

# Taxes could help GCC navigate new normal of low oil prices: The National Op-ed, 16 Jul 2016

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For residents of the largely tax-free economies of the GCC, the debate about the introduction of new taxes and tax regimes is one of natural concern. But at the broader government policy level, there is much to recommend the slow and carefully planned introduction of new forms of taxation that will generate new revenue streams and contribute to macroeconomic and financial stability in economies traditionally dependent on petrochemicals.

One way of introducing new levies is excise taxes on products such as tobacco, which will generate revenue as well as help control consumption and reduce health-care expenditure.

At an international level, the phased introduction of new tax regimes will be welcomed by financial institutions such as the World Bank, the International Monetary Fund and the Group of Twenty as a sign of the growing economic maturity of GCC countries, and their prudent planning for a more diversified and well-balanced fiscal and financial future.

The GCC has been relying heavily on oil and gas revenue, which accounted for 70 per cent to 95 per cent of total government revenue from 2011 to 2014, while non-oil tax revenue represented only 1.6 per cent of GDP. Despite the recent small recovery in oil prices to the US\$45 to \$50 a barrel range, regional governments are being forced to rethink their medium- and long-term fiscal sustainability and consider a number of

measures such as new tax regimes to diversify revenue and overcome the sharp rise in budget deficits they are facing – an average of 13 per cent of GDP last year.

Governments themselves now recognise that they need revenue diversification in order to function effectively, but in a manner that ensures the introduction of new taxes does not distort economic incentives or impede investment and growth.

But what mix of taxes should the GCC introduce? The issue of direct and indirect taxes has been a regular topic of discussion for GCC governments as they gear up for the new normal of much lower oil prices, rising populations and growing demand for large-scale infrastructure investment.

Among the various policies being undertaken by governments across the region to address their revenue vulnerability and fiscal sustainability, there is one common strand the planned introduction of value-added tax by 2018, with the rate anticipated to be 5 per cent.

Meanwhile, discussions are ongoing on potential new corporate and property taxes along with selective taxation in the form of higher excise duty on a range of commodities such as cigarettes and tobacco, alcoholic and non-alcoholic drinks, petroleum products, cars and mobile phones.

Excise taxes in particular are an area in which countries are taking action.

At the GCC ministers of finance meeting in November it was agreed that an additional uniform 100 per cent tax would be imposed on tobacco products. Bahrain and Saudi Arabia recently took action and moved to introduce additional “fees” on tobacco.

Bahrain has introduced a special goods fee on cigarettes, imposed when entering the domestic market and collected by customs, and equivalent to 100 per cent of the Cif (cost,

insurance and freight) value of goods. This has resulted in an increase in cigarette prices of about 40 per cent.

In Saudi Arabia, the minimum specific import duty has doubled. Import duties will now be assessed at either 100 per cent of the Cif value of cigarettes, or at a minimum specific of 200 Saudi riyals (Dh195) per 1,000, whichever is higher.

Excise taxes on tobacco products are an important revenue-generating source, and they also help achieve the objective of reduced tobacco consumption and the subsequent health benefits. But we need to take into consideration that excise taxes can be either specific taxes – based on quantity – or ad valorem, based on value.

A study of excise taxes on tobacco in Europe found that a 20 per cent increase in a specific excise tax would raise government revenue from cigarette consumption by 4 per cent to 6 per cent, but a 20 per cent increase in an ad valorem excise tax would reduce government revenue from cigarette consumption by 1.5 per cent to 2 per cent.

In Greece, excise and VAT were raised multiple times through 2010 to 2012. Initially, this resulted in higher illicit trade and a marginal increase in revenue. However, because of a high reliance on an ad valorem excise duty over the three-year period, tobacco excise revenue fell by more than €1.5bn (Dh6.1bn).

Let us consider a proposal for tobacco excise taxes in the GCC.

Existing World Trade Organisation and bilateral trade agreements place limits on the GCC countries when it comes to raising the common external tariff on cigarettes and other tobacco products. Introducing excise taxes would allow GCC member states to raise the tax burden on cigarettes, thereby reducing consumption and raising revenue without a breach of their international obligations.

Specific excise taxes are the recommended route to take, as they are easier to administer with a well-defined tax base, and generate higher and more predictable tax revenue. A uniform specific nominal excise duty consisting of a fixed amount per 1,000 cigarettes or equivalent units of other tobacco products should be introduced across the GCC. This would fall in line with global trends in relation to the excise tax structure, and ensure steadily growing tax revenues.

However, governments need to be careful not to impose successive large increases in tax rates, as this can lead not only to a loss of revenue but a damaging increase in illicit trade that can be used to finance organised crime and terrorist organisations such as ISIL.

Governments have to carefully look at a balanced approach when restructuring their tobacco excise tax policy, and any increase should be done as part of a comprehensive, multi-year tax reform plan aimed at revenue diversification, allowing the build-up of tax capacity and administration.