Economic and Social Commission for Western Asia (ESCWA)

Committee on Financing for Development in the States Members of the Economic and Social Commission for Western Asia
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The Arab Financing for Development Scorecard

Domestic public resources

Summary

As global growth loses steam and the specter of stagflation looms, developed countries’ primary response has been to introduce tax cuts and adopt populist expansionary fiscal policies. The Arab region is not at full liberty to pursue the same solution due to limited fiscal space. The region has been the recipient of generic prescriptions for fiscal consolidation, raising tax revenues, reducing indirect tax impact, limiting regressive tax practices, seeking income progressivity and rationalizing “harmful” subsidies. All this comes amidst tightening liquidity conditions, increased non-economic risks, trade and investment protectionism, declining real wages, rising threat of debt distress and high exposures to illicit financial flows (IFFs).

In the present document, the Economic and Social Commission for Western Asia (ESCWA) argues for an alternative reorientation of fiscal and tax policy, taking a cue from the outcomes of the first high-level Conference on Financing Sustainable Development held on 28 and 29 November 2018. It contends that there is room to improve fiscal and tax systems in the region but that any measure should take into consideration the region’s specificities, including the sizeable informal sector. Incremental tax revenues from an “overlapping tax base” and multiple tax structures obscures how tax revenues are collected and spent, thereby exacerbating inequality and eroding tax system transparency. Suboptimal tax policies not only undermine accountability and transparency but also discourage labour supply and savings and may lead to tax evasion and avoidance. This aggravates the region’s exposure to IFFs, which cause significant leakages in domestic resource mobilization capacities ranging between $60 billion to $77 billion per year. A regional road map that factors fiscal, tax and trade policies within a revamped regional integration framework could curb these flows and carve the fiscal space necessary to finance the 2030 Agenda for Sustainable Development in the Arab region and achieve Arab developmental regionalism.

The Committee on Financing for Development in the States Members of the Economic and Social Commission for Western Asia is invited to consider the policy considerations put forward in the present document and make comments in that regard.
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**Chapter**

### I. DOMESTIC PUBLIC RESOURCES: MAPPING THE GLOBAL LANDSCAPE

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### II. DOMESTIC PUBLIC RESOURCES: MAPPING THE REGIONAL LANDSCAPE

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Introduction

1. The third International Conference on Financing for Development resulted in a new global financing for development (FfD) framework to support the implementation of the 2030 Agenda for Sustainable Development. This framework, namely the Addis Ababa Action Agenda (Action Agenda), seeks to amalgamate financial sources (including official development assistance and foreign direct investment) and non-financial sources of financing (such as trade, pro-poor and pro-employment macroeconomic policies) to serve as a prime means to finance the 2030 Agenda. The framework also identifies the financing channels (public and private; domestic and international; bilateral and multilateral; traditional; and innovative) that can be mobilized to achieve the Sustainable Development Goals (SDGs).

2. Domestic public resources emerge as a central pillar in the FfD framework, not least, given their influence as a countercyclical adjustment buffer. According to the Action Agenda, the effective mobilization and use of domestic public revenues require coordinated actions to create the fiscal space for governments to finance development and overcome socioeconomic infractions and environmental challenges by, inter alia:

- Broadening the revenue side of fiscal policy: “enhancing revenue administration through modernized, progressive tax systems, improved tax policy and more efficient tax collection” and improving “the fairness, transparency, efficiency and effectiveness of our tax systems, including by broadening the tax base and continuing efforts to integrate the informal sector into the formal economy…” (Action Agenda, Paragraph 22);
- Rationalizing the expenditure side of fiscal policy: “rationalize inefficient fossil-fuel subsidies” (Action Agenda, Paragraph 31);
- Curb financial leakages undermining domestic resource mobilization capacities: “substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion” (Action Agenda, Paragraph 23).

I. DOMESTIC PUBLIC RESOURCES: MAPPING THE GLOBAL LANDSCAPE

A. GROWTH DYNAMICS AND FISCAL POLICY TRANSMISSION

3. The 2018 G20 Buenos Aires Summit recognized that fiscal policies should to be employed flexibly and be “growth-friendly”. In this vein, G20 leaders reaffirmed their commitment to address income distribution challenges by promoting sustainable tax systems and advance pro-growth tax policies. Global output growth for 2018-2019 was projected at 3.7 per cent, but the outlook was later revised downwards to reflect mounting concerns over tighter liquidity conditions, uncoordinated withdrawals of quantitative easing, and reversals in negative interest rate policies, all of which usher an end to the era of accommodative expansionary policies and fiscal stimuli that supported the recovery of many economies over the past decade.

4. Global growth projections were revised further downwards following the escalation of trade tensions due to the decline in global manufacturing output amidst fears over potential oil supply disruptions caused by a series of anomalies, including the collapse in Venezuela’s production, uncertainties over Iran’s oil exports, deepening rifts following Qatar’s withdrawal from the Organization of Petroleum Exporting Countries (OPEC) and the attack on oil plants in Saudi Arabia, including the world’s biggest petroleum processing facility.

5. Under current trajectories, the International Monetary Fund (IMF) expects growth in advanced economies to lose steam (from 2.3 per cent in 2018 to 2 per cent in 2019 and then 1.7 per cent in 2020). For the United States, output is expected to be sustained due to the Republican-supported tax-cuts and the maintenance of procyclical fiscal policies on the horizon, which will support social security and military spending (the latter, in excess of the 2 per cent North Atlantic Treaty Organization target). That said, the American budget deficit is expected to soar under the influence of these expenditures (to $1.2 trillion as estimated by the IMF).
6. Growth in the European Union (EU) was subdued as trade protectionism began to make a dent in productivity. The outlook remains clouded by the vortex of Brexit uncertainty and looming fears that loose fiscal policies, in violation of the Stability and Growth Pact, may reignite concerns about the sustainability of public debt (such as in Greece, Italy and Spain). Nationalist and far right, populist parties in Europe are moving to bring a decade-long of austerity measures to an end as they push forward with plans for fiscal stimulus in 2019 (figure 1).¹

![Figure 1. Most Eurozone countries are adopting expansionary fiscal policies in 2019](image)

Source: European Commission, country budget plans.

7. Given the above risks and uncertainties, the Secretary-General of the United Nations put forward his Strategy for Financing the 2030 Agenda for Sustainable Development (2018-2021) to accelerate the pace of implementing the 2030 Agenda. The Strategy’s first objective aims to align global financial and economic policies with the 2030 Agenda. It recognizes that public policies need to be supported by measures to preserve their systemic stability and reduce their vulnerability to economic, financial and climate shocks.

8. According to the United Nations Inter-Agency Task Force on Financing for Development, as global growth is projected to stagnate, further increases in fiscal space would require the application of political will to tax policy and administrative reform. These efforts must be accompanied by a focus on aligning the expenditure side of fiscal policy with sustainable development strategies to deliver public services equitably.

B. INTERNATIONAL TAX TRANSPARENCY, COLLECTION AND COOPERATION

9. At the Buenos Aires G20 Summit in December 2018, leaders called for continued action to modernize international tax systems, implement treaties to tackle tax avoidance and evasion and enhance tax transparency through:

- The universal application of the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) package of 15 actions to address tax strategies that exploit gaps in tax rules to artificially shift profits to low or no-tax locations, noting

that, according to the tax justice network, $1.1 trillion in bilateral trade mispricing into the EU and United States alone occurs from non-EU countries;²

- The application of the global Common Reporting Standard for the automatic exchange of financial account information in tax matters, which provides a greater level of information on non-residents’ wealth held abroad. The system requires tax jurisdictions to obtain information from their financial institutions on taxpayer’s accounts and automatically exchange that information with other jurisdictions on an annual basis and identifies jurisdictions that have not satisfactorily implemented the standard;

- Adherence to the Multilateral Competent Authority Agreement for the automatic exchange of financial account information, including details of financial assets held on behalf of non-resident taxpayers and the income derived therefrom. According to the OECD, the agreement led to the collection of $48 billion in payable taxes on income and wealth previously hidden from tax authorities;³

- The Multilateral Convention on Mutual Administrative Assistance in Tax Matters was revised for this purpose to provide for administrative cooperation between States in the assessment and collection of taxes to combat tax avoidance and evasion. This cooperation ranges from exchange of information to the recovery of foreign tax claims.

10. Tax evasion constitutes a major leakage in public revenues and erodes domestic resource mobilization capacities. According to the IMF, developing countries are said to be losing $500 billion in revenue a year, or about 1.3 per cent of the gross domestic product (GDP), due to multinational companies’ profit-shifting practice, whereas the OECD estimates that its member countries are losing between $100 billion to $240 billion annually.⁴

11. The United Nations Inter-Agency Task Force, nonetheless, finds that the sensitivity of profit declarations to tax rates is greater in developing economies than in developed economies, indicating that profit shifting by multinational corporations poses a more critical problem for developing countries. This challenge is compounded by the fact that developing countries have higher reliance on corporate tax revenues. Corporate income tax losses due to BEPS are estimated to be between 4 and 10 per cent of global corporate income tax revenues. According to the IMF, reducing corporate income tax rate by one percentage point raises reported profits by 1.5 per cent, with negative spillovers for the other economies, which see less profit reported.⁵

### C. ENERGY AND FOSSIL-FUEL SUBSIDY REFORMS

12. Developed and developing countries have long subsidized fuels for a variety of reasons. Fuel subsidies are often defended for their direct effect (namely improving the living conditions of the poorer deciles of the population) and for their indirect transmission effects (reducing the cost of energy-contingent products and services such as transport and food). The provision of cheap energy is also purported to induce comparative advantage in energy-intensive manufacturing sectors (such as steel, aluminum, etc.). Critics of energy subsidies point out, however, the high fiscal costs and burdens that these subsidies impose on budgets. Fossil-fuel subsidies are also criticized for encouraging irrational or excessive energy consumption (demand-side), and

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³ Some 104 tax jurisdictions signed the Multilateral Competent Authority Agreement including six Arab countries: Bahrain, Kuwait, Lebanon, Qatar, Saudi Arabia and the United Arab Emirates. Bahrain, Lebanon, Morocco, Mauritania, Qatar, Saudi Arabia, Tunisia and the United Arab Emirates are parties to the Convention on Mutual Administrative Assistance in Tax Matters.


for reducing the incentive to shift to alternate energy production patterns (supply-side), as well as for undermining sustainability outcomes.

13. The debate over energy subsidies is sometimes reduced to a binary choice in assessing whether energy subsidies are fundamentally good or bad for any combination of reasons. This binary depiction is elusive as the answer to such a question remains contingent on how governments harness the fiscal savings from energy subsidy reforms, and to what extent they do systematically rechannel the fiscal savings to increase social expenditures on health, education, social protection and sanitation to compensate the vulnerable groups that lost the benefits from energy subsidization. Another tier of complexity arises when attempts are made to establish whether increases in social spending actually targets those who have directly lost the consumption subsidy benefit in the first place. Many recognize that rationalizing or eliminating energy subsidies entails undesirable socioeconomic impacts. The issue then, is not whether energy subsidies are fundamentally good or bad, but rather what consequences arise from their reduction or elimination, and whether such consequences can be countered in an adequate manner.

14. This dichotomy is reflected by the careful choice of wording used to depict the Addis Agenda commitment to “rationalize inefficient fossil-fuel subsidies that encourage wasteful consumption by removing market distortions, in accordance with national circumstances, including by restructuring taxation and phasing out those harmful subsidies, where they exist, to reflect their environmental impacts, taking fully into account the specific needs and conditions of developing countries and minimizing the possible adverse impacts on their development in a manner that protects the poor and the affected communities” (para. 31). This exact wording was maintained and employed to articulate SDG target 12.C. Policymakers should consider the social implications and redistributive effects of energy subsidy reforms. The type of fiscal instruments employed and how the generated revenues are used are not neutral in terms of growth and employment creation.

15. At the time of the adoption of the Addis Agenda in 2015, the IMF estimated global pre-tax consumer energy subsidies at $492 billion and forecasted that their elimination would reduce fossil-fuel emissions by more than 50 per cent and carbon emissions by over 20 per cent. The OECD estimates that the annual energy subsidy bill of its members, on average, runs as high as $160 billion to $200 billion. The International Energy Agency, on its part, estimated the value of global fossil-fuel consumption subsidies at $302 billion in 2017, a 12 per cent increase from 2016. This trend is in direct opposition to the commitment of the G20 to phase out oil and other carbon subsidies by 2020 as part of efforts to combat global warming, as well as the G7 objective to eliminate government subsidies on coal, oil and gas (estimated at $100 billion per year) by 2025.

D. ILLICIT FINANCIAL FLOWS

16. To date, there is no multilaterally agreed definition of IFFs. Yet, the term is predominantly used to denote the cross-border movement of money that is illegally earned, transferred or used. The term essentially highlights four main conduits for illicit financing, associated with corruption (such as physical bulk cash transfers across borders, etc.); tax evasion (tax havens), base erosion and profit shifting (multinational corporations); trade-based money laundering (trade mis-invoicing), and transnational crime and terrorism financing.

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6 David Coady, and others, “How large are global energy subsidies?”, International Monetary Fund, Working Paper No. 15/105 (May 2015).
17. The United Nations estimates $2 trillion is laundered globally every year. Global Financial Integrity reports that the undetected and untaxed proceeds of transnational crime amount to $1.6 trillion to $2.2 trillion annually. Illicit revenues remain in circulation outside the formal economy and are associated with 11 illegal categories/activities (trafficking of drugs, humans, arms, human organs, cultural property, counterfeiting, illegal wildlife crime, illegal fishing, illegal logging, illegal mining and crude oil theft). Trade mis-invoicing, counterfeiting and drug trafficking generate the highest IFPs (between $923 billion and $1.13 trillion for trade mis-invoicing and counterfeiting, while the range for drug trafficking stands between $426 billion and $652 billion).

18. The upsurge in migration and exodus both from Africa and the Arab region have put more people at risk of exploitation. Smugglers and brokers have targeted refugees, particularly from the Syrian Arab Republic, who have been compelled to sell an organ to pay for their family’s safe passage to Europe. Syrian authorities estimate that between 18,000 and 20,000 Syrians have sold an organ since the beginning of the country’s unrest since 2011.

19. Financial innovation and the digitization of economies alongside advances in virtual currencies/crypto-assets have been exploited to launder the proceeds of illicit activities, namely those associated with tax and trade-based money laundering and terrorist financing. The Financial Action Task Force (FATF) recommended a set of comprehensive requirements to combat money laundering and terrorist financing, which applies to all forms of financial activity, including those that make use of virtual assets. The term “virtual asset” is used to refer to digital representations of value that can be digitally traded or transferred and can be used for payment or investment purposes, including digital representations of value that function as a medium of exchange, a unit of account, and/or a store of value. The FATF requires governments to regulate the providers of those virtual assets via applying risk-based Anti-Money Laundering (AML)/Counter Financing of Terrorism (CFT) regulations.

II. DOMESTIC PUBLIC RESOURCES: MAPPING THE REGIONAL LANDSCAPE

20. Domestic resource mobilization in the Arab region faces five major challenges: (a) the inability to set long-term fiscal policy horizons to sustainably finance development; (b) the need to increase governments’ fiscal space under tightening liquidity conditions amidst rising levels of debt fatigue; (c) how to consolidate budgets while ensuring increased quality social spending; (d) the need to design inflation-targeted tax structures especially given that a significant share of economic activity remains untaxed in the informal sector; and (e) a need to improve tax efforts at the national level, which ultimately requires enhanced forms of international collaboration to clamp down on tax evasion/avoidance and BEPS. Yet, domestic resource mobilization capacities remain intrinsic to the region’s exposure to non-economic risk, volatile oil and commodity prices, exogenous capital flows and the pace of debt accumulation.

A. FISCAL POLICY PERFORMANCE

21. Almost all Arab countries have fiscal deficits (with the exception of Djibouti, Mauritania and the United Arab Emirates). Extensive austerity measures have been put in place in most Arab countries since 2013. The average fiscal deficit for Arab oil-importing countries fell from over 9 per cent of GDP in 2013 to 6.6 per cent of GDP in 2018 and is expected to decrease to 6.3 per cent of GDP in 2019. For Arab oil-exporting countries,

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11 Ibid.

the overall fiscal deficit also declined from 5.1 per cent of GDP in 2017 to 1.6 per cent in 2018 and is expected to reach 0.1 per cent by year end 2019.13

22. Fiscal consolidation in the region has been pursued through several channels, at asymmetric paces and with varying degrees of regional and international support. The experience of Gulf Cooperation Council (GCC) countries shows a reliance on introducing energy subsidy cuts, regressive taxes (value added tax (VAT) on goods and services) and bridging fiscal deficits through debt-g geared instruments. Bahrain poses an interesting case as it trimmed its fiscal deficit by 35 per cent in 2018 as part of a plan to balance its budget by 2022 (cutting the deficit is a requirement to unleash a $10 billion aid package funded by neighbouring members of the GCC; the support package aims to reduce the risk premiums to allow Bahrain to borrow from international debt markets at cheaper rates and avert a currency devaluation).

23. Arab oil-importing economies (namely, Egypt, Jordan, Morocco and Tunisia) embarked on stabilization and structural reforms supported by the IMF Extended Fund (Egypt and Jordan) and Credit Facilities (Morocco and Tunisia). Given mounting risks, Lebanon opted to ease socioeconomic tensions by increasing public sector wages in 2017 (to $1.27 billion) and introduced more than a dozen new taxes to compensate the increase in public expenditure. However, these measures affected the country’s fiscal situation as the newly imposed taxes only generated revenues of $1.17 billion.14 Consequently, Lebanon’s expenditure as a percentage of GDP has been steadily increasing since 2016.

24. Arab oil-exporting economies rely on the resources mobilized from the sale of oil and gas. As such, their fiscal revenues remain vulnerable to international oil price fluctuations and their growth paths closely follow changes in oil prices. Persistently low oil prices have been a prime concern, constraining growth in the Arab region and the fiscal performance in oil-producing countries. Growing spending needs, coupled with uncertainty around the size and level of future oil revenues (especially under increasing commercial viability of renewable energy; growing supply from OPEC, driven by recoveries in production levels in Iraq and Libya, and from non-OPEC energy producers, particularly American shale gas and tight oil), raises the risk of growing fiscal shortfalls. This has been evident from the fact that the Arab region has witnessed annual declines in its oil export proceeds amounting to 51 per cent ($445 billion) between 2012 and 2017. ESCWA simulations in 2015 indicated that a 10 per cent decrease in oil prices could lead to a reduction between 0.15 and 1.5 percentage points in growth for the region.

B. BROADENING THE TAX BASE

25. Except for some oil-rich economies in the GCC, all Arab countries raise public revenues through non-resource tax revenues (personal income, corporate, trade, value added taxation, property, consumption (sales, excise and transaction) and stamps and fees).

26. Country-specific idiosyncrasies vary with respect to the main taxes employed. GCC countries do not adopt direct income taxation (econometric findings suggest that resource revenues partially crowd out non-resource revenues by about 20 cents on average for each dollar increase in resource revenue (Crivelli and Gupta, 2014)). Personal, wage and business income taxes are applied with varying thresholds and marginal rates of progressivity in non-resource rich countries (for example, Egypt (10-22.5 per cent), Jordan (7-20 per cent), Morocco (10-38 per cent), the State of Palestine (5-22 per cent) and Tunisia (15-35 per cent)). Most Arab countries have initiated significant reforms resulting in increased corporate income tax revenues, except for the GCC where it is mostly applied to foreign companies, and corporate taxation in non-oil-rich countries is comparable to the contributions of corporate income tax revenues in developing economies.

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14 عزة الحاج حسن، الضرائب المحصولة أقل من كلفة السلسلة، المدن، 24 شباط/فبراير 2018.
27. In terms of tax structure, the Arab region is less reliant on income taxes, and the tax base is more slanted towards corporate taxation (in middle-income countries) and trade taxes (in the least developed countries and conflict-affected economies). Wealth and property taxes constitute a negligible share of total tax revenue in most countries of the region. These tax asymmetries reflect the underlying socioeconomic paradoxes that governments contend with when articulating tax policies. In other words, governments are expected to:

- Ensure tax progressivity in a manner that does not aggravate poverty or raise the tax effort on the lower income deciles, yet empirical analysis offered by international organizations continue to argue that regressive taxes remain easier to collect and provide quick wins to generate public revenues, especially when institutional governance and collection capacity are weak. However, by design, indirect taxes are regressive, and the burden of taxes tends to be higher on the middle and lower classes (the largest segments of the consumer base in the Arab countries), whereas personal taxes focus on labour income and employees in the formal economy bear the brunt of direct taxation. This tends to undermine the fairness of tax systems and pushes economic activity further into informality;
- Broaden the tax base, while ensuring that a certain threshold of corporate tax/non-tax exemptions and incentives are warranted to remain competitive (given the global race to the bottom and proliferation of tax havens) and to counter disinvestment. These corporate tax exemptions, on their part, erode the tax base and are predominantly applied with a high degree of discretion and if not applied consistently, they may give rise to a breach in national treatment principles;
- Combat tax avoidance and tax-based IFFs (evasion). This becomes very cumbersome given weak tax collection capacities, growing informality, weak recovery frameworks for stolen asset and less than ideal international cooperation conditions to tax undeclared off-shore wealth, multinational profit-shifting practices and trade-based money laundering.

28. The region predominantly relies on sale taxes and VAT on goods and services, along with excise and other specific transaction taxes. Value added taxation varies, but on average, standard rates have increased in all countries reaching international levels on some products (box). According to the IMF, income taxes (not indirect taxes) partially compensated for lost revenue from trade liberalization in the Arab region. However, the Maghreb countries failed to plan a timely replacement for the lost revenue from trade taxes following preferential trade liberalization so the pressure to mobilize revenue fell on domestic taxes. Trade taxes and collected tariff revenues have been declining due to the proliferation of preferential trading arrangements and accession commitments to the World Trade Organization.

29. Despite the above, the traditional narrative tends to project the Arab region as having lower levels of taxes compared to other regions and their developing counterparts. The Arab region’s tax revenues are said to stand at 13 per cent of non-oil GDP, which is lower than emerging markets and developing countries’ average of 17 per cent. These sort of cross-sectional comparisons and the recommendations founded on them that call for a particular type of optimal tax design ignore the complications created by non-economic risks and the presence of a sizeable informal economy activity and the problems arising from tax evasion.

30. In fact, lower tax revenue figures employed in such comparisons do not seem to reflect differences in statutory tax rates between countries and regions, noting that top personal and corporate tax rates are not much higher among developed countries. Instead, the revenue difference largely reflects differences in the size of the informal economy. Moreover, incremental tax revenues from an overlapping tax base and multiple tax structure can distract both government and civil society from a clear focus on how tax revenues are collected and spent, thereby aggravating inequality perceptions. In such a case, sub-optimal tax policies not only discourage labour supply and savings but can also encourage greater efforts to evade taxes and push more

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activity into the informal sector. An inefficient or perceived bias in tax systems is also seen as a cause for IFFs to be it through corruption or tax and trade-based money laundering conduits.

In January 2018, Saudi Arabia and the United Arab Emirates were the first countries in the GCC to implement the VAT at the rate of 5 per cent under the GCC VAT framework treaty. VAT proceeds in Saudi Arabia amounted to $12.16 billion in 2018, more than double the initial estimate. In January 2019, Bahrain and the United Arab Emirates began to apply the GCC VAT, a step that is expected to increase its GDP by $12 billion.

ESCWA had estimated that a 5 per cent VAT for oil-rich countries would generate fiscal revenue of 2 per cent of GDP. As for non-oil countries, Egypt increased its VAT rates to 14 per cent on the 1st of July 2017. The VAT increase, along with higher excise taxes on tobacco and other increases in stamp duties on government services and licenses, are all part of a push for fiscal consolidation. Jordan also introduced a VAT-based tax law to fix its State finances and lessen its all-time high debt-to-GDP level. The measures included the sales tax increase from 10-16 per cent on tobacco and high-grade fuel.

Among the other tax measures taken in the region, Lebanon issued new tax measures and increased the VAT rates; Saudi Arabia increased taxes on foreign employees; Tunisia raised VAT rates on all tiers with a maximum bracket of 19 per cent and increased withholding tax on interest payments for non-resident banks and on dividends.

C. RATIONALIZING OR ELIMINATING SUBSIDIES

31. Governments in the Arab region have historically sought to bridge the gap between those covered by public sector employment and social insurance from formal employment and those outside the formal sector through subsidy schemes for fuel, food and housing. These schemes, together with public employment, historically formed the backbone of Arab social support systems aimed to reduce poverty and improve access to these goods by stabilizing their price. However, they have often been cited for being poorly targeted. On average, fuel and food subsidies account for 10 per cent of GDP and 20 per cent of total expenditures in the Arab region.

32. Spending on subsidies in Arab countries is traditionally higher than in other regions of the world. The Arab region accounted for more than a quarter (27 per cent) of global energy subsidies in 2015 (estimated at $117 billion out of $436 billion total worldwide). Arab oil-rich economies accounted for the lion’s share ($94 billion or about 5.5 per cent of their GDP). This figure nonetheless represents a decline from 2011 levels when total energy subsidies amounted to 8.4 per cent of oil-exporting countries GDP or $4,400 per capita.

Energy subsidies in oil-exporting countries dropped from $190 billion in 2014 to an estimated $86 billion in 2016 (ESCWA, 2017).

33. According to the IMF, every dollar of government resources removed from energy subsidies and placed towards productive investment translates into two dollars of added growth over the long term.17 Furthermore, the removal of fuel subsidies could raise GDP by 2 percentage points and allow for a 40 per cent increase in social protection spending. However, this remains contingent on putting in place a rules-based dynamic fiscal framework that guarantees that savings from fuel subsidy cuts would be effectively channeled to finance social expenditures as detailed in paragraphs 12 and 13 above.

34. Arab countries have been working to rationalize their subsidy expenditures and wean consumers and businesses off high-cost inefficient subsidized energy, while seeking to modernize and diversify their economies.18 By 2016, most Arab countries were well into their fiscal consolidation efforts, including cutting energy subsidies and reducing other elements of capital spending.19 Saudi Arabia managed to decrease its fossil-fuel subsidies from 0.8 per cent of its GDP in 2015 to 0.2 per cent in 2017 and plans on keeping it at the 0.2 per cent level. In Egypt, fuel subsidies declined from 5.9 per cent of GDP in 2013-2014 to 2.7 per cent of GDP in 2017-2018 and is projected to decline to 1.8 per cent of GDP in 2018-2019.20

D. THE ILLICIT FINANCIAL FLOWS-DEVELOPMENT CONUNDRUM

35. In 2015, the Global Financial Integrity think tank identified IFFs as the most damaging economic conundrum facing the developing world. The losses due to IFFs in the developing world are estimated to be increasing at a rate of 6.5 per cent per year. In 2018, the General Assembly recognized that combating IFFs involves an essential development challenge and emphasized that these flows subtract from resources available for financing for development. The General Assembly called for the disaggregation of the different components of IFFs and supported the view that separate analysis of channels or components of IFFs is more beneficial in designing policy responses to prevent illicit flows.

36. Responding to the call, ESCWA published the first mapping of IFFs in the Arab region. The report provided compelling evidence of the structural, socioeconomic, governance and security complications facing Arab economies due to the pervasiveness of IFFs. Illicit finance was found to be a major disabler to financing sustainable development in the region, posing severe drainage to domestic resource mobilization efforts.

37. Substantial leakages in the range of $60 billion and $77 billion associated with illicit flows and arising from skewed fiscal, tax and trade policies were identified as the most pervasive forms negatively impacting the region’s financing propensities. On average, financial outflows associated with trade mis-invoicing is estimated at $42.8 billion per year (import over mis-invoicing and export under mis-invoicing).

38. These leakages are tantamount to a lost opportunity that could have otherwise been harnessed to create the fiscal space necessary to sustainably finance development. Illicit flows are distorting trade and taxation systems in as much as they are creating inequalities and impairing governments’ expenditure eligibility requirements, and perception-based governance and corruption standings.


18 For a detailed list of subsidy reforms, refer to ESCWA Survey of Economic and Social Development 2016-2017 and annex 2 of ESCWA working paper on subsidy reform and environmental sustainability in the Arab region (E/ESCWA/SDPD/2017/Technical Paper.8).

19 ESCWA, “Survey of Economic and Social Developments in the Arab Region 2017-2018”.

39. International corporate tax is an important source of government revenue and represents a considerable share of total tax revenues in developing economies. Several estimates tried to monetize the global annual losses from tax avoidance: Crivelli and others (2016) estimate global revenue losses at around $650 billion while Cobham and others (2017) estimate it at $500 billion (in line with the IMF estimate mentioned earlier). All studies highlight the variance in intensity between countries.

40. Corruption in revenue administration is present in many countries, has a direct impact on revenue collection and is initiated by taxpayers or tax collectors. Taxpayers want to underreport their income and they are willing to offer bribes to tax collectors to change their tax liability or avoid registration. While tax collectors may threaten taxpayers of overassessment to extort them. A positive correlation exists between tax procedure complexity and corruption perception. This correlation applies to Arab countries. Via increasing transparency and simplifying procedures, governments can tackle corruption, push towards fairer tax systems and boost revenue collection.

41. Several governments in the Arab region have enacted legislation to combat money laundering, corruption and illicit enrichment (Egypt, Jordan, Morocco, Saudi Arabia, Tunisia and the United Arab Emirates). However, the latest edition of the Basel AML index still classifies most countries in the region as having a significant risk of terrorist financing and money laundering (figure 2). In addition, several countries in the region are still showing up on a number of “blacklists” in so far as combating AML and CFT is concerned (see table below).

![Figure 2. Basel Anti-Money Laundering Index for 2018](source: International Centre for Asset Recovery.)

42. The index focuses on AML and CFT frameworks and risk factors (corruption, transparency and the rule of law). Countries with a risk score of 5.0 or above are loosely classified as having a significant risk of money laundering and terrorist financing.
# Organizations/Commissions’ Assessment of Different Frameworks Related to IFFs

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| Countries complying with the international standard on exchange of information on request<sup>b</sup> | • Bahrain (compliant based on the second round of reviews)  
• Saudi Arabia (largely compliant based on the first round of reviews)  
• Qatar (largely compliant based on the second round of reviews)  
• Lebanon and the United Arab Emirates (provisionally largely compliant based on the first round of reviews) |
| Countries listed on the EU blacklist<sup>c</sup> | Iraq, Libya, Saudi Arabia, the Syrian Arab Republic and Yemen. |
| Countries assigned as a high priority within the scope of the EU assessment (subject to an assessment by the European Commission and given priority status)<sup>d</sup> | Iraq, Libya, Morocco, Saudi Arabia, the Syrian Arab Republic, Tunisia and the United Arab Emirates. |
| Countries listed on the United States Office of Foreign Assets Control sanction list<sup>f</sup> | Iraq, Lebanon, Libya, the Sudan, the Syrian Arabic Republic and Yemen. |
| Countries that have not yet signed intergovernmental agreements concerning the Foreign Account Tax Compliance Act<sup>g</sup> | Egypt, Jordan, Lebanon, Libya, Mauritania, Morocco, Oman, the State of Palestine, the Sudan, the Syrian Arabic Republic and Yemen. |

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<sup>f</sup> US Department of Treasury, available at: [https://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx](https://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx).