



## Fiscal Policy in Jordan: Towards a New Approach

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منتدى الاستراتيجيات الأردني  
JORDAN STRATEGY FORUM



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## 1. Background:

The full impact of COVID-19 on the Jordanian economy is still evolving. The signs, however, are already clear. For example, the IMF estimates that Jordan will witness a -1.6% real Gross Domestic Product (GDP) growth rate in 2020. The unemployment rate has increased from 19.0% (4<sup>th</sup> Quarter 2019) to 24.7% (4<sup>th</sup> Quarter 2020).

COVID-19 forced the Jordanian government to implement a myriad of monetary and fiscal policy measures to contain not only the human, but also the economic implications of the virus. These measures will press hard Jordan's public finance. Indeed, two challenges have emerged:

1. As public spending increases and local revenues decrease, the budget deficit will widen.
2. As public borrowing increases, public debt will rise.

Within the context of the socio-economic implications of COVID-19, one should remember that the Jordanian economy has been wrestling with a multitude of challenges, years before the onslaught of the virus. These challenges include modest economic growth rates, consistently high unemployment rates, especially among the young and university graduates, persistent budget deficits, and rising public debt. COVID-19 will bring nothing new, but further exacerbation of these challenges.

The overall objective of this Policy Paper, issued by the Jordan Strategy Forum (JSF) is to shed some light on the recent interplay between the overall performance of the national economy (growth), composition of Gross Domestic Product (GDP), and the status of public finance.

- A. In section 2, we outline the basic principles of fiscal policy.
- B. In section 3, we outline a number of observations about the growth performance of the Jordanian economy.
- C. In section 4, we outline a number of observations about the status of Jordan's public finance and tax effort.
- D. In section 5, we outline a number of recommendations whose aim is to enhance the interplay between growth, and public spending and the road ahead.

## 2. Fiscal Policy: Basic Socio-Economic Sense

Any economy is nothing but a collection of consumers and firms interacting with each other to determine what goods and services to produce, and at what prices. Within this context, it is useful to note that even in “predominantly market economies”, such as the UK, USA, Germany, and many others, governments play a dominant role in economic activity.

Governments raise revenues (tax and non-tax) and spend on public goods and services such as health care, education, transport, and others. In other words, through their fiscal policies, such governments are major players in economic activity.

Basic socio-economic sense asserts that the role of fiscal policy should be the promotion of growth, equity, and social cohesion, reduction in poverty, and protection against risk and vulnerability such as the human and economic experience of COVID-19.

The role of fiscal policy notwithstanding, one can argue that no government should assume a role in economic activities per se. There must be a clear “rationales” / justification for the government in the first place. The rationales for the existence of governments are three-fold (The World Bank / Economic Premise / 2012):

**1. To improve Resource Allocation and Efficiency:** The heart of the resource allocation rationale is to improve economic performance through public spending and tax policies that advance greater efficiency levels. Public spending on public goods and services (i.e. health, transport, education, infrastructure, and others) should raise private sector productivity and hence, growth. In addition, where markets fail, the government should intervene.

**2. To address Distributional Disparities:** The core of the distribution rationale is to adjust the distribution of income, opportunities, and assets, in a way that reflects the views of society (social contract).

**3. To promote Macroeconomic Stability:** The essence of the macroeconomic stability (volatility of annual changes in GDP, budget deficit and public debt) rationale has short-run and long-run dimensions.

**A.** The short-run dimension requires the government to have the ability to increase public spending during periods of weak economic growth or recessions, and to decrease public spending during growth periods. Indeed, the international evidence shows that governments that adopt such a policy (“countercyclical fiscal policy”) tend to have lower output volatility, higher growth rates, and lower inflation.

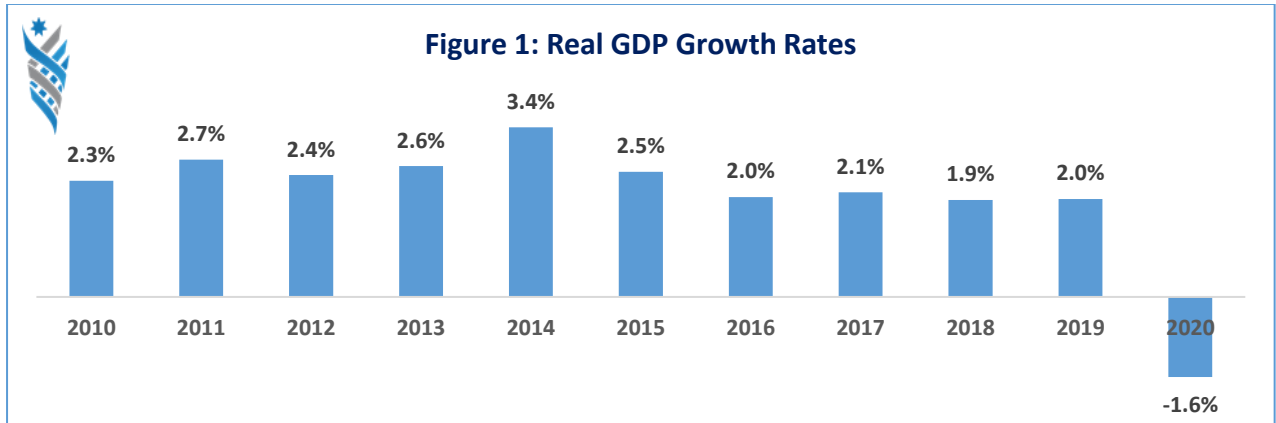
**B.** The long-run aspect of the public sector, on the other hand, requires the maintenance of sustainable deficits (and public debt levels). Otherwise, the issue of public finance itself (debt) would become a source of macroeconomic instability.

It is high time that all Jordanian stakeholders focus on these three rationales of fiscal policy when they address public finance and the role of the state. Measuring the success of the government should emanate from such pillars, and a result, should enhance transparency and good governance.

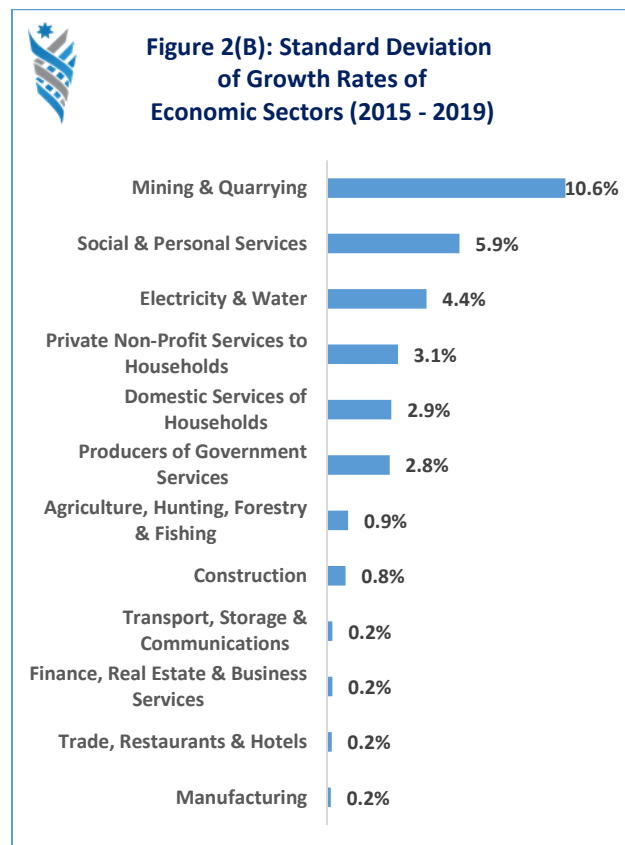
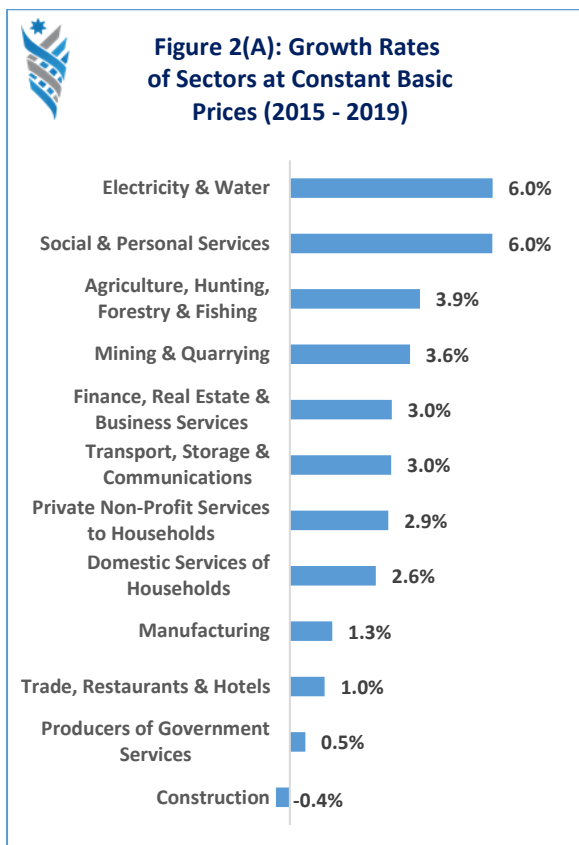
### 3. The Performance of the National Economy: Some Observations

Below, we outline some observations about the performance of the economy.

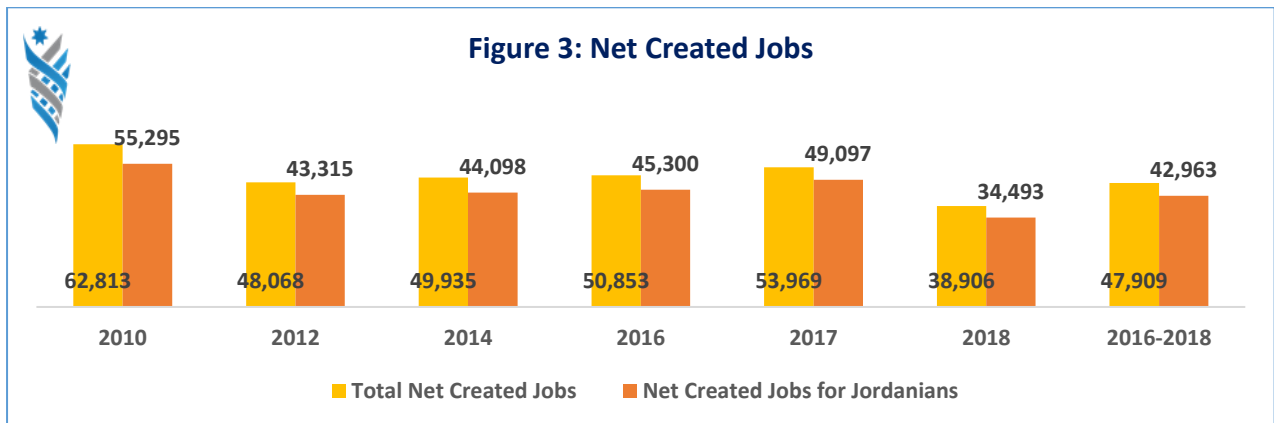
A. For so long, the Jordanian economy has been realizing modest growth rates.



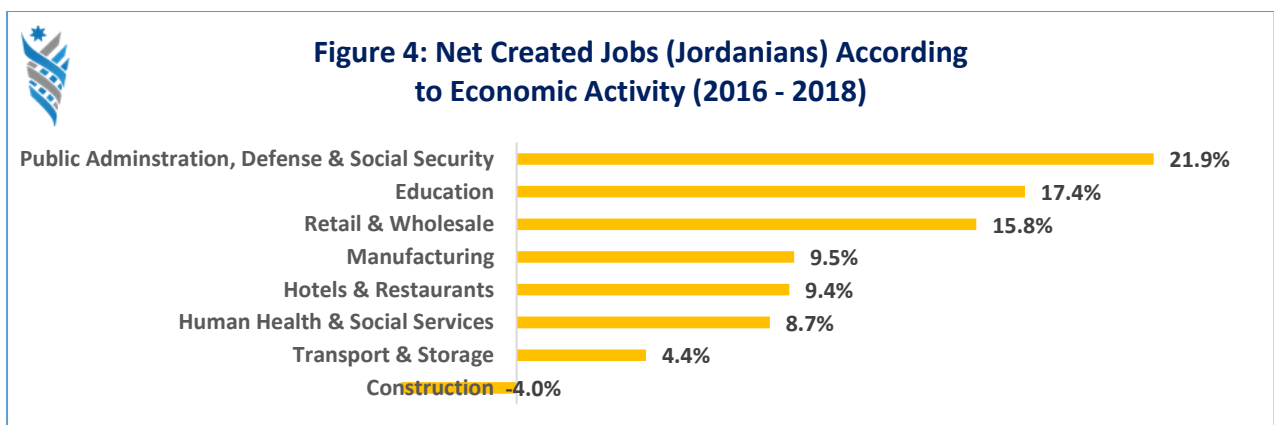
B. During the past few years (2015 – 2019), almost all economic sectors grew at positive rates. On average, the standard deviations of these growth rates are relatively low (Central Bank of Jordan Annual Report / 2019). In other words, these sectors' annual growth rates were stable.



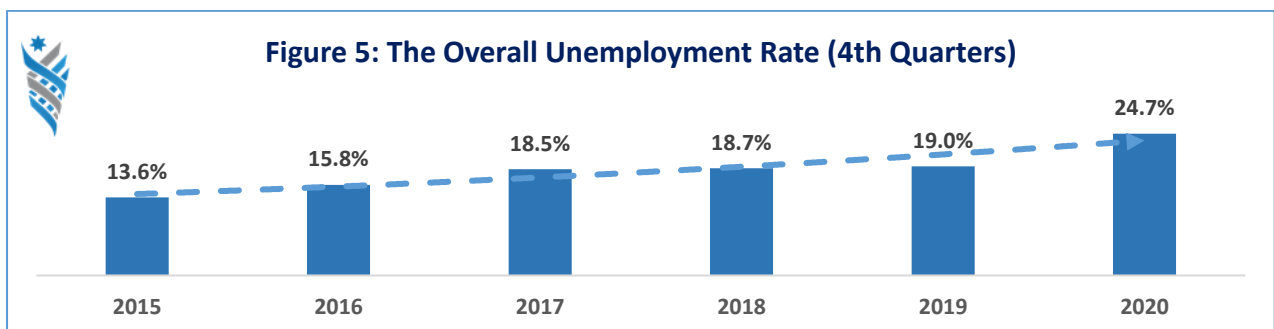
C. During the period 2016 – 2018, the total number of net created jobs (Department of Statistics) was equal to 47,909. For Jordanians, this number was equal to 42,963 jobs.



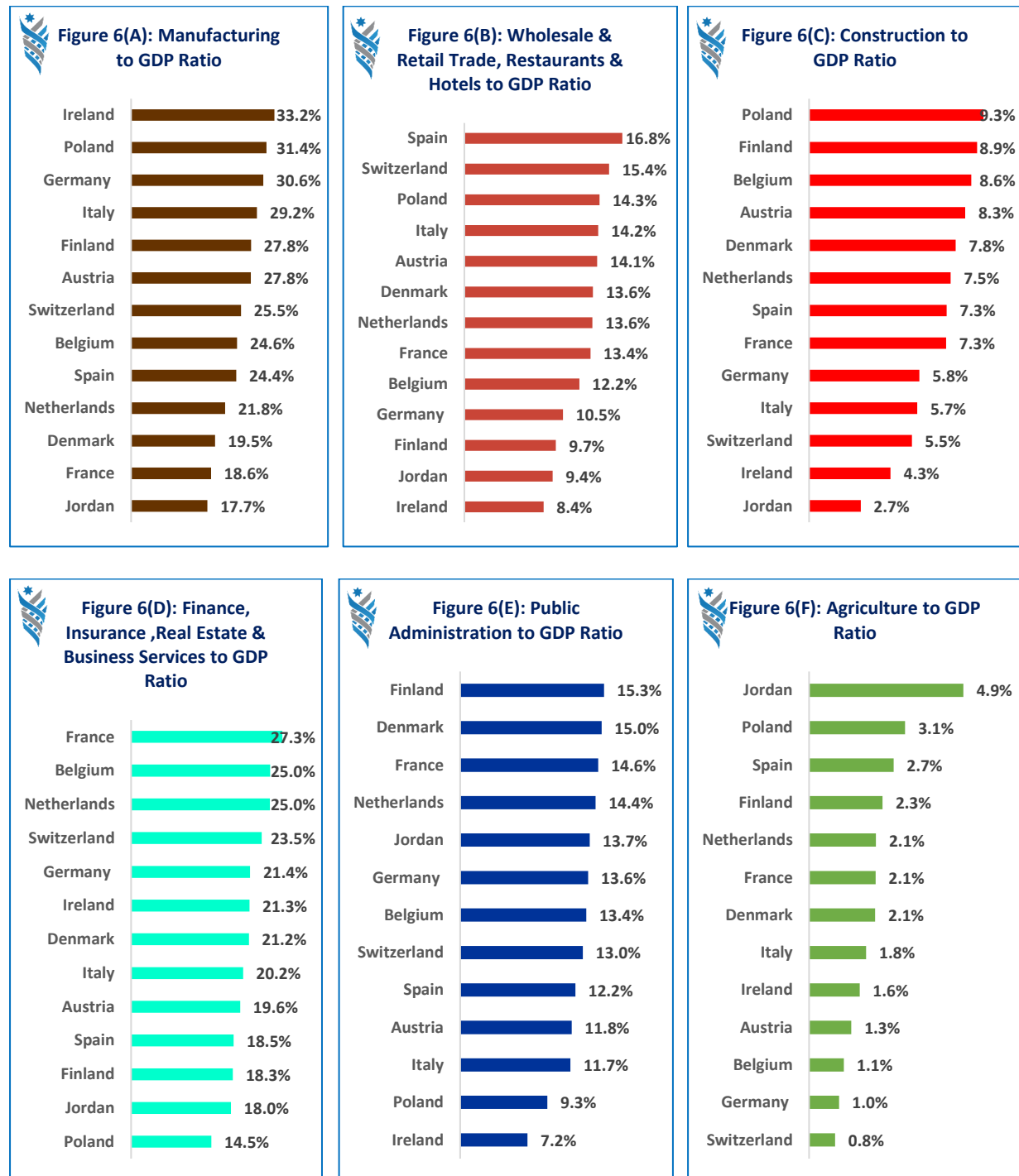
D. Three sectors (public administration, education and retail & wholesale) accounted for 55.1% of the net created jobs for Jordanians. It is also useful to note that the number of net created jobs for Jordanians with at least an undergraduate degree was equal to 20,558. Jordanians who graduated from universities in Jordan, however, was equal to 43,924 (Ministry of Higher Education & Research).



E. Notwithstanding the change in the methodology used in estimating unemployment (2017), the fact remains that unemployment has been on a rising trend. COVID-19 will only exacerbate the long-existing unemployment problem



F. It is interesting to note that the relative importance of the main economic sectors to GDP at market prices in Jordan is different from more advanced economies. For example, in the manufacturing sector, which tends to be large by employment, Jordan's proportion is low. This is also the case in the wholesale and retail trade, and restaurants and hotels sector and in the construction sector (Eurostat). These observations indicate that the Jordanian economy suffers from a structural imbalance. Indeed, this must be remedied.





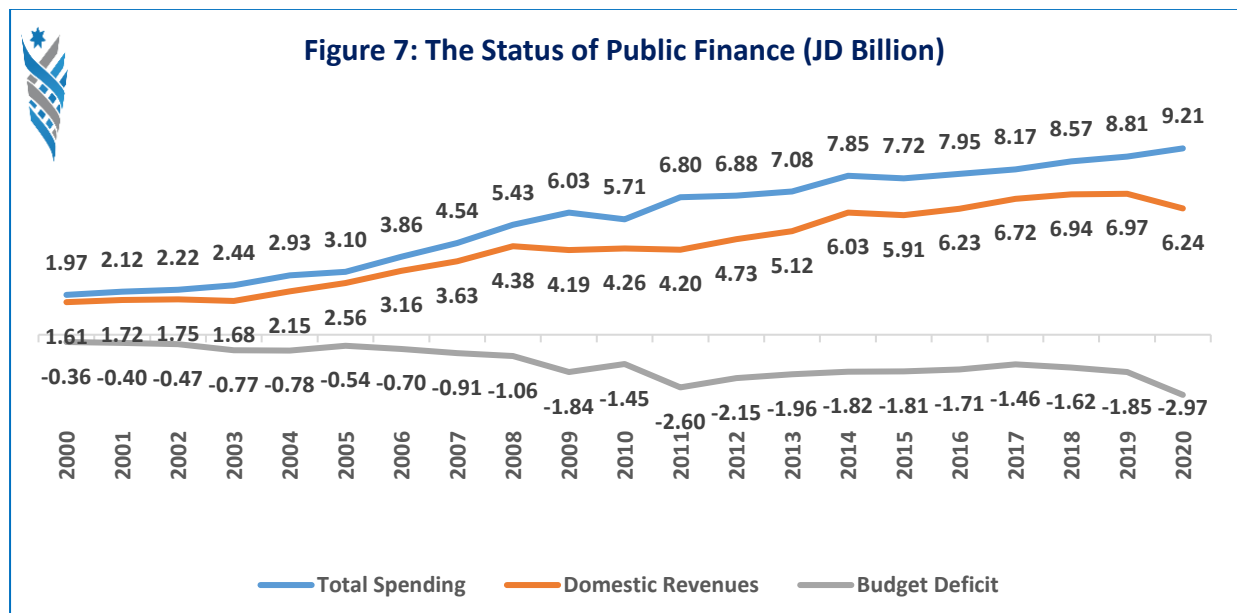
#### 4. The Economics of Public Finance in Jordan: Some Observations

Anyone can see that the public sector, which involves government spending, revenue raising, and borrowing, has a crucial role to play in any economy. What is less clear, however, is the fact that the public spending side of fiscal policy, for several reasons, must increase over time.

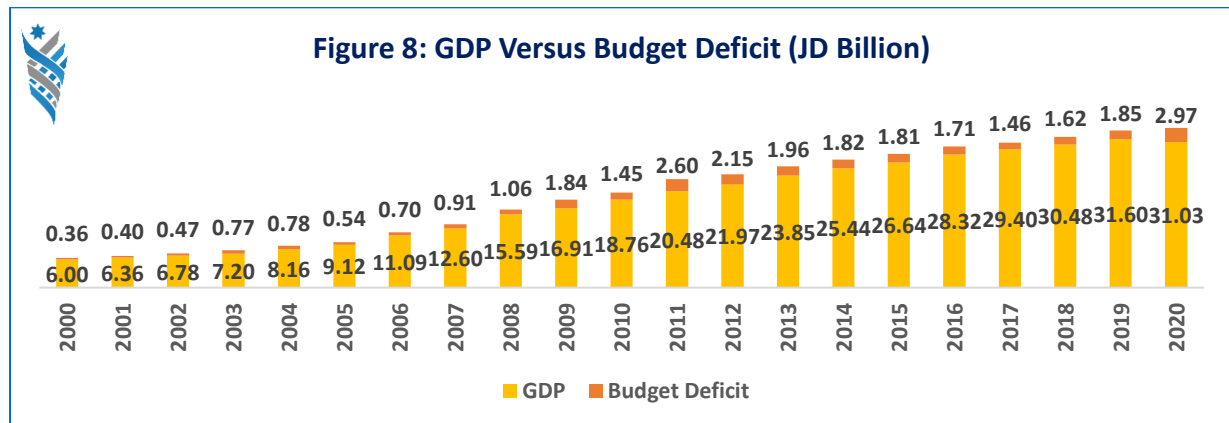
- a. With rising per capita income, the demand for public goods and services tends to increase. To meet this demand, government spending would increase.
- b. With rising prices, the government must increase its' public spending to maintain the supply of public goods and services intact.
- c. With increasing population, it is only natural to expect that public expenses will increase as the functions of the state need to be performed increase, and more extensively.
- d. The spread of urbanization leads to reciprocal increases in public spending on services like water supply, electricity, transport, maintenance of roads, schools and others.

Over time, the fact that public spending is expected to increase, it is critically important to realize that the long-run aspect of the public sector requires any government to maintain sustainable deficits (and sustainable public debt levels). In other words, unless public revenues keep up with the rising public spending, the issue of public finance itself (deficit and debt) would become a source of macroeconomic instability. If this is the case, what can we observe about the status of public finance in Jordan?

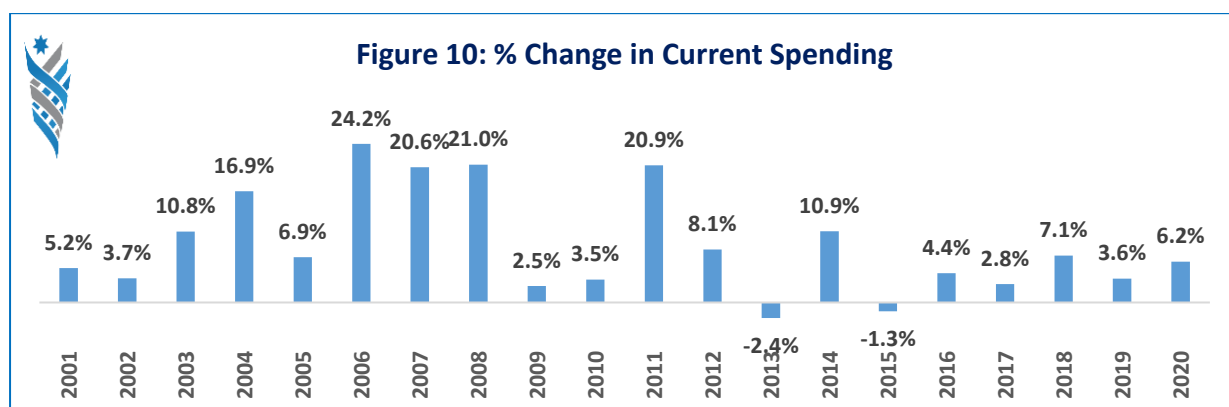
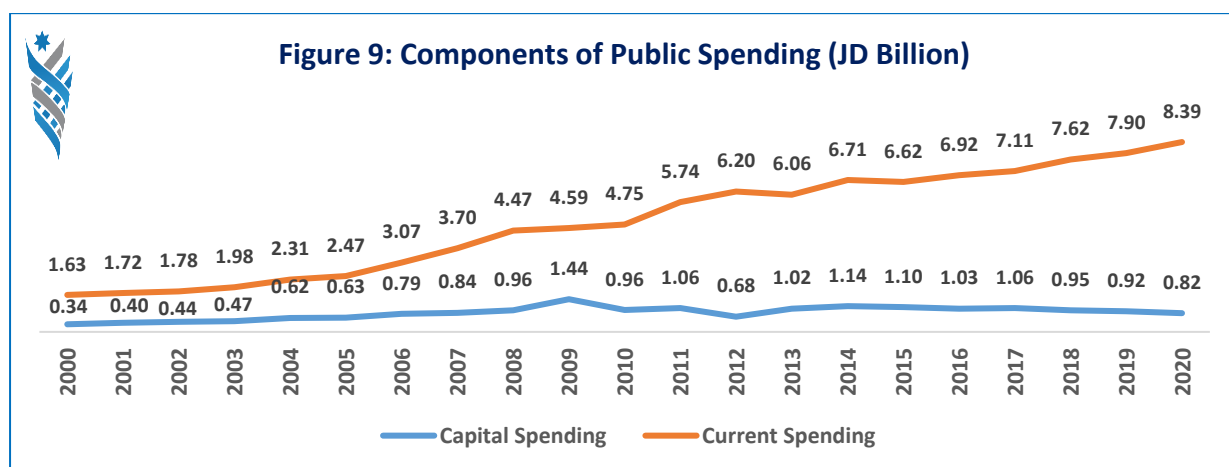
**First**, since the fiscal year 2000 (and before), no Jordanian government (with or without grants) has experienced a surplus in its budget.

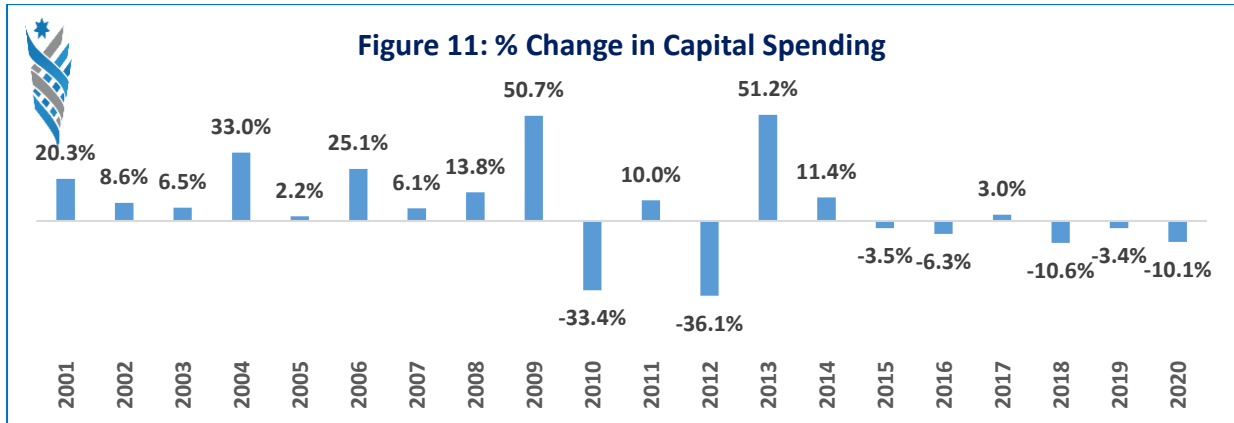


**Second**, on average, during the period 2000 – 2020, the increasing size of the national economy (GDP) has witnessed a reciprocal increase in the budget deficit.

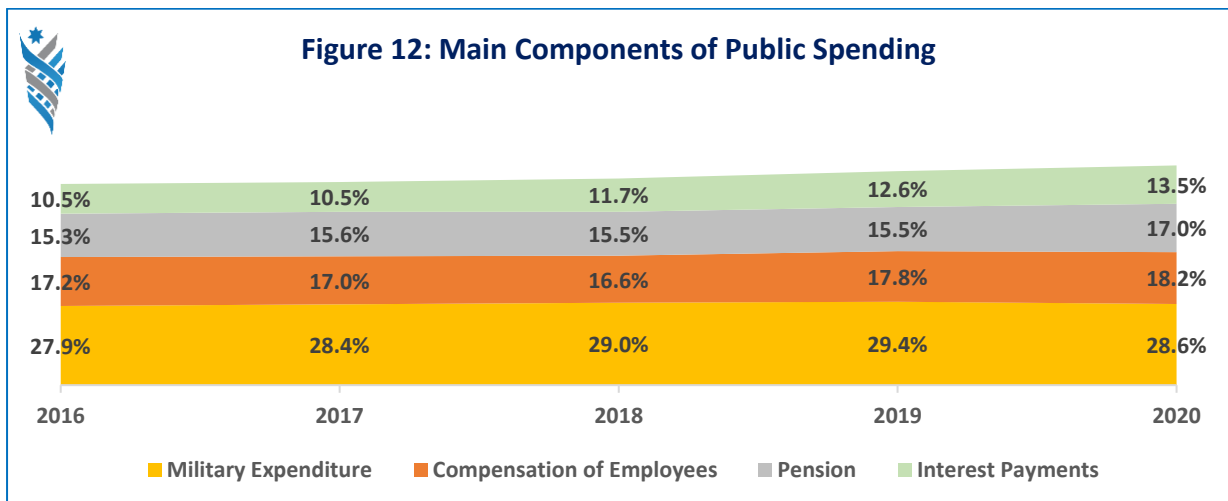


**Third**, as stated previously, public spending, for several reasons, must increase over time. After all, over time, the demand for public goods and services tends to increase. Within this context, it is critically important to note that the current side of public spending, and not the capital side of public spending, that has been increasing over time, and much faster. Indeed, current spending witnessed double-digit increases in the fiscal years 2003, 2004, 2006, 2007, 2008, 2009, 2011, and in 2014. The capital component of public spending, on the other hand, has been volatile.

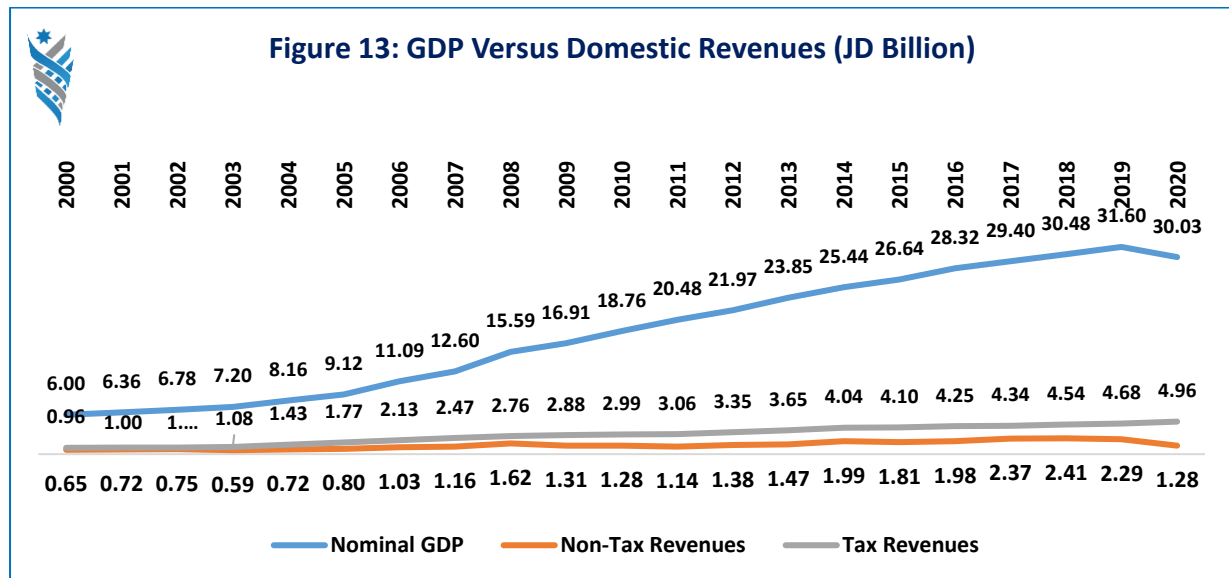




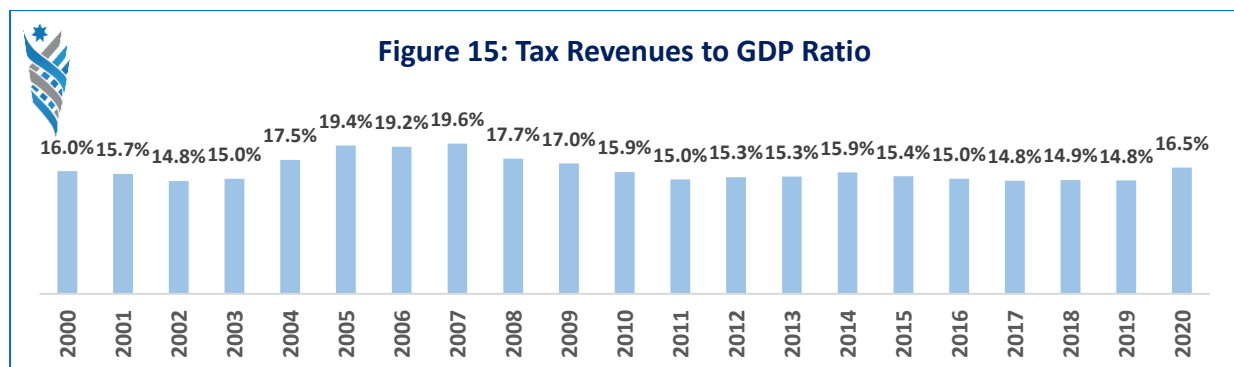
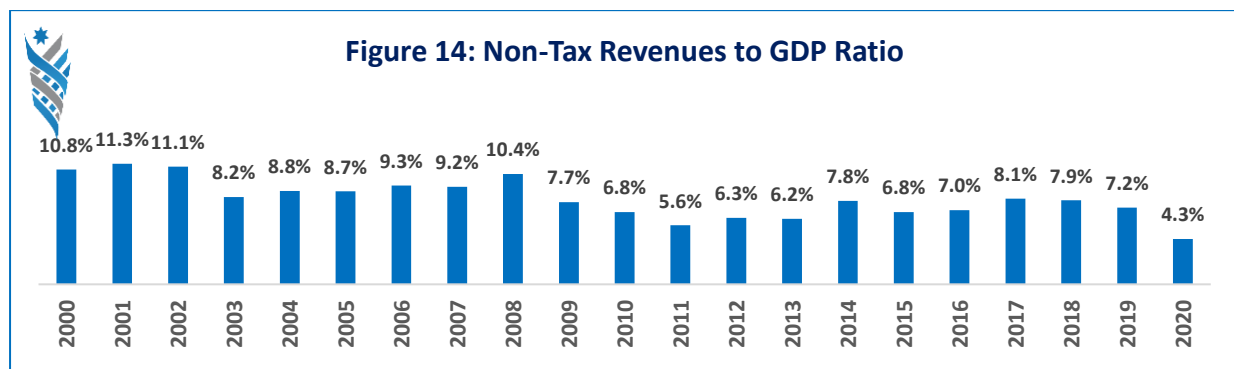
**Fourth,** few items (military, compensation of employees, pensions, and public debt interest payments) account for a large proportion of public spending. This implies that the government does not have much leeway, or margin, in re-allocating its financial resources or its policy priorities. Within this context, it is important to note that the international evidence and experience show that the relationship between spending on public goods and services (education, health, social security, transport, communication, public order and safety, and housing and community) and economic growth is positive.



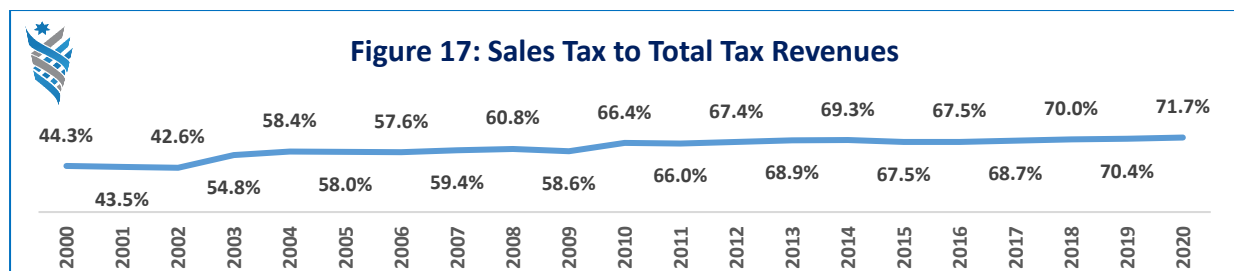
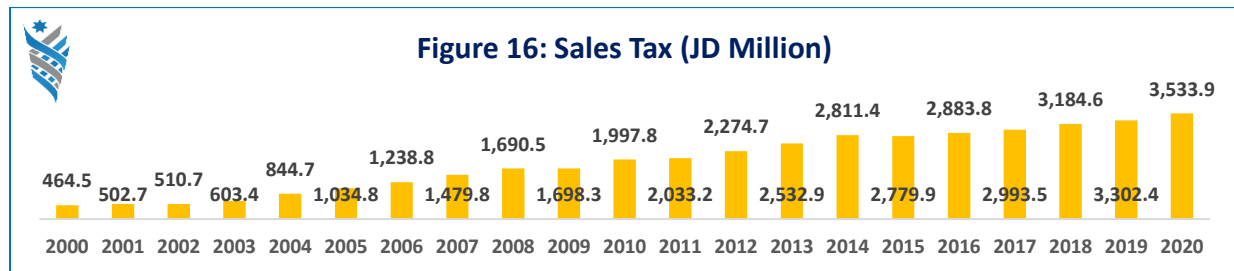
**Fifth,** the size of the economy has increased from JD 6.0 billion to JD 30.03 billion. Tax revenues and non-tax revenues, on the other hand, increased from JD 0.96 billion to JD 4.96 billion and from JD 0.96 billion to JD 2.29 billion respectively. The gap between the size of the national economy and tax and non-tax revenues are widening, and this indicates the presence of fiscal slippages.



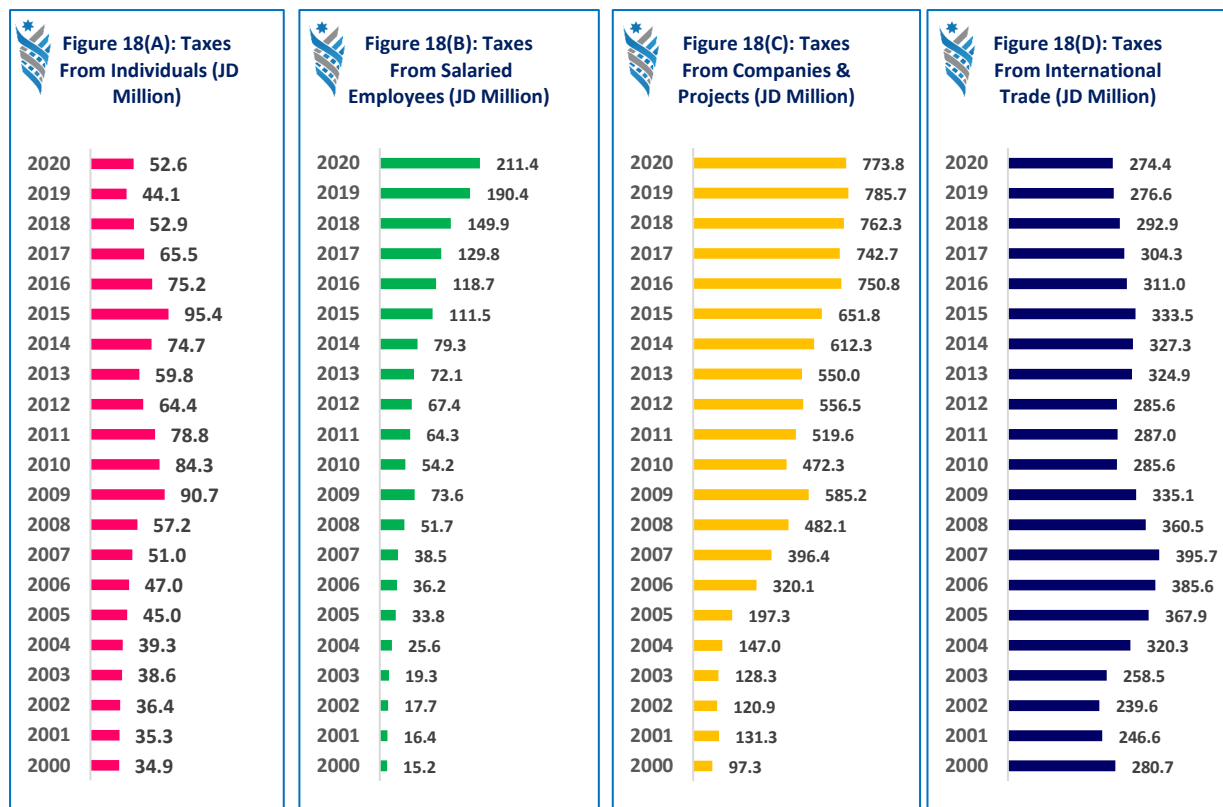
**Sixth,** non-tax revenues relative to the GDP, which stood at 10.8% in 2000, declined to 7.2% in 2019 and to 4.3% in 2020. Tax revenues to GDP ratio, on the other hand, remained much the same.



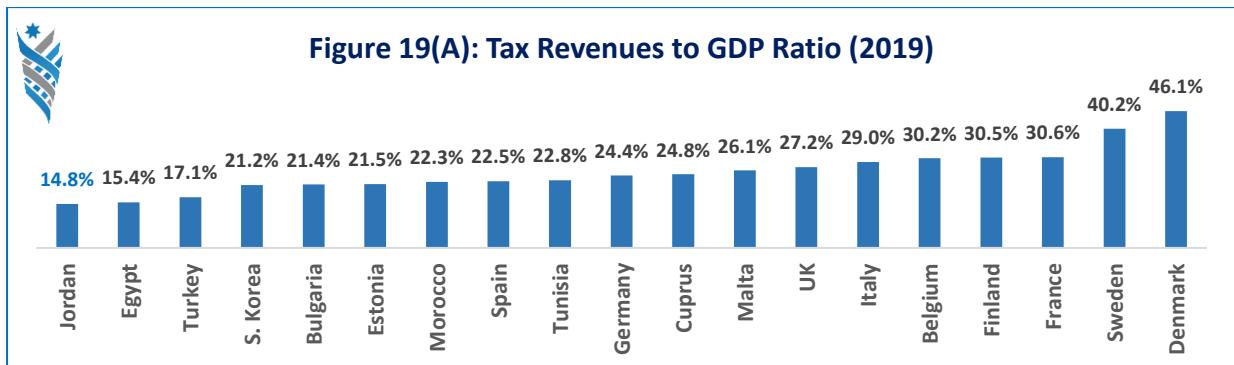
**Seventh,** sales tax has been the source behind the nominal increases in total tax revenues. Indeed, while sales tax accounted for 44.35% of total tax revenues in the fiscal year 2000, this proportion stood at 71.7% in 2020.



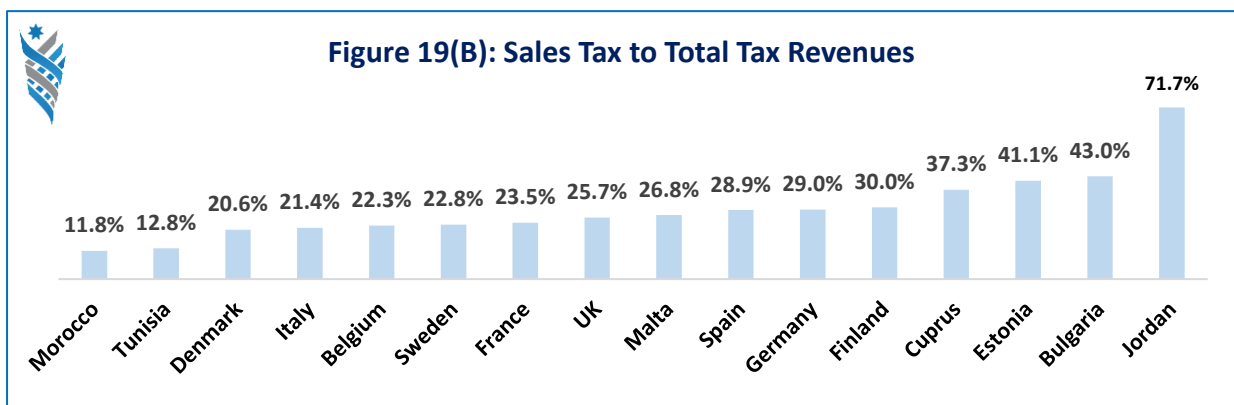
**Eighth,** taxes from salaried individuals and listed companies and large projects reflect healthy increases. However, while taxes from international trade have remained, more or less, constant, taxes from individuals did not reflect any significant increase. Here, one should note that “individuals” refers to the private sector outside listed companies and large projects. They cover private business / activities such as medical doctors, lawyers, retailers and wholesalers, butchers, private schools, garages, restaurants, cosmetic shops, pharmacies, and many others.



**Ninth**, no one can deny that total tax revenues to GDP ratio in Jordan are relatively low. Never mind the high tax to GDP ratio in Denmark (46.1%), with a ratio equal to 22.8%, Tunisia boats a higher proportion than in Jordan.



Within the context of the relatively low tax revenue to GDP ratio in Jordan, it is worth noting that sales tax (known for being regressive) in Jordan constitutes a major chunk of total tax revenues. Indeed, the 71.7% is way higher than other countries.



**Tenth**, relative to the above-mentioned observations about taxes in Jordan, it is useful to note that the international Monetary Fund (IMF) has issued its Staff Report about Jordan on 12 January 2021. The Report raises a myriad of observations regarding the subject matter of public finance.

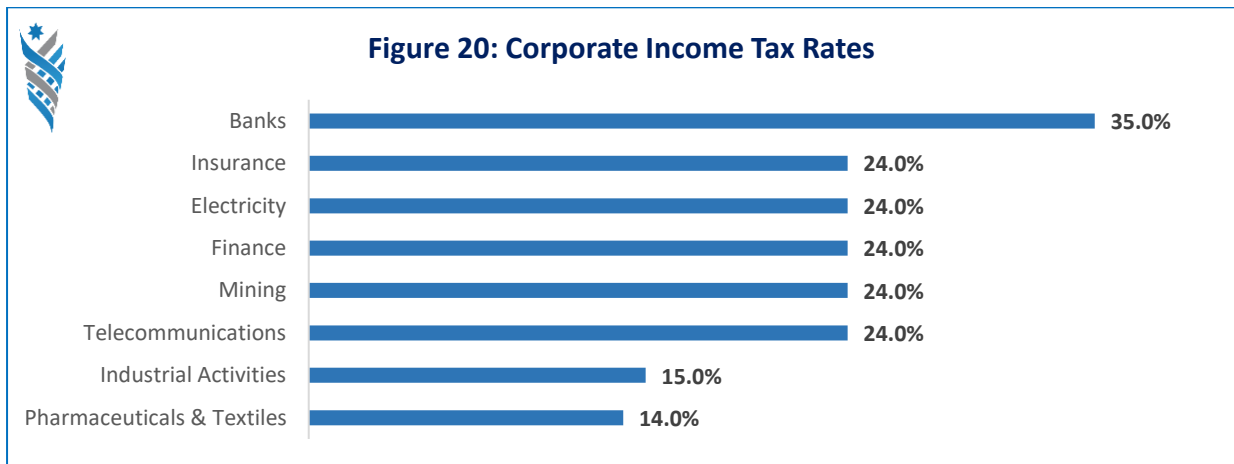
**A.** Public finances will deteriorate sharply this year (2020). Domestic revenues will be 9% lower than in 2019.

**B.** Despite the on-going pandemic, the authorities have persevered to strengthen tax administration and tax compliance. So far this year, the anti-tax evasion drive has uncovered around 2% of GDP in under-reporting of income tax liabilities.

**C.** The tax system in Jordan suffers from **“structural inefficiency”**. COVID-19 only “cast an additional spotlight on the limitations of the tax system”.

**1.** Corporate income tax and general sales tax suffer from the presence of many preferential regimes that narrow the tax base and “fracture” the system into a multiplicity of tax regimes. The IMF wonders why different business, depending on their size, activity, or location, pay

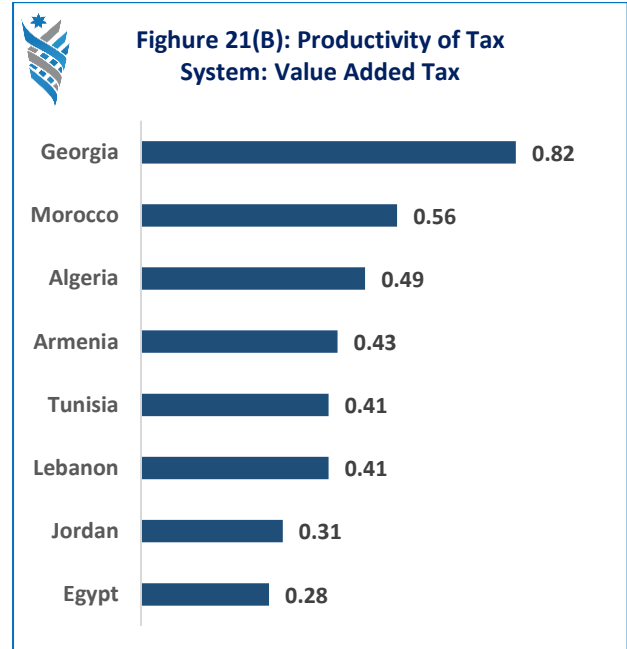
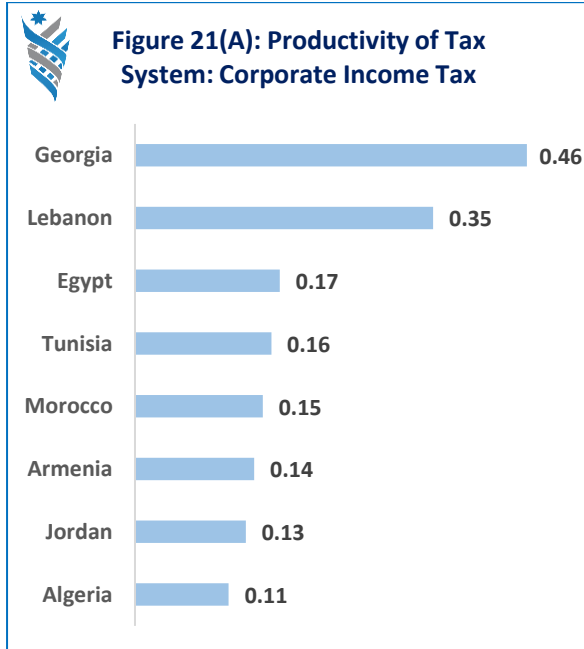
differentiated rates. “Preferential tax treatment is a norm rather than exception, even at the level of individual companies and products”, the reports states.



2. As a result of the many preferential tax regimes, the tax system suffers from:

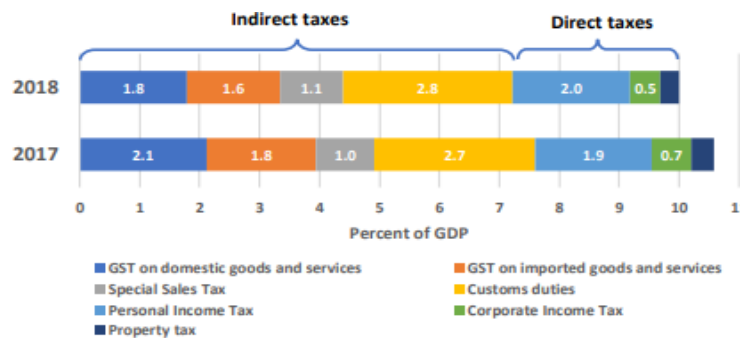
A. Corporate income tax productivity (revenue per point of the standard rate, in percent of GDP) is low.

B. General sales tax / value added tax productivity (revenue to total final consumption net of general sales tax revenue, divided by standard general sales tax rate) is low.



3. The presence of preferential tax treatment contributes to significant amounts of tax expenditures. The IMF Report relies on the most recent evaluation, conducted by the tax authorities in Jordan, to make this point. Indeed, the 2017 and 2018 results indicate that tax expenditures are equivalent to about 10.6% and 10.0% of GDP respectively.

**Figure 22: Tax Expenditures**



Sources: Ministry of Finance; and IMF staff estimates.

4. In addition to the above-mentioned preferential tax regimes, the IMF's Report raises the issue of the "elaborate network of economic zones" (55 in total) that exacerbates the differentiated tax application.

5. In addition to the resultant revenue drain and complexity of the tax system, the hitherto existing preferential tax regimes, the Report states, creates two main distortions.

**First**, businesses do not compete on a level-playing field. The system (tax) results in unfair competition between taxpayers.

**Second**, the effective tax rate differentials formed by the tax system creates opportunities to shift taxable profits and deductions across entities with different tax treatments.

6. Finally, it is useful to note that about half of corporate income taxes are collected from, not only highly regulated sectors, but also from sectors subjected to elevated tax rates (banks, financial institutions, insurance companies and mining sector).

Table 1: Corporate Income Tax Collection by Economic Sector (2019 / in Percent)			
Sector	Share of Taxpayers	Share of Total Tax Paid	Nominal Tax Rate
Banks	0.02%	39.40%	35.00%
Financial Companies	0.39%	2.50%	24.00%
Insurance Companies	0.02%	0.90%	24.00%
Telecommunications	0.01%	3.00%	24.00%
Mining	0.00%	3.90%	24.00%
Pharmaceuticals / Textiles	2.28%	2.00%	10.00%
Industrial Companies	7.21%	4.70%	15.00%
Hotels / Restaurants / Tourism	10.33%	5.10%	20.00%
Other	79.75%	38.50%	20.00%



## 5. Summary and Conclusions

The relationship between taxes and economic growth is a complex one, and depending on their economic structures, spending mechanisms, and nature of taxpayers, this relationship differs from one country to another.

The debate over the subject matter of tax, and its burden, will go on in Jordan. However, in many cases, it can be stated that adjustments in the tax law tend to target those who are compliant, especially in their income taxes. Indeed, and in addition to the informal sector, which operates outside the tax law altogether, a quick look at the number of taxpayers and their development during recent years indicates that this is the case. Moreover, while sales tax is the major component of total tax revenues, it is known for being regressive, reliable source of revenue, and not easy to dispense with.

Any new tax narrative should be related to the relationship between taxes and public spending on the one hand, and between taxes and economic growth on the other. In addition, such a relationship should also consider the optimal tax rates. Indeed, the philosophy of taxes should be based on its role in income distribution, employment creation, and the realization of growth. To focus on just tax collection, while ignoring the efficiency of public spending makes the debate on fiscal policy irrelevant, and fragmented. It is important to focus on a number of fiscal policy dimensions that constitute a basic road map for the new narrative.

### **The First Dimension: Efficiency of Revenue Collection and Legal Framework.**

- 1.** A reform path that manages tax exemptions better, and eliminates the differences in tax rates within and across the various sectors of the economy, would go a long way in restoring the neutrality of the impact of the tax system on investment decisions. Indeed, this would provide investors with a level-playing field, and enhance tax revenues.
- 2.** The issue of tax exemption should be re-examined in accordance with any new economic policy, and any identified targeted sectors. This should enhance competition, reduce tax distortions, and minimize the role of “personal judgment” in tax assessments (which often results in mismanagement).
- 3.** Enhance the efficiency of tax collection and strengthen institutional capacity by simplifying the legislative system and enforcement mechanisms. In addition, a reform path that expands the general sales tax base, abolishes the current preferential goods and services tax systems, which limits the efficiency of tax collection, especially those related to tax avoidance and evasion, should be adopted.
- 4.** A balance between strict tax collection procedures and the legal system should be the norm. The legal procedures should be clarified with clear instructions should be issued. It is also necessary to enhance the concept of the culture of tax participation, and to work with specialized bodies to clarify the sources of public revenues and spending in a simplified and participatory manner.

## **The Second Dimension: Public Spending and its Relationship with Growth, Employment, and Social Role.**

1. Linking tax exemptions with some vital economic indicators, such as employment creation and exports is a necessary step. Within this context, the setting of a time frame for such exemptions is critical. Indeed, this would limit the existing exemptions whose reasons / objectives are no longer relevant.
2. It is critical to adopt public spending policy that encourages and stimulates economic growth during economic slowdown or recession.

## **The Third Dimension: Overall Macro Stability Including Assessment of the Efficiency of Public Spending, and Institutional Framework.**

1. The structure of collected taxes and their relationship with the underlying social changes should be examined. Improving tax performance and enhancing transparency and accountability should be the norm. It is necessary to link tax revenues with the quality of public services, such as infrastructure, education and health.
2. Promote popular participation in the general budget debate to ensure wider participation and contribution in determining spending priorities. The budget should be "responsive" to the needs and priorities of the local communities.



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