



منتدى الاستراتيجيات الأردني  
JORDAN STRATEGY FORUM

# The Jordanian Tax Law

## A Need for a New Vision

April 2018





## منتدى الاستراتيجيات الأردني JORDAN STRATEGY FORUM

The Jordan Strategy Forum (JSF) is a not-for-profit organization, which represents a group of Jordanian private sector companies that are active in corporate and social responsibility (CSR) and in promoting Jordan's economic growth. JSF's members are active private sector institutions, who demonstrate a genuine will to be part of a dialogue on economic and social issues that concern Jordanian citizens. The Jordan Strategy Forum promotes a strong Jordanian private sector that is profitable, employs Jordanians, pays taxes and supports comprehensive economic growth in Jordan.

The JSF also offers a rare opportunity and space for the private sector to have evidence-based debate with the public sector and decision-makers with the aim to increase awareness, strengthening the future of the Jordanian economy and applying best practices.

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# 1. Introduction

Jordan faces a myriad of challenges including weak and fluctuating real GDP growth rate, consistently high unemployment rates, and existing poverty levels. Underlying these challenges, one should not forget the consistent budget deficits, and rising public debt levels.

There is no magic formula that results in strong and sustainable real economic growth with positive implications to unemployment and poverty. However, irrespective of what factors impact such growth, **economic logic asserts** that unless “**fiscal policy**” and “**macroeconomic stability**” (annual GDP growth rate, inflation, budget deficit) are right, the impact of these factors would be limited. After all, **fiscal policy and macroeconomic conditions set the framework within which economic growth takes place.**

1. The provision of public goods and services reduces inequality and promotes growth (fiscal policy).
2. Tax systems can promote growth and reduce poverty (fiscal policy).
3. Macroeconomic stability reduces uncertainty, increases savings and investments.

Fiscal policy is crucial in the short-run and long-run. **In the short-run**, and to maintain stability, the government must be able to increase spending during weak economic performance and vice versa (countercyclical policy). **In the long-run**, the government must be able to invest sufficiently and efficiently in physical and human infrastructure, and maintain sustainable public debt levels.

The fact that fiscal policy is crucial, we need to ask: **Where Does the Jordanian economy stand relative to macroeconomic stability and fiscal Policy?**

**First**, annual growth rates in real GDP have not been strong and stable. **Second**, fiscal policy has always been pro-cyclical and not counter-cyclical. Correlation between real government spending and real growth is equal to around +0.4, while it should be negative in healthy economies that follow a counter-cyclical fiscal policy! **Third**, total public capital spending has been falling at alarming rates affecting the quality and quantity of public goods and services. **Fourth**, budget deficit has been the norm and public debt has been increasing.

Given the above four observations, this policy paper raises two critical questions:

## Questions:

- (1) What is the reason behind the “**inability**” of the government to adopt counter-cyclical fiscal policy?
- (2) What is the reason behind the recent decrease in capital spending and consistent budget deficits?

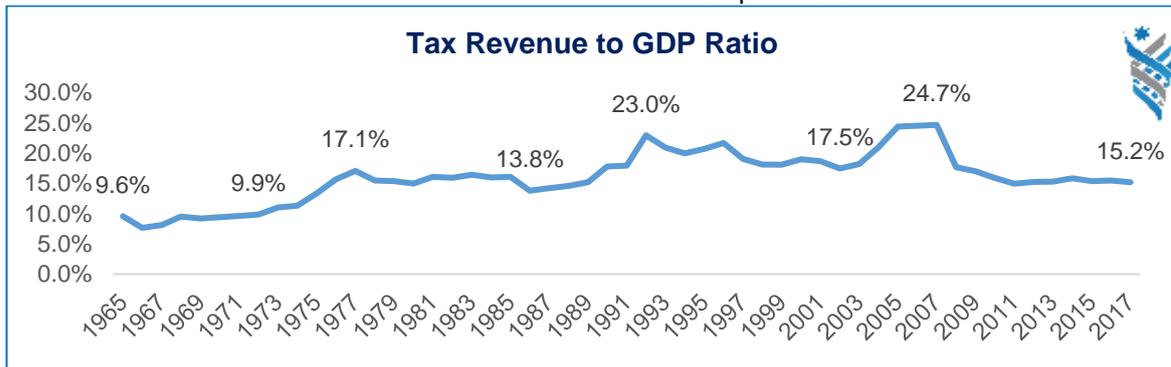
What follows are the answers to these questions. Based on this effort, the paper argues for the pressing need for a fresh look at the existing tax law, and recommends some policy options.

## 2. Fiscal Policy: The Answers

The objective of this section is to provide convincing answers to the reasons behind the **“inability”** of the government to adopt counter-cyclical fiscal policy, and the recent decrease in capital spending and consistent budget deficits?

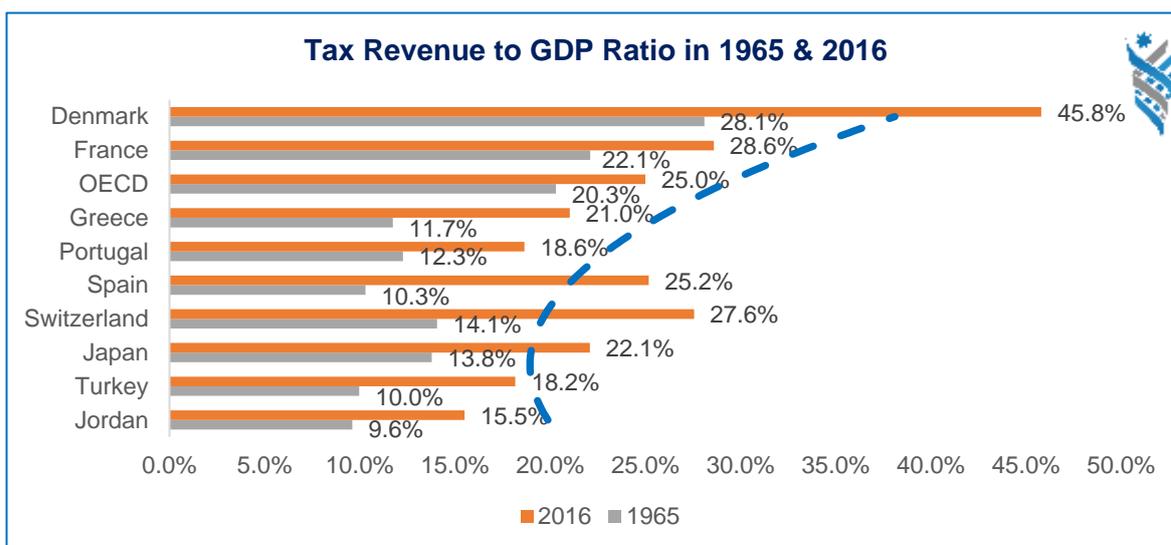
### Answers:

1. When total tax revenue to GDP ratio hovers around the 15% mark, the government simply does not have sufficient revenues to adopt counter-cyclical fiscal policy. Consistent budget deficit and foreign aid only exacerbate this problem.

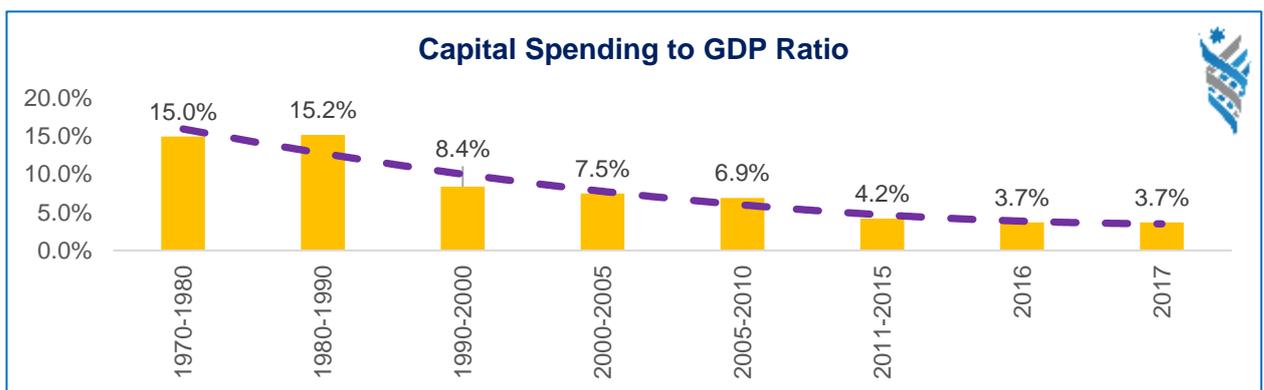
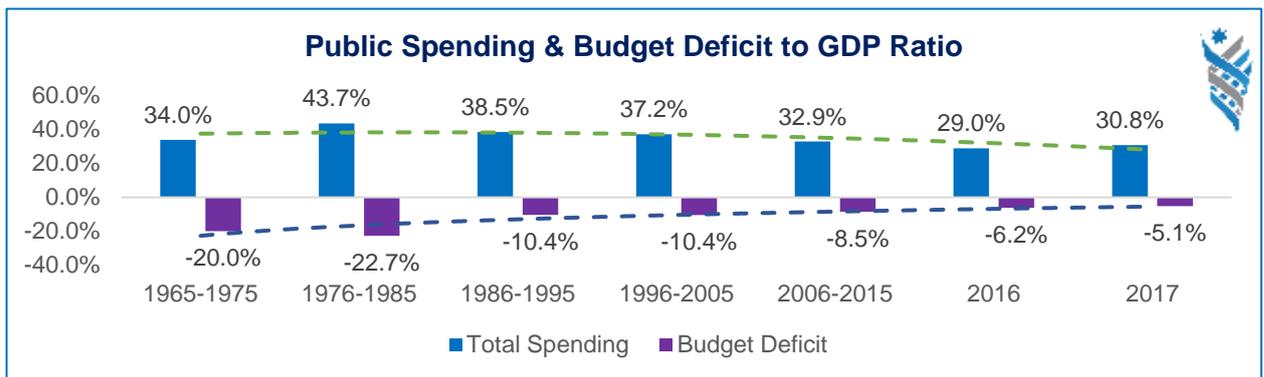


2. Back in 1965, countries like Greece, Spain, and Turkey had tax revenues to GDP equivalent to 11.7%, 10.3%, and 9.9% of GDP respectively. With 9.6% tax to GDP ratio, Jordan was not much different. However, in 2016, the Jordanian ratio increased to 15.5% only as opposed to Greece (21%), Spain (25.2%), and Turkey (18%). Denmark managed to increase the ratio from 28%

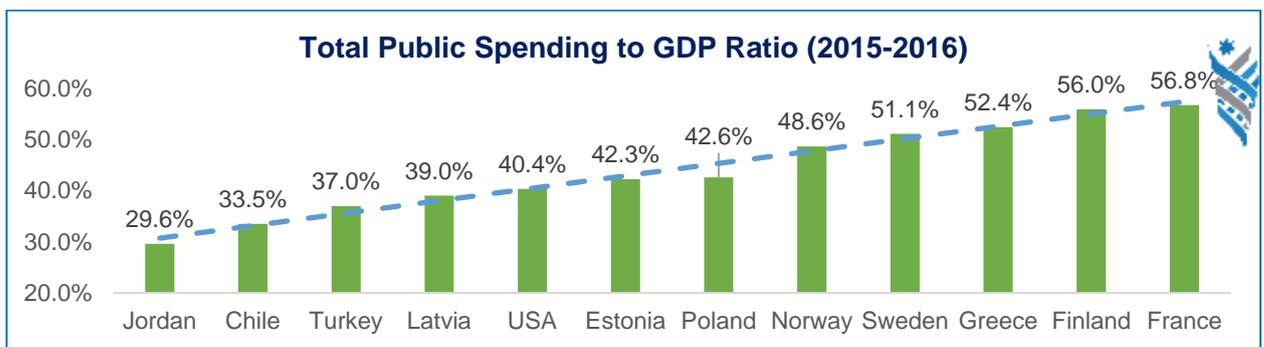
to increase it to 46%! Relative to this point, it is only fair to note that the government collects what is called a special tax on oil-related products, and if these funds are classified as part of tax revenues, the Jordanian tax to GDP ratio would be higher (around 18%).



3. Relative to the 1970s, 1980s, and 1990s, total public spending in Jordan has been falling. More alarming is the fall in capital spending!

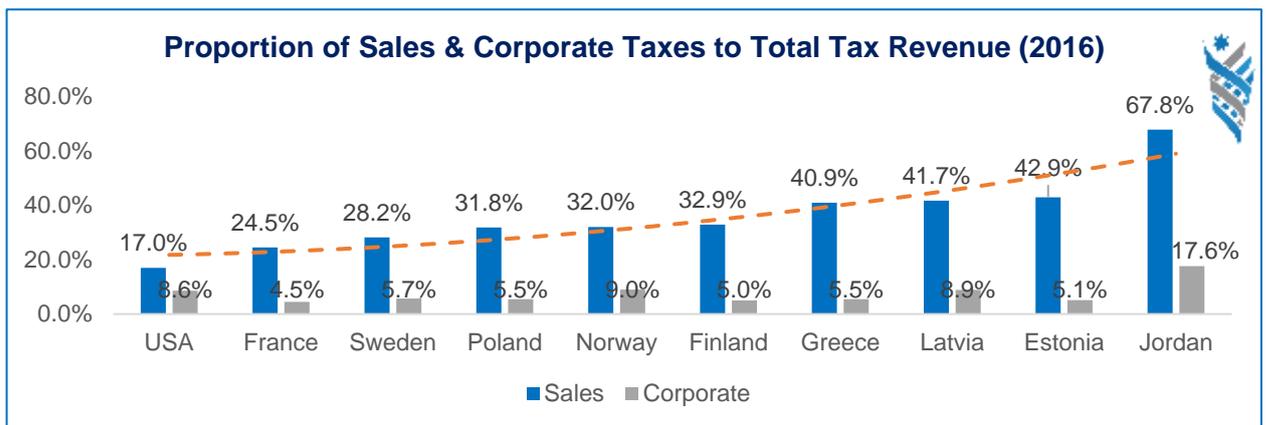
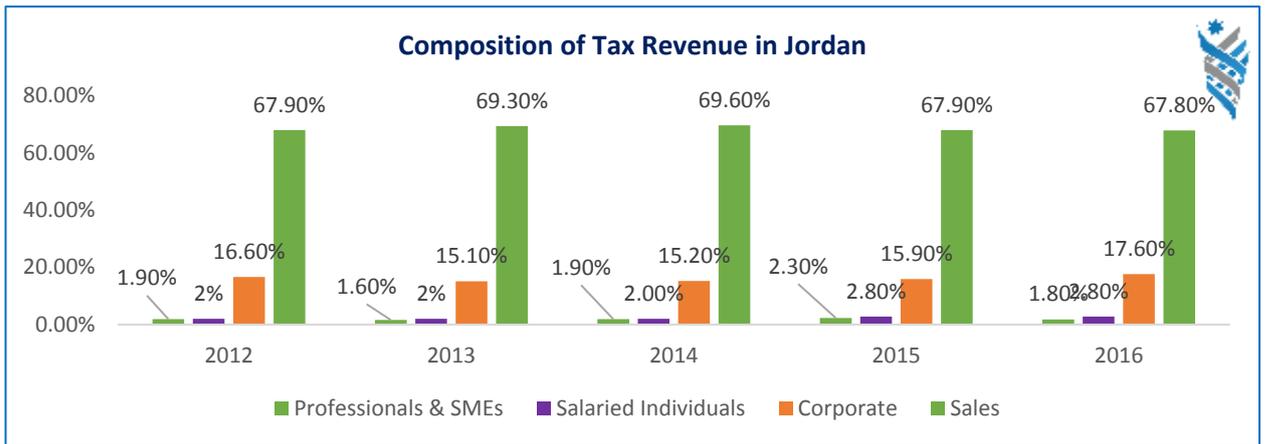


Also, if we compare total public spending to GDP in Jordan with some countries in the world, we see that Jordan spent the equivalent of 29.6% of GDP in 2015-2016, and this ratio is much lower than in many countries including Chile (33.5%, Turkey (37%), Latvia (39%), never mind France (56.8%).

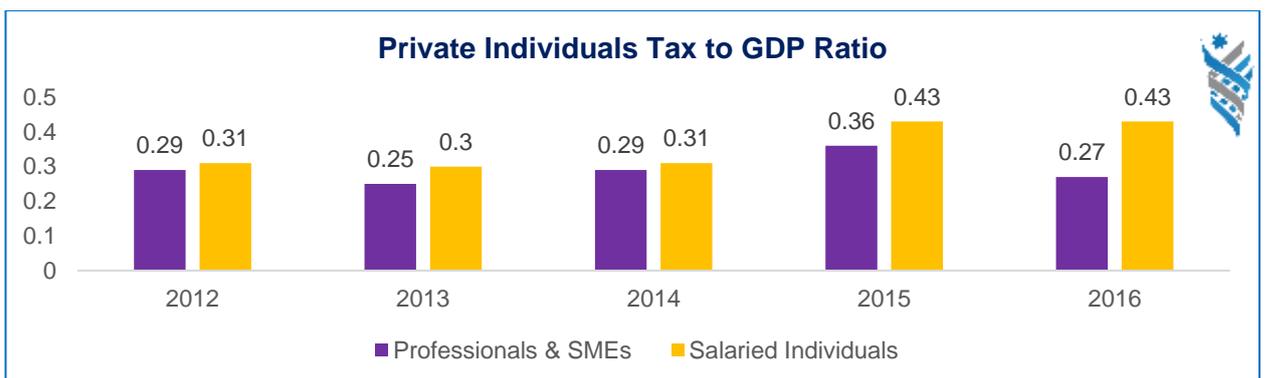


4. In addition to the above, it is worth pointing-out two further observations:

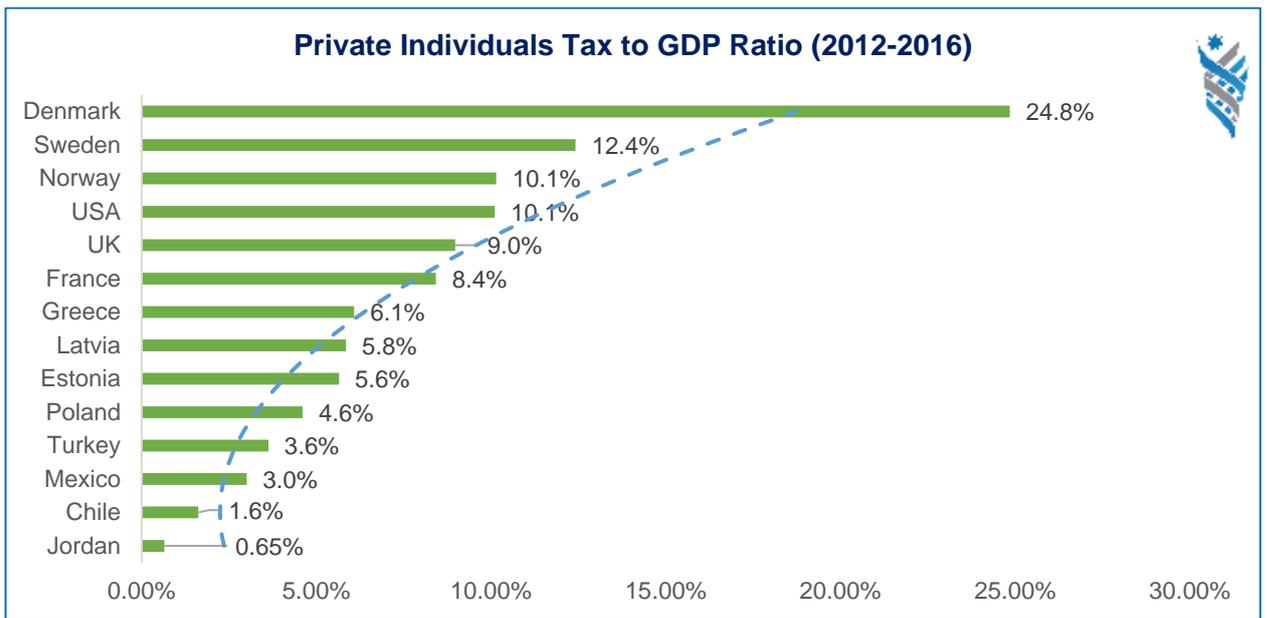
- A. The composition of tax revenues in Jordan provide us with contrasting differences. While sales tax constitutes about 68% of total tax revenue in Jordan, this proportion is much lower in, for example, Estonia (43%), Finland (33%), and the USA (17%). Also, the income tax on companies has also accounted for 17.6% of total tax revenues in Jordan, which is much higher than in countries such as Estonia (5.1%), Finland (5%), France (4.5%) and the United States (8.6%).



**B.** Private individuals in Jordan contribute very little towards total tax revenues. Those who earn wages (salaried individuals) contributed 0.43% of GDP in taxes. Individuals (professionals and private sector outside the corporate sector), on the other hand, contributed an even lower proportion (0.27% of GDP). In contrast, this sector contributed 3% in Mexico, 3.6% in Turkey, 6.1% in Greece, and 24.8% in Denmark. This very low percentage in the case of Jordan could be related to tax evasion!



Compared with other countries, the decline is noticeable in Jordan.



### 3. Recommendations

Without being over self-critical, the cumulative impact of macroeconomic instability, falling capital spending, rising debt levels, deteriorating government effectiveness, and other factors, have weakened the economy and made it settle at what is called “a low-efficiency equilibrium”.

#### Recommendations

##### 1. The government must adopt a modern tax law with good characteristics:

**A-** The law should yield adequate amount of resources for the government so that it becomes able to perform its increasing welfare and developmental activities. If the system fails, the government will have no choice but to resort to deficit financing.

**B-** When national income increases, the law should result in higher tax to GDP ratio (sufficient tax elasticity). If income tax is progressive, and the tax revenues are not dominated by one or few sources (sales tax), sufficient tax elasticity would be realized.

**C-** The burden of tax should be fair. **(1)** Those whose incomes are high should bear more burden than the poor. **(2)** Those whose incomes are equal, should pay the same amount of tax. To be fair, the tax system must not be dominated by indirect taxes (sales).

**D-** The law should not be complicated. It should be simple enough to safeguard the tax payer against the “exploitation” of tax authorities and experts.

**2. The existing and the proposed law must be professionally presented and well-explained to the public.** Anecdotal evidence shows that Jordanians think they pay tax a lot more than what they actually do (Tax Illusion)! This is due to several reasons including the frequent changes in the tax law and the hitherto existing poor provision of public goods and services.

**3. Within the context of the national dialogue on taxation, the government must be convincing in being inclusive, credible, and transparent in its commitment to serve the overriding interest of Jordan. Naturally, such transparency must be reflected in the General Budget. Sources of public revenues and sources of public spending should be classified in such a way that anybody can understand them without the help of any expert. Also, costs and revenues of certain public goods and services, such as electricity, should be made public in a transparent manner. For example, one wonders why the issue of cross-subsidy in the energy sector is not treated and reported as tax revenue!** The government must have Key Performance Indicators (KPIs) that really drive results, especially in maintaining current public spending at reasonable levels, and increasing capital spending (public goods and services) sufficiently and efficiently. Results-oriented budgeting should be the norm.

**4. There is nothing right or wrong in asking salaried individuals to pay more taxes.** However, the fact that the mean wage in Jordan is relatively low, this option is not viable. The Social Security Corporation 2016 figures show that about 80% of the employed subscribers earn less than JD 600 a month. Also, the total number of individuals whose income ranges between JD 500 – JD 1,000 a month and between JD 1,000 – JD 2,000 are equal to 264,911 and 63,144 respectively. Regardless of marital status, taxing these individuals at 5% income tax rate would contribute to the treasury a total of JD 25 million and JD 15 million respectively! Such amounts are not only “limited”, but would likely be lower if we take into consideration who is married among them, but also “costly” to collect. These are weak characteristics of any tax

system. Its not recommend to change the current tax law regarding these individuals.

5. **Those who are self-employed contribute very little taxes (0.27% of GDP). Increasing this ratio to 3% of GDP is equivalent to around JD770 million a year! This is the “problem”. A new and modern tax law and original tax collection policy are badly needed.** This sector is composed of professionals such as doctors, lawyers, carpenters, contractors and many other SMEs. It is worth looking into classifying this sector, based on sub-sectors and location, and apply lump-sum taxation system to each.
6. **There is nothing wrong with keeping the current sales tax as is.** Within this context, increasing tax revenue from the self-employed would automatically make the tax system more diversified.
7. Currently, the corporate sector contributes about 17% of total tax revenues. Notwithstanding the fact that this proportion is higher than those in, for example, the UK (10%), Denmark (9.5%), and Turkey (9.5%), it is useful to note that the financial sector in Jordan is responsible for about 40% of the paid taxes from the corporate sector. Based on these two observations, we recommend that the current corporate tax should not be changed. We need to refrain from **“taxing success”**. Some of these companies are paying the highest income tax in Jordan (banks pay 35% income tax).
8. Finally, it is important to note that the Ministry of Finance, in its General Government Bulletins, reports “miscellaneous” revenues whose details are not known. However, these revenue items probably include the special tax on oil-related products. If this source of revenue is classified as part of tax revenues, Jordan’s tax to GDP ratio would increase to around 18%.f some of

this income can be classified under tax revenue, we recommend reporting them accordingly.

Within the context of all of the above observations, arguments, and recommendations, the JSF calls all stakeholders to promote the adoption of the following collective vision:

**The intention of the adopted new Tax Law is to bring about strong economic growth, reduce inequality (income and opportunity), promote macro-economic stability, and other socio-economic objectives.**

The 18<sup>th</sup> century philosopher who is renowned as the father of modern economics, and a major proponent of free market policies (**Adam Smith**) stated:

*“The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state”.*

*“For a very small expense the public can facilitate, can encourage, and can even impose upon almost the whole body of the people the necessity of acquiring those most essential parts of education”.*

Finally, and more recently, the Director of the UNDP Global Centre for Public Service Excellence (Max Everest-Phillips), stated:

*“Successful state-building demands political leadership with a vision of tax as delivering a ‘national purpose’ that actual and potential taxpayers will support (and pay for). The tax system component of the state-building effort must explicitly link to a national strategy for promoting economic growth”.*

*“The usage of tax revenues is justified to taxpayers, who demand to know if tax revenues are properly used”.*

# Information Sources

1. Ministry of Finance: General Government Bulletins.
2. Central Bank of Jordan: Statistical Data and Monthly Reports.
3. The OECD Statistical Webpage.



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