Taxation and The Environment in MENA

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Content of presentation

• Overview of MENA’s tax system

• Links between taxation and the environment in MENA
  • Use of excises (or lack of) – subsidies to consumption of energy
  • Tax subsidies to production

• Policy suggestions
Important to keep in mind that taxation to address environment/climate issues must be consistent with economic and social goals, to gather political support.
• Such objectives require resilient tax systems, which MENA countries seem to lack in general

• Tax revenues increased in advanced economies as a response to the 2008 crisis

• But they declined in MENA and emerging economies

• Country experiences, however, differ

Source: IMF Fiscal Monitor.
• Lack of resilience of tax revenues in MENA is due primarily to three factors:
  • Predominance of oil revenue, with non-oil revenue lower than in low-income countries
  • Nearly perfect correlation between total revenue and oil revenue
  • Narrow tax bases imply low sensitivity to economic activity
Tax revenue across MENA differ by geography and endowment in natural resources.
• Looking at the evolution of MENA’s tax structures, the key trends are:

  • Domestic taxes (income and consumption) replaced trade taxes

  • Change in total taxes is recent, and due primarily to policy measures
• Low PIT, combined with poorly-targeted VAT tax expenditures imply overall low-progressivity, perhaps even regressivity in taxation
• Similar picture on energy subsidies (more on this later) worsens the equity implications of the tax-benefit system

### Distributional Impact of VAT Tax Expenditures in Morocco and Tunisia

(Percent of benefits by quintile)

<table>
<thead>
<tr>
<th></th>
<th>Poor</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q5</th>
<th>Total</th>
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<tr>
<td>Morocco</td>
<td>5.2</td>
<td>9.3</td>
<td>12.0</td>
<td>15.0</td>
<td>19.7</td>
<td>38.8</td>
<td>100</td>
</tr>
<tr>
<td>Tunisia</td>
<td>n.a.</td>
<td>7.7</td>
<td>12.7</td>
<td>17.0</td>
<td>23.2</td>
<td>39.2</td>
<td>100</td>
</tr>
</tbody>
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How have MENA countries reacted to recent deterioration in their fiscal balances?

• Overall, the estimated revenue adjustment is an increase of about 1.3 percent of GDP
  - 1.5 percent including VATs in Saudi Arabia and UAE (introduced in Jan 2018)

• 70 percent of this increase is attributable to VATs

• Equity consequences could be substantial, but hard to evaluate

Sources: TPD Rates Database and MENA Revenue Database (unpublished), and IBFD.
Note: The revenue impact is estimated by multiplying the absolute 2010-2016 cumulative rate change by the average of the corresponding productivity for the same period. Estimates include the impact of the anticipated VAT in Saudi Arabia and UAE in 2018.
Links between taxation and the Environment in MENA

Use of excises – subsidies to consumption of energy products
Tax subsidies to production
Why taxation for environmental objectives?

- Several MENA countries have constraints on the policy tools they can deploy to address environmental/climate issues.

- Taxation is convenient and effective for several reasons:
  - Can be equivalent to non-tax tools—e.g. pricing externalities.
  - Transparent—but politically more challenging.
  - Yields revenue to the budget.
  - Is consistent with other tax policy objectives, such as better progressivity and less tax-inefficiencies.
Excise taxes are the closest link

- Data are scarce, but overall excise revenues are lower in MENA, relative to comparators
- And they have declined over time
- In many countries, excises on energy products are mere accounting/earmarking tools
Consumer fuel prices in MENA are below international benchmarks, implying large (pre-tax) subsidies, which are highly correlated with international prices.

MENA accounts for 57.2% of the value of global fuel subsidies.

Consumer electricity prices are also well below production and distribution costs, implying large subsidies, with some correlation with fuel prices in oil exporters only.

• The cost of energy subsidies is largely in favor of high-income households

• Together with the very small role that PIT plays in MENA, the tax-benefit system may be regressive for certain income brackets

Tax subsidies to production – Corporate investment tax incentives

- Take the form of tax holidays
- Implication for investment:
  - Could attract FDI of footloose or highly mobile investments (e.g. financial, textile)
  - Have negligible effect on total investment...
  - ...but alter composition of investment – e.g. too many hotels, few supermarkets
- Implication for environment:
  - Could create oversupply of energy-intensive or other polluting activities – e.g. leather in Tunisia; tile manufacturing in Egypt
- Implication for growth is uncertain, since capital chases post-tax returns (not pre-tax returns)
Policy suggestions
For efficiency objectives, eliminating subsidies and pricing externalities (if only partially) is optimal

• Phasing out price subsidies can take years (e.g. Morocco and Lebanon)
• Need clear strategies to prevent falling back into “price discretion”
• Experience suggests that de-politicizing the price mechanism is necessary for success – provided accompanying measures are implemented

• Extending excises to certain items can help, but is small relative to fuel prices
  • Excises on cars and plastic

• Other important policies, which should be feasible in some countries:
  • Road (e.g. Morocco) and congestion fees

• Replacing tax holidays with better targeted tools to reduce capital cost where positive externalities exist
Multiprong and medium-term reform strategies could include:

- Slightly more progressive PIT rates
- Better taxation of self-employed
- Fundamental reforms to social security contributions
- Less and better targeting of VAT exemptions and low rates

Perception of “fair application” of laws is important

- This is as important, if not more, than the policies in place
- Discretion in application of tax laws distort the intended effects of policies

For equity/redistributive objectives, progressive tax systems are appropriate tools