

IMF STAFF DISCUSSION NOTE

# Fair Taxation in the Middle East and North Africa

Andrew Jewell, Mario Mansour,  
Pritha Mitra, and Carlo Sdravovich

**DISCLAIMER:** Staff Discussion Notes (SDNs) showcase policy-related analysis and research being developed by IMF staff members and are published to elicit comments and to encourage debate. The views expressed in Staff Discussion Notes are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

# IMF STAFF DISCUSSION NOTE

## Fair Taxation in the Middle East and North Africa

Andrew Jewell, Mario Mansour,  
Pritha Mitra, and Carlo Sdrilevich

**DISCLAIMER:** Staff Discussion Notes (SDNs) showcase policy-related analysis and research being developed by IMF staff members and are published to elicit comments and to encourage debate. The views expressed in Staff Discussion Notes are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

## INTERNATIONAL MONETARY FUND

Middle East and Central Asia Department

**Fair Taxation in the Middle East and Northern Africa**Prepared by Andrew Jewell, Mario Mansour, Pritha Mitra, and Carlo Sdrlevich<sup>1</sup>

Authorized for distribution by Masood Ahmed and Vitor Gaspar

**DISCLAIMER: Staff Discussion Notes (SDNs) showcase policy-related analysis and research being developed by IMF staff members and are published to elicit comments and to encourage debate. The views expressed in Staff Discussion Notes are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.**

JEL Classification Numbers: D63, E62, F59, H20, H22, H24, H25, H26

Keywords: Tax Revenues, Resource Revenues, Income Tax, Excise,  
Value-Added Tax, EquityAuthors' E-mail Addresses: [ajewell@imf.org](mailto:ajewell@imf.org), [mmansour@imf.org](mailto:mmansour@imf.org), [pmitra@imf.org](mailto:pmitra@imf.org),  
[csdrlevich@imf.org](mailto:csdrlevich@imf.org)

---

<sup>1</sup> The staff team was led by Pritha Mitra and supervised by Carlo Sdrlevich under the general guidance of Daniela Gressani and Michael Keen. Mark Fischer provided excellent research and Cecilia Prado de Guzman and Esther George helped greatly with editorial assistance. Kadima Kalonji prepared the box on Morocco's tax reform, and Lorraine Ocampos drafted the box on Tunisia's on- and off-shore tax systems. The paper incorporates helpful suggestions from Masood Ahmed, Annalisa Fedelino, Lorenzo Forni, Minsuk Kim, Adnan Mazarei, Eric Mottu, Manuel Rosales, Chad Steinberg, Zeine Zeidane, and Younes Zouhar. The authors also would like to thank MENA Finance Ministers, Central Bank Governors, and Executive Directors at the IMF for their comments on an earlier version of this paper.

# CONTENTS

<b>EXECUTIVE SUMMARY</b>	<b>4</b>
<b>THE NEED FOR FAIR TAXATION</b>	<b>7</b>
<b>CURRENT STATE OF TAX SYSTEMS</b>	<b>12</b>
A. Well-Established Non-Hydrocarbon Based Tax Systems	12
B. Hydrocarbon-Based Revenue Systems	18
<b>RECOMMENDATIONS FOR FAIRER TAXATION</b>	<b>20</b>
A. Well-Established Non-Hydrocarbon Based Tax Systems	20
B. Hydrocarbon-Based Revenue Systems	25
<b>ADDRESSING RESISTANCE TO REFORM</b>	<b>27</b>
<b>References</b>	<b>30</b>
<b>FIGURE</b>	
MENA: Income and Equity Indicators	8
<b>TABLE</b>	
Distributional Impact of VAT Tax Expenditures in Morocco and Tunisia	16
<b>APPENDICES</b>	
1. Tax Revenue by Category, Latest Available	34
2. MENA: VAT Main Exemptions under Current Laws	35
3. Middle East and North Africa: Personal Income Tax Brackets	36

## EXECUTIVE SUMMARY

### **Taxation and fairness**

Greater equality and fairness—and what governments can do to achieve them—are at the forefront of the economic and social debate all over the world. In the Middle East and North Africa (MENA), these themes assume particular significance in light of the strong demands for more equitable access to socioeconomic opportunities, which has been at the core of recent political transitions, but has not yet been fully addressed.

A more equitable society cannot be achieved by economic policy alone. But a well-designed fiscal policy is indispensable. Revenues, whether from taxes or natural resources, can be used to support growth and improve the distribution of wealth and well-being through spending, for example, on infrastructure, healthcare, and education. Taxes—a critical interface between the state and its citizens—can also play an important role, including in countries that rely primarily on commodity revenues.

This paper explores how tax systems can be improved to meet demands for more economic fairness in MENA countries. In recent years, IMF policy advice has focused on spending reforms—for example, how reforming energy subsidies can generate resources for pro-poor expenditures. But tax policy can play an important role in creating fairness, by determining how the tax burden is distributed, how much tax revenue is raised, and how taxation is implemented in practice. The analyses and recommendations in this paper are tailored to two distinct groups of countries: those with well-established non-hydrocarbon-based tax systems (mostly oil importers), and those with primarily hydrocarbon-based revenue systems (mostly oil exporters).

### **Underperforming and not very fair tax systems**

MENA countries with well-established tax systems have diversified sources of tax revenues, but lower levels of tax revenues compared to other emerging market and developing economies (EMDCs). Moreover, MENA tax revenues have been stable for the past two decades, whereas EMDC tax revenues have been on a strong rising trend.

There is also significant room to improve the fairness of tax systems. Personal income taxes in MENA often lack progressivity due to low top tier rates that often apply at relatively high income levels and exclusion of non-wage earnings. Corporate income taxes have relatively competitive rates, but suffer from widespread exemptions, often provided in non-transparent ways and with a high degree of discretion. Value-added taxes are also hampered by multiple rates and exemptions, which, in addition to reducing revenue efficiency, are generally poorly targeted. Excise taxes are often poorly designed and yield limited revenues. Tax administration is inefficient and exercises significant discretion in many countries, which leads to unfair treatment of citizens and businesses.

In MENA oil-exporting countries that depend primarily on hydrocarbon revenues, the dominance of these revenues has stifled the emergence of alternative tax instruments. Personal income taxes are rare and, where present, are applied only to foreigners. Value-added taxes do not exist for the most part. Corporate income taxes—generally only applied to foreign companies—and trade taxes account for the bulk of tax revenues. The need to develop tax systems that support the diversification of these economies provides an opportunity to design them with emphasis on fairness, simplicity, and efficiency.

### **How to make MENA taxation fairer**

*MENA countries with well-established non-hydrocarbon-based tax systems* should seek to broaden the tax base, eliminate privileged corporate income tax regimes, increase the progressivity of their tax systems (particularly personal income taxes), and strengthen administration. Eliminating exemptions will be key to improving fairness and will facilitate compliance and administration, bringing many informal activities into the open. Reform options include:

- Consolidating multiple VAT rates and rationalizing exemptions to improve targeting and reduce their cost to budgets.
- Eliminating corporate income tax exemptions and simplifying the rate structure to level the playing field for businesses and reduce collection costs.
- Raising the top marginal personal income tax rate (with lower income thresholds), setting three to four rates, and including non-wage earnings (for example, professional and capital income) in taxable income to improve progressivity.
- Introducing property taxes, other wealth taxes (for example, taxes on inheritances and gifts) in the long term, and excises on certain luxury goods, especially in the absence of an effective personal income tax to improve progressivity.
- Improving tax and customs administration with the introduction of “customer service,” simplified codes and regulations, and improved human and IT resources to simplify compliance for taxpayers and reduce arbitrary treatment.

*Oil-exporting countries that depend primarily on hydrocarbon revenues* should leverage the space provided by these revenues to design simple, fair tax systems and the capacity to administer them in ways that can be scaled up over time to introduce a full-fledged range of instruments. Revenues from oil production can be a particularly efficient and politically acceptable form of taxation. But a healthy non-oil tax system also has a critical role to play in securing resilience of the revenue base (to both oil price movements and, in some cases, expected declines in production), fostering accountability relationships between state and citizen, and providing tools to pursue wider efficiency, fairness and macroeconomic objectives. Priorities include:

- Introducing a low-rate VAT and CIT, preferably to be applied to all companies.



- Setting up property taxes and excises, or improving existing ones.
- Formulating plans for the introduction of personal income taxes.

### **Overcoming resistance to reform**

In addition to designing tax systems that are more fair and efficient, policymakers will need to tackle domestic resistance to reforms. This stems from vested interests, lack of broad-based support, and entrenched tax administrations with limited appetite for change. To advance tax fairness, governments can involve stakeholders in the design of the reforms, show that the revenues will be used effectively, and set an appropriate pace of the reform process. Effective communication—based on evidence—about the benefits of reform is particularly important to gather support.

## THE NEED FOR FAIR TAXATION

*Lack of fairness has been a root cause of discontent across the MENA region. Well-designed tax policy has an important role to play, alongside macroeconomic policies and structural reforms that promote growth and equitable access to socio-economic opportunities, including in countries that rely primarily on commodities revenue. Revenues, whether from taxes or natural resources, can support growth and wealth redistribution through spending on infrastructure, health and education.*

*“Fair taxation” can also help satisfy demands for greater socioeconomic equity and opportunity, as tax systems represent a critical interface between the state and its citizens. This paper reviews the current tax systems across MENA and proposes measures to make them fairer while tackling resistance to reform. Policy advice is tailored both to countries with well-established non-hydrocarbon-based tax systems (most of the region) and those that depend primarily on hydrocarbon revenues (several large oil-exporting countries).*

**Inequality is squarely at the forefront of the policy debate today.** In advanced as well as in developing economies, policymakers and the public are discussing the increase in income and wealth inequality that has been observed in many countries and the role of economic policy in addressing it (IMF 2014a). While the desired degree of income and wealth equality is ultimately a social choice made by each sovereign country, there are powerful arguments that extreme inequality is bad for the pace and quality of growth (Cingano 2014; Ostry and others 2014).

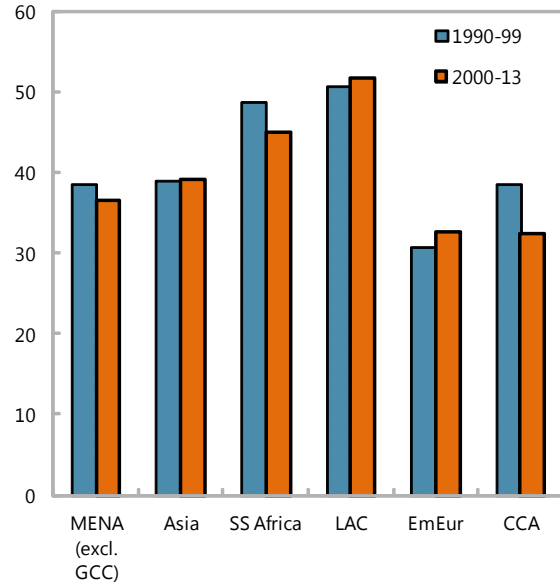
**A broader, concept of fairness is particularly relevant in the MENA region.** MENA countries are not particularly unequal in terms of income distribution compared to other regions (Figure 1). But the years following the onset of the political transitions in the Arab world revealed that several groups of citizens in many countries in the region have long felt barred from economic opportunities, harassed by corrupt officials (Pew Research Center 2014), and excluded from the benefits of the high growth of the early 2000s. This broader perception of fairness (or lack of it), is related to but more subtle than income inequality, and varies across countries and over time. It is rooted in several socio-economic aspects, including: differing living standards deriving from persistently high unemployment, especially amongst the youth; a high risk of falling into absolute poverty, concentrated in those segments of the population just above the poverty line who live on US\$2.00–2.50 per day (Figure 1); inadequate access to education and healthcare (Figure 1); lack of business opportunities and low competition in domestic markets (OECD 2011; Corak 2013; World Bank 2015; IMF 2014b); and views on how income from natural resources should be taxed when it accrues to foreigners as opposed to nationals.



**Figure 1. MENA: Income and Equity Indicators**

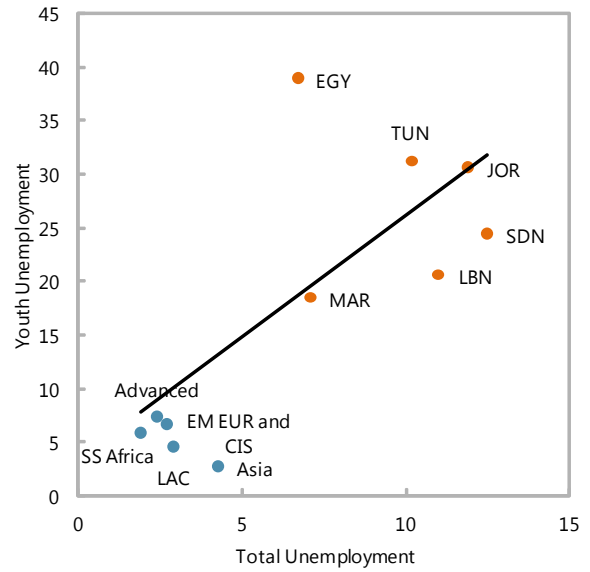
**Gini Coefficient**

(Period Average of Available Data)



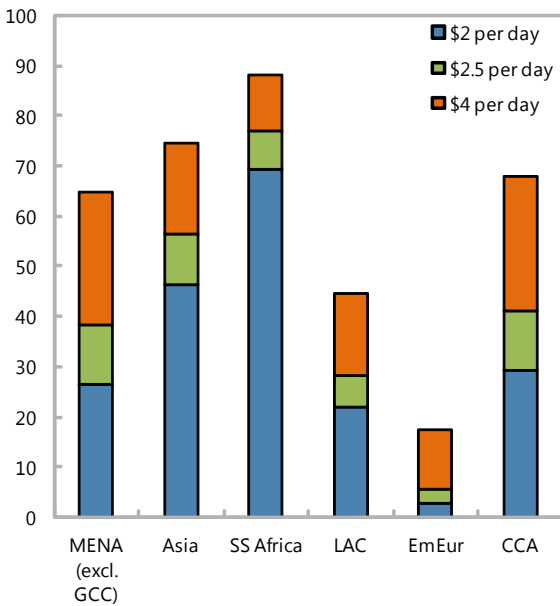
**Unemployment Rates**

(Latest Available, In Percent)



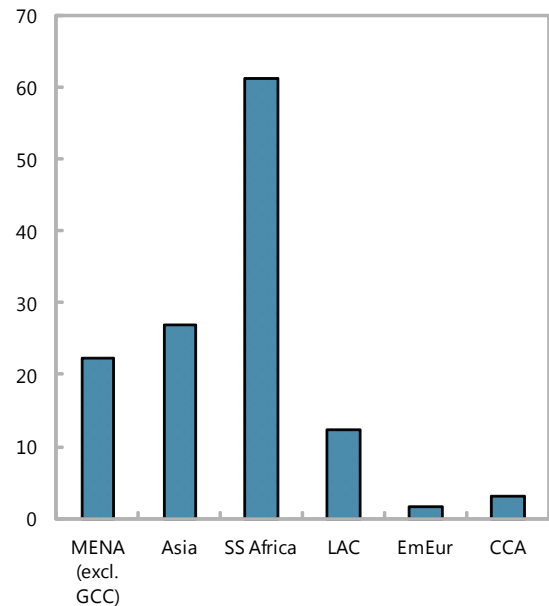
**Poverty Headcount Ratios**

(In Percent of Total Population)



**Multidimensional Poverty 1/**

(In Percent of Total Population)



Sources: World Bank; ILO; IMF; UNDP; and IMF staff calculations.

1/Defined as the share of the population deprived of access to three key welfare dimensions: education, healthcare, and standards of living. The measure is based on 10 indicators (such as access to cooking fuel, toilets, water, electricity, and assets) covering these three areas.

**Taxation plays an important role in creating fairness.** In MENA countries, policy has focused more on spending reforms in recent years, reflecting the need for more cost-effective means to support the poor and the greater potential of expenditure policies to redistribute income compared to tax policies. For instance, the IMF has promoted subsidy reform<sup>2</sup>—in the region and worldwide—coupled with a strengthening of social safety nets (IMF 2014c), which has provided important fiscal savings and improved support to poor households, thereby improving the fairness and social orientation of public expenditures. But, taxation (or lack thereof) contributes crucially to defining the relation between the citizen and the state in terms of equal treatment, burden-sharing, and economic opportunities. A discussion of taxation in MENA countries invariably raises difficult and still unresolved questions:

- ***Is the burden of taxation distributed evenly?*** MENA countries typically don't tax appropriately the return on various forms of individual savings, focusing only on labor income. Thus, employees in the formal economy (in many countries, largely public sector employees) bear the brunt of direct taxation. In addition, the distinction between insiders—associated with ruling families, the military, political groups, or business conglomerates—and outsiders is reflected in vastly uneven rates of effective taxation. In the region, the typical vehicle of discrimination is tax exemption, which often takes the form of tax exemptions provided to certain activities, such as export activities and tourism.
- ***Are most citizens paying taxes?*** Data on how many people pay taxes in MENA are scarce. However, available evidence does show that, for MENA countries in which tax systems are well-developed (mostly oil importers), withheld income taxes on wages occupy a very high share of total personal income taxes collected, suggesting that taxes paid by self-employed (for example, liberal professions) and taxes on non-wage income are very low. Low-wage earners would not be expected to pay much income tax in most countries given the existence of a minimum exempt income.
- ***Is the implementation of taxation fair?*** Even well-designed systems can be implemented unfairly. For example, Egyptian firms that have political connections have about a 15 percent probability of receiving exclusive benefits such as exemptions from corporate taxes or customs duties (World Bank 2015). An uneven implementation of the rules is related to perceptions of corruption (Box 1).

---

<sup>2</sup> Pre-tax energy subsidies (including on petroleum, natural gas, and electricity) were 0.7 percent of global GDP in 2011 and 2013 (Coady and others, 2015). A gradual reform strategy involves first raising consumer prices to cover supply costs and then incorporating an efficient tax level.

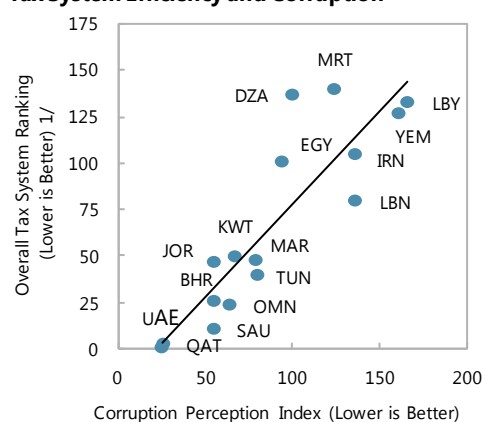
### Box 1. Corruption and (Un)fair Taxation

**Corruption in revenue administration, initiated by either taxpayers or tax collectors, is common in many countries.** Taxpayers may under-report their income, offer bribes to alter their tax liability, or avoid registration. On the other hand, tax collectors may use the threat of over-assessment to extort taxpayers. Companies can pay off senior officials to obtain exempt status.<sup>2</sup> No matter its form or prevalence, corruption undermines the respect for the tax system and ultimately weakens compliance and lowers revenue collection.

**Corruption also contributes to perceptions of unfairness in the tax system,** for two main reasons:

- A system that allows for discretionary (and therefore uneven) application of the rules cannot, by definition, be fair across taxpayers.
- Corruption in tax collection may well be regressive in its effect.<sup>1</sup> The upper-income segments have most to gain from understating or evading taxes and are least exposed to extortion (it is harder to credibly over-report their incomes and they typically enjoy positions of influence and power). At the other end of the spectrum, the poorest segments have fewer opportunities to evade taxes and their incomes can be more easily over-reported, thus exposing them to possible extortion by tax collectors.

**Tax System Efficiency and Corruption**



Sources: World Bank; World Economic Forum; Transparency International; and IMF staff calculations.  
1/ Equal weighted ranking of the burden of customs procedures for businesses, the number of tax payments per year, and the time spent on taxes per year.

**Finally, burdensome revenue administration appears strongly correlated with perceptions of corruption.** This relationship appears to hold for MENA countries, suggesting that increased transparency and simplification of procedures may go a long way in addressing perceptions of corruption and, ultimately, contribute to the application of a more fair tax system (and boost revenue collection as compliance is strengthened).

<sup>1</sup> Hindriks, Keen, and Muthoo (1999)

<sup>2</sup> The World Bank (2009) finds that officials are often perceived as being partial in changing or applying the law, for the benefit of a few firms, families, and institutions.

- **Could tax systems be more progressive?** Even abstracting from the distortionary effect of widespread exemptions, many systems in MENA have only limited progressivity. For example,

tax revenues rely largely on indirect taxation<sup>3</sup> compared to direct taxation, and property taxes are often absent.

- **Should tax revenues be higher, and would this be consistent with fairness?** MENA tax revenues do not fare well compared to other EMDCs, pointing to a potential for increase. Higher revenues would create fiscal space and allow for more spending on well-targeted social protection for the poor and infrastructure, healthcare, and education. The alternative is to continue with deficit financing, which not only imposes a burden on future generations, but also benefits the holders of government debt—typically a privileged few. Improving revenues is particularly critical to financing the increases in spending to meet social demands and support the economy following the global financial crisis and the onset of political transitions in the Arab world.

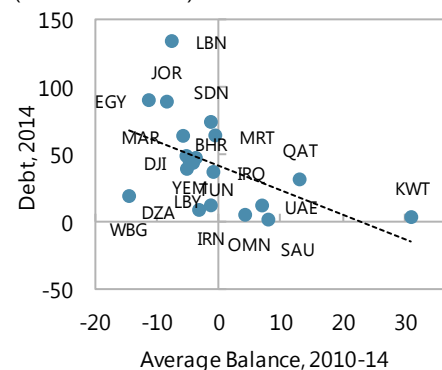
**This paper tries to address these questions and suggests measures to make tax systems in the region fairer.** Given the vast differences in the state of tax systems in the region, the paper distinguishes between two broad groups of countries:

- *Countries with well-established non-hydrocarbon-based tax systems.* Across most of MENA, both in oil importers and some oil exporters, tax systems are relatively developed, but reforms can make them fairer (and more efficient).
- *Countries with hydrocarbon-based revenues.* In the Gulf Cooperation Council (GCC), Iraq, Libya, and Sudan, public finances have long relied on natural resource revenues (not examined in this paper), and governments decided not to build up their non-hydrocarbon revenue systems. In these countries, the need to develop non-hydrocarbon tax systems—where feasible given the security situation—creates the opportunity to orient them toward principles of fair taxation.

### Fairness is but one aspect of good tax systems.

Efforts toward tax fairness should be consistent with a broader vision of the fiscal role of the state, encompassing both revenue and expenditure roles. Further, reforms to achieve fairness should not overlook the complexity of setting the level and structure of taxation appropriate for each country, an exercise that depends on individual countries'

**Fiscal Balance and Debt**  
(In Percent of GDP)



Sources: National authorities; and IMF staff calculations.

<sup>3</sup> The regressivity of indirect taxes can be overstated given that many countries in the region apply reduced VAT rates to necessities, for instance. However, that is a very expensive way of protecting the poorest (Ebrill and others 2001).

economic and social contexts and macroeconomic conditions.

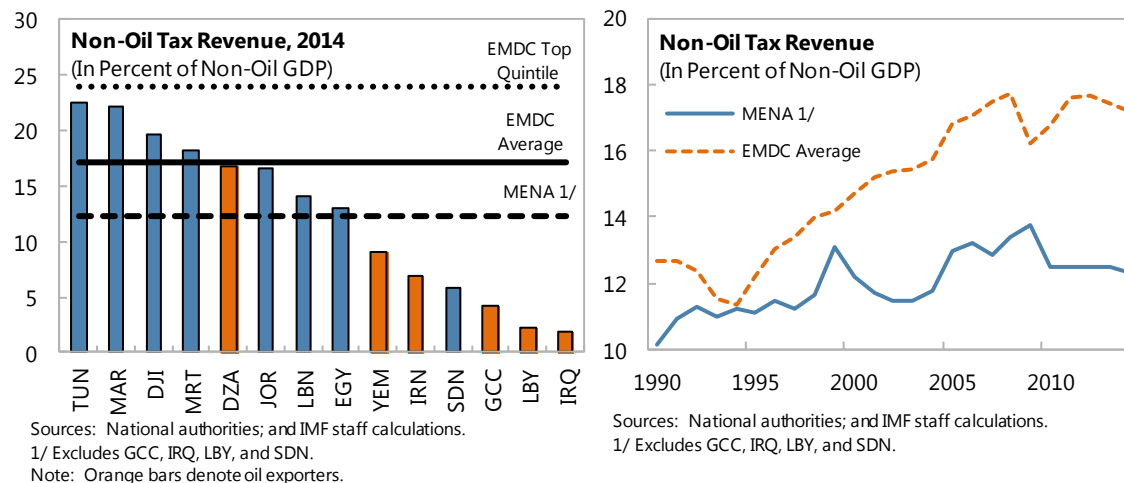
**This may be the right time to press ahead with fair taxation reform.** For oil importers, the impact of the global financial crisis and the consequences of the onset of political transitions in the Arab world are bringing about a rethinking of tax systems—in the context of ensuring fiscal adjustment to reduce the burden of large fiscal deficits and public debts. For oil exporters, the oil price decline may create new pressures—and associated political demands—to mobilize non-hydrocarbon revenues. In fact, the likelihood of successful tax reforms increases during crisis periods, as Latin America experienced in the 1990s with regard to inflation episodes (Mahon 2004).

**But, reforms will face challenges.** While the current environment may provide impetus for reform, there will still be resistance. The most powerful obstacles to reform come from political economy factors, such as distrust of the state (which leads to tax evasion); long-standing vested interests; poor administrative capacity; and weak, fragmented political systems. In some countries in the region, political tensions and conflict can make reform particularly challenging, if not impossible, at the current juncture. Nonetheless, the principles and policy recommendations in this paper can help guide reform once conditions allow.

## CURRENT STATE OF TAX SYSTEMS

### A. Well-Established Non-Hydrocarbon-Based Tax Systems

*The majority of MENA tax systems feature stable and diverse sources of revenues, but the levels are lower than in emerging market and developing economies. Further, tax systems suffer from low progressivity, do not support a level playing field for businesses, and are overly complex, making tax administration more difficult. Multiple tax exemptions and rates often reduce equity in the administration of VAT (the main revenue source in many countries), corporate income taxes, and international trade taxes. The design of personal income taxes and excises often inhibits their ability to redistribute income while wealth taxes, such as property taxes, play only a small role.*



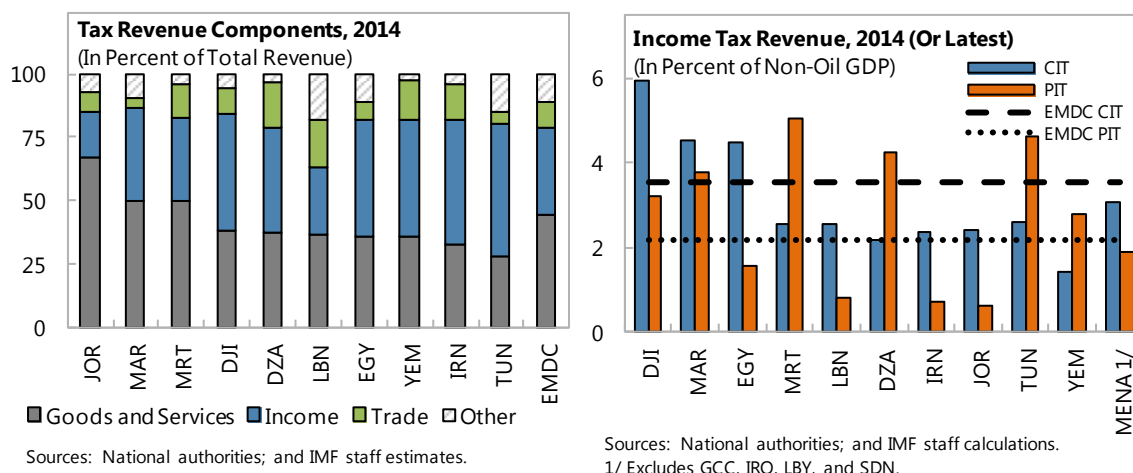
**For MENA countries with well-established non-hydrocarbon based tax systems, tax revenues have been stable and diversified over the past two decades.** Notably, some of these countries, for example Egypt, also have hydrocarbon revenues.

- The region's tax revenues, at about 13 percent of non-oil GDP, are lower than the average of 17 percent in other EMDCs.<sup>4</sup> Further, they have fluctuated around that level since 1990 while they have been on a clear rising trend in other EMDCs.
- In most of the region, domestic taxes on goods and services, consisting of VAT and excises, are the broadest sources of tax revenues, accounting for about a third of tax revenues—in line with the EMDC average. VAT revenues generate from as low as 1.8 percent of non-oil GDP in Iran to as much as 11.1 percent in Jordan, the largest yield in the region (Appendix 1).
- Similar to EMDCs, taxes on personal and corporate income are about a third of tax revenues in most of the region.
- The remainder of tax revenues mostly comes from trade taxes.<sup>5</sup>

<sup>4</sup> Regional and EMDC averages are weighted by GDP measured in purchasing-power-parity (PPP) terms.

<sup>5</sup> In some cases, revenues that are essentially taxes are classified as non-tax revenues such as recurrent property fees.





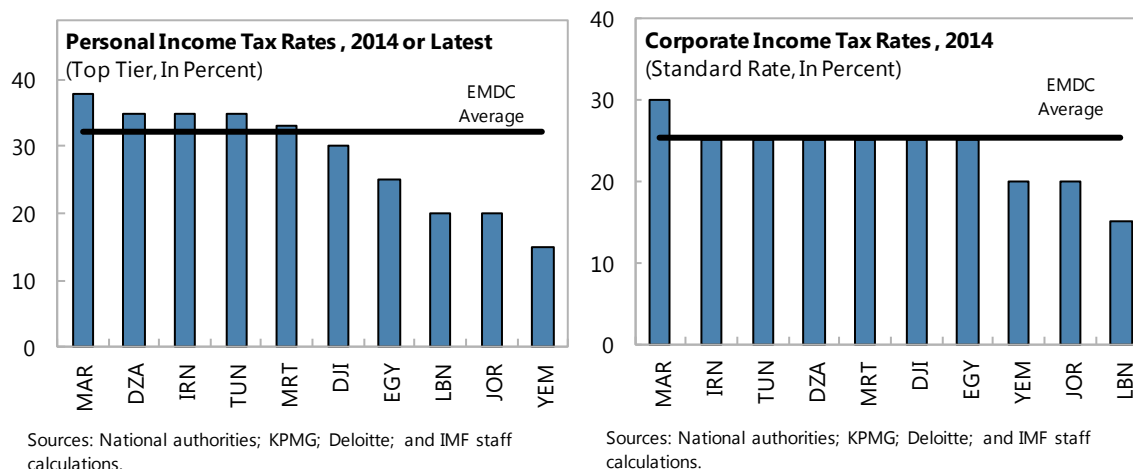
### Income Taxes

#### Personal income taxes (PIT) yield less than those in EMDCs and often are not very progressive:

- *The top PIT rate* in Djibouti, Egypt, Jordan, Lebanon, and Yemen is below the EMDC average top rate. Besides low top rates, excessively high income thresholds for the highest brackets exclude a large portion of well-off households (text table and Appendix 3). Egypt's highest income tax bracket with a rate of 25 percent is only paid by those earning at least 10 times the per capita income. Similarly, Jordan's newly adopted income tax law has added a third bracket at 20 percent that targets those who make seven times the per capita income.
- *The tax base* frequently excludes non-wage income, such as capital earnings, which disproportionately benefit the rich.<sup>6</sup> Capital controls in place in several of the region's countries limit (albeit imperfectly) capital outflows, and can in principle make taxing capital at progressive rates easier. Morocco's recent tax reform has included certain types of non-wage income in the personal income tax base, and Tunisia reintroduced dividend taxation in 2014.

<sup>6</sup> In the region, bank secrecy laws often prevent tax authorities from obtaining information about capital earnings.

- *Compliance* is low, partly due to a large informal economy and widespread cash payments of portion of salaries. Capacity constraints hinder income verification, and pervasive and complex deductions facilitate tax avoidance. Presumptive and minimum tax regimes can also facilitate evasion, if not rigorously applied.



**Corporate income taxes (CIT) are applied at relatively moderate rates, but suffer from multiple rates and extensive tax expenditures.** Over the past two decades standard CIT rates have declined across the region (Mansour 2015) and are now comparable to CIT rates in EMDCs. While the decline may have improved competitiveness and expanded the tax base,<sup>7</sup> industries are taxed at varying rates and benefit from many exemptions.<sup>8</sup> In Tunisia, CIT rates on telecommunications are 35 percent, instead of the standard 25 percent. Exemptions and multiple tax rates (even though sometimes appropriate as second-best measures to capture sector-specific rents)<sup>9</sup> generally make the tax difficult to administer, create tax avoidance opportunities, and damage the business environment by increasing complexity. In many countries, off-shore regimes (as in Tunisia) or free-trade zones (Djibouti and Egypt) offer tax holidays and exemptions, and streamlined tax systems—but often favor insiders and over-burden taxpayers in the on-shore sector. Large gaps between the highest rates for CIT and PIT also distort the choice of incorporation.

<sup>7</sup> De Mooij and Ederveen (2008) find that a 1 percentage point decrease in the CIT rate expands the CIT base by 3.1 percent. Additional reductions in the top rates could improve competitiveness further.

<sup>8</sup> Dividends and capital gains taxes, not discussed in this paper, also play a role in companies' incorporation decisions.

<sup>9</sup> Rents in telecommunications, for instance, might be best taxed by auctioning spectrum rights.

**Domestic Taxes on Goods and Services**

**Most countries with well-established tax systems have introduced VAT.** While VAT accounts for a large share of tax revenue, as noted above, its design and implementation suffer from a number of shortcomings.

- **Tax expenditures (for example, tax exemptions, special rates and thresholds, etc.) worsen the already limited progressivity of the VAT and hamper efficiency and administration.** The VAT can be easy to administer, transparent, and relatively non-distortionary, but its burden is likely to fall on end-consumers, and may result in a larger percentage of income from poorer households going toward the VAT than from richer households (O'Donoaghue, Baldini, and Mantovani, 2004; Cnossen 2005).<sup>10</sup> Multiple rates, tax exemptions,<sup>11</sup> and low registration thresholds (particularly in Egypt,<sup>12</sup> Morocco, and Tunisia) may amplify this effect by producing large variations of the effective tax rate. Tax expenditures, even when designed to help the poor, end up benefitting mostly the rich: in Morocco and Tunisia, the top quintile of the income distribution reaps nearly 40 percent of VAT tax expenditures compared to less than 10 percent for the bottom quintile (Table 1).<sup>13</sup> Tax expenditures also lead to an uneven treatment of businesses, raise costs of administration (especially given capacity constraints), reduce transparency, and create tax avoidance opportunities.

Top-Tier Income Tax Rates			
	Non-Oil Corporate	Personal	Difference
Yemen	50	15	35
Jordan	35	20	15
Egypt	25	25	0
Tunisia	35	35	0
Morocco	37	38	-1
Djibouti	25	30	-5
Lebanon	15	20	-5
Mauritania	25	33	-8
Iran	25	35	-10
Algeria	23	35	-12

Sources: National authorities; KPMG; Deloitte; and IMF staff calculations.

**Table 1. Distributional Impact of VAT Tax Expenditures in Morocco and Tunisia**

	Poor	Q1	Q2	Q3	Q4	Q5	Total
Morocco	5.2	9.3	12.0	15.0	19.7	38.8	100.0
Tunisia	N/A	7.9	12.7	17.0	23.2	39.2	100.0

Sources: Fouzi Mourji (2011) for Morocco; and calculations for Tunisia based on 2010 household survey data from the Institut National de la Statistique. Estimates for both countries assume no behavioral responses to removing reduced rates or exemptions.

<sup>10</sup> In cases where countries rely largely on less redistributive or more regressive taxes (for example, indirect and trade taxes), spending measures can be designed to enhance progressivity of the fiscal system.

<sup>11</sup> Appendix 2 provides a list of exemptions. While reduced rates benefit the poor, they benefit the wealthy even more in absolute terms.

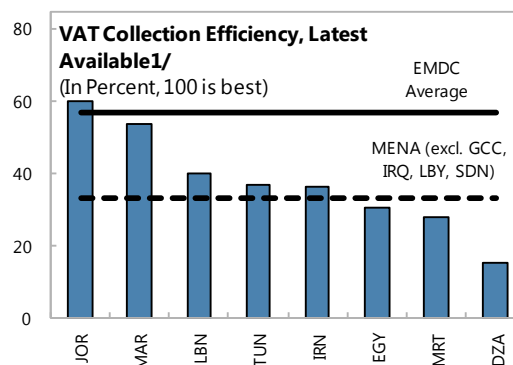
<sup>12</sup> This refers to the General Sales Tax in Egypt, where there is currently no VAT.

<sup>13</sup> Reduced rates and exemptions are so ineffective in targeting support for the poor that the impact of eliminating them can be pro-poor (Keen 2014).

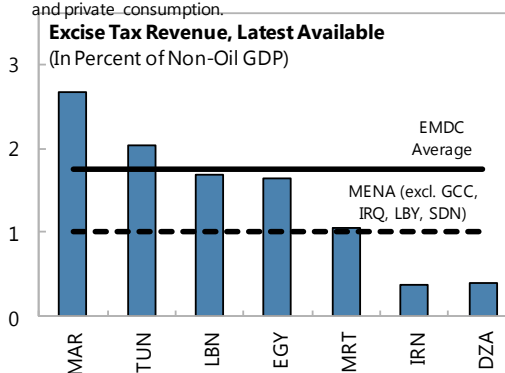
- Reflecting the above factors, in most MENA countries the VAT collection efficiency (C-efficiency)—comparing actual VAT yields to potential yields from the benchmark of a perfectly administered VAT levied at a uniform rate on all consumption—is below the EMDC average. The tax effort, measured as actual tax collection in percent of potential tax revenues (estimated based on actual revenues of comparator countries) is under 50 percent for Algeria and Iran (Fenochietto and Pessino, 2013; IMF 2014d; IMF 2013).

**Poorly designed excises do not currently target equity and provide limited revenues.**

Generating lower tax revenues than in EMDCs, the region’s excises do not particularly target goods and services consumed by high-income households. In Lebanon, while heavy excises on imported alcohol are aimed at taxing the wealthy, alcohol consumption (especially for beer and wine) has shifted to little-taxed domestic brands.



Sources: National authorities; and IMF staff calculations.  
1/ Calculated as VAT revenue divided by the product of VAT rates and private consumption.

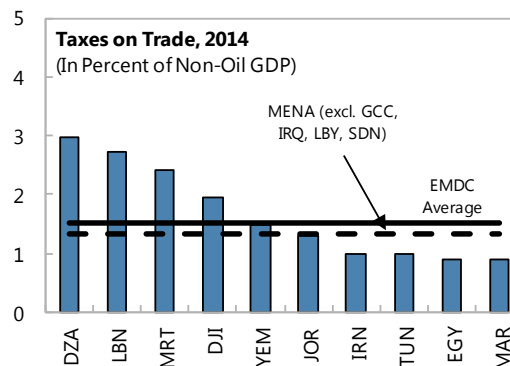


Sources: National authorities; and IMF staff calculations.

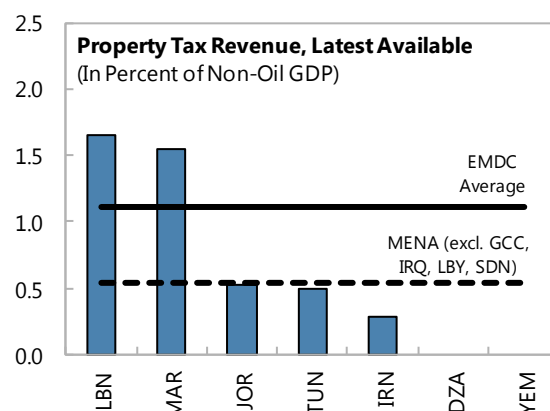
## Other Taxes

**International trade taxes have an uneven tariff structure.** Trade liberalization has reduced tariff levels, made imported production inputs cheaper, and broadened export markets. However, multiple tariffs and sometimes high most-favored-nation rates (the lowest rate charged to favored trading partners), exemptions, and other tariff preferences create an uneven playing field for the region's businesses, erode the effectiveness of international trade agreements, and constrain yields (mostly derived from imports).

**Property taxes currently play a small role in the region.** They only exist in a handful of countries and yield revenues typically far below the EMDC average. While property taxes remain largely underutilized globally (OECD 2011), they nonetheless offer great potential, especially in countries where, like in the MENA region, wealth is concentrated in real estate. They are also more difficult to evade, given the immobility of the tax base. However, administering these taxes requires significant investment in establishing comprehensive cadastres and other administrative infrastructure.



Sources: National authorities; and IMF staff calculations.

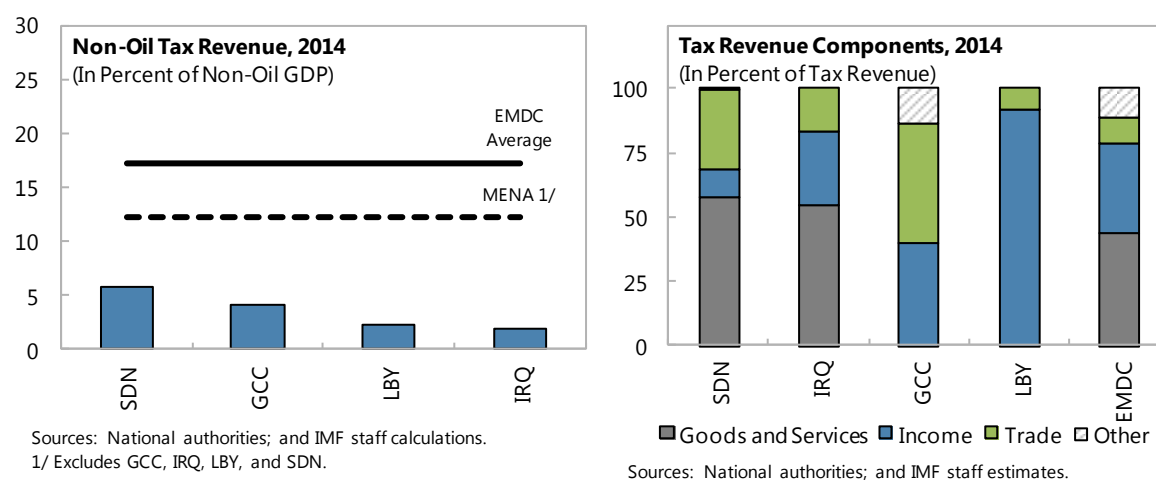


Sources: National authorities; and IMF staff calculations.  
Note: In Egypt, there is no property tax. However, in the fiscal accounts, interest tax is misclassified as property tax.

## B. Hydrocarbon-Based Revenue Systems

**Non-resource tax revenues in most oil-exporting countries in the region are very low.** They represent less than 5 percent of non-oil GDP, significantly below the EMDC average and the average in the rest of MENA (IMF 2014a).

**There are several reasons for the limited use of tax systems in these countries.** First, in many oil exporters (though not all), natural resource revenues have historically been very large in per capita terms, decreasing the pressure to search for alternative revenues and crucially weakening the political case for them. This may be changing, though, as populations increase (quite dramatically in the case of the GCC), oil revenues are hurt by the collapse of oil prices, and some oil-exporting countries approach the extraction sunset. Second, natural resources are seen as property of the citizens. A key concern of fiscal policy is the distribution of natural resource



revenues—putting the spotlight firmly on expenditures rather than revenues. Third, in the “GCC model” the government provides employment for nationals, who also benefit from highly subsidized energy products. In this context, income taxation would therefore amount to a wage cut which would then trigger social pressures to restore previous wage levels. Finally, indirect taxes on fuels would effectively be a reduction of subsidies and would therefore be seen as threatening the universal provision of low-cost energy to citizens.

#### Taxes in these countries have tended to focus on CIT (on non-nationals) and trade:

- **PIT is rare and mainly applied to foreigners.** Saudi Arabia is the only GCC country with PIT, which is applied exclusively to expatriate workers. Libya, Iraq, and Sudan have PIT structures, but the top rates are low at 10 percent in Libya and 15 percent in both Iraq and Sudan (Appendix 3). Compliance and enforcement are also often poor.
- **CIT and trade taxes are the main non-hydrocarbon taxes revenues in the GCC, Iraq, Libya, and Sudan.** CIT generally represents two-thirds of these revenues (except in Sudan where it is negligible). In Iraq, Kuwait, and Qatar, CIT rates are well below those in other EMDCs. The CIT base is also narrow, as the tax is applied only to foreign companies. In the United Arab Emirates, the focus is even narrower, with CIT paid exclusively by foreign banks. In Oman, extensive exemptions are provided for several industries. More broadly, across the GCC, income taxes are not well enforced.
- **Indirect taxes, such as VAT, do not exist in the GCC and Libya.** Although the VAT is present in Sudan, the tax effort is less than 50 percent (Fenochietto and Pessino, 2013; IMF 2014d; IMF 2013). Iraq has introduced sales tax on internet services, mobile phones, and imported vehicles in the 2015 budget.



- **Wealth is generally not taxed**, even though in some countries (for example, Saudi Arabia), the state collects *zakat*, an obligatory payment made annually under Islamic law on certain kinds of property and used for charitable and religious purposes, at the rate of 2.5 percent (in other countries, including oil importers, *zakat* is regulated by the state but voluntary).

## RECOMMENDATIONS FOR FAIRER TAXATION

*Tax policies and tax and customs administration reforms have the potential to rapidly alter public perceptions. In countries with well-established non-hydrocarbon-based systems, these can be simplified through a reduction in the number of indirect taxes and tariff rates, while the bases can be broadened through a reduction of exemptions. Such changes would create a more level playing field for businesses and reduce perceptions of arbitrary treatment across taxpayers. The progressive features of PIT can be increased, and taxes on property introduced or improved (both in terms of design and administrative capabilities). Countries with hydrocarbon-based systems can gradually design fair, simple, and effective tax systems, focusing initially on VAT and CIT. This approach would allow for developing tax revenue administrations that can be leveraged in the future to introduce more direct taxation of personal incomes.*

### A. Well-Established Non-Hydrocarbon-Based Tax Systems

#### ***Simplifying tax systems, broadening the tax base***

**Broaden bases and simplify the rate structures of VAT and international trade taxes.** For both efficiency and equity reasons, base-broadening is generally preferred over across-the-board rate increases. Take, for instance, the VAT. In equity terms, a reduced rate of tax on items important in the budgets of the poor can actually benefit mainly the better-off, since they typically consume absolutely more of these items; even poorly started spending measures can, as a result, be more effective ways of supporting the less well off (Keen, 2014). In efficiency terms, there are rarely strong arguments for deviating from the basic principle that the VAT should serve as a uniform tax on all consumption. Recent evidence confirms that base broadening is also better for growth<sup>14</sup>. Key policies include the following:

- *Reducing or eliminating tax exemptions and deductions* (except those specifically targeted to the poor). This will simplify administration and reduce opportunities for tax avoidance and corruption, reducing perceptions of arbitrary treatment across taxpayers.
- *Consolidating multiple rates*. This applies to the VAT, where ideally one or two rates should be applied, while raising registration thresholds (see below); and to international trade tariffs, whose structure could be flattened while reducing the number of rates (including maximum

<sup>14</sup> Box 4, IMF (2013)

rates). By simplifying the system, these changes support more equitable treatment across taxpayers and less distortions in production and consumption choices.

- *Setting VAT registration thresholds sufficiently high to simplify administration.* This could provide some price advantage to small businesses and reduce their compliance costs, especially those located in rural areas where VAT compliance is particularly problematic. In the Dominican Republic, for example, an increase in the VAT threshold has been found to have strong pro-poor effects (Jenkins, Jenkins, and Kuo 2006).

**Simplify the CIT and reduce related exemptions, notably for export (off-shore) sectors and free-trade and other special economic zones.** The design of CIT can help level the playing field for businesses. The elimination of a privileged regime would also contribute to improving governance and promote the creation of new businesses, especially if the usually streamlined regulatory environment designed for the off-shore sector is extended to the economy more broadly. The experience with off-shore sectors could thus be seen as a pilot or model for a broader revamping of the business environment (Box 2). Improvements to the CIT include:

- *Removing exemptions and certain deductions, possibly paving the way for lower rates while preserving revenue yields.* This applies in particular to off-shore sectors and special tax privileges in free-trade zones, which should be gradually phased out. Any adverse consequences for the off-shore sectors will be partly offset by reduced compliance costs. The tax base broadening deriving from the inclusion of off-shore companies (often the most profitable and dynamic) would allow a reduction in the overall rate structure while maintaining or even increasing revenues.
- *Introducing a simple rate structure, generally limited to two rates (a standard rate and, if needed, a second rate for specific sectors earning extraordinary profits).*
- *Eventually aligning corporate and top personal income tax rates to reduce profit-shifting incentives (notably through incorporation).*

### Box 2. Tunisia: On-Shore Off-Shore Dual Development Model

**Tunisia’s development model during the last three decades was based on an incentives code favoring exporting “off-shore” firms.** These firms benefited from tax exemptions on profits during the first 10 years of activity (profits were taxed at 35 percent in the on-shore sector, now at 25 percent), a 50 percent reduction for another 10 years, and a full tax deduction for reinvested profits. Off-shore firms also benefitted from duty-free access for all inputs and equipment. Streamlined customs procedures in the off-shore sector represented significant cost-cutting in view of a complex and inefficient tax administration and red tape. According to recent World Bank estimates, the total cost of fiscal incentives for the offshore sector amounted to about 2 percent of GDP in 2012.

**This duality between “on-shore” and “off-shore” sectors led to:**

- **Unequal access of opportunities.** Average poverty rates remained four times as high in the interior of the country as in richer coastal “off-shore” areas, which are close to the export infrastructure. At 25 percent, unemployment rates in the interior regions are double those of coastal areas, and only 13 percent of foreign firms were created in the interior regions. Also, off-shore firms often turned out to be larger, more productive, and more likely to be foreign-owned.
- **Creation of jobs in low value-added activities.** The generous tax regime for off-shore companies attracted mostly assembly type investments that generated mostly low-skill jobs. This generated low value-added manufacturing and exports, exacerbating the mismatch between the high demand for unskilled labor and the large supply of an educated workforce.
- **No transfer of technology and know-how from the off-shore sector to the rest of the economy.** This lack of transfer was exacerbated by heavy regulatory burden in the on-shore sector, which kept it isolated from the rest of the economy and subject to cronyism, privileges, and rent extraction.

**Addressing the weaknesses of the dual developmental system is a key priority of the Tunisian authorities since the onset of the revolution.** Efforts have focused on revising the investment code—which dates back to 1994—to create an environment that fosters private sector development. Key priorities include: (1) increasing market access; (2) streamlining the institutional framework governing investment to limit discretion; and (3) simplifying and reducing fiscal and financial incentives for investors. On the latter, an important step has been taken toward enhancing equity and a fair level playing field by reducing the corporate tax wedge between the on-shore and off-shore sectors from 30 to 15 percent (the standard rate for on-shore activities was reduced from 35 to 25 percent, except for banks and telecoms, while export activities are now subject to a 10 percent rate). A timetable for the full convergence of the offshore and onshore corporate taxes is expected to be part of the global tax reform to be unveiled later this year. Convergence to a single corporate tax rate of 15–20 percent would still keep the rate below regional peers, thus keeping Tunisia competitive while ensuring a more equitable and efficient system. The re-introduction of dividend taxation in 2014 would help keep the CIT tax rate convergence revenue neutral.

### ***Making tax systems more progressive***

**Strengthen the progressive features of the PIT.** Personal income taxation is the main and first best vehicle to address income inequality and fiscal redistribution on the revenue side, since it directly accounts for households' ability to pay (IMF 2014b).<sup>15</sup> The PIT design should target schedules with higher tax rates for upper-income groups, shifting the tax burden to wealthier households whose tax burden would only marginally increase as a share of their income.<sup>16</sup> To avoid behavioral distortions, the top rate should be capped, perhaps no more than 50 percent (IMF 2014a). Sometimes, income tax progressivity can offset the regressivity of other taxes such as the VAT. In Latin America, governments reduced the VAT burden on low-income earners by lowering PIT rates and instituting direct transfer payments. In MENA, more progressive PIT implies:

- *Raising rates on the highest income earners* (Jordan, Iraq, Libya, Sudan, Yemen, Egypt, Iran, and Lebanon), coupled with lower rates for the lowest income earners (or a higher income threshold for the lowest rate). In addition, income thresholds for the highest rates should be set at a level that captures a significant number of high-income earners. China has made reforms along these lines by reducing the starting rate and widening the band to which the top rate applies (IMF 2013).
- *Setting three or, at a maximum, four rates.* Systems with three or fewer PIT rates and brackets (as opposed to a flat tax) avoid burdening the middle class, as happened in Eastern European and Central Asian countries when flat systems were introduced in the mid-1990s—including on IMF advice (Keen, Kim, and Varsano 2008). Moreover, too many rates are often unnecessary to achieve a desired level of progressivity.
- *Including non-wage income in taxable income.* Taxing, including through withholding, dividends and interest income earned by individuals' bank savings at a lower rate than wage income, as already practiced to some extent in Egypt and Lebanon, can address capital mobility and bank secrecy laws. Recently, Tunisia relaxed some of its bank secrecy rules, providing tax authorities with greater access to information. To address the difficulties in taxing capital gains on investment, some Latin American countries have started imposing withholding taxes on capital gains at source.
- *Facilitating tax administrators' access to social security, healthcare, and customs databases—*

<sup>15</sup> Regression-based studies suggest greater reliance on income taxes reduces inequality (Chu, Davoodi, and Gupta 2004; Niehues 2010; Ospina 2010; Martinez-Vazquez, Vulovic, and Moreno-Dodson 2012; Muinel-Gallo and Roca-Sagles 2013; and Woo and others 2013).

<sup>16</sup> Flat PIT structures are generally not the best way to organize redistribution efficiently (Keen and others 2008). However, due to their ease of administration the IMF had supported their use in Emerging Europe during the 1990s, where income inequality was relatively low compared to peers.

subject to country laws on such access—to help them estimate individuals' incomes, and subsequently raise compliance. Currently, both Morocco and Tunisia have made plans to initiate such processes.

**Use property taxes to increase progressivity of the overall system.** Taxes on property, often a large portion of wealth, can compensate for PIT systems—the first-best instrument to address income inequality and redistribution—that are constrained by administrative capacity. Where income taxation is particularly weak, there may also be a role for taxes on high-income household consumption, equivalent to categorical taxing of luxury goods. Recommendations in this area include:

- *Raising or introducing recurrent property taxes* (while protecting low-income property owners). This would increase revenues and also fairness, since it would mainly affect the better-off. The marginal effectiveness of property taxes would be high in MENA, given that they are now low and largely evaded. Tunisia and Algeria have begun administering these taxes in wealthy urban areas, creating incentives to enforce collection by allowing municipalities to keep most of the revenues. However, implementation of property taxes requires substantial upfront investment in administrative infrastructure, including a comprehensive cadastre, valuation mechanism, and effective enforcement. Yields are also likely to increase only over time, as administrative infrastructure improves and is used more effectively.
- *Considering other wealth taxes* (for example, on transactions, inheritance tax, or gifts) which are also progressive but are often hard to administer given the mobility of assets.
- *Relying on excises on luxury goods* to temporarily introduce a very visible element of progressivity while a progressive PIT is introduced. Excises are generally used to easily provide revenues and discourage consumption that harms the user or creates negative externalities (for example, excises on cigarettes, alcoholic beverages, and gambling). But, excises could also be redesigned to improve redistribution of income by targeting a short list of luxury goods.

### ***Making administration friendlier, fairer***

**Strengthen tax and custom administration.** A focus on administration should be a priority in light of its key role as an interface between the state and citizens. Strengthened administrative capacity and enhanced compliance and efficiency reduce corruption and level the playing field for companies, while promoting foreign investment and competitiveness and raising tax revenues. Better tax administration also reduces a key impediment to formalization and greater formalization would support a broader culture of tax compliance (Unsworth 2005). As informality declines, tax rates and thresholds will need to be adjusted to take into account a broader tax base. Overall, strengthened tax and customs administration entails:

- *Starting to develop simple “customer service” systems* to make the interaction with tax and customs administration friendlier and less arbitrary. The introduction of feedback practices can also increase accountability and transparency.
- *Establishing stable and simplified tax codes, tax regimes, and customs codes*, information sharing across tax and customs, and reduced, risk-based physical examination requirements and clearance periods.
- *Introducing a risk-based compliance system*, which could be especially important in countries with a large taxpayer population.
- *Setting up large taxpayer units*—including a dedicated unit with highly skilled officers undertaking audit and risk analysis (IMF 2015)—to secure the bulk of revenue and improve administrative efficiency and specialized compliance programs for high-wealth individuals
- *Strengthening withholding and third party reporting*, which narrow the number of collection points and reduce the probability of false reports, respectively (IMF 2015).
- *Investing in human, financial, and technological resources* that pay off through higher tax yields, especially in countries with a culture of low tax compliance. Introducing automated tax forms, e-filing, and e-payment of taxes (particularly for trade taxes) are some examples.

**Improve institutional and legal frameworks.** The impact of these reforms would be enhanced if applied in conjunction with key institutional and legal reforms. In particular, strengthened dispute resolution mechanisms and legal reforms can increase fairness by reducing favoritism, bureaucracy, and corruption.<sup>17</sup>

## B. Hydrocarbon-Based Revenue Systems

**Aim to develop full-fledged tax systems for non-hydrocarbon taxation—though this will require time.** The development of comprehensive tax systems in the GCC, Iraq, and Libya becomes more important as the non-hydrocarbon sectors develop following diversification efforts. In Sudan, this has become imperative due to the loss of oil revenues following the secession of South Sudan in 2011. Furthermore, supplementing resource revenues becomes critical as populations increase and natural resource revenues weaken because of low oil prices and/or the exhaustion of reserves. In this context, tax systems can be gradually developed—exploiting the space provided by natural resource revenues—with the objective of improving

---

<sup>17</sup> These reforms can also be designed to improve compliance. Firms are more likely to pay taxes if compliance costs are low and bring other non-tax benefits (such as better capital market access). More broadly, financial sector and business environment reforms that ease access to credit, procurement contracts, and external markets and lower the cost of doing business (Friedman and others 2000) provide additional incentives for firms to become fully compliant with all their obligations.



equity and fairness by following the main recommendations described above. “Leapfrogging” countries should ultimately aim for broad bases accompanied by flat rates in VAT, CIT, and international trade taxes; the introduction of property taxes; and a progressive PIT.<sup>18</sup>

**Start by developing a few simple instruments and administrative capacity.** In terms of priorities, governments should consider the following sequencing:

- *Introducing VAT:* A low-rate VAT should be considered as a natural first step as it is efficient and broad-based, if care is taken to keep the number of exemptions and rates at a minimum. The GCC is already considering the adoption of a VAT for all its members.<sup>19</sup>
- *Starting to develop a CIT:* A low-rate CIT would be relatively easy to justify on the basis of the benefit principle (i.e., corporations in oil-exporting countries benefit from infrastructure, education, and other externalities provided by the state) and the large economic rents<sup>20</sup> that some companies enjoy because of their location in these countries. Ideally, the CIT should be applied to all companies operating domestically (including foreign-owned companies) to avoid subsidizing local companies and to level the playing field, but if this is politically sensitive, governments can consider a foreign-company-only CIT as a pilot to build a comprehensive tax later.
- *Setting up property taxes and excises:* Property taxes, typically on land and real estate, would be relatively simple to introduce and would address wealth inequality and indirectly income inequality in the likely long transition to setting up an effective PIT. In addition, governments could consider the expansion of excises on luxury goods—for example on high-end cars—subject however to the qualifications described above.
- *Making plans for the future introduction of personal taxation:* The PIT is still not politically feasible in many oil-exporting countries, particularly if applied to nationals. But countries should make long-term plans for the introduction of PIT. In countries where the PIT exists but is only applied to foreigners, this should be seen as a temporary phase that can provide lessons for a tax applied universally.

**Build administrative capacity and taxation expertise that can be leveraged later to scale up tax systems.** The proposals above would require setting up proper tax administration, including databases and information systems. The availability of natural resources revenues and tax revenues from expatriate workers would allow for developing administrative capacity while the various tax instruments become self-financing. Country authorities should rely on this

<sup>18</sup> IMF recommendations for tax reform in the GCC over the past decade (consistent with IMF technical advice) provide specific advice in these areas.

<sup>19</sup> In the GCC, the VAT would also enable reduction of distortionary fees and stamp duties.

<sup>20</sup> Profits over and above what would be required by investors.

infrastructure to scale up tax frameworks with the introduction of additional instruments when allowed by political conditions or required by economic circumstances.

## ADDRESSING RESISTANCE TO REFORM

*In conjunction with designing tax system reforms, it will be critical for MENA policymakers to develop strategies for gaining broad public buy-in for the reforms and for convincing reform opponents.*

### **Political economy factors often underpin resistance to reforms:**

- *Vested interests.* These can obstruct reform that affects the distribution of income and the tax burden. Well-organized groups will in many cases wield more economic and political power than groups in favor of reform. Despite some dilution of the influence of wealthy elites and businesses, they remain powerful and continue to gain from non-transparent tax systems that facilitate rent extraction and political lobbying (von Haldenwang 2008).
- *Lack of broad-based support.* Across much of MENA, there is a perceived lack of confidence that reforms will actually lead to higher revenues, that governments will use additional revenues productively, and that all taxpayers will pay their fair share (Pew Research Center 2014 and 2015; World Bank Enterprise Survey).
- *Lack of political consensus.* Fragmentation of political parties and coalition governments who cannot agree on reforms or have conflicting agendas—especially in countries in political transition—often pose obstacles to reform.
- *Structure and capacity of tax administration.* Resistance to change within the tax administration or limited capacity can pose a significant challenge.

**To push reform ahead, governments should reach out to a broad range of stakeholders but also reach in to their own administration.** Broad consultations, including with poorer groups that lack political power, help build public trust in the reform process, as in Morocco (Box 3). Enhancing voice and accountability and reducing corruption, including through measures to combat money laundering, raise public confidence in the government’s ability to effectively implement reforms. Consulting potential losers from the reform can help to identify ways to provide partial compensation, for example, by stressing that the increased rates some companies might face would be combined with reduced compliance costs. In all countries, tax and customs administration reforms can visibly address governance issues, subsequently increasing public confidence in the government’s ability to implement reforms. Finally, political leadership needs to provide incentives for the tax administration to buy into the reforms—for example, by seeking their input in the design of reforms (IMF 2015).

**Public financial management measures can support tax reform.** Improvements in budget planning and execution, and transparency in the use of public resources, can boost trust in the

government and make tax reform—especially if it involves an increase in effective tax levels—more acceptable to the public.

**The political feasibility of reforms often depends on their pace.** A gradual pace can be more politically palatable and can build confidence in the government’s commitment to reforms. Over the long run, this strategy can convince entrenched interests to back broader reforms while offering important support to reform leaders. Examples of incremental reforms include greater progressivity in income taxes and use of information technology in tax administration.

**A solid communication strategy is critical to gaining public buy-in.** Messages—to the extent possible based on solid evidence—should emphasize how reforms are advancing equity, including how greater government revenues create funding for well-targeted social spending and growth-enhancing infrastructure, healthcare, and education spending, and how reforms level the playing field for businesses. Communication also weakens resistance to reform from wealthy elites and businesses looking to protect their interests. Transparency is a key component of such communication. In the context of base broadening, for example, Morocco’s publication of an annual tax expenditure review has helped by highlighting the costs of exemptions. In some particularly opaque off-shore/free-trade zone regimes, the publication of a list of beneficiary companies would be an important first step. In the GCC and other oil exporters with few non-resource taxes, introducing new taxes will require strong explicit political commitment since their populations are not used to being taxed.

**External partners can play a key role in bringing about reforms.** Bilateral donors and international organizations—including the IMF—can serve as advisors and honest brokers who can help explain the pros and cons of reforms to the public, add credibility, and provide technical assistance to facilitate design and implementation.

### Box 3. Tax Reform in Morocco

**The Moroccan authorities have recently initiated a broad social dialogue on revamping their tax system to enhance its fairness.** A national conference, held in April 2013, included representation of domestic stakeholders (public and private sector representatives, members of Parliament, labor and trade unions, and academia) and external participants. It identified three strategic reform areas: widening the tax base, reducing tax expenditures, and cultivating the relationship between the tax administration and taxpayers.

**The Moroccan tax system is characterized by a very narrow base and embedded tax incentives that create relatively high tax expenditures.** Economic operators find the narrow tax base and high tax rates to be key constraints to growth.<sup>1</sup> Despite tax revenues comparable to levels in other EMDCs (averaging almost 25 percent of GDP) over the past three years, a large share of the economy is either exempt from or evades taxation. About 80 percent of corporate taxes are paid by 2 percent of all enterprises operating in the country; more than 70 percent of income tax receipts are paid by wage earners while self-employed and liberal occupations (for example, doctors and lawyers) pay disproportionately low taxes; and sectors such as agriculture were, until 2014, exempted. In 2013–14, tax expenditures were 4 percent of GDP. Further, the VAT has resulted in a large accumulation of refund credits due to enterprises creating cash-flow problems for the smaller ones with limited liquidity.

**The national conference issued several recommendations to address these issues:**

- Reduce tax expenditures by (1) evaluating current tax incentives relative to government priorities, (2) widening the income tax base, and (3) progressively taxing the agriculture sector.
- Improve the business environment through better tax administration (including streamlining red tape).
- Clear the stock of VAT tax credits and reform the system to prevent the buildup of credits, simplify the VAT by reducing the number of rates, and reduce inappropriate VAT exemptions.

**The 2014 and 2015 budgets have started implementing the conference's recommendations.** The 2014 budget introduced measures to tax large agriculture firms, as a first step toward the full taxation of the sector; better enforce the taxation of the self-employed and liberal professions; and start reforming the VAT regime. The 2015 budget continued in the same direction by introducing new, if not bold, steps to reduce the number of VAT rates and further measures to improve tax compliance.<sup>2</sup>

<sup>1</sup> Global Competitiveness Report (2012).

<sup>2</sup> Other measures include the establishment of a procedure for reimbursement of VAT credits and the elimination of the one-month lag for deduction of the VAT.

## References

- Acosta-Ormachea, S. and J. Yoo, 2012, "Tax Composition and Growth: A Broad Cross-Country Perspective," IMF Working Paper 12/257, International Monetary Fund, Washington.
- , M. Keen, and J. Yoo, Forthcoming, "Growth and the VAT." International Monetary Fund, Washington.
- Besley, T. and T. Persson, 2011, "Fragile States and Development Policy." *Journal of the European Economic Association*, 9(3): 371–98.
- Cingano, F., 2014, "Trends in Income Inequality and its Impact on Economic Growth." OECD Social, Employment and Migration Working Paper 163, Organisation for Economic Co-operation and Development, Paris.
- Chu, K-Y., H. Davoodi, and S. Gupta, 2004, "Income Distribution and Tax and Government Social Spending Policies in Developing Countries." In *Inequality, Growth, and Poverty in an Era of Liberalization and Globalization*, edited by Giovanni Andrea Cornia. New York: Oxford University Press.
- Coady, D., I. Parry, L. Sears, and B. Shang, 2015, "How Large Are Global Energy Subsidies?" IMF Working Paper 15/105, International Monetary Fund, Washington.
- Cnossen, S., 2005, *Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, Polluting, and Driving*. Oxford: Oxford University Press.
- Corak, M., 2013, "Income Inequality, Equality of Opportunity, and Intergenerational Mobility." *Journal of Economic Perspectives* 27 (3): 79–102.
- de Mooij Ruud A. and Sjef Ederveen, 2008. "Corporate Tax Elasticities A Reader's Guide to Empirical Findings," Working Papers 0822, Oxford University Centre for Business Taxation.
- Ebrill, L., M. Keen, J-P. Bodin, and V. Summers, 2001, "The Modern VAT," (Washington: International Monetary Fund)
- Fenochietto, R. and C. Pessino, 2013, "Understanding Countries' Tax Effort." IMF Working Paper 13/244, International Monetary Fund, Washington.
- Friedman, E., S. Johnson, D. Kaufmann and P. Zoido-Lobaton, 2000, "Dodging the Grabbing Hand: The Determinants of Unofficial Activity in 69 Countries." *Journal of Public Economics* 76(3): 59–93.

Hindriks, J., M. Keen, and A. Muthoo, 1999, "Corruption, Extortion, and Evasion." *Journal of Public Economics* 74: 395–430.

International Monetary Fund, 2013, *Fiscal Monitor*. Washington, October.

———, 2014a, "Fiscal Policy and Income Inequality." IMF Policy Paper, Washington.

———, 2014b, *Regional Economic Outlook: Middle East and Central Asia*. Washington, October.

———, 2014c, *Subsidy Reform in the Middle East and North Africa: Recent Progress and Challenges Ahead*. Washington.

———, 2014d, *Toward New Horizons: Arab Economic Transformation amid Political Transitions*. Washington.

———, 2015, *Current Challenges in Revenue Mobilization: Improving Tax Compliance*, IMF Board Paper, Washington.

Jenkins, G., H. Jenkins, and C.-Y., Kuo, 2006, "Is the Value Added Tax Naturally Progressive?" IMF Working Paper 10/59, International Monetary Fund, Washington.

Keen, M., 2014, "Targeting, Cascading, and Indirect Tax Design." *Indian Growth and Development Review* 7(2): 181–201.

———, Y. Kim, and R. Varsano, 2008, "The "Flat Tax(es)": Principles and Experience." *International Tax and Public Finance* 15 (6): 712–51.

Mahon, J., 2004, "Causes of Tax Reform in Latin America, 1977–95." *Latin American Research Review*, 39 (1): 3–30.

Mansour, M., 2015, "Tax Policy in MENA Countries: Looking Back and Forward." IMF Working Paper 15/98, International Monetary Fund, Washington.

Martínez-Vázquez, J., V. Vulovic, and B. Moreno-Dodson, 2012, "The Impact of Tax and Expenditure Policies on Income Distribution: Evidence from a Large Panel of Countries." *Review of Public Economics* 200: 95–130.

Mourji, Fouzi, 2011, *L'incidence fiscale au Maroc – Cas de la TVA*. Presentation at the FERDI Conference on Taxation and Development, October 24–25.



Muinel-Gallo, Leonel, and Oriol Roca-Sagalés, 2013, "Joint Determinants of Economic Growth, Income Inequality, and Fiscal Policies." *Economic Modelling* 30: 814–24.

Niehues, J., 2010, "Social Spending Generosity and Income Inequality: A Dynamic Panel Approach." IZA Discussion Paper 5178, Institute for the Study of Labor, Cologne.

O'Donoaghue, C., M. Baldini, and D. Mantovani, 2004, "Modelling the Redistributive Impact of Indirect Taxes in Europe: An Application of EUROMOD." Euromod Working Paper EM7/01 University of Essex, Colchester, United Kingdom.

Organisation for Economic Co-operation and Development (OECD), 2011, *Divided We Stand: Why Inequality Keeps Rising*. Paris. <http://dx.doi.org/10.1787/9789264119536-en>.

Ospina, M., 2010, "The Effect of Social Spending on Income Inequality: An Analysis for Latin American Countries," Working Paper, Center for Research in Economics and Finance, Medellín, Colombia.

Ostry, J.D., A. Berg, and C. Tsangarides, 2014, "Redistribution, Inequality, and Growth," IMF Staff Discussion Note 14/02, International Monetary Fund, Washington.

Pew Research Center, 2014, *Crime and Corruption Top Problems in Emerging and Developing Countries*. Washington.

———, 2015, "Discontent with Politics Common in Many Emerging and Developing Nations." Washington.

Unsworth, S., 2005, *Signposts to More Effective States: Responding to Governance Challenges in Developing Countries*. Brighton: Institute of Development Studies.

von Haldenwang, C., 2008, "Taxation, Social Cohesion and Fiscal Decentralization in Latin America." Discussion Paper 1/2008, German Development Institute, Bonn.

Woo, J., E. Bova, T. Kinda, and S. Zhang, 2013, "Distributional Consequences of Fiscal Consolidation and the Role of Fiscal Policy: What Do the Data Say?" IMF Working Paper 13/195, Washington.

World Bank, 2009, *From Privilege to Competition: Unlocking Private-led Growth in the Middle East and North Africa*. Washington: World Bank.

———, (various years), Enterprise Surveys.

———, 2015, *Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa*, MENA Development Report. Washington: World Bank Group.

World Economic Forum, 2012, *The Global Competitiveness Report 2011-12* (Geneva).

## Appendix 1

**Tax Revenue by Category, Latest Available**  
(In Percent of Non-Oil GDP)

	<b>Total</b>	<b>Goods and Services</b>	<b>VAT</b>	<b>Excise</b>	<b>Personal Income</b>	<b>Corporate Income</b>	<b>Trade</b>	<b>Property</b>
Algeria	16.7	6.1	2.1	0.4	4.2	2.2	3.0	0.0
Bahrain	0.8	-	-	-	-	N/A	0.8	0.4
Djibouti	19.6	7.3	N/A	N/A	3.2	5.9	2.0	N/A
Egypt	13.0	4.6	2.6	1.7	1.6	4.5	0.9	0.9
Iran	6.9	1.8	1.3	0.3	0.3	2.3	1.0	0.3
Iraq	1.9	1.0	N/A	N/A	0.3	0.2	0.3	N/A
Jordan	16.5	11.1	11.1	N/A	0.6	2.4	1.3	0.5
Kuwait	2.2	-	-	-	-	0.8	2.0	0.1
Lebanon	14.0	5.1	4.0	1.7	0.8	2.5	2.7	1.7
Libya	2.2	-	-	-	-	N/A	0.2	-
Mauritania	18.2	9.0	2.4	1.1	5.0	2.6	2.4	N/A
Morocco	22.2	11.0	8.2	2.7	3.8	4.5	0.9	1.5
Oman	6.4	-	-	-	-	3.2	1.7	-
Qatar	12.9	-	-	-	-	12.1	0.8	-
Saudi Arabia 1/	2.4	-	-	-	-	0.9	1.5	-
Sudan	5.6	3.2	2.1	0.4	0.1	0.5	1.7	0.0
Tunisia	22.5	6.2	6.2	2.0	4.6	2.6	1.0	0.5
United Arab Emirates	4.8	-	-	-	-	1.4	1.1	N/A
Yemen	9.1	3.2	N/A	N/A	2.8	1.4	1.5	0.0

Source: National authorities; IMF staff calculations.

Note: Due to discrepancies between the latest data point across categories or incomplete information, components may not add up to the total.

1/ Does not include revenue from zakat, which could amount to up to 2.6 percent of non-oil GDP.

## Appendix 2

### MENA: VAT Main Exemptions under Current Laws

Algeria	Bread; milk; certain pharmaceutical products; newspapers; periodicals; books; sports materials produced in Algeria and acquired by the Sports National Federation.
Egypt (applies to General Sales Tax only)	Restaurant foods (outside hotels); books and magazines; local dairy products; pasta and bread; meat and fish; domestic fruits and vegetables; baked sweets.
Jordan	Bread; wheat; olive oil; construction steel bars; fuel derivatives; vehicles; medicines and medical supplies; valuable metals (gold-made jewelry, diamonds, precious stones); electricity; water; education; construction and real estate activities; mobile phone subscriptions; financial intermediation and insurance.
Iran	Unprocessed agricultural products; flour; bread; meat; sugar; rice; cereals; soya; milk; cheese; vegetable oil; baby food; books and notebooks; medical products and services; education services; pet food.
Lebanon	Medical services; education; agricultural farm supplies; all food in raw state; bread, flour, meat, fish, yogurts, rice, sugar, salt and vegetable oil; books, magazines and newspapers; gas for household use.
Mauritania	Medical services; basic foodstuffs, including bread, meats, vegetables, etc.
Morocco	Basic food stuffs and items for which prices are regulated; newspapers, periodicals, books and educational audio-visual products.
Tunisia	Basic food stuffs such as bread, milk, four, etc. and items for which prices are regulated; pharmaceutical products; newspapers, periodicals, books and educational materials.
Yemen	Books; newspapers and periodicals; medical services; transportation of individuals.

## Appendix 3

### Middle East and North Africa: Personal Income Tax Brackets

(In U.S. dollars)

Country	Rate (Percent)	Income Bracket	Country	Rate (Percent)	Income Bracket
Algeria	0	\$0 - \$1,380	Lebanon	2	\$0 - \$3,980
Income per Capita:	20	\$1,380 - \$4,140	Income per Capita:	4	\$3,980 - \$9,950
\$5,020	30	\$4,140 - \$16,570	\$11,280	7	\$9,950 - \$19,900
	35	> \$16,570		11	\$19,900 - \$39,800
				15	\$39,800 - \$79,600
Djibouti	2	\$0 - \$170		20	> \$79,600
Income per Capita:	15	\$170 - \$280	Libya	5	\$0 - \$9,040
\$1,800	18	\$280 - \$840	Income per Capita:	10	> \$9,040
	20	\$840 - \$3,380	\$7,260		
	30	> \$3,380			
Egypt	0	\$0 - \$700	Morocco	0	\$0 - \$3,380
Income per Capita:	10	\$700 - \$4,190	Income per Capita:	10	\$3,380 - \$5,630
\$3,610	15	\$4,190 - \$6,290	\$3,240	20	\$5,630 - \$6,760
	20	\$6,290 - \$34,960		30	\$6,760 - \$9,020
	25	> \$34,960		34	\$9,020 - \$20,290
				38	> \$20,290
Iran	0	\$0 - \$3,570	Sudan	0	\$0 - \$1,520
Income per Capita:	10	\$3,570 - \$5,070	Income per Capita:	5	\$1,520 - \$1,540
\$4,890	20	\$5,070 - \$7,140	\$2,020	10	\$1,540 - \$1,580
	25	\$7,140 - \$12,500		15	> \$1,580
	30	\$12,500 - \$39,290			
	35	> \$39,290	Tunisia	0	\$0 - \$810
			Income per Capita:	15	\$810 - \$2,690
Iraq	3	\$0 - \$430	\$4,440	20	\$2,690 - \$5,370
Income per Capita:	5	\$430 - \$860		25	\$5,370 - \$10,750
\$5,090	10	\$860 - \$1,720		30	\$10,750 - \$26,860
	15	> \$1,720		35	> \$26,860
Jordan	7	\$0 - \$14,104	Yemen	0	\$0 - \$560
Income per Capita:	14	\$14,104 - \$28,208	Income per Capita:	10	\$560 - \$1,120
\$5,360	20	> \$28,208	\$1,620	15	\$1,120 - \$3,910
				20	> \$3,910

Sources: International Bureau of Fiscal Documentation; World Bank; and IMF staff calculations.

Note: End of 2014 exchange rates were used to convert tax brackets from national currency. Figures are rounded to the nearest \$10. Income per capita data are the latest available from the World Bank.