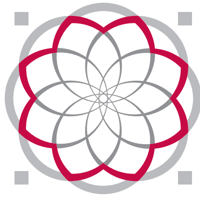

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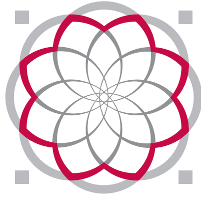
Fiscal Policy and Private Investment for Inclusive Growth

Policy Paper

April 2019



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Review and Synthesis of the 2018 IMF Regional Economic Outlook:

Fiscal Policy and Private Investment for Inclusive Growth

Policy Paper

Naser Abdelkarim, PhD

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I. Introduction

The main purpose of this paper is to react to the policy recommendations of the IMF which were provided in its latest Regional Economic Outlook (REO) published in November 2018. The reaction is mainly addressing two key economic issues covered in the REO, which are:

1. **Fiscal policy for durable and inclusive growth in the Middle East and Central Asia.**

2. **Private investment for inclusive growth in the Middle East and Central Asia.**

In the first section, the IMF's policy recommendations for the Middle East region on the two issues under examination are reviewed, with the focus on oil-importing, low to middle income countries. This is due to the fact that most oil-exporting countries in the region had just recently introduced taxation, particularly VAT on consumption of certain goods and services, and thus have short history of taxation. Furthermore, tax revenues in the budget of these countries are relatively low when compared to oil-related revenues. The report will in the second section analyze the IMF's recommendations and explore their economic and social impacts and potential implications to sustainable and inclusive growth. In the last section, concluding remarks and alternative policy recommendations are provided.

II. Fiscal policy and inclusive growth

Most of the countries in the region, if not all of them, are running budgets with high level of deficit. Tax and non-tax revenues have become insufficient in recent years to meet increasing social and economic needs. This phenomenon has risen due to many reasons include declining oil prices, declining private and public investment which led to slow economic growth, resulting in high unemployment and poverty rates. This budget deficit has forced countries to accumulate public debt over years. Countries like Bahrain, Egypt, Jordan, Lebanon, Mauritania, Morocco, Sudan, and Tunisia have a debt above 60 percent of their Gross Domestic Product (GDP). This level of debt puts increasing burden on the budget due to the fact that it consumes good portion of financial resources in the form of debt service (interest and repayments).Total tax revenues in the region are significantly less than in other emerging markets. In the emerging markets, tax revenues to GDP is higher than 20 percent, while in oil-importing countries in the region (Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Somalia, Sudan, and Syria) stood at around 16 percent in 2017, and in oil-exporting countries in the region (Algeria, Bahrain, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, UAE, and Yemen) is less than 10 percent of GDP (REO, 2018).

In oil-importing countries, indirect taxes on domestic trade in goods and services (indirect taxes on consumption), which consist of value added tax (VAT) or sales tax, excise taxes and purchase taxes, represent the largest sources of tax revenues, averaging about 65% of tax revenues, in line with the average of emerging market and developing countries (AbdelKarim, 2017). In oil-exporting countries, especially in the Gulf Cooperation Council (GCC) countries, there is no personal income tax but 62 percent of their tax revenues are corporate income taxes (REO, 2018).

The IMF reaffirms that "Middle East and Central Asia policymakers face the challenge of boosting inclusive growth amid limited fiscal space" (REO, 2018). One of the critical issues in the view of the IMF is that the region suffers from high levels of debt, which requires it to take measures for fiscal consolidation in order to secure debt and fiscal sustainability.

The IMF admits that the adopted measures like cuts in spending or revenue boosting or both were not effective. In other words, they were not fostering durable and inclusive growth. It also admits that even if fiscal consolidation goes as planned in 2018, countries like Egypt, Jordan, Lebanon, Mauritania, Morocco, Sudan, and Tunisia will continue to suffer from high debt levels and significant gains from fiscal adjustment lost as a result of the increase in debt service.

Based on this assessment, the IMF recommends that the Middle East and Central Asia (MECA) need to adopt new restructuring plans to reach fiscal consolidation by:

1- **Rebalancing the composition of expenditure toward growth-enhancing and high-quality capital investment, while fostering well-targeted social spending.**

2- **Moving to a more progressive tax structure, diversifying the revenue base, and eliminating distortion in the tax system.**

The IMF suggests a fiscal policy design for inclusive growth, and to avoid any pitfall, the adjustment plan should be grounded on a medium-term fiscal framework (REO, 2018, p.42).

This recommended design of fiscal policy covers different aspects discussed as follows:

1) Revenue Reforms

- Indirect taxes

The IMF in its report calls for completing the introduction of value added tax (VAT) and excise tax in the remaining countries of the Gulf Cooperation Council (GCC) as soon as feasible. It is worth noting that these taxes were introduced in some of the GCC countries just recently.

As a starting point, "the tax system plays a pivotal presumptive role in achieving economic and social justice by redistributing income and wealth to poor and low-income categories at the expense of rich and affluent people" (Abdelkarim, 2017, p.102).

According to Abdelkarim (2017), there are sufficient evidence to conclude that the tax policy in the region does not respond to social justice, and therefore produces inequalities between rich and poor. "In the event that most tax revenues come from indirect taxes (trade and consumption), rather than from direct taxes on income and wealth, there will be an imbalance in the tax structure, which necessitates assessing and reforming the negative implications it may have on the fairness of the entire tax system" (AbdelKarim. 2017, p.107). VAT or sales tax has been considered useful in many countries because it distributes the tax burden on a broad tax base, although vigilance may be necessary to prevent that the bulk of this burden falls on the poor.

AbdelKarim (2017) states that tax systems in the region do not distribute the tax burden fairly on taxpayers, but rather favor capitalists and rich people at the expense of poor and less advantaged categories. On the other hand, tax systems in the region are more regressive and less progressive.

The management of tax systems in these countries is weak and flabby and lacks transparency, simplicity, control and accountability. In addition, its application favors big companies and taxpayers who are close to the government. These gaps in the application of tax systems offer a greater opportunity for the rich to evade or avoid taxes, and public corruption in these countries does not help much in the management of tax systems fairly and efficiently (AbdelKarim, 2017).

The past experience showed that introducing or rising regressive taxes like the VAT will be harmful to the society and widening the inequality among people. Raising the VAT and/or cutting wage bill, as suggested in point no. 3, will affect directly the purchasing power of the major segment of the population and contrary to the concept of social justice (Sherry, 2017; Hussein, 2017 and 2018a). Imposing the VAT without discrimination between rich and poor, and without distinction between luxury and basic goods and services ignores the principle of economic and social justice among the different segments of the society (Abdelkarim, 2017).

- Personal income tax

The IMF in its report suggests a gradual introduction of personal income tax in the GCC countries. Introducing a progressive personal income tax is better than imposing a regressive VAT in terms of social justice. But should take into account the particularities and income levels of each taxpayer group, which is one of the fundamental characteristics of fair tax system (Awad, 2018). Personal income tax introduced should differentiate properly between income segments to reflect the inequality in income levels between poor, middle class, and high level of income. On the other hand, the IMF is not clear enough about the introducing of income tax. It doesn't state if wealth (mainly real estate gains) is included in the tax base, also the income from rent, capital gains and interest on deposits, which is well known that these types of income are in the hands of wealthy people.

It is important when introducing a personal income tax to enjoy a high level of progressivity. The marginal tax paid by taxpayers should increase in proportion to the marginal increases in their incomes. On the other hand, number of income brackets should reflect income levels properly taking into account that the marginal differences in tax rates imposed on these brackets are significant (AbdelKarim, 2017).

- Social contributions

The IMF encourages the region's countries to find ways to increase social contributions in MENAP countries, such as by encouraging an increase in the formality of the economy, strengthening tax administration, or decoupling social contributions from wage earnings, would help broaden the financing and increase the scope to spend on social benefits (REO, Nov. 2018, p.43-44).

The suggestion of increasing the formality of the economy is good, but not for the purpose of collecting social contribution only, as most of workers in the informal sector are low-income earners. Decoupling social contributions from wage earnings is socially inequitable since most wage earners are classified as middle class people, while this suggestion excludes wealthy and rich people.

- The management of tax system

The IMF claims that there is room to simplify the tax system and remove distortions by:

1. **Further reduce exemptions, (all corporate must pay taxes, and taxes must be in favor of small and medium enterprises (SMEs) and less in favor of large companies).**

2. **Improve the progressivity of the tax structure, (wealthy people must pay taxes more than poor).**

3. **Broaden the tax base (decrease the informal sector and tax expenditure).**

This will not only improve tax revenues (fiscal adjustment), but also help make it more equitable, efficient, and growth-friendly (REO, Nov. 2018).

These suggestions are welcomed, as they take into account tax justice and equality from one hand, and do not harm the productive sectors or those that rely on labor intensity or on bringing and settling modern technology on the other (Abdelkarim, 2017).

According to AbdelKarim (2017), building a transparent, accountable and corruption-free tax administration, as well as reducing the extent of tax evasion are necessary conditions for the expansion of the tax base. The poor fiscal policies and the huge bureaucracy of governments, and the non-implementation of a tax law reflecting justice among citizens economically; this may be one of the most important factors of tax evasion, and thus complicate the tax system. Unfair tax system that favors the rich also helps tax evasion.

Here, we must emphasize that the IMF's policies with the countries of the region as conditions for financing must take these suggestions into consideration and not to contradict these suggestions. We must also be cautious about broadening the tax base so as not to hurt the poor and those with limited incomes. On the other hand, we should be careful about gender inequality in the region. Reforms to tax systems should be free from gender biases in order to remove distortions.

2) Expenditure Reforms.

As data indicates that expenditure (mainly public wage bill and other expenses including subsidies and transfers) as a percentage of GDP is higher in the oil-exporting countries in the region compared to emerging market. Consequently, IMF suggests that streamlining public-sector wage bills should continue to be a priority. IMF claims that reforming public compensations in the GCC countries could also improve the incentives for nationals to take employment in the private sector, which would foster private-sector growth and economic diversification (REO, Nov. 2018, p.45).

In the oil-importing and middle-income countries, however, the situation is different. Public wage bill is not high, but capital spending is low, which needs to be improved taking into considerations the high debt burden and therefore debt service.

In the low-income countries in the region (Djibouti, Mauritania, Somalia, and Yemen), spending on goods and services and wage bill is large, which suggests a rationalization of expenditure in those countries. It is wiser and less harmful to socioeconomic well being of people, particularly poor and marginalized, if these countries rationalize rather than cut size of expenditures on wages and subsidies.

Other expenditure (mainly defense expenses) is large in the region, mainly in the GCC countries, due to the conflict in the region, which is a further indication of the economic costs of conflict and highlights the potential benefits of securing greater stability in the region.

Hussein (2017) and Sherry (2017) have pointed out that wages and subsidies cuts are harmful to the economy. Most of those receiving wages and benefiting from subsidies are of the middle and poor class, and thus reducing their wages and cutting subsidies will harm their purchasing power. Consequently, there will be weak demand, declining growth rates, higher rates of poverty and

unemployment, and less tax revenues.

Lessons learned from the experiences of the IMF with the countries of the region confirmed that the policy of reducing wages and subsidies did not work, but on the contrary economic and social conditions have deteriorated. Among those studies, Hussein (2018b) pointed out that reducing wage and energy subsidy bill are socially unjust, whereby the first sectors to be affected are social services, especially education and health. (Abdo, 2018) argues that "the IMF policies on wages and reducing personnel cost in the public sector in order to reduce deficit and better service public debt would mean reducing the income share of the bottom 50 percent and channeling them to the top 1 percent who also control deposits that finance the government"[1].

Cuts in government spending by reducing or freezing wages of the public servants will cause a decline in their disposable income which affects negatively consumption expenditure and investment. Lower consumption and investment affect negatively business activities that lead to an employment losses and slower growth (Saadi, 2018).

Subsidy reform, on the other hand, is constrained by the lack of robust systems of identity verification, especially to develop secure payment methods. The lack of reliable mechanisms to assess the identity and the socio-economic status of individuals and households does not facilitate the implementation of these reforms," (World Bank, 2017, p. 2).

As Sherry (2017, p. 30) pointed out "by further advancing wage containment as a measure to downsize the deficit, the IMF would be viewing the Egyptian state as a mere administrative body while stripping it of its social function, thus putting social and economic rights as well as stability at grave risk".

Thus, the bad experience of the IMF measures (cutting spending on wages, subsidies, and transfers) with the Arab oil-importing countries should be taken as a lesson to learn from when applying such policies in the GCC countries. Such measures should be implemented with caution. It is important not to harm the low-income and poor people, where reducing wage bill could be focused on high-income earners and avoiding the low-income and middle class employee. On the other hand, any suggested mechanism that provide direct support for the poor instead of the subsidy programs, should be socially just, effective, sustainable, inclusive, and not limited to the poor but also to the low-income class.

According to the IMF, capital spending in the oil-importing countries in the region is low and need to be improved, but with an eye looking at the debt burden and interest payments. This is true, but it is well-known that oil-importing countries in the region suffer from high debt burden and high interest payments, which in turn greatly affects their ability to improve their capital spending. The gains made by these countries by increasing revenues and reducing expenditures offset by interest payments and therefore capital expenditures did not improve in these countries during the last period.

Improving capital expenditure is an urgent necessity for these countries so that they can stimulate the economy and achieve an inclusive growth. However, this spending must be socially just, so that the largest beneficiaries will be the low-income people, in addition to the small and medium enterprises through infrastructure projects and provide logistic services in order to promote these enterprises economically, and thus decrease rates of unemployment and poverty and rising standards of living.

1 According to Abdo (2018), 1 percent of the Lebanese controlled 23.4 percent of the total income, while 50 percent controlled 10.6 percent of the total income in Lebanon.

In low-income countries, rationalizing expenditure should not hurt the poor and low-income segment of the population. In 2015, a World Bank study on Yemen showed that subsidy removal will be hurting the purchasing power of the vulnerable groups, and full removal of the subsidy would result in an increase of the poverty rate by 9.3 percentage point (1.5 million people).

Government expenditure must be of high quality not only to better use of resources and value to the taxpayer, but also promote growth. Thus region's countries must have strong public investment management frameworks including project appraisal, selection, and evaluation, to ensure additional capital expenditure is truly productive. Similarly, while expenditure on health and education is in line with international peers, it has not translated into high educational attainment and health outcomes, with most countries falling below the estimated health and education efficiency frontiers (REO, Nov. 2018, p. 46).

This is true. Government plans and strategies must be built not only on how much spending but also on quality of spending. Providing high quality government investment spending will reduce the wasted money and also reduce future burdens on government (like subsidies and social transfers) and the value added of these investments especially in health and education sectors.

IMF in its REO (Nov. 2018) suggests that completing subsidy reform would help build and preserve fiscal buffers, increase the durability of adjustment, remove market distortions, free up budget resources for social spending, and reduce overconsumption and overproduction. It also claims that energy subsidy in the oil-exporting countries is in favor of capital intensive industries at the expense of labor-intensive industries, given that these countries have a rapidly growing workforce.

To prove its claims, IMF proved examples of success stories of countries have made progress in reducing subsidies, especially fuel subsidy and improved their fiscal resilience. Those countries are Egypt, Jordan, Pakistan, Oman, and Saudi Arabia.

In this regard, Hussein (2018b, p.4) argues that the IMF-backed plan to reduce energy subsidy bill in Egypt is ill-planned, poorly executed and hence failed to create fiscal space in order to compensate the poorest quintiles of the population. It also failed to liberate resources in order to increase public social spending. On the other hand, Hussein claims that fuel subsidy fell because of declining international oil prices before 2016, but in 2016-2017 fuel subsidies have doubled due to the increase in oil prices, and it is expected to increase if oil prices continue at high levels.

Reducing subsidies in Jordan failed to achieve its goal. Prices increased (fuel and food) and led to a further deterioration in the living conditions among the poorer social strata.

It is important to know that the IMF meant by the improvement in the fiscal resilience is the primary balance (debt service excluded). Thus, this improvement is distorted, because the debt service is high in some of the region's countries especially Egypt and erode all the gains from the removal of the subsidies. On the other hand, the replacement mechanism of the subsidy removal (social safety nets or cash transfers to certain segments of the people) was not effective and these cash transfers diminished overtime due, mainly, to the high interest payments.

Reforming subsidy in the oil-exporting countries, mainly GCC countries, should be planned carefully and they must learn from the past experience of the IMF with some countries in the region. Subsidy reform should target the rich and wealth people and do not harm the poor and low-income strata.

3) Transparency and accountability in fiscal policy

Increased transparency facilitates greater public accountability not only by supporting spending controls and fiscal discipline but also by reducing the scope for corruption, misappropriation of public resources, and boosting tax revenues. On the other hand, better perceptions of government accountability can also help reduce the cost of borrowing for both the state and the private sector, further boosting investment and growth (REO, Nov. 2018, p.47).

The IMF states that some countries in the region achieved progress in this regard. Tunisia modernized and strengthened anti-corruption institutions, Egypt and Saudi Arabia adopted a new procurement laws.

The IMF suggests that MENA countries need to digitalize government procedures in the region to foster transparency and openness, to lower administrative costs, to improve indirect tax collection, and to ensure better targeting of expenditure. IMF provides success cases in the region regarding digitalization. Bahrain and United Arab Emirates rank as top performers in United Nations e-government development index. Morocco, Oman, and Tunisia perform well in the United Nations e-participation index (this index measures access to information, public service, and participation in policymaking).

Transparency and accountability are important not only to improve tax collection and reduce expenditure, but also to achieve social justice. Hence, the participation of all population segments in the policy making should be guaranteed.

III. Private Investment for Inclusive Growth

The IMF report (REO, 2018, Ch.5) states that, compared with the other regions in the world, private investment in the region is very low as a share of gross domestic product (GDP), and thus its contribution to growth has been declining. The highly growing population region needs to improve private investment to achieve inclusive growth, mainly by creating jobs.

The IMF in its report aims to understand the main drivers of private investment in the region in order to help guide policy and reform efforts to mitigate current impediments to private investment and unlock the region's growth potential.

Private investment is low in the region and declined, mainly after the global financial crisis erupted in September of 2009. This is due to a combination of factors, including weak economic activity, firms' expectations of lower profitability, and tighter financial conditions, coupled with the sharp decline in oil prices over 2014–15 (REO, Nov. 2018, p.54).

In oil-exporting countries in the region, the ratio of private investment to GDP is broadly stable except for Algeria which increased resulting from the large investment of state owned enterprises (they are difficult to disentangle from private investment in the data). In oil-importing countries, the ratio of private investment to GDP declined since 2008, particularly in Egypt (mainly due to political instability).

The report states that investment flows in the region driven by commodity cycles. Higher commodity prices, mainly oil prices tend to be associated with an expansion in public investment in oil-exporting countries. Oil-importing countries are affected indirectly by the higher prices of oil through remittances, grants, and direct investment from oil-exporting countries. Thus, when oil prices declined, public and private investment declined in both oil-exporting and importing countries in the region.

On the other hand, foreign direct investment (FDI) inflows concentrated in commodity sectors. FDI is heavily concentrated in the commodity sector (oil sector). FDI declined and become more concentrated in the oil sector with less impact on job creation as oil sector is capital intensive sector.

The report claims that the large public sector is impeding private sector development. There are indications that public investment is crowding out private investment in the region, mainly in credit and talent. For example, In oil-exporting countries, especially in GCC countries, public wages is several times the wages in the private sector, which effectively rising the cost of labor in the private sector. The heavy dependence on the oil sector and the interlinkages between oil and the other sectors of the economy (which are capital intensive sectors) with the high role of the state in the productive sector, leave no enough space for the non-oil sectors, and thus very limited job creation. Furthermore, the reatively large size of state in almost all Arab countries increases the competition that faces private sector businesses, specially SMEs, in the financial markets. This is due to the fact that good portion of banking credit is given to state and ore state enterprises, which leaves smaller financial space for private sector and may also raise the cost of financing.

The report says that the constraints on the business climate are holding back the private investment. Business environment is very weak in the region and is a major obstacle to private investment. Access to finance and talent, government bureaucracy and regulations, and the heavy presence of the state in the economy are important impediments to doing business in the region (REO, Nov. 2018).

The report provides empirical determinants of private investment. According to the IMF, empirical analysis shows that financial development, domestic growth prospects and trading partner growth, oil price volatility, and public investment are key determinants of private investment. All these factors positively affect private investment except public investment which crowed out private investment.

The analysis in IMF report further points out that there are a number of institutional factors that discourage private investment such as access to education and infrastructure, stable political environment, strong governance, government effectiveness and integrity, and the rule of law.

The analysis shows that the region lags behind in many keys areas and need to be improved to boost private investment. Among those keys is the financial development, the rule of law, access to education and the quality of education, and the infrastructure for some countries in the region.

Finally, the report provides some policy recommendations. Those recommendations are summarized in three points:

1. **Financial development. Some measures should be taken to increase access to finance, allow for greater competition among banks, deepen domestic capital markets, strengthening insolvency and bankruptcy frameworks, as well as furthering the development of Fintech, and regulatory and supervisory frameworks would need to be strengthened.**

2. **Public spending. Well targeted public spending in education (orienting education and**

vocational training) will promote private investment. For those countries in the region facing fiscal constraints, there is a need to reallocate spending from unproductive uses (untargeted subsidies and wage bill) toward investment. And build a strong public investment management framework.

3. Improve government effectiveness. Reducing bureaucracy, enhancing transparency and accountability to reduce perceptions of corruption, and strengthening the legal framework for businesses, lowering barriers to entry and reducing the public footprint.

Generally speaking, what IMF state in its report is convincing, but need to take some specific issues into considerations that we are going to highlight in the following subsections:

1. The economic structure of the region's countries. It is well known that the countries of the region either they are oil-exporting countries or oil-importing countries. There are common factors that describe both groups like both are considered as developing countries; weak private sector, high informal sector, financially undeveloped, high unemployment rates, high small and medium enterprises (SMEs) sector, and high deficit in the current account. But the structure of their economy is different, and thus policies taken in each group should be different.

1. In oil-exporting countries which are highly depend on oil, the focus need to be on diversifying the economy by stimulating and supporting non-oil economic sectors (mainly SMEs) and attract foreign investments to those sectors not just the oil sector.

.5

2. In oil-importing countries, the situation is different. The public sector in this group of countries has very limited resources to stimulate the private sector. Thus, the focus needs to be on the regulations and policies that aims at stimulating the private investment.

2. The impact of FDI on the economy is ambiguous. Thus the countries should be careful regarding this issue and design the proper policies and regulations so FDI achieve the expected benefits needed.

3. Oil prices. There may be some positive externalities of the increase in oil prices on oil-importing countries through remittances, grants, and direct investment. But most probably higher oil prices will lead definitely to an increase in the cost of production in oil-importing countries, and thus higher consumer prices and weaker demand.

4. SMEs as a proportion of business enterprises are very high in the region either in the number of enterprises or in the number of jobs. Large companies in the region are concentrated in the oil, financial, and construction sectors. The oil sector is capital intensive industry and has insignificant contribution to job creation. Financial sector has a very low contribution to the value added. And construction sector is also not an income generating and job creating sector. In sum, these sectors have a very low share of labor in the income of those sectors.

5. Investment policies and regulatory frameworks. Policies and regulations should take into account that SMEs are the highest gainers of these policies and regulation frameworks. SMEs are in nature labor intensive and have the highest proportion in the number of enterprises and jobs in the economy. They are also economically diversified.

6. **The public sector. Successful practice has required that the public sector undertake policies to support and discipline both public and private enterprises to channel their activities to new and productive areas.**

7. **Fiscal policy. From one hand, the IMF suggests austerity measures to decrease the deficit including improving tax revenues and reducing expenditure. These measures contradict the efforts of stimulating the private investment in the other hand.**

8. **Monetary policy. Conservative monetary policy to stabilize prices by increasing the interest rate is harmful to the private investment.**

VI. Concluding remarks

The IMF admits that its previous policies and recommendations to the region's countries were not effective, financial resources for governments, mainly oil-importing countries, still very low, spending is inefficient, with high deficit and debt levels. Beside all of this, inequality is increasing in the region.

Now the IMF tries to look at the sustained problem from another angle, which is inclusive growth. In its latest regional economic outlook, the IMF suggests some policy recommendations to promote inclusive growth by two channels: fiscal policy and private investment.

The IMF has succeeded in describing the reality of the situation in the region and that inclusive growth is the best solution to the problem, especially in reducing inequalities. IMF's recommendations for inclusive growth in both fiscal policy and private investment were fairly good, but remained close to its previous policies, particularly with regard to tax and spending policies.

It is strange that the IMF asks oil-exporting countries in the region to apply the policies that totally failed in the oil-importing countries, like further introducing regressive tax, reduce spending particularly subsidies and wages, given that these policies widening the gap between rich and poor and are socially unjust.

Another note, the IMF in its report did not address monetary policy in the region and how this policy can work to achieve inclusive growth. It is worth mentioning that the IMF imposed a currency floating in Egypt and Morocco, which turned out to be not effective, harmful to the economy, socially unjust, and also contradicted their recommendations of fiscal policy. i.,e. the monetary policy in those countries were not accommodative to the fiscal policy.

From a balance sheet perspective, the net wealth of all economic sectors must sum to zero. In other words, if the net wealth of the private sector (households, financial and non-financial firms) and the foreign sector (international investment position) are positive, then the net wealth of the government should be negative (local and external debt) and equal in size of the private and foreign sectors. In order to make everybody happy in the country (the private sector to accumulate wealth and the public sector to sustain its debt), then the net wealth of the foreign sector must be negative.

The table below provides the main points that we agree with the IMF, which stated in its report, and those we disagree with:

Agree points	Disagree points	Notes
		Fiscal policy
The previous policies imposed by the IMF on some of the region's countries were not effective		
	IMF continue to insist on introducing indirect tax as a major source of funding for the budget in the GCC countries	The past experience shows that these types of taxes are harmful to the poor and widen inequality further.
A gradual introduction of progressive personal income tax in the GCC countries		But here the IMF is not clear enough about how to introduce this type of tax and appropriate mechanisms to ensure that the poor and those with limited incomes are not harmed
	Increase tax revenues and social contributions in the MENA region by encouraging the formality of the economy	.1 Increasing social contributions should be by targeting rich and high income people. .2 It is good to increase the formality of the economy but not for tax collection purposes.
Simplify the tax system and remove distortions by further reduce exemptions, improve the progressivity of the tax structure, and broaden the tax base		But here one should be careful not to harm the low and middle income classes. Tax exemptions must target the high income people and corporations.
	Cuts in the wage bills and subsidies	In the current situation with weak private sector and state-led economies, cutting wage bills and subsidies will be harmful to the low and middle income classes. Unless the region has a strong private sector, these measures are unfavorable.
	Capital spending in the oil-importing countries in the region is low and need to be improved, but with an eye looking at the debt burden and interest payments.	The problem is with the debt burden. If we keep looking at the debt burden, the countries will continue to have a very low levels of capital spending. Capital spending need to be improved without looking at the debt burden.
Government expenditure must be of high quality not only to better use of resources and value to the taxpayer, but also promote growth.		
Increase the transparency and the accountability of the public sector		This is an important condition not only to improve the fiscal situation of the public sector, but also to stimulate private investment and growth, and to improve the social justice.
		Private investment

Private investment in the region is very low as a share of GDP and its contribution to growth has been declining		
	Oil-importing countries are affected indirectly by the higher prices of oil through remittances, grants, and direct investment from oil-exporting countries.	Higher oil prices will lead to a higher cost of production in oil-importing countries and thus higher consumer prices and weaker demand.
FDI inflows concentrated in commodity sectors, particularly in oil-exporting countries.		
The large public sector is impeding private sector development. Public investment is crowding out private investment in the region, mainly in credit and talent.		This is crucial, higher demand on credit from the public sector will lead to an increase in interest rates, which will be harmful to the private investment.
Many key areas need to be improved to boost private investment. Among those keys is the financial development, the rule of law, access to education and the quality of education, and the infrastructure for some countries in the region		
Improve government effectiveness. Reducing bureaucracy, enhancing transparency and accountability to reduce perceptions of corruption, and strengthening the legal framework for businesses, lowering barriers to entry and reducing the public footprint.		

V. Policy Recommendations

This section offers a number of policy reform recommendation that may complete the analysis and recommendations of the IMF, and furnishes better grounds for achieving inclusive and just growth in this region of the world. Some of these recommendations are either nonexistent in the IMF report, while others are driven more by the goal of social justice.

Fiscal policy:

1. **Fiscal policy should be taken as a tool to improve income distribution and reduce inequalities.**
2. **Public spending on health and education should be maintained if not increased with more focus on the quality of these services in order to promote growth and reduce inequality.**
3. **Well-targeted transfers that benefit poor, vulnerable, and disadvantaged groups will be effective tools for inclusive growth in the region.**
4. **Fiscal policy should rely more on progressive tax (income tax) and less on regressive tax (VAT).**
5. **Fix fair rates and brackets that are proportional to the capacity of the taxpayer after studying the tax potential and the tax burden (Abdel Karim, 2017).**
6. **Justice and efficiency considerations should take a prominent place in tax reforms rather than increasing the tax burden on individuals in these resource-poor countries (Abdel Karim, 2017).**
7. **Restructure government spending by reallocating more resources to public investments because of their positive economic outcomes in the long run and on sustainable development.**
8. **Support for basic goods and services must be restructured to target the poor more than the rich.**
9. **Fiscal policy should be pro-cyclical in times of booms and counter-cyclical in times of recession.**
10. **With limited fiscal space, the government of the region must tax and spend efficiently.**
11. **Monetary policy must be accommodative to fiscal policy.**

Private investment:

1. **Set a public development strategy and encourage the private sector to participate in**

this strategy for the benefit of both the public sector and the private sector.

2. **Adopt strategies centered on promotion of entrepreneurship and innovation in the region. SMEs should receive the greatest attention in these strategies.**

3. **Those strategies must be directing private investment towards productive, labor intensive, and tradable economic sectors.**

4. **More attention and operationalization of accountability mechanisms when expanding the private sector participation in public development agendas.**

5. **The responsibility and accountability of the private sector that should be associated with the development processes.**

6. **Utilize the needed mechanisms to ensure accountability and effective linkages between the private sector interests and public interests.**

7. **Investment protection. By:**

a. Monitoring FDI and investigate its effects on the stability of the economy, the balance of payments, capital accumulation, industrial developments from one hand, and activate its potential benefits to the economy on the other. Some actions need to be taken to achieve that like prohibitions on the performance requirements and capital controls to smooth disruptions in capital flows and thus stability in the economy.

b. Support infant industries and domestic firms in order to enable them to compete with foreign affiliates (Mohamadieh, 2018).

8. **Private investment should go in line with sustainable development goals (SDGs). Enhancing growth, friendly with the environment, and promoting equality in income and access to resources.**

9. **The social responsibility of the financial system is very much needed to cooperate with the public sector to support the private sector and to enhance and diversify production in order to create jobs, reduce poverty and unemployment levels and promote economic growth. In other words, align the financial system with the social agenda.**

10. **Fiscal and monetary policies must be accommodative to macroeconomic policies to stimulate private investment and boost economy-wide labor productivity (Sherry, 2017; Hussein, 2017; Abdo, 2017).Tax legislations, policies and procedures should be given high importance in the framework of the efforts made by governments of the region to provide an enabling environment for private investment (Abdel Karim, 2017).**

11. **Institutional and laws reforms are very much needed stimulate the private investment. Reduce procedures, bureaucracy, paper work, improve access to finance, fighting corruption and eliminating nepotism, ensure transparency, promote intellectual property and encourage competition are crucial issues to promote private investment in the region.**

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P.O.Box: 4792/14 | Mazraa: 1105-2070 | Beirut, Lebanon
Tel: +961 1 319366 | Fax: +961 1 815636
www.annd.org

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