The New Tax Law in Jordan & The Global Competitiveness Index

The Connection

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منتدى الاستراتيجيات الأردني
JORDAN STRATEGY FORUM

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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. Background

A Royal Decree was issued on Thursday 14 June 2018 approving the formation of a new Cabinet, headed by Omar Razzaz. His Majesty King Abdullah II has tasked the government with a myriad of objectives. These include the launching a national dialogue whose objective is to deliver a new tax law that achieves growth and justice, and enhances the quality of public goods and services (education, healthcare, and public transport).

Within the context of the objectives of Razzaz's government, this position paper, published by the Jordan Strategy Forum (JSF), is a modest contribution whose aim is to highlight the relevance of the 2018 Global Competitiveness Index (GCI) to the expected NEW TAX LAW.

2. The Global Competitiveness Index

The GCI is an annual report that ranks and measures 137 countries worldwide based on their respective competitiveness. The report, published by the World Economic Forum (WEF), aims to "serve as a neutral and objective tool for governments, the private sector, and civil society to work together on effective public-private collaboration to boost future prosperity".

According to the GCI reports, **"Competiveness"** is defined as the set of institutions, policies, and factors that determine the productivity level of an economy, which then determines the level of prosperity that the country can achieve.

The WEF measures competitiveness based on factors that determine productivity and long-term prosperity. The GCI measures a total of 114 indicators. These indicators are grouped into twelve pillars:

First Pillar: Institutions

"The institutional environment is determined by the legal and administrative framework within which individuals, firms, and governments interact to generate wealth" (WEF).

Second Pillar: Infrastructure

"Extensive and efficient infrastructure is critical for ensuring the effective functioning of the economy, as it is an important factor in determining the location of economic activity and the kinds of activities or sectors that can develop within a country" (WEF).

Third Pillar: Macroeconomic Environment

"Running fiscal deficits limits the government's future ability to react to business cycles. Firms cannot operate efficiently when inflation rates are out of hand. In sum, the economy cannot grow in a sustainable manner unless the macro environment is stable" (WEF).

Fourth Pillar: Health and Primary Education

A healthy workforce is vital to a country's competitiveness and productivity. In addition to health, this pillar takes into account the quantity and quality of the basic education received by the population, which is increasingly important in today's economy" (WEF).

Fifth Pillar: Higher Education and Training

"Quality higher education and training is crucial for economies that want to move up the value chain beyond simple production processes and products" (WEF).

Sixth Pillar: Goods Market Efficiency

"Healthy market competition, both domestic and foreign, is important in driving market efficiency, and thus business productivity, by ensuring that the most efficient firms, producing goods demanded by the market, are those that thrive" (WEF).

Seventh Pillar: Labor Market Efficiency

"Labor markets must therefore have the flexibility to shift workers from one economic activity to another rapidly and at low cost, and to allow for wage fluctuations without much social disruption" (WEF).

Eighth Pillar: Financial Market Development

"Business investment is also critical to productivity. Therefore economies require sophisticated financial markets that can make capital available for private-sector investment from such sources as loans from a sound banking sector, well-regulated securities exchanges, venture capital, and other financial products" (WEF).

Ninth Pillar: Technological Readiness

"In today's globalized world, technology is increasingly essential for firms to compete and prosper. The technological readiness pillar measures the agility with which an economy adopts existing technologies to enhance the productivity of its industries" (WEF).

Tenth Pillar: Market Size

"The size of the market affects productivity since large markets allow firms to exploit economies of scale. Traditionally, the markets available to firms have been constrained by national borders. In the era of globalization, international markets have become a substitute for domestic markets, especially for small countries" (WEF).

Eleventh Pillar: Business Sophistication

"There is no doubt that sophisticated business practices are conducive to higher efficiency in the production of goods and services" (WEF).

Twelfth Pillar: Innovation

"Although substantial gains can be obtained by improving institutions, building infrastructure, reducing macroeconomic instability, or improving human capital, all these factors eventually run into diminishing returns. The same is true for the efficiency of the labor, financial, and goods markets. In the long run, standards of living can be largely enhanced by technological innovation" (WEF).

All twelve pillars are then further organized into three sub-indicators:

(1) Basic Requirements. These include pillars of institutions, infrastructure, macroeconomic environment, and health and primary education.

(2) Efficiency Enhancers. These include the pillars of higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, and market size.

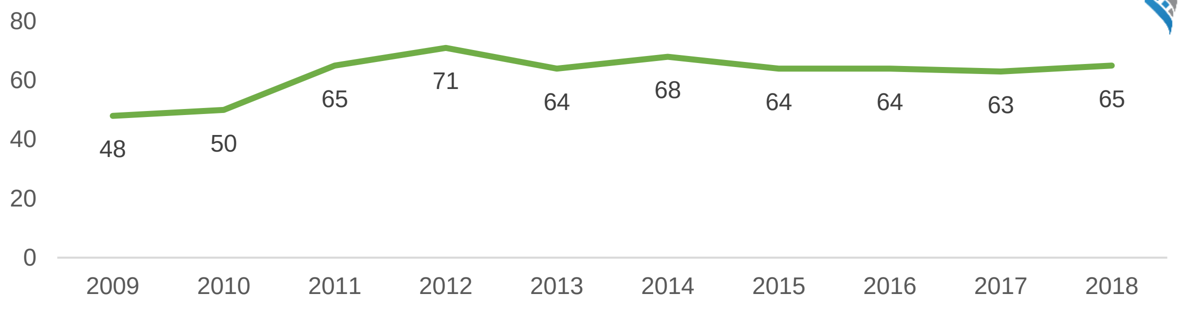
(3) Innovation and Sophistication factors. These include the business sophistication and the innovation pillars.

This year (2018) marks the 10th anniversary since the 2008 global financial crisis and resultant recession, making the report that much more significant. As the global economy continues to recover, growth rates remain below historic levels, and world leaders continue to struggle with economic policy to accelerate economic progress. Competitiveness is pivotal for increased well-being and higher per capita income.

3. Jordan on the Global Competitiveness Index

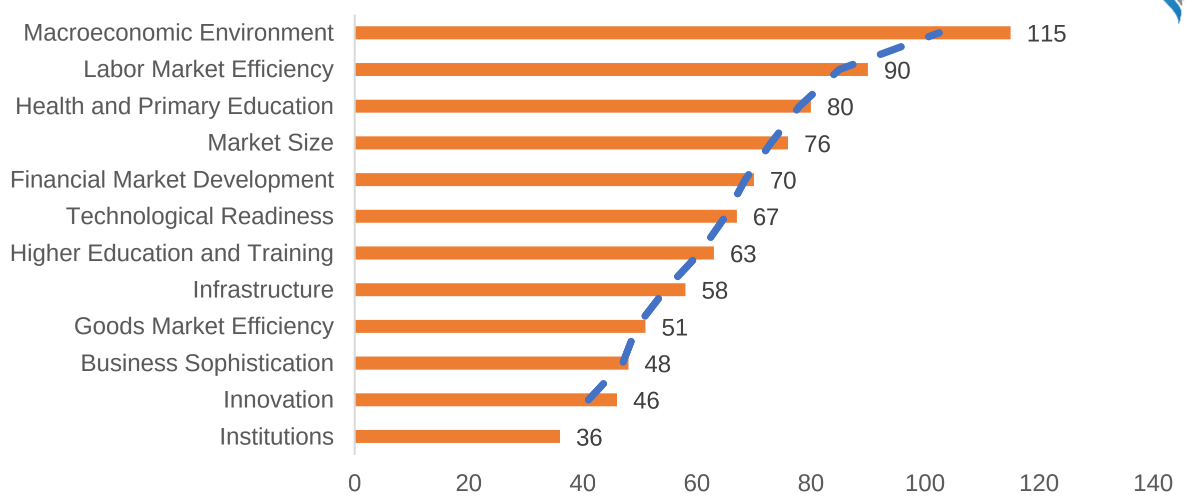
Jordan ranks 65th in the 2017-2018 competitiveness index. Between 2017 and 2018, Jordan slipped two positions. However, Jordan's ranking has been relatively stable since 2013.

Figure 1: Jordan's Global Competitiveness Index (2017/2018) Rank (out of 137 Countries)



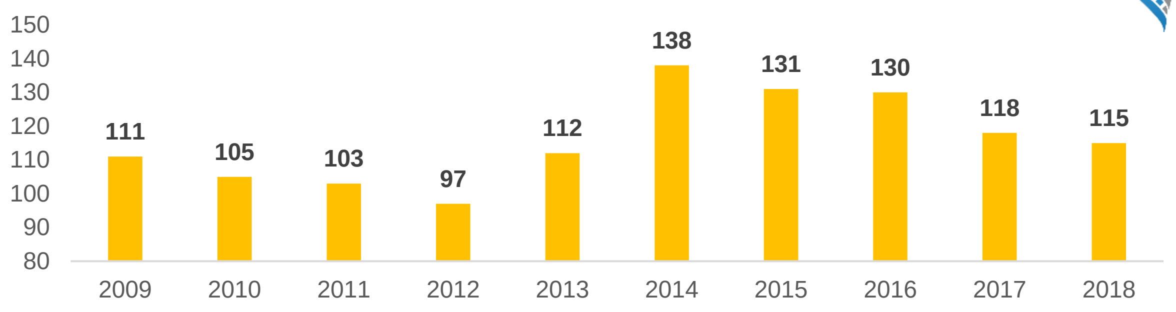
Despite Jordan's decent performance in the overall ranking, the country's ranking in the 12 pillars reflect some significant variations (Figure 2). Indeed, in terms of the macroeconomic environment, Jordan's ranking (115th) leaves a lot to be desired.

Figure 2: Jordan's Ranking in all 12 Pillars of the Global Competitiveness Index (out of 137 Countries)



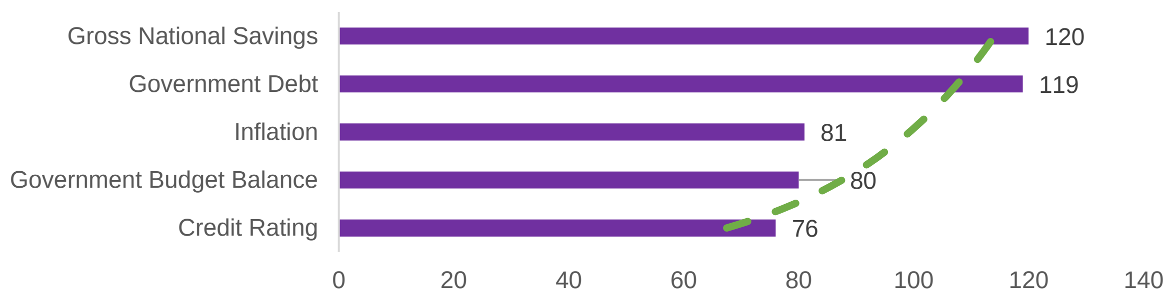
Notwithstanding the fact that Jordan's ranking in the macroeconomic environment is poor, it must be acknowledged that this pillar has witnessed some improvement in recent years. Jordan ranking has improved from 138th in 2014 to 115th in 2018 9Figure 3)!

Figure 3: Jordan's Macroeconomic Environment Ranking - Global Competitiveness Index (out of 137 Countries)



The poor ranking of Jordan in the macroeconomic environment pillar is largely the result of its national savings and government debt components (Figure 4). In terms of gross national savings and government debt, Jordan is ranked 120th and 119th respectively! Even in terms of inflation, budget balance, and credit rating Jordan's rankings are way above the overall rank (65th).

Figure 4: Macroeconomic Environment Sub-Indicators Global Competitiveness Index (out of 137 countries)



One cannot underestimate the socio-economic importance of improving Jordan's ranking in the overall competitive index as well as in it sub-components. Indeed, competitiveness is important for three reasons.

1. "More productive countries can create greater wealth, higher living standards and more happiness for their citizens" (WEF).

2. More productive countries offer greater returns on investment. This matters to companies choosing whether to invest in physical capital. But it also means that national investments in areas such as infrastructure, education and skills development have greater potential to translate into economic growth" (WEF).

3. Competitiveness implies economic stability and resilience. Data analyzed in last year's Global Competitiveness Report found that the more competitive an economy was in 2007, the less severely it was affected by the recession that followed.

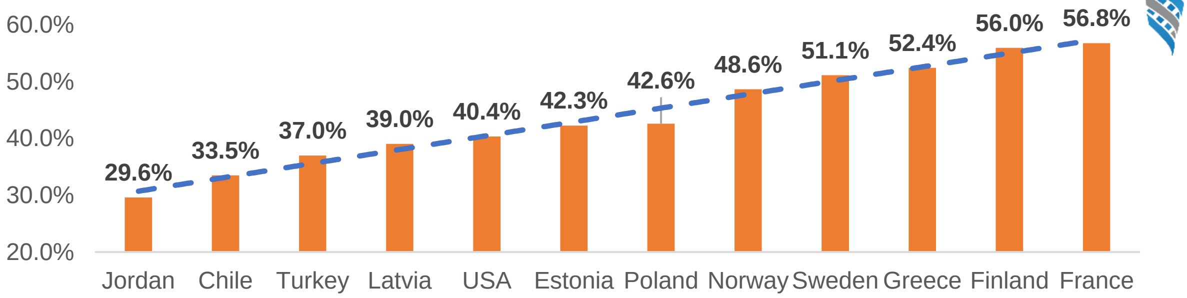
4. Fiscal Policy in Jordan and the Global Competitiveness Index: The Connection

In accordance with HM King Abdulla's efforts to launch a national dialogue whose objective is to deliver a new tax law, the JSF advocates for and encourages reforming taxation laws in order to establish a fair, progressive, and uncomplicated tax system that yields the government higher tax revenues. Within this context, JSF recommends the following:

Jordan's current fiscal policy is restricting the government's ability to play a more positive role in the national economy.

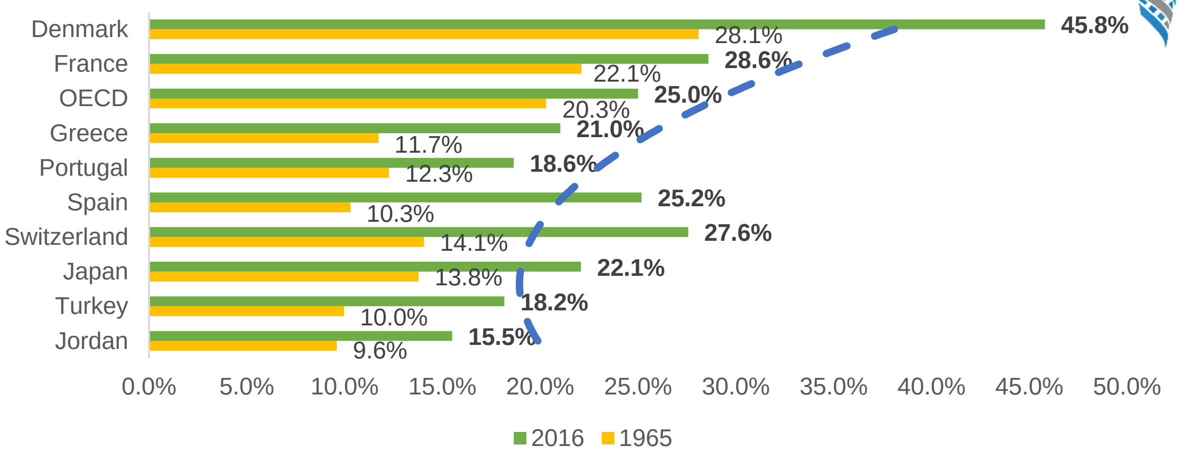
A. Jordan's total public spending to GDP ratio is significantly lower than in other countries (Figure 5).

Figure 5: Total Public Spending to GDP Ratio (2015-2016) in Jordan



B. Jordan's tax revenue to GDP ratio is not only low in comparison to other countries such as Denmark and France, but it has also grown by only 5.9% between the year 1965 and 2016. In countries such as Spain, tax to GDP ratio had increased from 10.3% in 1965 to more than 25% by the end of 2016!

Figure 8:Tax Revenue to GDP Ratio in 1965 & 2016



Relative to Jordan's public spending and tax revenues, it is important to note that fiscal policy has short-run and long-run implications.

In the short run, the government must be able to increase spending during weak economic performance and vice versa (countercyclical policy). Research shows that countries which can adopt such a policy achieve higher and more stable growth rates and lower inflation rates.

In the long run, the government must sufficiently and efficiently invest in physical and human infrastructure, while maintaining sustainable deficits (and public debt levels). If this is not the case, the issue of public finance itself would become the source of economic instability.

In other words, enhancing public revenues should allow the government to maintain more stable economic growth and lower inflation rates, reduce the existing budget deficits and high debt levels, and invest (capital) in the Jordanian economy. In turn, this would improve Jordan's ranking on the macroeconomic components of the GCI.

5.Summary and Recommendations

Despite a promising ranking of 65 in the overall Global Competitiveness Index, Jordan finds itself at the bottom of the rankings when it comes to government budget balance, gross national savings, inflation, government debt and credit rating. Jordan has shown slight improvement since 2014 in the macroeconomic environment pillar, moving up from 138 to 115. Measures need to be taken to stabilize Jordan's macroeconomic environment in order to ensure that Jordan reaches its full potential in economic growth.

1. The New Tax 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" (JSF, 2018).

2. "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" (Max Everest-Phillips, 2009).

3. "The public sector is, collectively, the world's largest service provider. Any incremental improvement in public services positively affects millions of people. The first step to 'delivering the customer promise' is to know your customers and their needs" (Price Water House Coopers, 2015).

4. "The government cannot provide services efficiently if it has to make high-interest payments on its past debts" (WEF).

5. The Government must seriously consider the macroeconomic environment pillar, and this pillar should be used as a key performance indicator to evaluate its performance in macroeconomic policies. However, the government must reduce instability in the macroeconomic environment to enhance Jordan's ranking on the macroeconomic environment stability pillar and the overall index.

6. Finally, the new tax law, which expected to be delivered by Dr. Razzaz's Government, should be the first step in economic reform in Jordan. The new tax law should yield sufficient public revenues which results in reducing the budget deficit and public debt levels.

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