 million in 2013 (more than 50%) to reach approximately 23.4%. Unemployment among women remained at 24.3% compared to 9.7% for men. The percentage of women entrepreneurs is 1.6% compared to 13.7% for men. More importantly, income tax revenues fell from 158 to 15 billion pounds, while indirect taxes increased from 184 to 199.5 billion pounds between 2015 and 2016. By the end of 2015, tax evasion was estimated at 60 billion pounds annually. In addition, 95% of Egyptian women in rural areas do not receive their inheritance and are often paid a small sum instead.
- In Jordan, the tax burden is estimated at about 25% of GDP while income tax revenues do not exceed 4% of GDP due to high tax evasion.

Recommendations:

A. Tax justice:

- Tax policy requires restructuring that guarantees more focus on consolidating direct tax revenues (income and wealth) rather than indirect taxes (consumption taxes).
- It is important to increase the number of tax brackets to ensure better social equity. A progressive tax on income must be adopted.
- Tax incentives must be redesigned to target not only large investments, but also small and medium-sized enterprises, which account for more than 95% of business in these countries.
- The tax burden must be reconsidered so as to contribute to social justice. This requires a review of the current tax base to include non-traditional activities and non-productive and non-value-adding activities that generate large and rapid profits, such as real estate transactions and speculations in financial markets. At the same time, it is important to increase exemptions for low-income people, individuals and businesses engaged in productive

activities, located in vulnerable rural areas. Further tax exemptions for higher value added activities and those that create new jobs are expected. Control methods must be applied to ensure that companies pay the actual taxes due on their income and reduce their tax evasion phenomena.

- Grant full tax exemptions for agricultural income and pensions.
- Reconsider the VAT to be based on the distinction between luxury and basic goods.
- Implement strict rules to combat all forms of corruption and tax evasion in tax districts; ensure transparency and define clear and decisive instructions regarding the assessment of fair and taxable income by tax officials. The horizontal rather than vertical expansion of tax collection should also be increased, so that the collected tax revenues are increased, but by expanding the tax base so as not to increase the tax burden on the committed taxpayers.
- Expand community participation and give preference to the language of dialogue and discussion with the social groups affected by the Tax Law, and enhance the role of the civil society by broadening the concept of community accountability and its applications.

B. Gender justice:

- Remove any clear prejudices against women in tax laws in these countries, review the tax laws in favor of a more equitable system based on direct taxation rather than the current model, and apply gender-specific tax incentives and exemptions.
- Call for gender-detailed data on taxpayers and informal workers as an important step towards tax policies that can promote more equitable gender relations.
- Implement indirect taxation policies that are gender sensitive by abolishing taxes on goods and services that are primarily consumed by women or of primary importance to them. Thus, pressure must be made for a preferential tax treatment for those goods and services, which would significantly promote gender equality and social welfare in fields such as reproductive health.
- Gender tax justice should be applied in the framework of gender social justice in public policies, in order to eliminate discrimination between women and men in the economy as a whole.

The Arab NGO Network for Development works in 12 Arab countries, with 9 national networks (with an extended membership of 250 CSOs from different backgrounds) and 23 NGO members.

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