GCC FISCAL REFORM: OIL, GOVERNMENT REVENUE, EXCISE TAXES & THE TOBACCO MARKET

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Executive Summary

Government spending in the Gulf Cooperation Council (GCC) countries has been rising rapidly since the onset of the Arab Spring. On the revenue side, oil & gas revenues account for more than 85% of GCC government revenue. This high dependence on oil & gas makes the GCC countries highly vulnerable to oil price fluctuations, with the recent decline in oil prices bringing fiscal sustainability concerns to the forefront. The IMF has recently warned that: (a) oil exporters' fiscal surpluses are set to vanish by 2017; (b) if oil prices hit $75 per barrel for a prolonged period it would reduce GCC's GDP by 1 percentage point; and (c) this could reduce the aggregate fiscal surplus from a current projected $275bn to around $100bn in 2015. Moreover, GCC countries do not have monetary independence given their peg to the US dollar and cannot adjust exchange rates when faced with external shocks.

To address their revenue vulnerability and fiscal sustainability the GCC countries should prioritize fiscal reform and put in place policies to diversify the sources of government revenue. Revenue diversification policies should be directed not only at mobilizing non-oil revenue in the short run, but also at improving the buoyancy of tax revenue. Government revenue diversification reforms are recommended with the most efficient plan being to introduce both broad-based sources of taxation (a Value Added Tax) and indirect taxes (excise taxes) on specific goods and products like gasoline, diesel, alcohol and tobacco. This White Paper focuses on tobacco taxation, though the argument applies to the other products.

International & bilateral trade agreements constrain the GCC countries from raising the common external tariff on cigarettes and other tobacco products thereby restricting the ability of the GCC to raise prices to reduce tobacco consumption and smoking incidence, while increasing government revenue from tobacco taxation. However, international best practice suggests an alternative structure for tobacco taxation, which would allow GCC member states to raise the tax burden on cigarettes without violating their international obligations.

This White Paper recommends: (a) Agreement of the GCC countries to introduce excise taxes on tobacco consumption as a policy tool to increase tobacco prices for health reasons and to raise revenue; (b) The introduction of domestic excise taxes on tobacco in the form of a specific nominal excise duty to be introduced in each GCC member state consisting of a fixed amount per 1,000 cigarettes or equivalent units of other tobacco products; (c) GCC policy harmonisation: introduction of tobacco excise taxes should be applied uniformly (including on domestic production), equally and in synchronized manner in all countries in order to prevent arbitrage opportunities and illicit trade or smuggling. (d) The process of implementation of the new tax structure should be gradual to avoid encouraging smuggling & illicit trade. (e) The building of tax capacity in the form of tax revenue authorities to implement the fiscal reform, monitor and collect revenue.

GCC FISCAL REFORM: OIL, GOVERNMENT REVENUE, EXCISE TAXES & THE TOBACCO MARKET[ii]

GCC governments' over-dependence on oil & need for fiscal reform

The Gulf Cooperation Council (GCC) region and wider Middle East & North Africa (MENA) region is enormously wealthy in energy and other natural resources, with 48.5% of the world's proven oil & gas resources. Given the State ownership structure, governments are the main beneficiaries of oil revenues. But oil exporters have an extremely narrow revenue base with high dependence on hydrocarbon revenues, which represent more than 85% of total revenue. These revenues are vulnerable to the volatility of international oil & gas prices and to market demand & supply conditions, which are largely outside the control of any individual oil exporting country. Given that the GCC countries typically implement balanced-budget policies, the implication is that their spending policies and fiscal policies are tied to oil revenues. This imparts a destabilising, pro-cyclical bias to fiscal policy: increased spending in boom times and declining spending in downturns. Typically governments should be running contra-cyclical fiscal policies to stabilise economic activity by lowering the growth of spending in boom times and increasing spending in downturns. Thus, the fiscal policy decisions of oil exporters have a major impact on macroeconomic performance and on the development of the non-oil economy. In addition, oil and gas are non-renewable resources and therefore decisions on extracting, spending, investing or saving also affect intergenerational equity. When more is extracted and spent today, less is available for future generations.

The GCC countries also face a constraint on the use of monetary and exchange rate policy. Exchange rates are pegged to the US dollar, resulting in an inability to pursue active monetary policy, or allowing exchange rates to fluctuate when faced with external shocks. As a result, spending policy is the main, if not only, instrument for economic policy management. But spending policy alone cannot be effective in the absence of strong fiscal management frameworks and other tools for active fiscal policy designed to stabilize economic activity and achieve other objectives such as economic diversification. The GCC countries need to not only diversify their production structures towards non-oil activities, but also to diversify their sources of government revenue.

Table 1 below shows that GCC countries have very low tax bases and are highly dependent on oil & gas revenues which account for more than 90% of government revenues in Saudi, 88.5% in Bahrain, and 82% in Oman. The UAE and Qatar have both more diversified economies and have managed to reduce their dependence on hydrocarbon revenues. The non-hydrocarbon sector makes a small contribution to government revenue in the GCC, reflecting the policy decision to provide a low-tax environment to stimulate private sector activity including through the absence of a corporate income tax in most countries and the absence of a personal income tax. The consequence is that the GCC countries remain highly vulnerable to the volatility of energy market prices and conditions.

Table 1. GCC's dependence on Oil & Gas Revenues (2013)

	Bahrain	Kuwait	Oman	Qatar	KSA	UAE
Non-oil revenue (USD bn)	0.9	23.3	4.8	34.2	28.0	29.7
Total revenue (USD bn)	7.9	129.3	39.9	94.1	347.7	139.4
Total revenue (% of GDP)	24.3%	73.6%	51.7%	47.0%	46.5%	33.6%
Share of oil revenue in total revenue	88.5%	82.0%	87.9%	63.7%	91.9%	78.7%
Oil exports (% of total exports)	63.8%	87.1%	64.1%	86.1%	83.3%	27.4%
Tax revenue (% of GDP)	1.0%	0.7%	3.0%	5.8%	1.2%	2.8%
Tax revenue (% of non-oil GDP)	1.4%	1.8%	5.3%	19.9%	3.2%	4.6%
Direct tax (% of total tax revenue)	0.0%	21.3%	46.4%	92.0%	36.7%	3.2%
Budget balance (% of GDP)	-1.9	32.1	8.1	15.4	8.7	6.5
Budget balance (% of non-oil GDP)	-34.6	-81.7	-78.9	-23.1	-53.2	-33.9

Source: IMF Regional Economic Outlook, Oct 2014, Article IV reports, National sources. Note: Data are for 2013 and denoted in USD bn, unless specified.

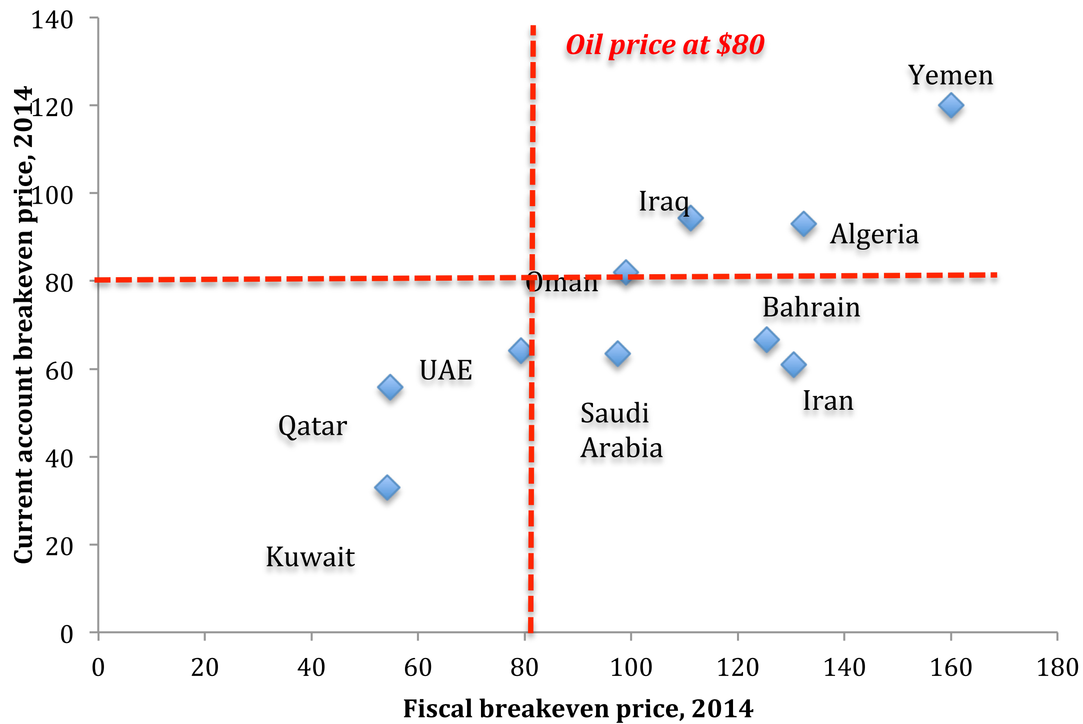
Given their dependence on oil exports, the recent weakness and downward trend in oil & gas prices means that the GCC countries face lower current account and balance of payments surpluses, implying lower accumulation of net foreign assets and greater vulnerability to external shocks. On the domestic front, lower oil prices means lower oil revenues which threatens fiscal stability. The absence of fiscal policy instruments (such as taxation) adds to the burden of adjustment to the recent large negative oil price shock.

This is best illustrated by the chart below (Fig 1), which highlights the break-even price of oil for the GCC countries. The horizontal axis represents fiscal breakeven i.e. the price of oil required to maintain a balanced budget, while the vertical axis tracks the oil price that would keep the current account balanced (i.e. no surplus, no deficit). All GCC governments have reacted to the Arab Spring developments with a surge in spending (mostly on wages, salaries, pensions, subsidies and other current spending) that has raised break-even oil prices. Political economy calculus suggests that the ratchet effect will not be scaled back. Add to this the lack of revenue diversification, and there is a high probability that Saudi Arabia, the UAE and Kuwait will be running budget deficits in the coming years, in addition to Bahrain and Oman, in the absence of major reforms.

Currently, the main GCC non-oil revenue base includes trade taxes (mainly customs duties), payroll & employment taxes along with a large number of distortionary license fees and charges. However, trade tax revenues are being eroded by the Free Trade agreements and WTO commitments. Fees & charges lack elasticity and buoyancy being unresponsive to the state of the economy, do not grow with GDP, are an inefficient source of revenue and suffer from relatively high costs of collection. Additionally, the

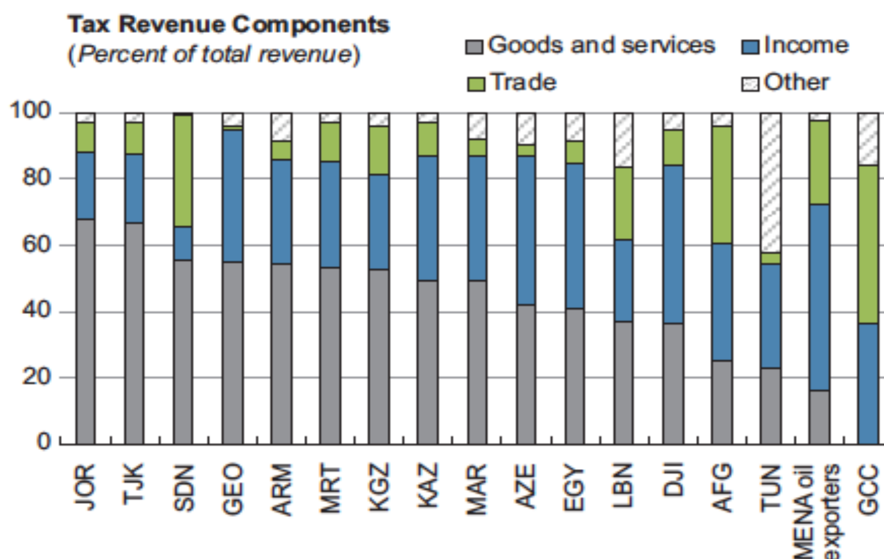
fees and charges directly add to the cost of doing business for the private sector and act as impediments to trade with a negative effect on diversification efforts.

Fig1: Fiscal & Current Account Break-Even Oil Prices



Source: IMF Regional Economic Outlook., Oct 2014. Report can be accessed here: http://www.imf.org/external/pubs/ft/reo/2014/mcd/eng/mreo1014.htm

Fig 2: Trade Taxes Form Bulk of Tax Revenue in GCC



Source: IMF Regional Economic Outlook, Nov 2013.

Revenue Diversification and Fiscal reform: Broad based Taxes & Excises

The GCC need to adjust to oil price volatility and the prospects of a downward trend in oil prices by diversifying the sources of government revenue. Revenue policies should be directed not only at mobilizing non-oil revenue in the short run, but also at improving the buoyancy of revenue sources. This White Paper recommends that this can most efficiently be done by introducing (a) broad-based sources of taxation (e.g. a Value Added Tax or a General Sales Tax) and (b) other indirect taxes (excise taxes) on specific goods and products like gasoline, diesel, tobacco and alcohol (where it is sold).

The argument in favour of introducing a broad-based source of revenue such as a Value-Added-Tax on consumption (VAT) has grown stronger in the past years in order to compensate for the gradual erosion of trade tax revenues, build fiscal sustainability and protect expenditure plans from the growing risk of lower oil revenues while fiscal stimulus packages have pushed break-even oil prices higher. In addition, there is a fiscal equity issue: the GCC countries are host to large expatriate populations that do not pay income or other taxes but benefit from the quality infrastructure, public utilities and social amenities provided by host governments but whose costs are not covered by the prices of utility services. Imposing a broad-based consumption tax such as VAT would help address these equity concerns.

Specifically, we propose the introduction of a common GCC-wide low rate of VAT of 5%. Introducing VAT at 5% could raise revenue of about 3-4% of GDP depending on the scope and coverage. This would strengthen fiscal stability, diversify revenue sources and would provide a source of revenue that grows with consumption spending and GDP. The GCC countries could also use the introduction of VAT to remove the large number of existing distortionary license fees, permits and other charges and thereby lower the cost of doing business.

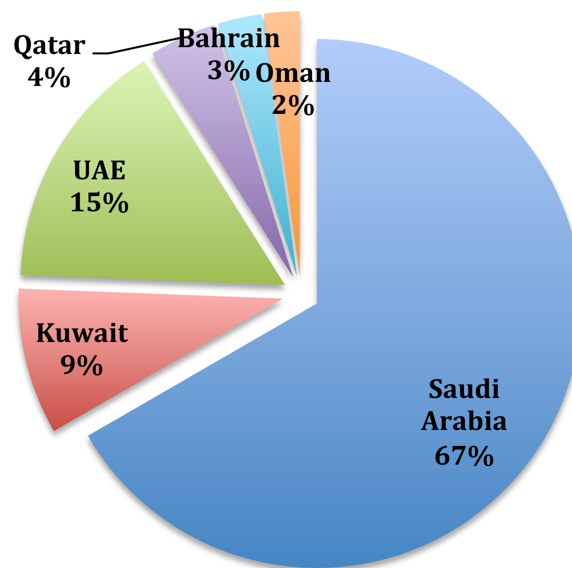
Fiscal Reform & Excise Taxation of Oil and Tobacco

As part of a fiscal reform programme aiming at (a) increasing and diversifying sources of revenue and (b) achieving economic, social, and environmental and health objectives, the GCC countries should consider introducing excises taxes. Excise taxes are taxes on a selected good produced for sale within a country, or imported and sold in the country, they can be specific or ad valorem[iii]. In particular, this White Paper advocates introducing excise taxes on items like gasoline and oil products, alcohol and tobacco.

GCC gasoline, oil and diesel prices are a fraction of international prices, with the high level of subsidies imposing a large burden on government budgets, while the benefits largely accrue to the wealthy and high-income earners. Furthermore, subsidized domestic oil prices encourage energy intensive activities, energy inefficiency and reduce the amount of oil available for export, eating into potential government revenue. The oil & gas subsidies should be gradually removed and excise taxes introduced so that prices converge to international prices. The impact on government budgets would be substantial: GCC energy (including fuel & electricity) subsidies amount to $US160 billion and represent about 10% of GDP.

The Middle East and North Africa region is one of the fastest growing consumers of tobacco products, especially cigarettes. With a young, fast-growing population, where smoking is culturally acceptable and with low awareness of health implications, tobacco consumption is high. In 2010, the region accounted for a 7.1% market share of global cigarettes volume, the fourth largest globally. Significantly, the smoking of pipe tobacco in the region, popular due to the consumption of *shisha*, represents roughly 45.5% of global demand. By country, Saudi Arabia has the highest per capita consumption of shisha pipe tobacco in the world while Egypt, which is MENA's largest cigarettes market, consumes most in volume terms. Fig.3 shows that Saudi Arabia, with the largest GCC population, is the largest market for the cigarette industry, closely followed by the UAE.

Fig 3: Total Cigarette Industry Volume – Market share of GCC countries 2013



Source: Data from multiple sources, compiled by Phillip Morris International.

Constraints on GCC Tobacco Tax Policy Options

The GCC countries are considering raising custom duty on tobacco, both to raise revenues and for health objectives of reducing consumption and smoking incidence (as per WHO guidelines). However, they face a number of constraints in achieving their objectives given their international obligations.

The **GCC nations are members of the WTO** and have to comply with their treaty commitments and with a maximum import duty, known as the 'bound' rate. The current 100% import duty across the GCC is set at the bound rate for both Bahrain and Kuwait.

Free trade agreements (FTAs): Though the GCC has begun the process of signing free trade agreements as a bloc, Bahrain and Oman each have a separate bilateral agreement with the US, signed in 2004 and 2005 respectively. As per the FTAs, the countries need to remove tariffs on cigarettes (among other products) within a ten-year timeframe i.e. by Jan 2015 and 2018 respectively. There is, in addition, a standstill provision meaning current applied rates cannot be increased during that period.

Table 2. WTO Bound Rates in the GCC

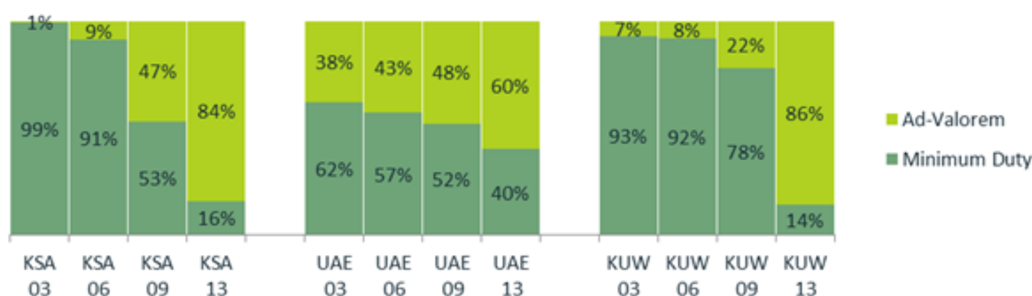
Country	WTO bound rate on "ordinary customs duties"	WTO bound rate on "other duties & charges"
Bahrain	100%/ 35%	0%
Kuwait	100%	15%
Oman	150%	0%
Qatar	200%	3%
Saudi Arabia	200% or SAR 200 per 1000 cigarettes, whichever is higher	SAR 0.03/ packet
UAE	200%	0%

Source: World Trade Organisation, by HS code

The GCC Customs Union. Within the framework of the 2003 GCC Economic Agreement, the GCC nations need to abide by a Customs Union that includes a Common External Customs Tariff (CET) for goods imported from outside the GCC, as well as common customs regulations and procedures, free movement of goods between GCC countries and a single entry point where customs duties are collected. The Economic Agreement forms the basis of the uniform system of cigarettes and Other Tobacco Products (OTP) taxation in the GCC and has enabled a move away from the previously uncoordinated increases in level of customs duties and changes in the structure of taxation (particularly, the use of minimum specific tax rates).

The uniform system of cigarette taxation places the Common External Tariff at 100% of the CIF price (ad valorem) and a minimum specific duty equivalent to SAR 100 per 1,000 cigarettes, whichever is higher. The minimum specific duty component of taxation is an essential component, given that it enables a secure contribution towards the government revenue base. The minimum specific duty was first introduced by Saudi Arabia in the 1990s and was fully harmonized among GCC Member States when Kuwait adopted the current KWD 8 per 1000 cigarettes minimum in 2002. In the years that followed, manufacturers have increased prices of many brands above the levels at which the minimum duty applies, thus increasingly subjecting them to the ad valorem component of the tariff. However, the minimum specific duty was not systematically adjusted for inflation and its real value and incidence has declined.

Fig 4: Evolution of Duty Revenue in select GCC countries, by source



Source: Data from multiple sources, compiled by JTI.

As figure 4 shows where once most government revenue was generated by the minimum specific duty, today a sizeable and growing share emanates from the ad valorem levy. Any increase in specific duty would mean that all cigarettes must pay the minimum amount of tax regardless of their CIF price. By contrast, when the *ad valorem* duty rises, the price of mid and premium price cigarette brands increase by more than that of low and cheap brands given that the tax charged is a proportion of the CIF price. To address these issues, government should consider a mix of ad valorem and specific excise tax regimes in order to attain their health and revenue objectives.

Table 3. GCC Minimum specific duty rates on Cigarettes & Tobacco

Country	Rate per 1000 cigarettes (local curr.)	Rate per 1000 cigarettes (USD)	Rate per gross kg of tobacco (local curr.)	Rate per gross kg of tobacco (USD)
Bahrain	BHD 10	26.95	BHD 2	5.39
Kuwait	KWD 8	28.4	KWD 1.5	5.33
Qatar	QAR 100	27.46	QAR 20	5.49
Oman	OMR 10	26.05	OMR 2	5.21
Saudi Arabia	SAR 100	26.6	SAR 20	5.32
UAE	AED100	27.2	AED20	5.44

Source: World Trade Organisation, by HS code

Absent reform, tobacco tax policy is likely to be forced in directions contrary to GCC government objectives. As it stands now, import duties discriminate against imported products and free trade agreements usually require participating countries to gradually phase them out. As import duties are phased out, the government loses the revenues they generate. Supplementing import duties with excise taxes can compensate for these revenue losses. However, the rate structure also needs to be decided – whether specific or ad valorem or a combination of the two. Understanding international best practices related to tobacco taxation can provide helpful guidance for policy.

Lessons from international tobacco taxation: best practices

International evidence shows that indirect taxes levied on tobacco products (e.g. excise taxes of various types, import duties, sales taxes and value added taxes) have the most significant policy impact on the price of tobacco products. Within indirect taxes, excise taxes are the most important because they are applied directly to tobacco, and contribute the most to substantially increasing the price of tobacco products.

Internationally, excises and Value Added Tax (VAT) are the most common forms of domestic consumption taxation levied on tobacco products. Based on available data, 166 out of 186 countries (about 90% of countries) levy excises on cigarettes. The notable exceptions are the GCC countries, some Pacific island countries (e.g., Marshall Islands, Niue, Palau and Kiribati), some Caribbean island countries (including Antigua & Barbuda and St. Lucia), and Afghanistan and Maldives[iv].

Excise taxes can be either specific taxes (based on quantity) or *ad valorem* (based on

value). Globally, cigarette excise taxes account for about 45% of retail cigarette prices on average, while the structure of tobacco excise taxes varies considerably across countries: out of a total 186 countries, 56 use specific excise taxes, 50 use ad-valorem while 60 practice a mixed system (and 20 have no excise taxes).

Specific excise taxes maximise the revenue from tobacco taxes by reducing the gap in prices between premium and low priced alternatives. For countries that currently rely on an ad valorem tax or a mix of ad valorem and specific taxes, evidence suggests that it is best to set a sizeable specific excise tax that applies to all brands with an ad valorem tax applied above this. Over time, the ad valorem rate could be reduced with greater increases in the specific tax so that the total tax increases as a share of retail price, and with the specific tax accounting for a greater share of the total excise tax. In some countries, a more complex multi-tiered structure is adopted whereby different rates are imposed on cigarettes with different characteristics (e.g. price, length, presence of filter, and/or other factors), which increases the complexity of revenue administration.

Economic theory and evidence indicates that the choice of a tobacco excise tax structure will have a significant impact on a government's ability to achieve its objectives[v]. Uniform specific excise taxes on cigarettes are relatively easy to administer. By contrast, price-based multi-tiered specific taxes and ad valorem taxes are more difficult and costly to administer, as they require determination of value (which can be subject to manipulation) and therefore require an experienced tax administration in order to deter tax avoidance. On the other hand, the real value of specific taxes will erode over time unless tax rates are regularly adjusted for inflation in contrast to ad valorem taxes which will rise with prices (similarly, ad valorem taxes will decline with price cuts).

The revenues generated by ad valorem taxes are more sensitive to pricing decisions than revenues generated by specific taxes. This is because industry price changes result in greater changes in retail prices given the multiplicative nature of an ad valorem tax. Moreover, industry pricing decisions are influenced by ad valorem taxation, consumer purchasing patterns and the degree of market concentration. As a result, ad valorem taxes can lead to tax erosion and instability of government revenues. Similarly, the multiplier effect of an ad valorem tax creates disincentives for the production of higher "quality" products when compared to a specific tax, leading to greater availability of relatively low priced, low "quality" products. Tax structures that use a mix of specific and ad valorem taxes can incorporate the strengths and weaknesses of both types of excises, yet at the cost of adding to administrative complexity.

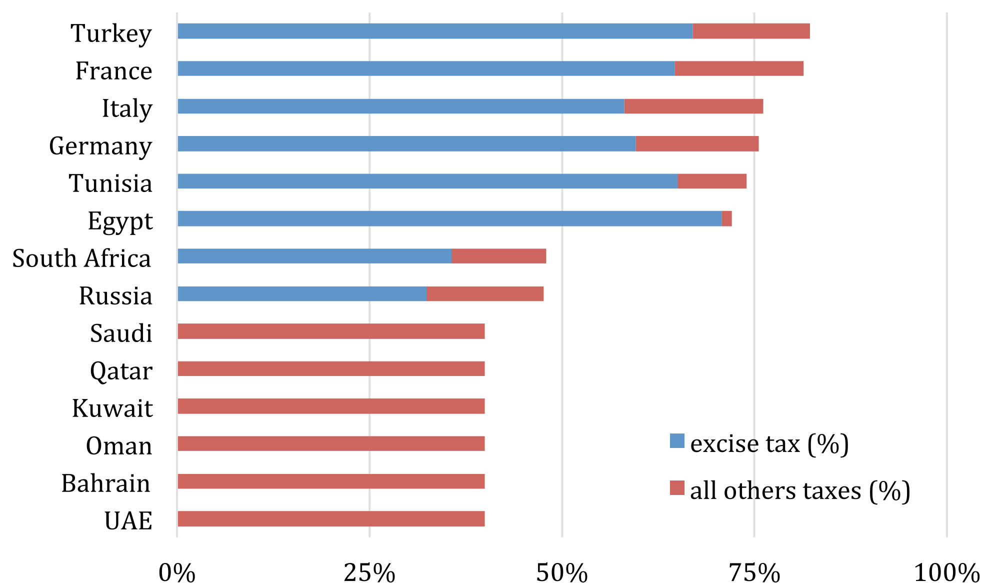
Almost all countries levy a tariff on imported cigarettes, although under the WTO and increased adoption of international trade agreements there is general decline in the effective import tariff rates. In general, import duties are collected from the importer at the point of entry into the country. Countries impose high import duties either to protect their domestic industry or to generate government revenue or a combination. Countries with no substantial cigarette production or no excise taxes have a tendency to levy higher import duties on cigarettes for revenue purposes. As noted above, the GCC nations are good examples of this - Bahrain, Kuwait, Qatar, Saudi Arabia and UAE each impose a 100% duty (ad valorem) based on importers' declared CIF (Cost, Insurance,

Freight) value and a minimum specific duty per 1000 cigarettes, whichever is higher. However, the 100% duty acts as an imperfect substitute to a domestic tax.

The international evidence indicates that the effectiveness of import duties in generating higher revenues and increasing retail prices has been decreasing as countries adopt bilateral, regional, and global trade agreements. Consequently, relying on domestic tobacco excises would ensure sustainability of tobacco tax revenues. For countries that currently rely heavily on import duties from tobacco products, an appropriate transition strategy would be to introduce and gradually increase both ad valorem and specific tobacco excise taxes so that total taxes on tobacco products are increasing over time.

International evidence shows that in many high-income countries, about 50 to 60% of the retail price of the most-sold brand is a specific excise tax on tobacco or some variation of it (as in the example of the European Union), but in low- and middle-income countries, this proportion is typically only about 35 to 40%. Fig. 5 shows the breakdown of total and excise taxes as a percentage of the (average weighted) market price.

Fig 5: Total and Excise Taxes as % of the Market Weighted Average Price



Source: Data from multiple sources, compiled by Phillip Morris International.

From the above chart, it is evident that the GCC nations have a much lower share of total tax in the overall pricing. The GCC countries also stand out by *not* using excise taxes. In addition, given that cigarette prices are also lower in the GCC, there is substantial scope to increase revenue through higher taxes.

A simpler, but uniform tax structure is preferred to complex tax structures that apply different tax rates to different brands and/or products based on various product characteristics.

Proposal for a New GCC Excise Duty Regime for Tobacco

International & bilateral constraints prevent GCC countries from raising the CET on cigarettes and OTP and stand in the way of GCC governments meeting their objectives for both increased revenues from cigarettes and for a reduction in tobacco consumption and smoking incidence. However, international best practice reviewed above suggests a supplementary structure for tobacco taxation, which would allow GCC member states to raise the tax burden on cigarettes without violating their international obligations.

Specifically, the **policy proposal and recommendation** is:

a) Agreement of the GCC countries to introduce domestic excise taxes on tobacco consumption as a policy tool to increase tobacco prices for health reasons and to raise revenue
b) A specific nominal excise duty would be introduced in each GCC member state consisting of a fixed amount per 1,000 cigarettes or equivalent units of OTP. Such a policy reform would simultaneously reduce consumption *(in accord with the directives of Health Ministries),* gradually raise prices towards relevant international benchmarks and raise substantial revenues *(satisfying the objectives of Finance Ministries)* for governments.
c) To avoid introducing distortions, the specific excise duty should apply equally to imports and domestic production, including that originating in Free Zones (regardless of source of origin).
d) The excise duty rate should be harmonised, introduced in synchronised manner and be the same in all member states to prevent market fragmentation, avoid arbitrage and tax avoidance/evasion through sourcing from low excise tax jurisdictions.
e) The excise duty should be set at a moderate rate per 1,000 cigarettes, in line with international practice (see chart 5 above). But, unlike the current Customs Duty, there would be no constraint on GCC Finance Ministers choosing a higher excise duty rate to meet health or revenue objectives.
f) The excise duty will be an internal tax payable to the national revenue authority in the country of final consumption. It is recommended to use digital markers on tobacco products to signal excise duty paid as this enhances supply chain security and helps fight illicit trade.
g) The new excise duty would be introduced by Ministries of Finance with a revised mandate enabled by the requisite legal & regulatory reforms, which would set up the revenue administration. It is also feasible that the revenue administration be out-sourced to customs which become Customs & Excise.
h) The set-up of an excise revenue administration has the added advantage of facilitating the introduction of other excises, notably on alcohol, gasoline, diesel and other oil products.
i) Bahrain and Oman will have to phase out their tariffs (including on tobacco) given their FTA with the US by 2015 and 2018. The other GCC countries would need to consider administrative and other measures (including duties) to avoid tobacco trade diversion towards Bahrain & Oman.

Policy reform implementation issues:

a) **Harmonization of policy between GCC members**: Any change in policy should be harmonized and synchronised across the GCC. If not, there could be potential loss in tax revenues as consumers either opt for illicit trades or legally cross the border to potentially buy the cheaper goods.

b) **Tax/ Revenue administration**: the GCC countries need to build tax capacity as well as ensure that taxation policy is easy to administer, estimate and monitor. Effective administration would imply not only maintaining high compliance levels but also that administrative cost is kept low relative to revenue collected.

c) **Distribution of revenue between GCC members**. One of the outstanding issues of the GCC Customs Union is the revenue sharing agreement. The excise duty reform proposal should help resolve these issues since it is a domestic tax and collected by national authorities in each country. Given their size and consumption patterns, Saudi Arabia and UAE would raise the bulk of the revenues from an excise duty.

d) **Combating smuggling and illicit trade**. The level of illicit trade is dependent on several factors including neighbouring countries' tax regimes, price levels and overall levels of compliance and enforcement activity. The size and speed of tax increases could also affect the level of illicit trade with sudden one-off increases resulting in a move away from duty paid cigarettes and encouraging smuggling. This needs to be avoided. Any significant increase in the tax burden needs to be accompanied by countries' stringent levels of enforcement capability and strategy for tackling illicit trade.

Concluding remarks

The GCC countries are highly dependent on oil export revenues as the major source of government revenue. Falling oil prices are leading to lower revenues and threatening fiscal stability at a time when fiscal break-even levels of oil prices have been rising due to increased spending. The GCC countries need to diversify their sources of government revenue to address the threat to fiscal stability and sustainability. This White Paper recommends fiscal reform on three broad fronts: (a) the introduction of a broad-based tax on consumption in the form of a value-added tax for fiscal stability; (b) the gradual removal of energy subsidies that are a major burden on government budgets and distort economic choices; (c) the introduction of excise taxes on tobacco in order to address heath objectives of reducing tobacco consumption and also raise government revenue.

Appendix: A Comparison of various tobacco taxes levied across the globe

Type of Tax	Description
Amount-specific excise taxes	An amount-specific excise tax is a tax on a selected good produced for sale within a country, or imported and sold in that country. In general, the tax is collected from the manufacturer/wholesaler or at the point of entry into the country by the importer, in addition to import duties. These taxes come in the form of an amount per stick, per pack, per 1000 sticks, or per kilogram.
Ad valorem excise taxes	An ad valorem excise tax is a tax on the value of a selected good produced for sale within a country, or imported and sold in that country. In general, the tax is collected from the manufacturer/wholesaler or at the point of entry into the country by the importer, in addition to import duties. These taxes come in the form of a percentage of the value of a transaction between two independent entities at some point of the production/distribution chain; ad valorem taxes are generally applied to the value of the transactions between the manufacturer and the retailer/wholesaler.
Import duties	An import duty is a tax on a selected good imported into a country to be consumed in that country (i.e. the goods are not in transit to another country). In general, import duties are collected from the importer at the point of entry into the country. These taxes can be either amount-specific or ad valorem. Amount-specific import duties are applied in the same way as amount-specific excise taxes. Ad valorem import duties are generally applied to the CIF (cost, insurance, freight) value, i.e. the value of the unloaded consignment that includes the cost of the product itself, insurance and transport and unloading.
Value added taxes and sales taxes	The value added tax (VAT) is a “multi-stage” tax on all consumer goods and services applied proportionally to the price the consumer pays for a product. Although manufacturers and wholesalers also participate in the administration and payment of the tax all along the manufacturing/distribution chain, they are all reimbursed through a tax credit system, so that the only entity who pays in the end is the final consumer. Most countries that impose a VAT do so on a base that includes any excise tax and customs duty. Some countries, however, impose sales taxes instead. Unlike VAT, sales taxes are levied at the point of retail sale on the total value of goods and services purchased.

Source: World Health Organisation. World Bank, IMF.

[i] Nasser Saidi & Associates, www.nassersaidi.com

Dr. Nasser Saidi is founder and president of Nasser Saidi & Associates and former chief economist at Dubai International Financial Centre.

[ii] The viewpoints and proposals in this White Paper are the author's own. Phillip Morris International (PMI) and Japan Tobacco International (JTI) supported the research for this White Paper.

[iii] See the Appendix for a classification and description of different types of taxes.

[iv] Source: WHO Report on the Global Tobacco Epidemic, 2013.

[v] According to Arthur Laffer's "Handbook of Tobacco Taxation: Theory and Practice", there are many factors that policymakers must consider when choosing between a specific excise and an ad valorem excise. These factors can either pertain to the economic climate or to the overall goals of policymakers. Addressing the economic climate first, in countries where both current inflation and expected inflation are high, policymakers should consider an ad valorem excise tax structure since it will not need to be regularly adjusted for inflation (again, assuming the price of the taxed commodity follows inflation), or alternatively implement a specific excise tax that is automatically linked to the Consumer Price Index, thereby adjusting the tax for inflation. If tax administration is problematic (which can be the case in countries that lack sufficient funding and government infrastructure), then a specific excise tax policy should be pursued since it is far easier to evaluate the quantity of products than the value of the product.