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From the Editor: In this issue of showCASE, our Political Economist takes a close look at the tax reform in Jordan, put on hold following mass protests in June 2018, in an attempt to answer to question: what can the government do to warm the citizens to the idea of increasing the country's tax base?

No Taxation without Representation? On Tax Reforms in Jordan

By: Katarzyna Sidło, CASE Political Economist

As Jordanians celebrated Eid al-Adha (commemorating the willingness of Prophet Abraham to sacrifice his own son at the will of God) last month, the spirit of protests that shook the political scene in the country only two months ago seemed to have diluted. With festivities and indeed the holiday period approaching their end, it might be a good moment to take a step back and analyse one particularly controversial aspect of the proposed – and for the time being withdrawn – reforms that sparked so much discontent in the country earlier on: taxes.

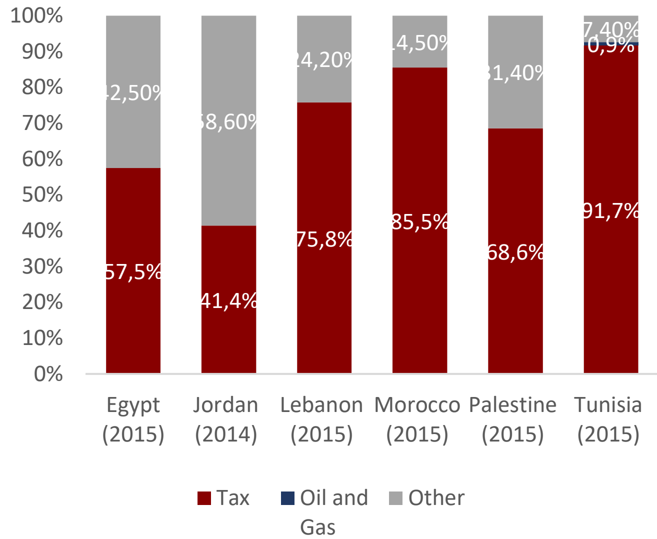
Photo: Protests near the Prime Minister's office in Amman, Jordan, June 6, 2018. REUTERS

The protests broke out on May 31, 2018 following an announcement by the government of a new set of austerity measures aiming to improve the economic situation in the country. Particularly disputed were the proposed amendments to Tax Income Law. In an attempt at widening the tax base, the government planned to decrease the limit of non-taxable income from Jordanian Dinar (JD) 12,000 (approx. USD 17,000) down to JD 8,000 (approx. USD 11,000) for individuals and from JD 24,000 to JD 16,000 for families. Moreover, the law assumed removal of additional exemptions of up to JD 4,000 on expenditure items such as education, housing loans' interests or medical expenses and introduced alterations to the income tax brackets decreasing them from five to three. Additionally, new penalties for tax evasion (in the amount of 100% of the amount due), tax understatement (between 10% and 50% of understated tax depending on the amount of understatement above a 20% threshold) and late tax filing (5% of tax due calculated on monthly basis, up to a 25% threshold) were introduced as well.

In terms of corporate income taxation (CIT), proposed changes included increasing tax rates for entities in banking industry (up to 40% from 35%), mining (up to 30% from 24%), and insurance and leasing sector (up to 40% form 24%). Additionally, some other proposed changes included introduction of a 15% tax on capital gains from sales of unlisted shares and increase of corporate income tax rate for foreign branches of Jordan-domiciled companies from 10 to 30%. Tax breaks for exporters of Jordanian origin goods were also to be removed.

The proposed tax reform (which, if implemented, would be the fifth one in the last eight years) angered many echelons of society, from the urban and rural poor through professionals and middle classes to business people. Indeed, the protests, initiated by Jordanian professional associations and civil society groups such as the youth movement Hirak Shababi, attracted thousands of people of all backgrounds not only in Amman, but also in smaller cities such as Maan or Ramtha. What was unprecedented about the protests was participation of young urban middle class (the "Starbucks drinkers") who did not necessarily take part in the Arab Spring protests, seeing it as a struggle of lower classes. This time, in a breach of an existing social contract, they were asked to contribute directly to the state budget without being offered anything concrete in return.

Figure 1. Revenues from tax and oil and gas as % of total revenue



Source: Own preparation based on data from ESCWA, 2017

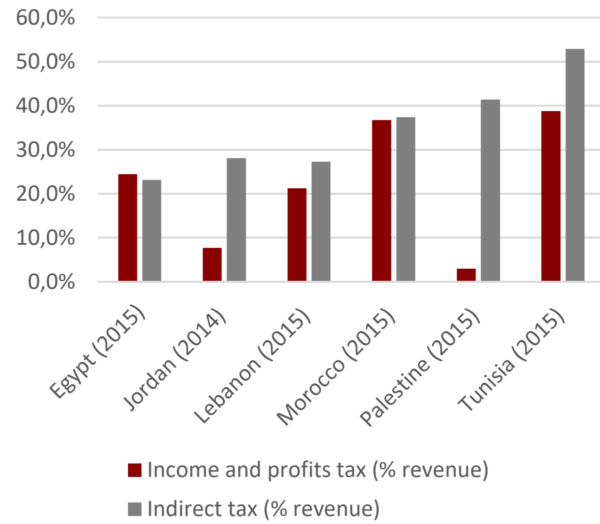
Currently, only between 4% and 5% of Jordanians are subject to an income tax. The proposed law was to increase this base up to 10%. And such an increase, while understandably contested by those directly affected (i.e. the middle earners that would make up the missing 5 to 6 percentage points), is desperately needed. At 41.4% in 2014, Jordan had the lowest tax as percentage of revenue among the oil-poor countries in the Middle East and North Africa (MENA) (See Figure 1). Crucially, 28.1% of this income came from indirect taxes, while only 7.7% from income and profit taxes. This trend has been only been gaining on strength during the past decade. Between 2004 and 2015, the share of indirect tax in the country's total revenue increased from 23.7% to 28.1%. This is bad news especially for the lower and middle classes because indirect taxes (save for those levied on luxury goods) are generally believed to affect disproportionally the poorer sectors of the society. Regressive taxes such as VAT on basic foodstuffs, water or electricity are borne by everyone regardless of their income. For instance, one study from 2015 found that in Jordan contribution to the budget in terms of indirect taxes paid by the lower 40% of the population was higher than that of the higher-income Jordanians. This was despite the fact that the ratio between expenditure of the affluent Jordanians and the rest of the population have been on an increase.

Broadening the tax base as well as increasing wealth taxes on capital gains and CIT for certain industry sectors is therefore a much more logical move than increasing VAT. That said, for the people of Jordan to accept the reforms, significant communication effort on the part of the government and its new Prime Minister Omar Razzaz (the previous one, Hani Mulki, was forced to resign over the protests) is needed.

First of all, the government needs to take responsibility for the economic effects of its actions. Blaming the austerity measures on the International Monetary Fund (IMF) is only strengthening people's (and some analysts') conviction that they are ruled by international institutions while in fact some of the controversial measures recently introduced by the government, such as lifting bread subsidies and increasing tax on medications, were opposed by IMF. To make people better understand the need for reforms – which result from internal not external pressures – the government should be more honest about the economic situation in the country (ceasing to understate official unemployment rates would be a good start). It should also make it very clear that maintaining the current strategy of counting on foreign aid packages such as the recently pledged USD 2.5 billion from the Gulf, or indeed IMF's, loans is both unsustainable strategy and comes with strings attached.

Secondly, the government should fight corruption, tax avoidance (which according to the Income and Sales Tax Department in 2016 cost the budget JD 3 billion), mismanagement, and cronyism to make Jordanians feel their taxes are being put to a good use. One study, conducted by the University of Jordan Strategic Studies Center and NAMA Consultants, argues that only 35% of Jordanians have a positive view on how the governments serves the people, a steep decline from 65% in 2011. Even larger number – 79% of the population according to Arab Barometer – believe state institutions are corrupted, and consider economy and corruption their biggest worries. This is confirmed by Jordan's ranking in 2017 Transparency International's Corruption Perceptions Index – 59th position among 180 countries. An illustrative example of how big of a problem corruption in the country is might be the recent cigarette scandal involving accusations of local authorities granting tax exemptions to a businessman owning a number of unlicensed cigarette manufacturing plants all over the kingdom, which – according to whistle-blowers – may have cost the budget a loss of over JD 150 million. If Jordanians are to accept tax increases, they need to trust that no one is able to escape making a contribution just because they have *wasta* (good connections).

Figure 2. Indirect and Income and profit tax as % of revenue



Source: Own preparation based on data from ESCWA, 2017

Finally, the government must acknowledge the fact that by requiring more citizens to directly contribute to the budget it is breaking the current social contract. In a democratic state that Jordan aspires to be, old truth of "no taxation without representation" should also apply. Once Jordanians accept the reforms, they will expect more budgetary transparency and accountability in return for their efforts. Especially that austerity measures threaten to cost the middle classes their middle-class status; as already noted, salaries are low, unemployment rates are high, and Jordan is not a cheap country to live in (indeed, Amman is the second most expensive city in MENA according to the Economist).

The task is by no means easy and will take a lot of good will both from the government and Jordanian citizens. The former will most likely by the end of the year propose a new set of austerity measures. Income tax reform is quite sure to be one of them. Hopefully, this time the government will learn from the past experiences and at the very least conduct a round of public consultations, making Jordanians feel included in the reform process their country so badly needs.

This week: According to the Central Statistics Office (GUS) data, retail sales at constant prices were by 7.1% higher in July 2018 than the same period the year before (against a growth of 6.8% in July 2017). Compared with June, this year retail sales increased by 0.2%. In other news, household debt increased by PLN 1.2 billion, up to PLN 706 billion.

GDP (Q2 2018)

5.1% y/y

Down from 5.2 % in Q1 2018

Inflation (August 2018)

2.0% y/y (est.)

Unchanged since June 2018

Unemployment (July 2018)

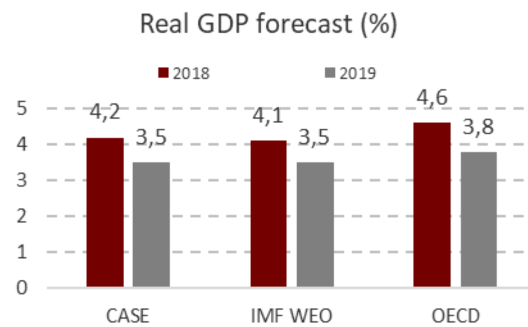
5.9%

Unchanged since June 2018

NBP Base rate

1.5%

From 2% in March 2015



This week: The Central Bank of the Russian Federation decided to temporary halt purchases in the foreign exchange market between August 23 and September 30. The decision was made in order to increase monetary authorities' actions and reduce the volatility of financial markets. A decision to resume the currency purchase will be made taking into account the overall situation in the financial markets throughout September 2018.

GDP (Q2 2018)

1.8% y/y

Up from 1.3% in Q1 2018

Inflation (July 2018)

2.5% y/y

Up from 2.3% in June 2018

Unemployment (June 2018)

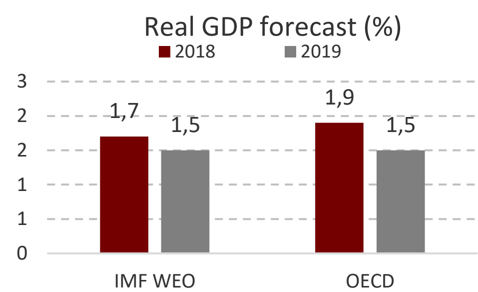
4.7%

Unchanged since May 2018

CBR Base rate

7.25 %

From 7.5% in Feb 2018



This week: The road crash in Genoa and collapse of the German motorway A20 commenced a discussion on once envied and now outdated infrastructure across the country. Most of approx. 140,000 bridges and viaducts are made of reinforced concrete while only a few have a wooden, stone or steel construction. This has been reflected in the latest World Economic Forum competitiveness ranking, where the country fell to 15th place in terms of road quality, behind Oman and Portugal.

GDP (Q2 2018)

2.0% y/y

Down from 2.1% in Q1 2018

Inflation (July 2018)

2.1% y/y

Unchanged since June 2018

Unemployment (July 2018)

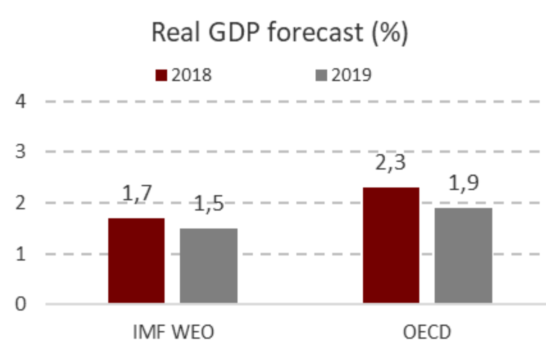
3.4%

Down from 3.5% in June 2018

ECB Deposit rate

-0.4%

From -0.3% in Dec 2015



This week: According to the Ministry of Economic Development and Trade of Ukraine in Q1 2018, the shadow economy amounted to 33% of the official GDP, 4% less compared to the same period in 2017. The contraction of the shadow economy was possible thanks to positive macroeconomic expectations and policies aimed at increasing domestic demand. It was also influenced by the increase in incomes and implementation of reforms in the investment sector.

GDP (Q2 2018)

3.6% y/y

Up from 3.1% in Q1 2018

Inflation (July 2018)

8.9% y/y

Unchanged since June 2018

Unemployment (Q2 2018)

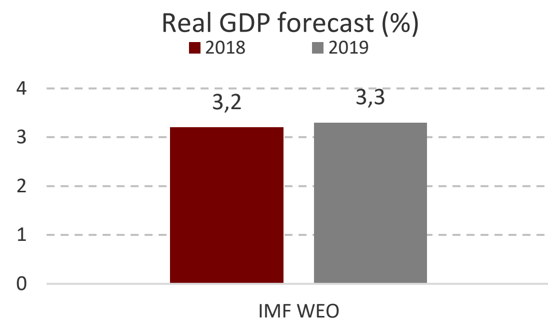
9.7%

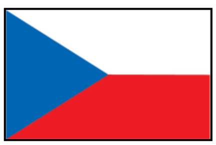
Down from 9.9% in Q1 2018

NBU Base rate

17.5%

From 17.0% in May 2018





This week: Prague has been repeatedly accused of violating the air pollution limits set by the EU. The source of pollution is primarily related to gases produced by cars, which is why the Prague city council decided to fight this problem in an unusual way - by encouraging the citizens to drink beer. The logic behind the campaign is that citizens under the influence of alcohol will be forced to leave their cars and use the public transport instead. A special anti-smog campaign has been launched and a beer with the meaningful name “Prague's pedestrian” has hit the market.

GDP (Q2 2018)

2.3% y/y (est.)

Down from 4.2% in Q1 2018

Inflation (July 2018)

2.3% y/y

Down from 2.6% in June 2018

Unemployment (Q2 2018)

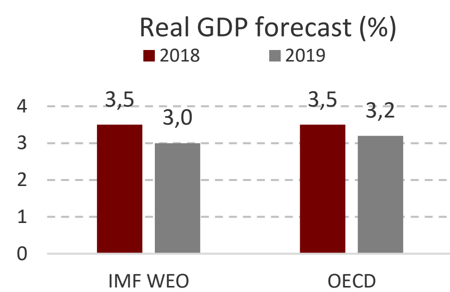
2.2% (est.)

Down from 2.4% in Q1 2017

CNB Base rate

1%

From 0.75% in Feb 2018



This week: Human Rights Watch issued a communication regarding persons who are in the transit zones on the Hungarian-Serbian border. According to HRW, the Hungarian authorities stopped feeding people whose application for asylum was rejected. The HRW expresses the view that it was "a cynical move to force people to quit applying for asylum and leave Hungary." According to the regulations that came into life on July 1, applications for asylum may not be accepted from persons who have come from a country where they are not exposed to persecution, such as Serbia.

GDP (Q2 2018)

4.4% y/y

Down from 4.8% in Q1 2018

Inflation (July 2018)

3.4% y/y

Up from 3.1% in June 2018

Unemployment (Q2 2018)

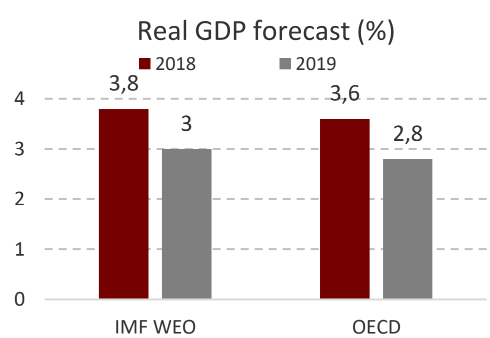
3.6%

Down from 3.7% in Q1 2018

MNB Base rate

0.9%

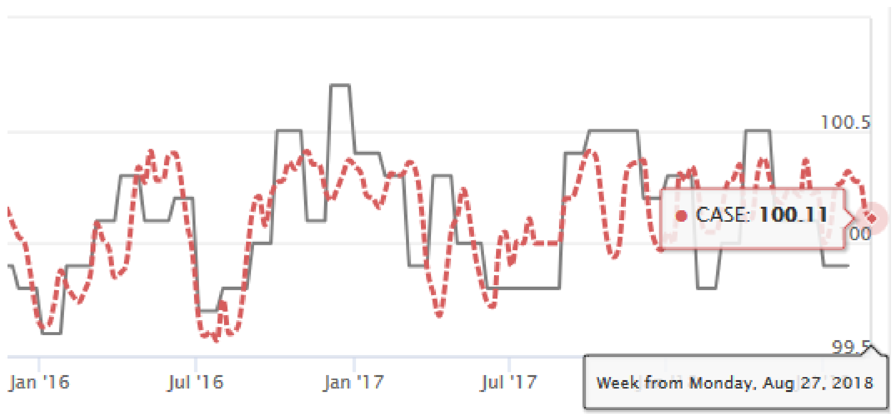
From 1.05% in May 2016



The weekly online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly.

Our weekly online CASE CPI



Online CASE CPI (----) vs GUS CPI (——)

Monthly CASE forecasts for the Polish economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2018	4.2	4.1	4.5	3.7	2.5
2019	3.5	3.6	3.3	3.8	2.3
	Nominal monthly wages	**Merchandise exports (USD, bn)**	**Merchandise imports (USD, bn)**	**Merchandise trade balance (USD, bn)**	**CA balance (USD, bn)**
2018	4.5	233.4	235.2	-1.8	-3.9
2019	3.7	242.7	244.6	-1.9	-4.1

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