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IMF Interventions and Tax Justice in Jordan

Policy Brief

October 2018

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This publication has been produced with the financial support of the Development and Peace (CARITAS CANADA), This information contained in this publication does not necessarily reflect the position or opinion of the Development and Peace (CARITAS CANADA)

Table of Contents

Introduction:	4
The IMF and Tax Policies:	5
Tax Policies in Jordan:	6
Recommendations:	8
References:	9

Introduction:

Today, Jordan, a developing country, faces a broad range of political, economic and social challenges exacerbated by both exogenous regional factors as well as endogenous factors ones. The former mainly originate from wars and internal conflicts generating instability in the region, the last of which being the Syrian war and its resulting refugee crisis. The latter originate from the social and economic policies adopted in Jordan over the years, which have left the country increasingly dependent on international aid, particularly in the form of grants, soft loans, and in-kind aid.
The policies pursued have also weakened the several political and legislative institutions, and progressively minimized the role of civil society organizations in public policy discussions. In addition, they have undermined the chances for productive social dialogue policy development. Simultaneously, Jordan has witnessed a concentration of power and influence in the hands of the Government, at the expense of the remaining political and social actors and institutions, with the former issuing unilateral decisions on various issues, notably those concerning economic policy. Lastly, the implemented policies have been followed by a weakening of the rule of law and a decline in transparency and accountability.
A new draft for an Income Tax issued in 2018 threatens to perpetuate this situation, and the government is unable to amend it under constriction by the IMF. The proposed legislation will further stunt the economy, at a time when it's paramount to boost economic growth, especially as national debt has reached %96 of GDP. In a statement, the Deputy Prime Minister has claimed that the IMF is requesting that the Government of Jordan push the law through Parliament, which not only constitutes a blatant act of overreach, but also threatens to weaken the country's political life at all levels and hinders the ongoing process of democratisation. Moreover, it's worth mentioning the mass protests which took place across Jordan last June, in the wake of these demands, with many protesters demanding an end to IMF interference in Jordan's political and economic affairs.
Available data indicate that the IMF's pressure on the Jordanian government to pass an unfair income tax bill would threaten the political and social stability of Jordan. These pressures are prompting citizens to take to the streets on a regular basis and damaging the balance between political institutions, by eroding the independence of the legislative (Parliament).
In short, due to both endogenous and exogenous factors, over the past three decades Jordan has had to contend with a series of crises and chronic social, political and economic imbalances which mirror the country's own atrophied economy and unsustainable public financing mechanisms. Yet, throughout the years, decision makers have responded to these challenges by capitalizing on the country's geostrategic importance and its partners' interest in keeping relatively stable, in order to procure ever-greater grants and loans. All the while, IMF-prescribed policies have led to a decrease in living standards and continue to strain relations among political actors in the country.
However, in spite a steadily increasing inflow of foreign financial aid into the country over the years, successive Jordanian governments have failed to achieve sustained economic growth, which is but one sign that the country has neglected to establish an independent national economy, capable of eventually sustaining itself without having to resort to foreign financial aid. On the contrary, Jordan has become increasingly dependent upon its partners, as well as upon international financial institutions such as the IMF.
The same economic and social imbalances Jordan faced thirty years ago continue to plague the country to this day: a large State budget deficit, high levels of domestic and foreign debt, a gaping balance of payments deficit, rampant unemployment and widespread poverty – which continue to contribute to the deterioration of average living conditions – broad social inequalities, and low-quality health, education and transport services.

While numerous Governments have successively repeated their intentions to reform the tax system and increase its efficiency, none of the measures actually implemented have noticeably contributed to addressing the system's fundamental imbalances. Tax revenues continue to account for %26.5 of GDP, 2017[1]. Tax evasion levels remain particularly high, at an estimated loss of 650 million JOD per year (900 million US$)[2]. Income taxes now account for less than %4 of GDP, while indirect taxation (general sales tax, special taxes and miscellaneous fees) has been steadily expanded, further deepening social inequalities by disproportionately impacting the poor and widening the gap between them and the remaining social classes.
In this context, the current Prime Minister, assigned after the previous government fell due to the social protests in various parts of the kingdom, has stated that the tax policies applied in Jordan to date are unfair.

The following paper will examine the impact of IMF policy prescriptions (stated as requirements and/or recommendations) contained in the Extended Fund Facility (EFF) agreements signed by Jordan on social inequality in the country.

The IMF and Tax Policies:

Upon signing its three-year Extended Fund Facility agreement with the Government of Jordan in 2016, the International Monetary Fund (IMF) underlined the need for a "fair taxation"[3] system. As per this agreement, the previous Government of Jordan expanded indirect taxation by removing tax and customs exemptions on certain commodities. The agreement stipulated "a new tax exemptions framework to reduce exemptions on domestic and imported goods and services, and exemptions on customs duties," as well as a new Income Tax Law expanding the base of social groups subject to this tax. These measures were eventually implemented during 2017 - 2016. These measures have led to an increase in social inequality in Jordan, shining a light on the conflict between the IMF's claims to supporting "fair taxation" and the tax policy prescriptions imposed on the Jordanian government.
It should be emphasized that, generally, the tax and fiscal policies implemented in Jordan over the past three decades have been carried out within the framework of agreements signed between the government and the IMF, and under the latter's supervision. Such policies reflect the Fund's vision for Jordan, and the Fund has remained committed to its approach despite the periodic statements issued by national actors to senior IMF officials, warning of the consequences of the strategies pursued.
At present, it is important to take into consideration the standards which serve to frame the notion of tax justice throughout this paper as standards of tax justice. In essence, there are a number of criteria which must be met, are tied to the principle of ability to pay, in two senses: First, that people and institutions with the same income should be subject to the same degree of taxation; secondly, people and institutions facing disparate economic realities should be taxed proportionately, so that those in a better economic situation are subject to higher taxes than those who are worse off.
Tax revenues generally flow from two main sources: direct taxes, including income, property and wealth taxes, and indirect taxes, including the value added tax, general sales tax, special taxes, and customs duties.
For the purpose of this paper, the criteria for fairness in tax systems can be summarized in three principles: Progressive direct taxation, including taxes on income and wealth; the differentiation between goods and services to be subject to indirect taxes, which include the general sales tax and/or the VAT; and balance in the structure of direct and indirect tax revenues.

Tax Policies in Jordan:

On the subject of Jordan's tax policies reforms, implemented under agreements signed between the government and the IMF over the past several years, and in light of the tax justice standards set out above, this section will analyse the fairness of such policies and assess their impact on social justice and social inequality.

1. Poor application of the principle of progressive taxation in direct taxes. A substantial amount of economic literature emphasizes that progressive taxation, especially in income and wealth taxes, accounting for the particularities and income levels of each taxpayer group, is one of the fundamental characteristics of a fair tax system. The need for progressive taxation lies in its potential for reducing social inequality and as a means for promoting economic development, attracting investment, and providing more employment opportunities to larger swathes of the population; one of the principles of fairness in taxes is their adequateness to the taxpayer's ability to pay, i.e., charging taxpayers in accordance with their financial means, while seeking to curb tax evasion. According to this principle, the suggested income tax system may be described as semi-progressive, as it's made up of six narrow segments which do not adequately account for income disparities. Its progressive nature is visible in the the middle class only, while favouring high income earners and big business enterprises.

   As per draft tax laws, rates per income level stipulate that a family earning 18,000 JOD or less per annum is exempt from income taxation; those whose annual earnings range from 18,000 to 23,000 JOD are subject to a %5 tax, rising to %10 for those earning between 23,000 and 28,000 JOD per year, then to %15 for those earning 28,000 to 33,000 JOD, %22 for the 33,000 to 38,000 JOD bracket, %25 for those between 38,000 and 1 million JOD, and finally, %30 for all those earning 1 million JOD per year or more. These segments are narrow enough that they do not reflect income inequalities between the various social groups, contributing to rising inequality due to the undifferentiating between middle-class incomes and very high levels of income. In order for clearer distinctions to be established, these tax brackets must be subject to further division and discrimination.

2. Substantial decrease in income tax revenues. Income taxes continue to account for only a small percentage and account for less than %4 of GDP. Over the last 10 years, this figure has dropped from %4.5 to [4].%3.6 Such a decline is owed to several factors, such as substantial levels of tax evasion, and the failure to effectively apply the principle of progressive taxation. This has also affected tax justice, in that individuals and institutions are not being effectively taxed according to their income, profits, and their ability to contribute. Moreover, the lack of income tax revenues is also owed to bureaucratic inefficiency, namely that of fiscal agents at all levels.

3. The expansion and insufficient differentiation of indirect taxes, including the general sales tax, special taxes, and customs duties. The vast majority of goods and services are subject to similar tax rates. Most commodities are subject to a %16 tax rate, which is particularly high. Under the pressure of the people in Jordan, the new government recently reduced the general sales tax on several basic commodities such as foodstuffs (vegetables, fruits and flour), agricultural goods, and other essential commodities – following waves of protests in the summer of 2018. Despite these reductions, indirect taxes remain very high, and have continued to drive commodity prices up over the past years. Notably, the new government has acknowledged that indirect taxes on petroleum derivatives are close to %50. The new taxes suggested by the IMF will add to the high special taxes already

being imposed on such commodities as communications, cigarettes, and other goods, in addition to basic fuels – which, in the absence of an efficient public transport system, are essential to the population.

It is useful to note here that the powers granted to the Council of Ministers when determining general sales and special tax rates, in accordance with the provisions of Article 6 of the General Sales Tax Law No. 6 of 2000 and its amendments, are at the source of this increase in indirect taxes. As per this Article, the Council of Minister possesses the power to issue special regulations specifying the amount and proportions of such taxes. This leaves the government free to expand the base of taxable goods and services, either through general taxes or special taxes, which goes against Article 111 of the Jordanian Constitution, where it is stated that taxes and levies are to be imposed by law alone.

4. Indirect tax revenues far outweigh direct tax revenues, underlining imbalances in Jordan's tax system. The data indicate that indirect taxes, especially the General Sales Tax, have become the main source of government revenue. Indirect taxes rose from accounting for %10.6 of Government revenues in -1985 1988 to %45.8 in 2012-2009. Moreover, indirect taxes rose from representing %61 to %69 of total tax and non-tax revenues between 2009 and 2012.[5] At the end of 2016, these accounted for about %74 of tax revenues,[6] while direct taxes accounted for %26. Such rates reflect the lack of tax justice in Jordan.

   Fair taxation depends heavily on progressive and direct taxation (notably, income taxes), so as to ensure that the principle of ability to pay if abided by. Indirect taxation tends to be less just, because such taxes are charged without accounting for inequalities among taxpayers. Instead, the tendency is for indirect taxes to contribute to deepening social inequalities, reducing aggregated demand for goods and services, and subjecting GDP growth rates to downward pressure.

5. Widespread tax evasion. In Jordan, tax evasion accounts for an estimated loss of 650 million JOD (900 million US$) per year, according to official statements. Every year, there is an estimated loss of 450 million JD in sales taxes and 200 million in income taxes. The motives for tax evasion may be legal, political, economic or social. Law enforcement in this field has remained weak, due to the absence of meaningful political reform, allowing for the emergence of centres of influence where government institutions are unable to enforce the law.

Recommendations:

The following recommendations are addressed to both the International Monetary Fund and Government of Jordan for the purpose of contributing to greater justice and efficiency within the Jordanian tax system, that it may better contribute to alleviate social inequality and to overcome the political and social crisis experienced by the society and the Jordanian state:
The IMF must cease the imposition of all forms of conditionality on Jordan, and not linking the release of the last instalment of the loan agreed with the IMF to the endorsement of the new unfair income tax law. Jordan's political and legislative institutions must be permitted to develop a fair and balanced income tax law that is adequate to the country's political, economic and social circumstances.

In order to more effectively apply the principle of progressive taxation stipulated in Article 111 of the Jordanian Constitution, which is one of the key aspects of just taxation, the number of tax groups should be increased. The proposed income tax law should preserving the exemptions set out in the current law pertaining to expenses in education, health, housing loans, and technical services. The lower bracket should begin at %3 as opposed to %5, and then escalated at annual income rates. This would also reduce tax evasion and expand the income tax base. In addition to increasing and widening, the tax categories to reflect real incomes in Jordan.

In order to increase income tax revenue in absolute terms as a percentage of GDP and achieve greater tax justice, it is necessary to boost law enforcement by speeding up political reform, strengthening constitutional institutions and ensuring that all income tax and general sales tax laws are duly applied. In addition, implementation of the billing system (billing for all financial transactions) should be ensured, forcing institutions and private individuals to disclose their financial transactions, thus hindering tax evasion. Moreover, the efficiency of the administrative body working in taxation must be improved both at the technical and informatic levels.

The promotion of tax justice in Jordan requires the easing of the tax burden on the middle and poor social classes, as well as greater differentiation between indirect taxes, which include the general tax on sales, special taxes and customs duties. It is recommended that the general sales tax be lowered from %16 to %10, and that many special taxes on commodities such as telecommunications and petroleum derivatives also be cut. Tax exemptions should once more be available to low and middle-income citizens on basic commodities, alleviating poverty and increasing aggregated demand for goods and services, accelerating economic growth.

Achieve tax justice by reducing the disproportionality between indirect and direct tax revenues. For this purpose, it is recommended to review Article 6 of the General Sales Tax Law No. 2000/6 and its amendments. It is important to limit the powers of the Council of Ministers to issue special levies, in accordance with Article 111 of the Constitution, which states that taxes and fees are to be imposed by law alone.

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