eJournal of Tax Research

Volume 14, Number 3 December 2016

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eJournal of Tax Research (2016) vol. 14, no. 3, pp. 683-706

Tax policy challenges in an era of political transition: The case of Egypt

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Abstract

Tax policy is normally formulated and implemented during politically stable periods. The collapse of the Soviet Union and Eastern bloc countries in the early 1990s have allowed researchers to study tax policy reform in transition economies with changing political and economic systems. This article aims to examine tax policy challenges in Egypt as a result of the revolution in 2011. Egypt has been chosen because of its importance in the Arab world and its interesting tax reform, including a rationalisation of tax incentives. It is found that Egypt has adopted a combination of counter-cyclical government expenditure policy and pro-cyclical tax policy in an era of political transition. This combination is interesting as it is well known that developed countries tend to employ counter-cyclical fiscal policy whereas developing countries tend

1. INTRODUCTION

Theoretical and empirical studies of tax policy design and implementation are typically concerned with countries, mainly developed countries, having stable political and economic regimes. The collapse of the Soviet Union and the Eastern bloc countries in the early 1990s has allowed tax researchers to study tax policy reforms in the context of simultaneous political and economic transition (see, for example, Martinez-Vazquez & McNab, 2000). However, in some formerly central planned countries such as China and Vietnam, tax reforms have taken place within politically stable but economical [illegible]

stimulation, and (iv) modernisation of tax administration (Vermeend et al., 2008). In an era of political changes, policymakers tend to be mostly concerned with economic stabilisation and economic growth. These two issues will be further considered below.

2.2 Tax policy and macroeconomic stabilisation

Macroeconomic stabilisation programs mainly focus on tackling a number of economy-wide issues, particularly unemployment, inflation and budget deficit. Tax policy, among other economic policies, is employed to overcome those issues (Montiel & Servén, 2006). However, a strong link can be easily identified between tax policy and budget deficits. In this regard, tax policy is being used to increase tax revenue through various techniques such as introducing new taxes, increasing tax rates, broadening tax bases, and changing the tax mix (Listokin, 2012).

Many developing countries had restructured their tax systems to increase tax revenue relative to GDP. This process resulted in changes in the tax mix through moving from easy to tax and collect into hard to tax and collect (Aizenman & Jinjarak, 2009). Consequently, foreign trade taxes have declined, especially as a percentage of total tax revenue, while Value Added Tax (VAT) and excise taxes have become more important (Keen & Simone, 2004). At the same time, income tax has been simplified and the marginal tax rates have been reduced. Those measures have led to significant results with regard to increasing tax revenues and consequently curbing budget deficits. Nevertheless, the ratios of total tax revenue to GDP in developing countries are still low in comparison with those of developed countrie ro 0.002 Tc -0.002 Tw -34.652 -1.152SfMC /Referenl (s)]TJ 4.8 (o)-11 (pe)-1.8 (d634.8 (o) tax incentives may not always be the optimal solution. Tax policymakers must find a proper way to assess the costs and benefits arising from tax incentives.

2.4 Criteria for assessing tax policy and political transition

Under the normative approach, researchers often use a small number of criteria to assess overall tax policy (Wagner, 1985). The monumental and seminal work of Adam Smith forms the core of current assessment criteria, which are equity, efficiency, certainty and flexibility (Coutinho, 2001). In an e f f i . T c

the shrinking role of the government and an increasing role of the private sector in the economy. As a result of a lack of transparency and accountability, privatisation increased the level of corruption and income concentration.

As summarised in Table 1, growth rates of real GDP and real GDP per capita in Egypt have generally decreased over time, especially during the period just before the revolution. Table 1 also shows that the growth rate of GDP per capita has been considerably lower than that of GDP.

Table 1: Average Annual Growth Rates of GDP and GDP per Capita, Egypt

	1961–2010	1995–2011	2008–2011
Average annual GDP growth rates (%)	5.1	5	3.8 5

Table 3: Labour Force (mil people) and Unemployment Rate (%), Egypt, 2000 to 2014

Year	Total labour force	Total employment	Total unemployment*	Unemployment rate (%)
2000–01	19.3	17.6	1.8	9.2
2001–02	19.9	17.9	2	10.2
2002–03	20.4	18.1	2.2	11
2003–04	20.9	18.7	2.2	10.3
2004–05	21.8	19.3	2.5	11.2
2005–06	22.9	20.4	2.5	10.6
2006–07	23.9	21.7	2.1	8.9
2007–08	24.7	22.5	2.1	8.7
2008–09	25.4	23.0	2.38	9.4
2009–10	26.2	23.8	2.35	9
2010–11	26.5	23.3	3.2	12.0
2011–12	27.0	23.6	3.4	12.7
2012–13	27.2	23.6	3.6	13.3
2013–14	27.6	23.9	3.7	13.3

Source: Central Bank of Egypt.

Political transition also impacts on private investment, which has declined sharply since the revolution. For example, FDI has significantly declined since 2011 to date as shown in Table 4.

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Table 5: Government Expenditure (current million EGP), Egypt, 2001 to 2014

Year	Government expenditure	Growth rate (%)
2001–02	115 542	
2002–03	127 320	10.2
2003–04	145 988	14.7
2004–05	161 611	10.7
2005–06	207 811	28.6
2006–07	222 029	6.8
2007–08	282 290	27.1
2008–09	351 500	24.5
2009–10	365 987	4.1
2010–11	401 866	9.8
2011–12	470 992	17.2
2012–13	588 188	24.9
2013–14	701 514	19.2

Source: Central Bank of Egypt.

Since the revolution, government expenditure growth rates increased from 9.8 per cent in 2010 το 2011 to 17.2 per cent in 2011 το 2012 and then again to 24.9 per cent in 2012 το 2013. At the same time, government revenue has not increased at the same rate, as illustrated in Table 6.

Table 6: Government Revenue (current million EGP), Egypt, 2001 το 2014

Year	Total Revenue		Tax Revenue		Other Revenue	
	Amount	Growth rate (%)	Amount	Growth rate (%)	Amount	Growth rate (%)
2001–02	78 318		50 801		23 252	
2002–03	89 146	13.8	55 736	9.7	30 120	29.5
2003–04	101 881	14.3	67 147	20.5	29 683	-1.5
2004–05	110 864	8.8	75 759	12.8	32 252	8.7
2005–06	151 266	36.4	97 779	29.1	51 108	58.5
2006–07	180 215	19.1	114 326	16.9	62 003	21.3
2007–08	221 404	22.9	137 195	20.0	82 746	33.5
2008–09	282 505	27.6	163 222	19.0	11 1299	34.5
2009–10	268 114	-5.1	170 494	4.5	93 288	-16.2
2010–11	265 286	-1.1	192 072	12.7	70 927	-24.0
2011–12	303 622	14.5	207 410	8.0	86 109	21.4 494

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Table 7: Budget Deficits as a Percentage of GDP, Egypt, 2001 το 2014

Year	Percentage
2001–02	9.8
2002–03	9.1
2003–04	9.1
2004–05	9.4
2005–06	9.2
2006–07	5.7
2007–08	6.8
2008–09	6.6
2009–10	8.1
2010–11	10.0
2011–12	10.9
2012–13	13.6
2013–14	12.3

Source: Central Bank of Egypt.

The above table shows that the budget deficit as a percentage of GDP in 2008 to 2009 was 6.6 per cent and it has been increasing steadily although it slightly declined to 12.3 per cent in the fiscal year 2013–14. Recently the IMF commented on the fiscal situation in Egypt as a result of high budget deficits and increasing level of finance. It stated that 'countries with high levels of deficit and debt and large gross financing needs (including Egypt, Jordan, Morocco, and Pakistan) are exposed to shocks and swings in market sentiment and thus must take early decisive steps to safeguard against adverse debt dynamics and bolster credibility' (IMF, 2013b).

The Egyptian government tends to rely heavily on domestic sources for funding budget deficits and this has a crowding out effect on private investments. With regard to tax policy, increasing budget deficit is related to the criterion of revenues adequacy, which will be used to assess the tax policies implemented since the 2011 revolt.

3.2 Tax policy in Egypt prior to 2011

In 1991, the Egyptian government, with the cooperation of international financial institutions, launched an economic stabilisation program. Accordingly, a new

4. ASSESSING TAX POLICY DURING POLITICAL TRANSITION

4.1 Tax policy and business cycle

Discussions of economic challenges after the 25 January 2011 Revolution in Egypt have shown that there are a number of challenges facing the government, namely, (i) declining GDP growth rate, (ii) rising unemployment rate, and (iii) growing budget deficit. The first and the second macroeconomic issues require economic policy, particularly fiscal policy, to be employed in order to stimulate the economy. So government expenditure increase, as recommended by the Keynesian policy, is an important economic tool. A 1 per cent increase in government expenditure can, in principle, raise GDP by more than 1 per cent because of the government expenditure multiplier (Mankiw, 2007, p. 294).[7]

The second tool of fiscal policy to deal with economic downturn is tax rate cut in order to reduce the tax burden on business, which consequently promotes GDP the possible impact of raising tax rates on investments (OECD 2010). The current situation of increasing the marginal tax rate on individuals and legal persons from 20 per cent to 25 per cent can create economic distortions and contradicts the experiences of many developed countries which have adopted tax cut to stimulate the economy and create economic growth (Mankiw, 2007). Thus an increase in tax rates will have a negative impact on both investment and unemployment.

Tax revenue figures of fiscal years from 2010 to 2013 (Table 8 below) show that the private sector share of tax revenue has declined over the years. More specifically, the combined income tax revenue share of companies and individuals decreased from 60 per cent in 2010 τo 2001 to only 46 per cent in 2012 τo 2013. In more recent years, these combined shares More4c ho3-1 T-39 d aT-39 Tj5 -39 Tj5 s. m4c Tj5 s.oo3-1 2c 0

Table 8: Breakdown of Income Tax Revenue (million EGP), Egypt, 2001 to 2013

Year	Total income tax revenue	EGPC*		SCA**		CBE***		Other		Individuals	
		Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
2001-02	19 624	3562	18	3406	17	841	4	5.276	27	6539	33
2002-03	20 842	2564	12	4188	20	514	2	6.857	33	6719	32
2003-04	27 280	4771	17	6514	24	317	1	7.518	28	8160	30
2004-05	31 571	4030	13	7343	23	212	1	10.671	34	9315	30
2005-06	48 268	23 620	49	7321	15	0	0	7.946	16	9381	19
2006-07	58 535	25 380	43	9144	16	0	0	14.291	24	9720	17
2007-08	67 059	29 268	44	10 268	15	0	0	16.028	24	11 495	17
2008-09	79 073	34 135	43	10 391	13	0	0	20.263	26	14 284	18
2009-10	76 618	32 181	42	9443	12	0	0	18.591	24	16 403	21
2010-11	89 593	34 308	38	10 900	12	0	0	25.330	28	19 055	21
2011-12	91 245	34 075	37	11 800	13	0	0	23.674	26	21 696	24
2012-13	117 762	45 816	39	12 150	10	8 290	7	25.275	21	26 231	22

Source: Central Bank of Egypt.
Notes: * EGPC - Egyptian General Petroleum Cooperation
**SCA - Suez Canal Authority
***CBE - Central Bank of Egypt.

4.3 Tax policy and revenue adequacy

Revenue adequacy refers to the capability of the tax system to generate sufficient revenue to finance government expenditures. Assessing the tax policy in Egypt in terms of revenue adequacy reveals that the tax revenue has increased in fiscal years 2011 το 2012 and 2013 το 2014 as shown in Table 9 below.

Table 9: Tax Revenue as Share of Total Government Revenue, Egypt, 2001 to 2014

Year	Total revenue	Tax revenue	Tax revenue/Total revenue (%)
2001–02	78 318	50 801	65
2002–03	89 146	55 736	63

Such increase in tax revenue share is attributable to the following:

1. imposition of withholding tax on interest income derived from treasury bills and government bonds (see Table 8)
2. introduction of tax incentives in a form of specific discount rate for paying tax debts
3. increase in the sales tax rates on a number of goods and services.

The increase of tax revenue is evidence that the tax policy during the political instability focused on increasing tax revenue to meet increasing trend of government expenditure. However, the gap between government expenditure and government revenue has still remained high, and the budget deficit accounted for 13 per cent of GDP in 2012 τo 2013. Consequently, the government should find another means to increase its revenues such as through improving enforcement measures and modernisation of tax administration. These measures entail fighting tax evasion and closing tax avoidance loopholes to increase the share of tax revenue to GDP above 14 per cent, as reported by the IMF (2013b).

4.4 Tax policy and equality

Achieving income equality and minimising social injustice were the main objectives of the 2011 revolution to which the tax system can significantly contribute and achieve through creating a tax system characterised by equity. Nevertheless, h (he)-123d ( )Tj(o)2 (b)122 s0 Tc 0Td [(t)

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