Fiscal Reform & the New Oil Normal Meeting the Challenges of Tax Policy Reform

Presentation at the Sixth Meeting of the MENA Tax Forum
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Dr. Nasser Saidi

NASSER SAIDI
& ASSOCIATES

Agenda

- ✓ **Global Economy & the New Oil Normal**
- ✓ Adjustment New Oil Normal requires government policy reform
- ✓ Government revenue diversification: New Tax Regimes
- ✓ Key Takeaways

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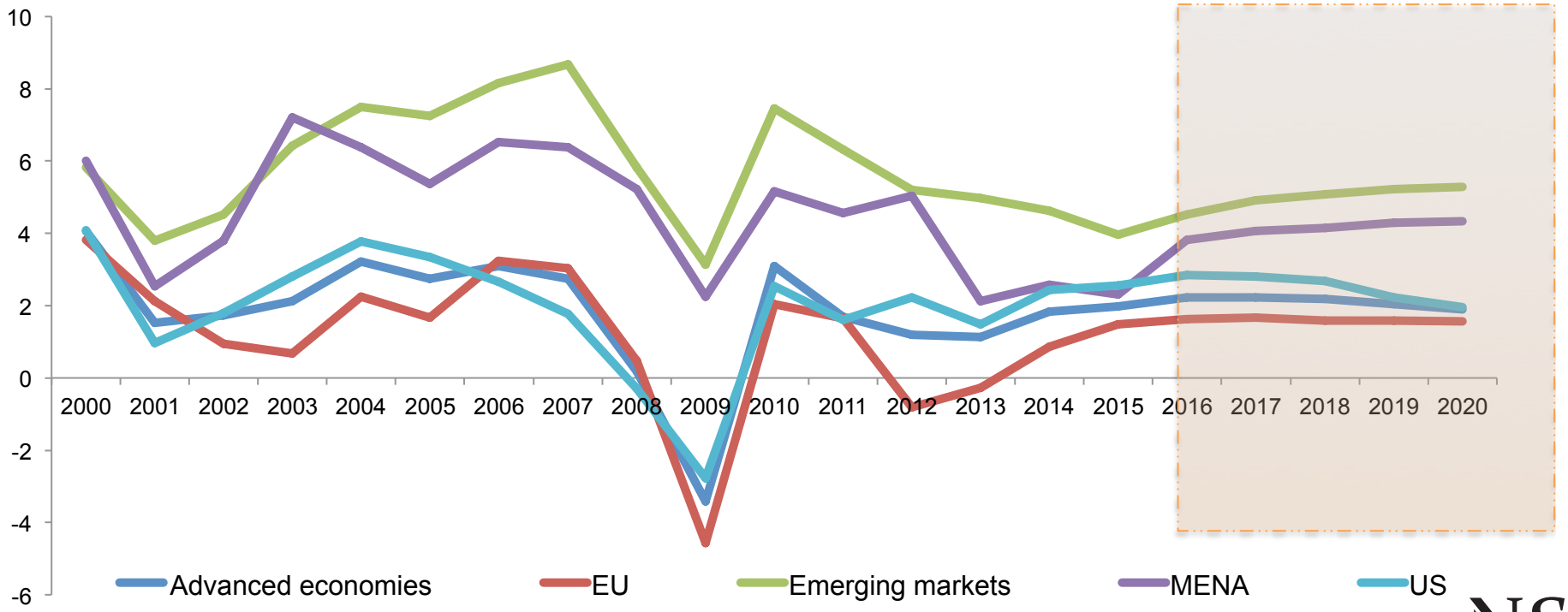
Global recovery remains fragile & uneven; ‘Secular Stagnation’ & New Economic Geography

	World	US	EU	Emerging markets	China	Russia	Japan
2015	3.1	2.6	1.5	4.0	6.8	-3.8	0.6
2016	3.6	2.8	1.6	4.5	6.3	-0.6	1.0



Source: IMF WEO, Oct 2015. GDP growth in yoy terms, shaded area denotes forecasts.

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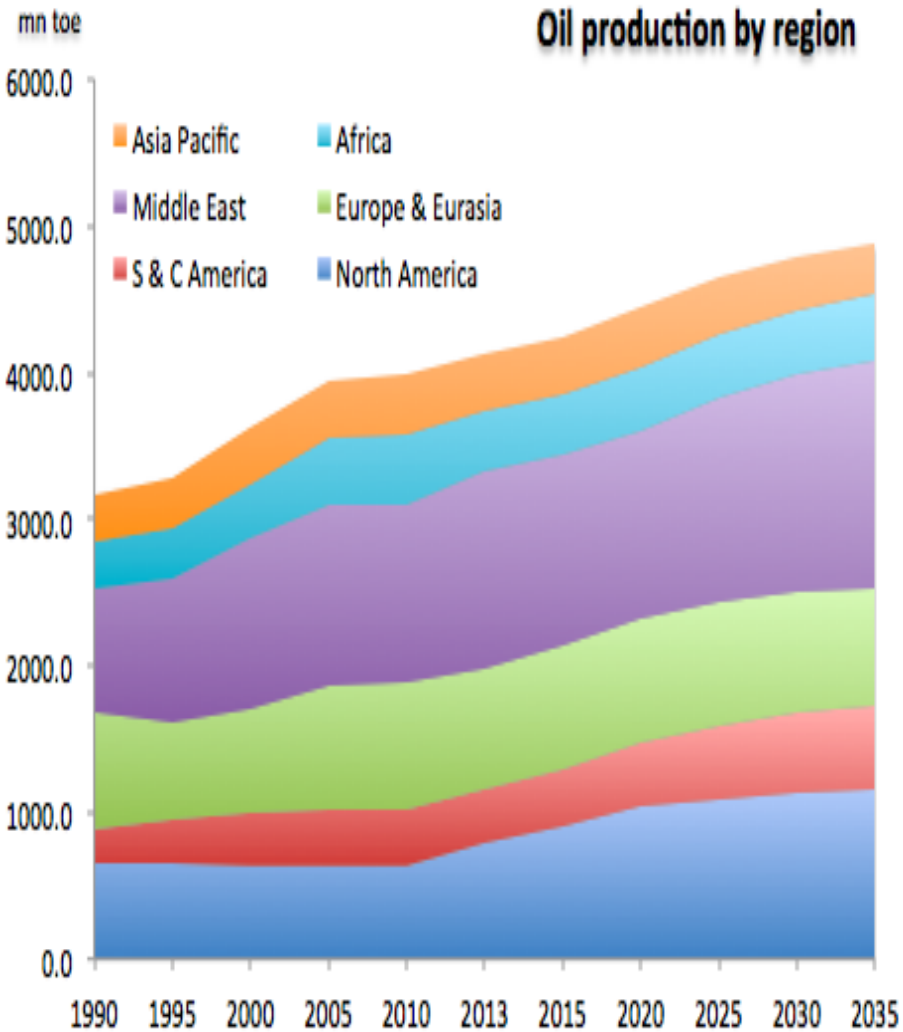
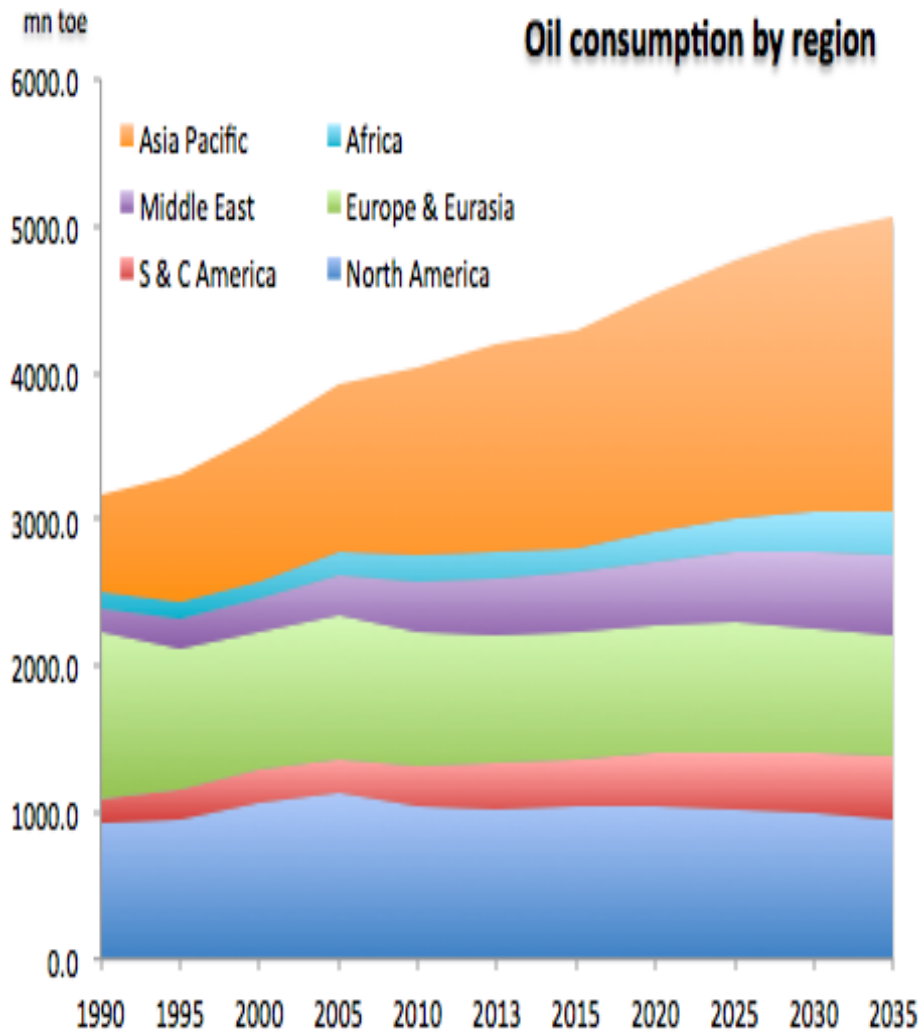
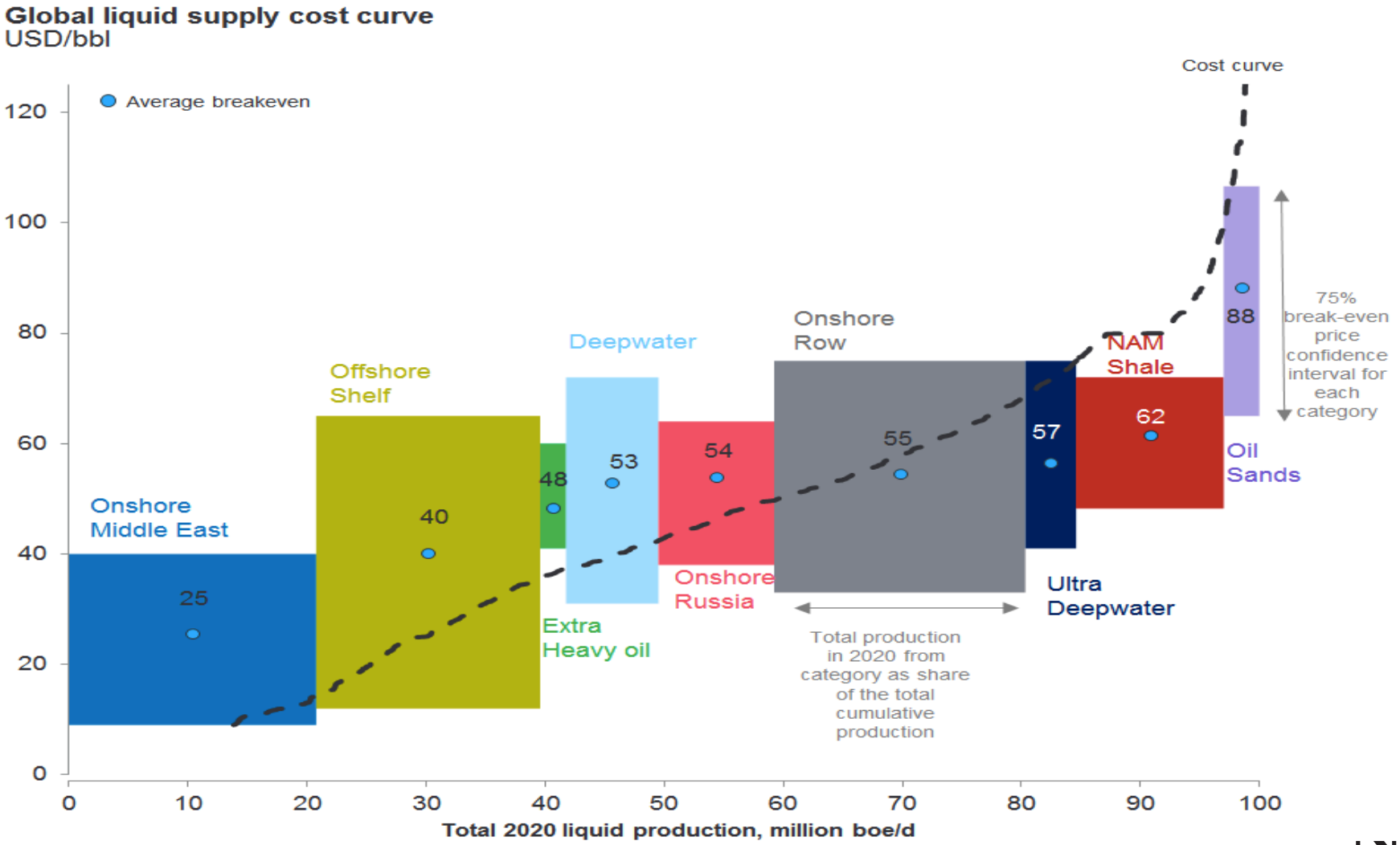
"New Oil Normal": demand dynamics dominated by EMEs; new sources of supply





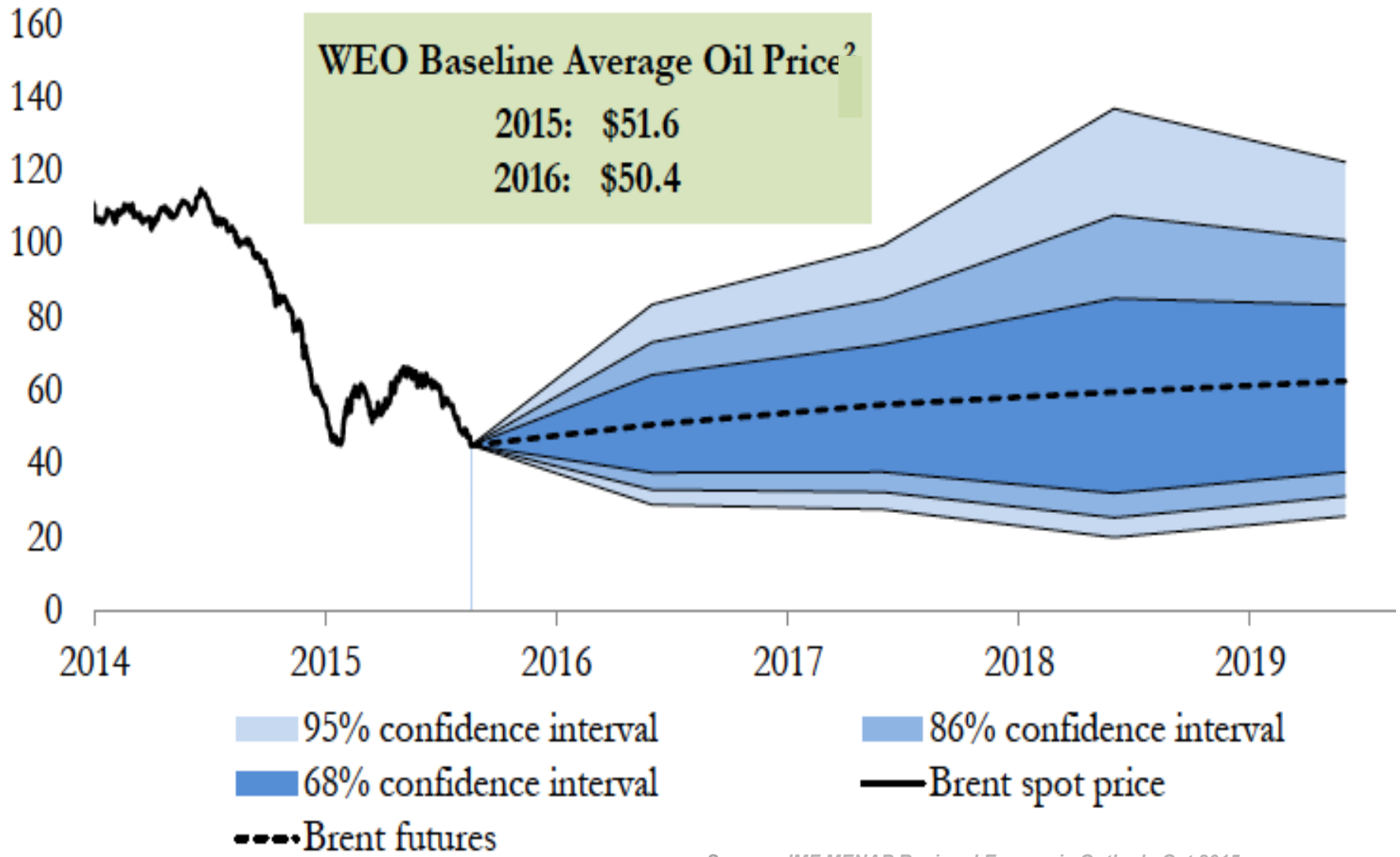
Source: Energy Outlook 2035, BP (Feb 2015)

“New Oil Normal”: OPEC aims to drive out competition. Disruptive technology driving costs down for shale, RE



Source: Rystad Energy estimates, Jan 2015

Oil price weakness likely to persist: demand & supply factors weighing on market



Source: IMF MENAP Regional Economic Outlook, Oct 2015.

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MENA macroeconomic outlook: growth below potential amidst conflicts & lower oil prices

	Real GDP			Budget balance (% of GDP)			Current Account (% of GDP)		
	2014	2015f	2016f	2014	2015f	2016f	2014	2015f	2016f
Oil Exporters	**2.6**	**1.8**	**3.8**	**-3.0**	**-11.0**	**-9.4**	**8.9**	**-3.4**	**-4.3**
Saudi Arabia	3.5	3.4	2.2	-3.4	-21.6	-19.4	10.3	-3.5	-4.7
UAE	4.6	3.0	3.1	5.0	-5.5	-4.0	13.7	2.9	3.1
Iran	4.3	0.8	4.4	-1.1	-2.9	-1.6	3.8	0.4	1.3
Oil Importers	**2.9**	**3.9**	**4.1**	**-7.9**	**-7.3**	**-5.8**	**-4.2**	**-4.2**	**-4.2**
Egypt	2.2	4.2	4.3	-13.6	-11.7	-9.4	-0.8	-3.7	-4.5
Morocco	2.9	4.9	3.7	-4.9	-5.3	-4.2	-5.5	-2.3	-1.6
MENA	**2.6**	**2.3**	**3.8**	**-2.8**	**-11.8**	**-10.1**	**6.1**	**-4.0**	**-4.7**
Maghreb	0.7	2.5	3.6	-15.0	-25.7	-20.6	-8.1	-15.8	-13.8
Mashreq	2.2	3.9	4.1	-7.9	-15.1	-13.2	-4.6	-6.3	-6.6

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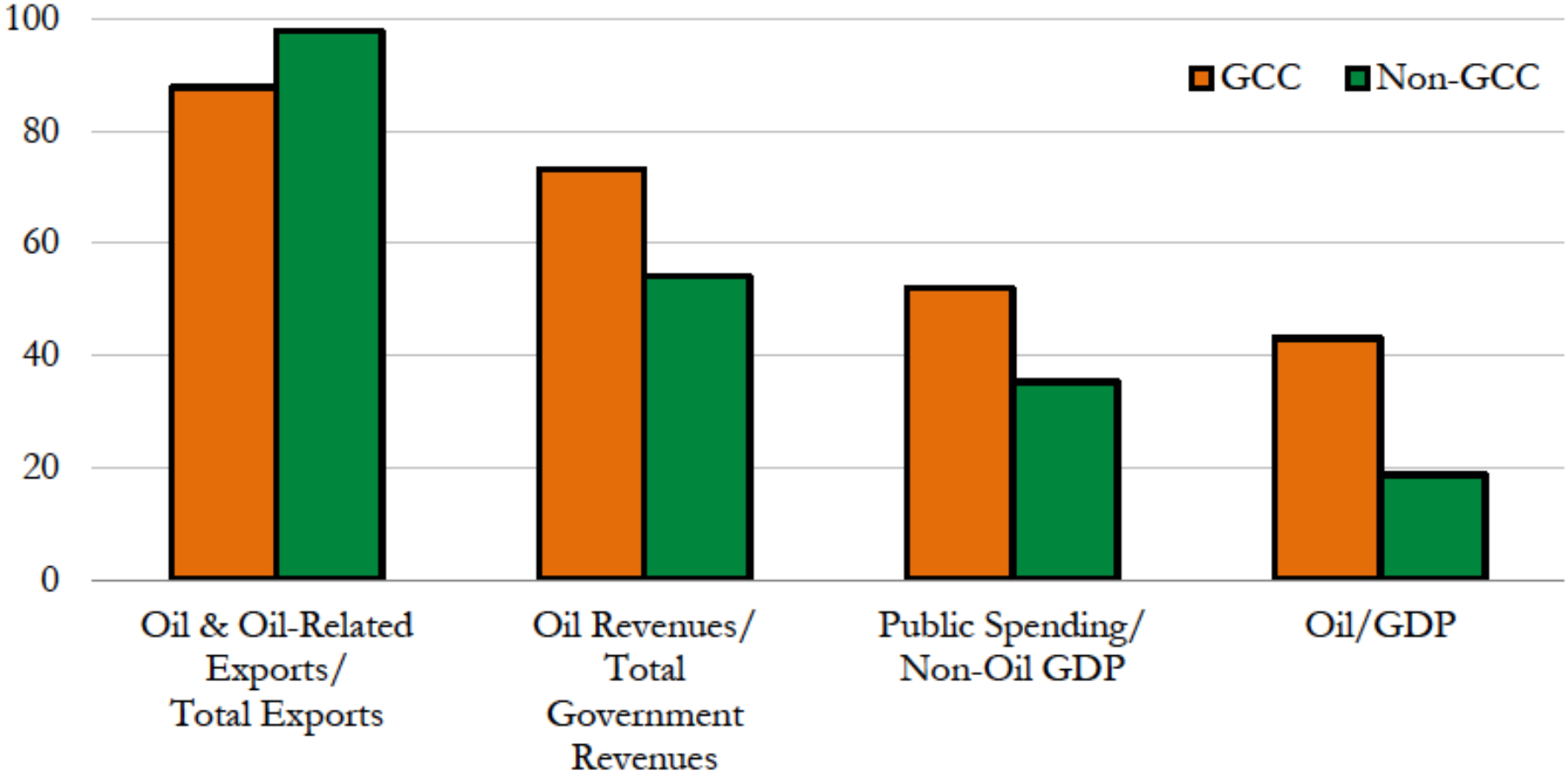
Source: IMF Regional Economic Outlook Oct 2015

Oil producers are facing external & domestic shocks from lower oil prices

GCC alone reported loss in export revenue of $277bn in 2015; government revenue losses amounted to $232bn



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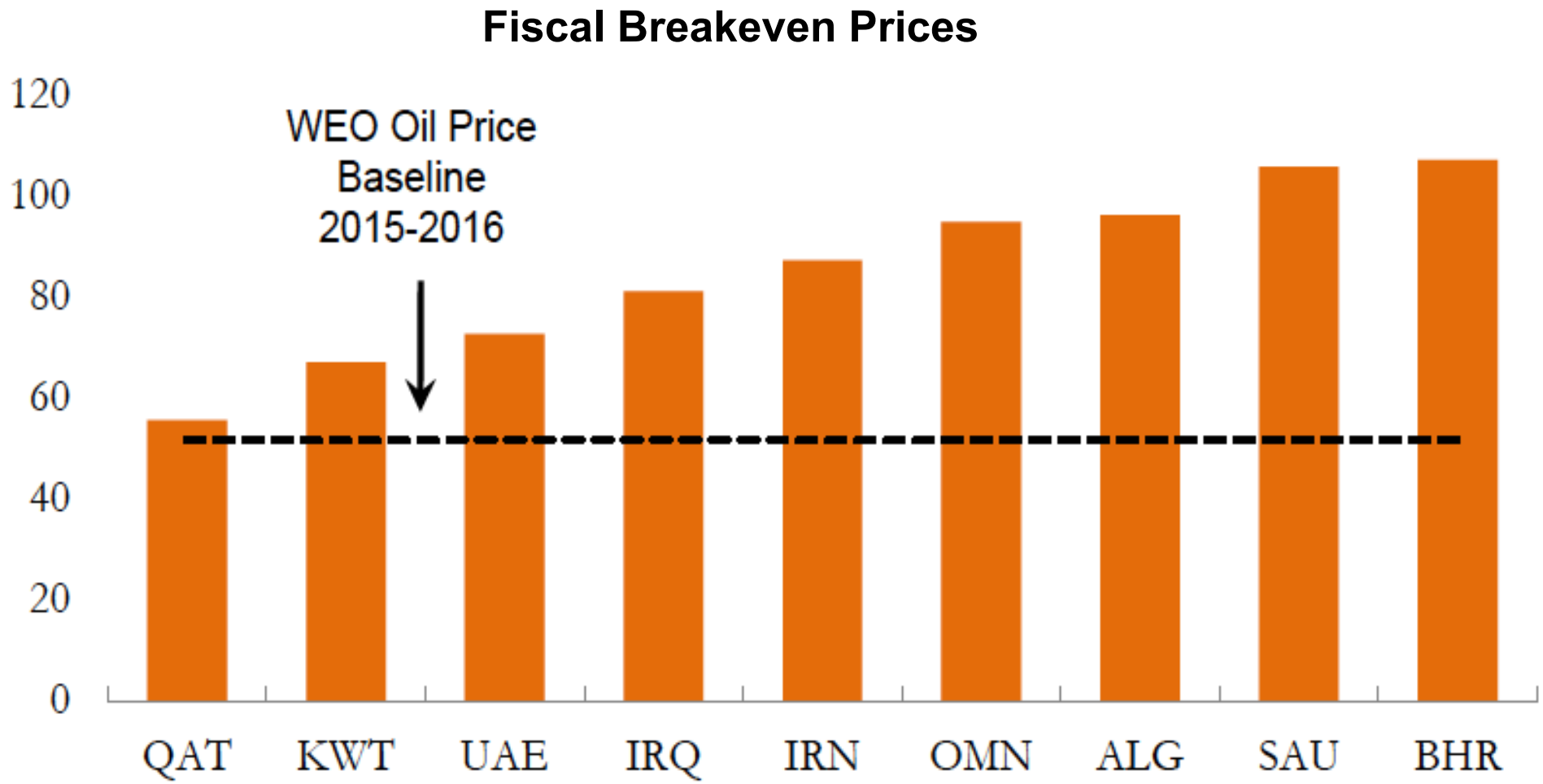
Source: IMF MENAP Regional Economic Outlook, Oct 2015.

Most MENA Oil Exporters will exhaust their financial buffers in less than 5 years! Financing needs reach $1 trillion over 5 years



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Source: IMF MENAP Regional Economic Outlook, Oct 2015.

Consequences of lower oil prices amidst high oil dependence

GCC	Avg. 2000-11	2012	2013	2014	2015f	2016f
Budget bal (% of GDP)	10.8	13.5	10.6	2.9	-13.2	-12.6
Current account bal (% of GDP)	16.4	25.0	21.6	14.8	-0.2	-2.5

- Large budget & current account deficits; spending delays
- Declining accumulation or drawdown of international reserves & net foreign assets
- Draw-down of fiscal buffers (government deposits at banks) => declining liquidity and lower credit growth
- Danger of financial crowding out as governments start borrowing from domestic banks and raising rates

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Adjusting to new oil normal requires radical government policy reforms

1. **GCC need both economic & revenue diversification;** focus on increasing private sector participation, PPP & privatisation
2. **GCC economies require new tax regime for economic policy management,** including broad-based (e.g. VAT) & selective taxation (e.g. excise taxes).
3. **Implement: expenditure reducing policies** (e.g. remove subsidies) and e**xpenditure switching policies** to build social capital (health, education) and increase productivity growth
4. **Efficient, equitable pricing of public services & utilities**
5. **Use financial markets for development & infrastructure finance**

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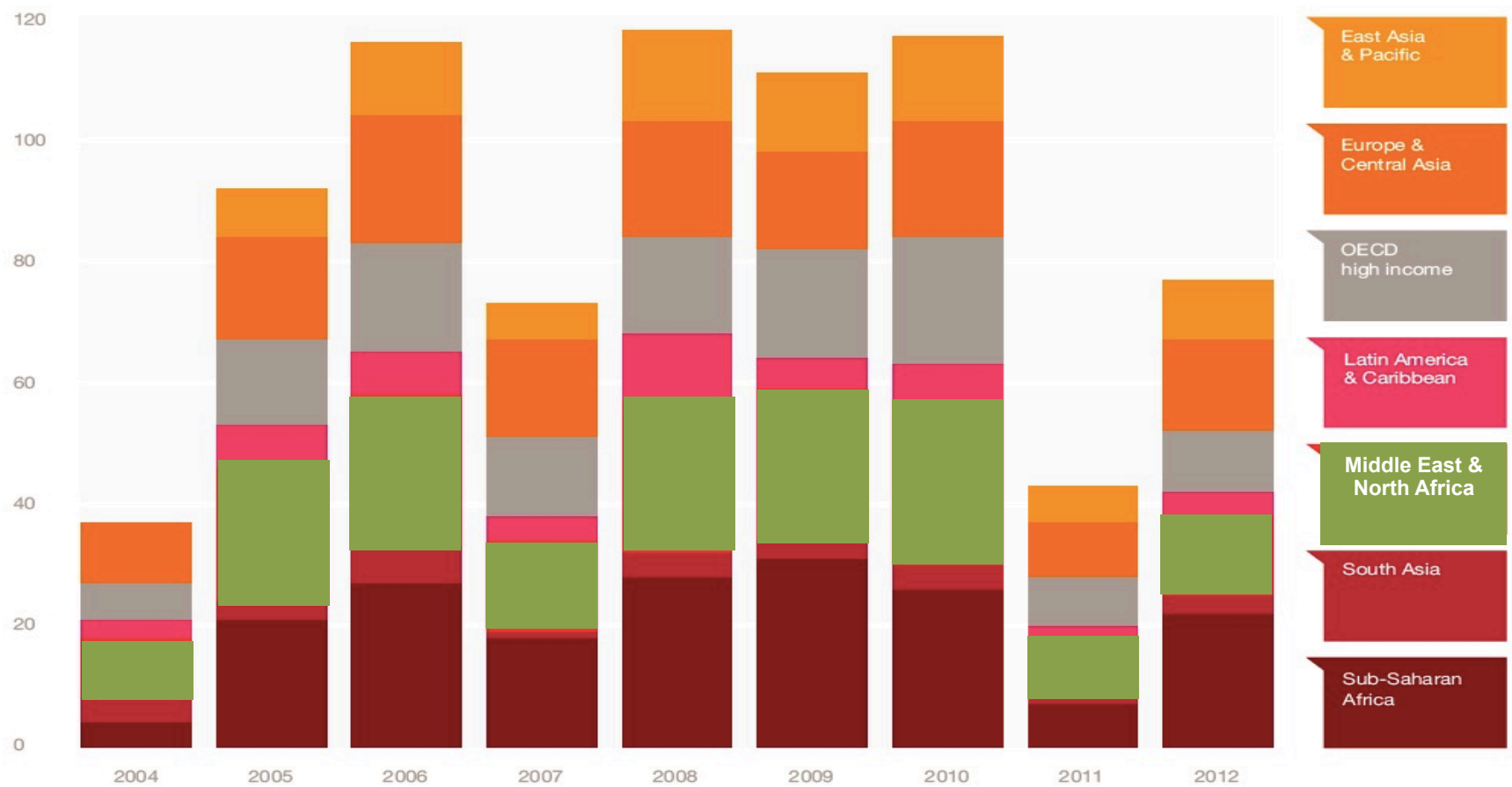
GFC ushered in an accelerating pace of tax reform

Number of Changes making it easier or less costly to pay taxes
(WB, Doing Business report)



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Source: Paying Taxes 2015, PwC

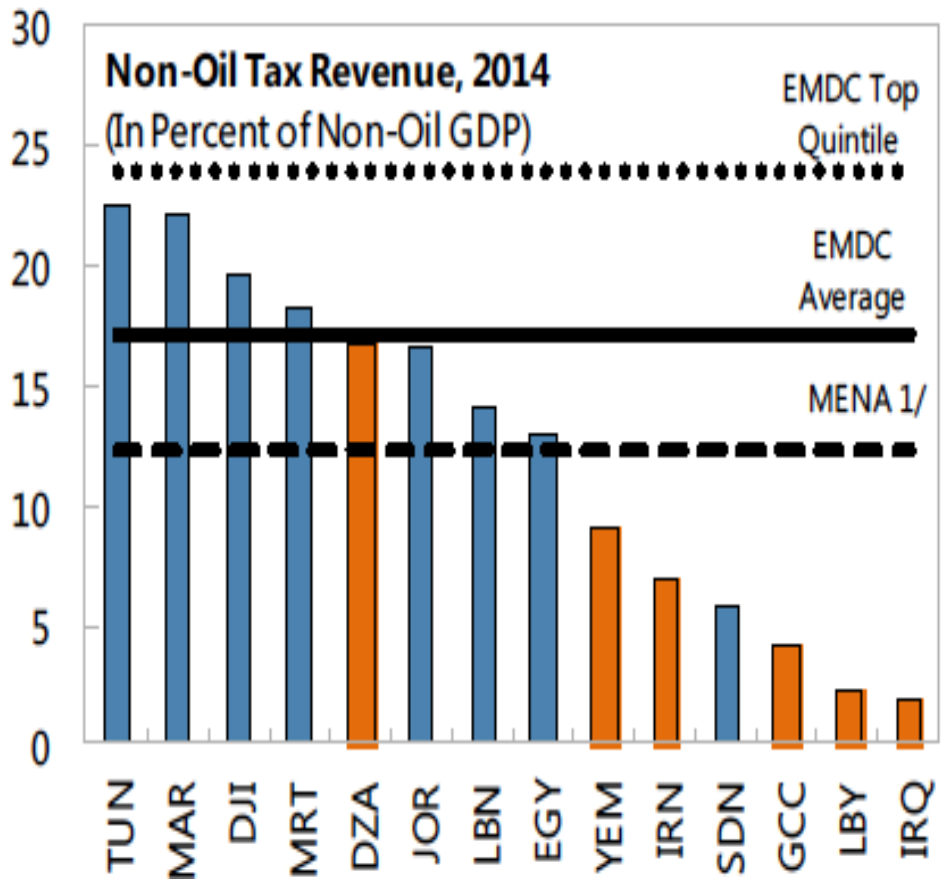
Low cost of paying taxes in GCC under current tax regimes

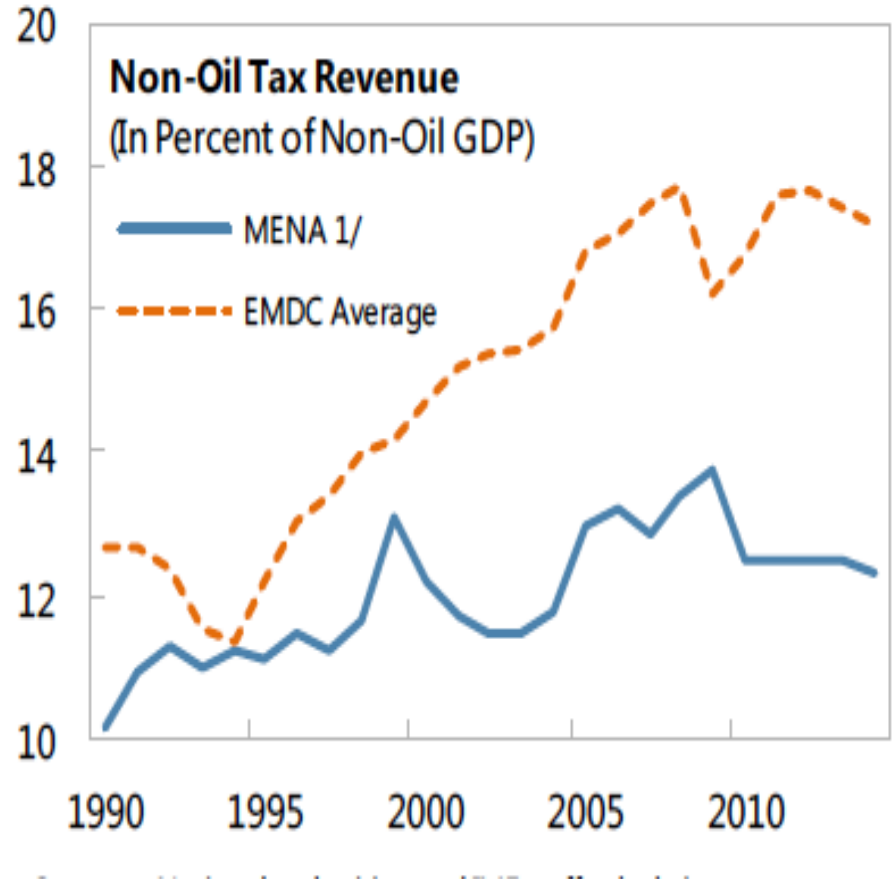
	Payments (no. per year)	Time (hours per year)	Total tax rate (% of profit)	Profit tax (% of profit)	Labour tax & contributions (% of profit)	Other taxes (% of profit)
Algeria	27	385	72.7	6.6	30.6	35.5
Djibouti	36	82	37.6	17.7	17.7	2.2
Egypt	29	392	45	16.3	24.1	4.6
Iran	20	344	44.1	17.8	25.9	0.4
Iraq	14	312	27.8	14.3	13.5	0
Jordan	25	151	29.5	13.1	14.4	2
Lebanon	20	183	30.3	6.1	23.8	0.4
Libya	19	889	32.8	22	10.5	0.3
Malta	7	139	41.3	30.1	10.7	0.5
Morocco	6	211	49.1	25.4	22.3	1.4
Syria	20	336	42.7	23	19.3	0.4
Tunisia	8	144	59.9	12.8	25.2	21.9
West Bank &Gaza	28	162	15.3	15	0	0.3
Yemen	44	248	33.1	20	11.3	1.8
Bahrain	***13***	***60***	***13.5***	***0***	***13.5***	***0***
Kuwait	***12***	***98***	***13***	***0***	***13***	***0***
Oman	***14***	***68***	***22.9***	***11***	***11.8***	***0.1***
Qatar	***4***	***41***	***11.3***	***0***	***11.3***	***0***
Saudi Arabia	***3***	***64***	***15***	***2.2***	***12.8***	***0***
UAE	***4***	***12***	***15.9***	***0***	***14.1***	***1.8***

Source: Doing Business 2016, World Bank

MENA taxation is low compared to other emerging & developing economies

Well-established Non-Hydrocarbon-Based Tax Systems





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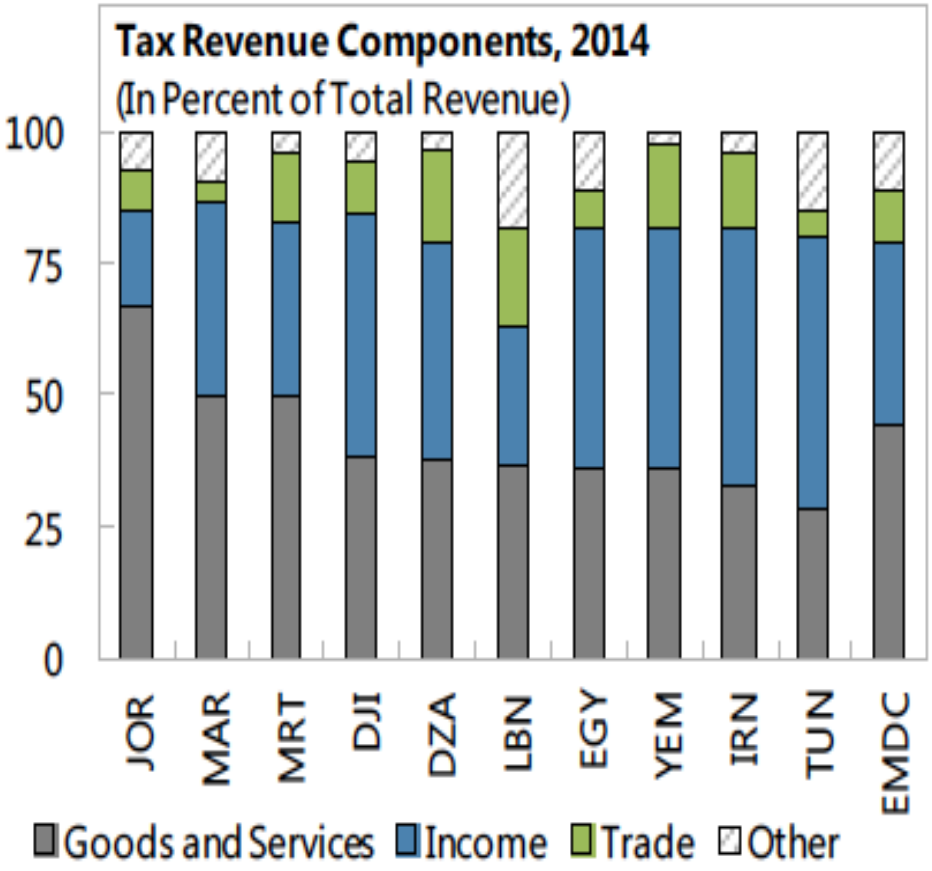
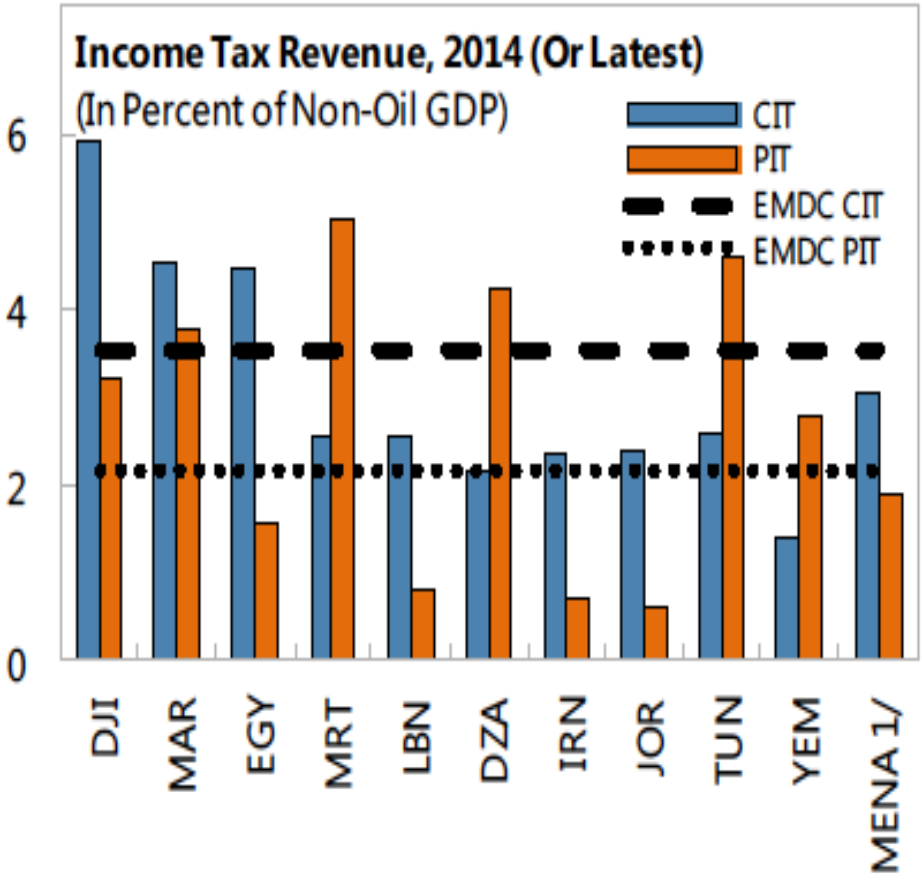
Source: Fair Taxation in the Middle East and Northern Africa, IMF Staff Discussion Note, 2015

MENA non-oil economies are developing & diversifying their tax systems

Well-established Non-Hydrocarbon-Based Tax Systems





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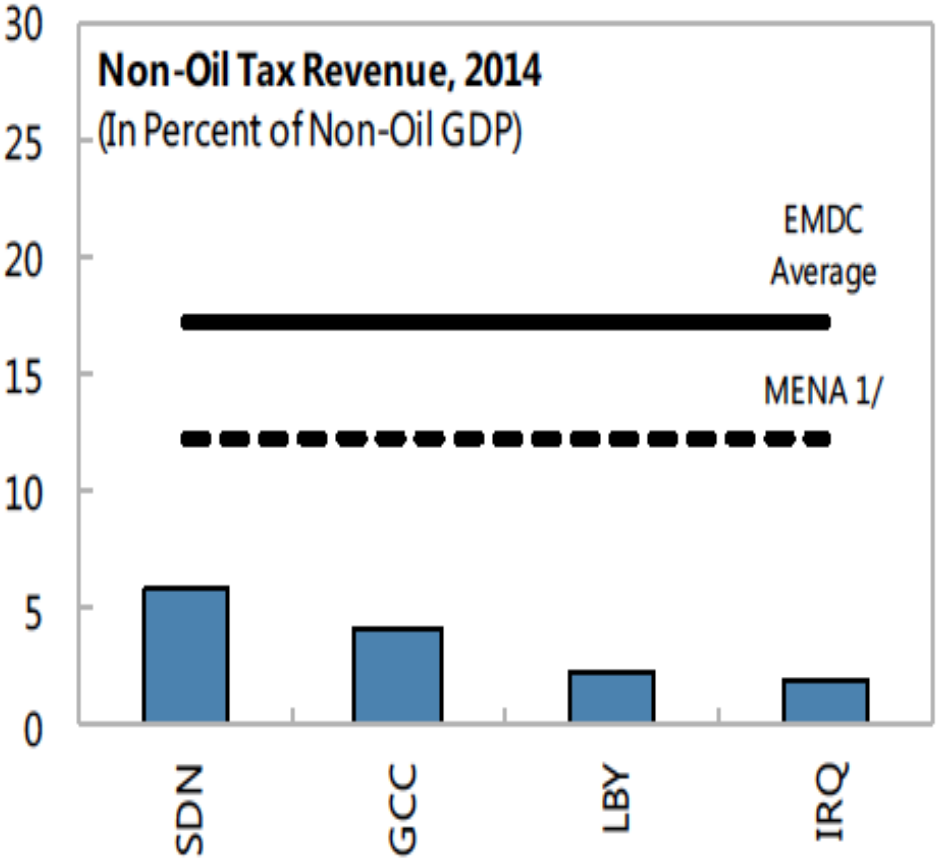
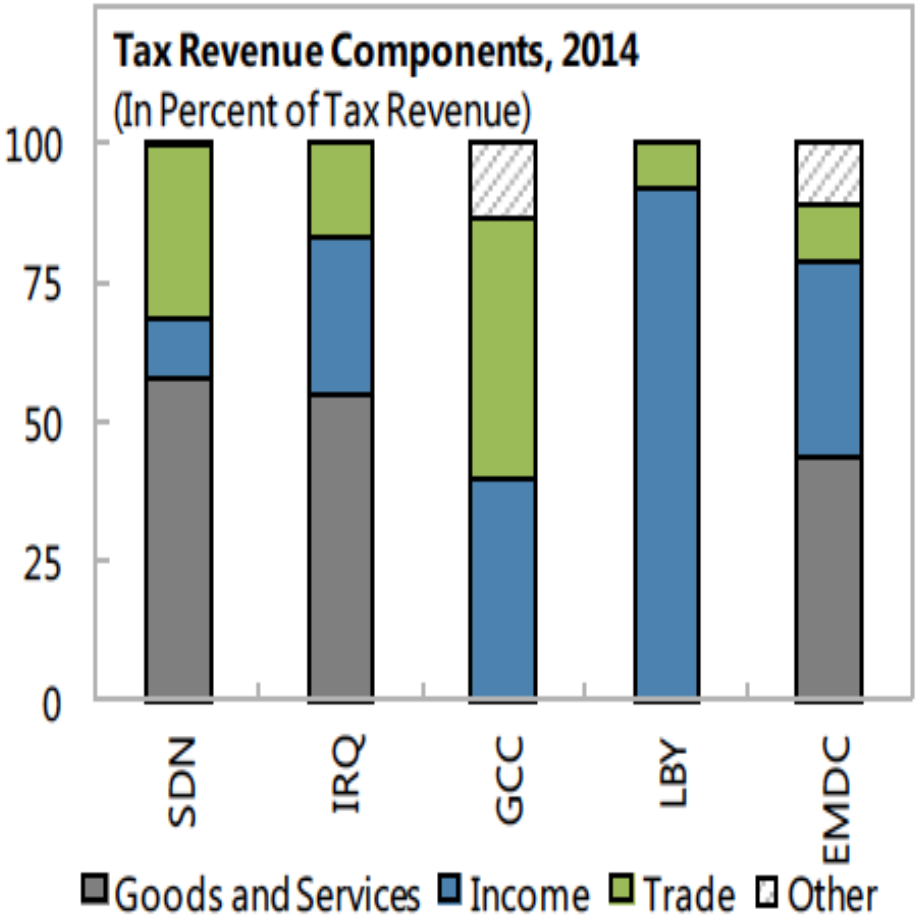
Source: Fair Taxation in the Middle East and Northern Africa, IMF Staff Discussion Note, 2015

GCC are reliant on trade taxes which will have to be phased out

Taxes focus on CIT (on non-nationals) and trade taxes



Sources: National authorities; and IMF staff calculations.



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Source: Fair Taxation in the Middle East and Northern Africa, IMF Staff Discussion Note, 2015

Current tax regime in GCC limits use & effectiveness of fiscal policy

Main non-oil revenue taxes: customs duties, fees and charges

- Inadequate tools for counter-cyclical fiscal policy
- Do not constitute a complete panoply of modern tax tools
- Limited ability to influence behaviour of private sector
- Distortionary impediments to trade: with cascading due to taxation of inputs
- Significant loss in revenues due to WTO and bilateral FTAs

Aim to develop new tax regimes:

- **Broad based taxation**: VAT/GST to be implemented in conjunction with a reduction in tariffs & distortionary fees and charges
- **Selective taxation:** Excise taxes on items like tobacco, alcohol, cars, gas

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Tax sequencing & importance of communication

- **GCC economies are maturing**: need stable sources of revenue
- **Political leadership is a necessity** for fiscal reform & taxation
- A solid **communication strategy** is critical to gaining public buy-in
- Start by **developing & implementing a few simple instruments:** low-rate VAT, CIT and excise taxes
- **Build administrative capacity and taxation expertise** that can be leveraged later to scale up tax systems
- **Improvements in budget planning and execution, efficiency and transparency in the use of public resources**, can boost trust in the government & therefore tax reform.

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What should the private sector do to implement VAT?

Private sector needs education & investment in tax accounting, reporting & compliance, including to:

- Understand the likely impact of VAT on demand for G&S and competitor responses
- Understand VAT obligations and application for VAT registration
- Ensure that relevant books and records are maintained for tax reporting
- Revise terms of business with customers to ensure that VAT becomes a cost to customers not to suppliers;
- Revise Enterprise Resource Planning (ERP) systems to ensure that they can cope with the charging and recovery of VAT; Implement manual VAT accounting processes if no central ERP system is used;
- Change invoicing templates to include new fields relevant for VAT accounting
- Ensure the business is structured to avoid unnecessary cash-flow or absolute VAT costs arising, particularly on inter-company transactions.

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Introduce Excise Taxes

- Excise taxes are selective taxes on the sale or use of specific goods and services, such as tobacco, cars, alcohol and gasoline, produced for sale within a country, or imported and sold in that country
- Four reasons for imposing excise taxes:
  - Revenue generation
  - Tailored to impose tax burdens on those who benefit from government services financed by excise taxes (e.g. roads)
  - Control of externalities (e.g. pollution, climate change)
  - To discourage consumption of potentially harmful substances
- Excise taxes have existed for centuries and are widely used. For the OECD countries, taxes on specific G&S represent some 11% of total taxation
- The tax is usually collected from the producer or wholesaler or at the same point in the distribution chain as import duty or final sale to the consumer

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Excise Taxes: specific vs. *ad valorem*

	Ad valorem tax	Specific tax
Tax base	Based on price	Based on quantity (e.g. 1000 cigarettes)
Administration	Higher administration costs as prices and total market value need be monitored	Easier to administer as only volume needs to be known – lower administration costs
Invoice undervaluation concerns	Sensitive to undervaluation as taxation is based on invoice price - tax avoidance is possible	Tax is not based on price, so this is not an issue
Tax rate increase	Excise tax goes up automatically with price increase	Rates need to be regularly adjusted by inflation – a multi-year tax schedule can address this
Tax revenues	Excise revenue is more volatile and less predictable as excise level depends on consumption dynamics and manufacturer price	Excise tax revenues are likely to be higher, stable and more predictable
Public health	Provides a higher incentive to lower prices as taxes reduce accordingly	Encourages relatively higher prices

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WTO Bound Rates on Tobacco in GCC

	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%

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Policy Priorities for Governments: Pace, Implementation, Enforcement

- New tax regimes should be harmonized across GCC, introduced in a synchronised manner, and be the same in all member states to prevent market fragmentation, avoid arbitrage and tax avoidance/evasion.
- Implementing revenue diversification by introducing new taxes such as VAT or excises should follow a multi-year plan to allow build-up of tax capacity & administration and for private sector to adjust & make necessary investments to comply.
- Effective enforcement is required. Governments should implement track & trace systems, develop specialised resources and tools, with officials skilled in audit, ability to use IT tools, analyse and assess tax declarations and data sources.

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Policy Priorities for Governments: Pace, Implementation, Enforcement II

- New excise duties should be introduced by the Ministries of Finance, with a revised mandate enabled by the requisite legal & regulatory reforms, which would set up the revenue administration.
- An excise revenue administration set-up would have the added advantage of facilitating introduction of other excise taxes in the future
- Excise taxes are a domestic tax; to avoid distortions, these should apply equally to imports & domestic production, including those originating in FZs.
- Governments need to maintain reasonable expectations about revenues to be collected from the implementation of excise taxes: they will not compensate for oil revenue gap

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Key Takeaways

- Oil price crisis presents ‘perfect storm’ opportunity for economic policy reform in oil producers given high dependence on oil revenues & low tax levels
- Fiscal consolidation is imperative: remove subsidies & diversify revenue through introduction of taxation. Privatisation & PPP
- VAT on G&S, Excises on tobacco, oil products, cars etc. are good starting points to develop a more comprehensive tax regime
- GCC needs to build tax administration capacity, harmonise & synchronise introduction of new taxes
- Public & private sector awareness/ buy-in is necessary before implementation

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Thank you

Dr. Nasser Saidi
www.nassersaidi.com
@NSA_economics

NASSER SAIDI
& ASSOCIATES