

The Political Economy of the General Sales Tax in Jordan

A decline in rents accruing to the Jordanian economy—mainly private remittances and official aid flows from Arab countries—led the government to introduce tax reforms in the late 1980s, with a general sales tax (GST) as the centerpiece.¹ A sales tax had been a well-established source of revenue before Jordan embarked on its first IMF-supported program. However, the plan of the government to change it into a GST with features of a value-added tax (VAT), had important implications for many business and consumer groups—and was resisted at various levels. This annex looks at how various stakeholder groups behaved during the introduction and implementation of the GST, thereby revealing the political economy of a major intervention.

Introduction of the GST

The government prepared the first draft of the GST law during 1989–91 without much formal consultation with stakeholders. The initial public reaction to both the draft and the way it was prepared was negative. The private sector claimed that the economy was not ready for the introduction of such a tax. The Amman Chamber of Commerce and other business associations were concerned at the lack of consultation. Parliament, on the other hand, was conscious of the potential political ramifications; the demonstrations from 1989 over fuel price increases loomed large. Furthermore, some members of parliament held the view that the new tax was an imposition from multilateral agencies and the West.

In an attempt to accommodate stakeholder demands for broader consultation, the Economic Consultative Council (ECC)² and the Ministry of Finance began holding meetings with business and

NGO representatives from late 1992, and the government postponed the introduction of the GST to after parliamentary elections scheduled for November 1993.

Following the elections, the new government promoted the GST more vigorously than its predecessor. In early 1994, the government embarked on broad consultations with business groups to study their concerns and a committee was set up to scrutinize their recommendations. Significantly, differences arose between the Amman Chamber of Commerce (ACC) and the Amman Chamber of Industry (ACI) regarding the treatment of various types of imports. ACI sought tax exemptions on a broad range of imported inputs, while the ACC wanted exemptions to be more product specific. However, both demanded that the basic GST rate be lower than the proposed 10 percent.

On the whole, the GST debate was a new experience. It was the first clear example in Jordan of the emergence of a participatory process in government decision making. The media followed the debate closely, with articles in favor and against. Those in support cited the need to abandon old policies and to move towards a more market-oriented regime. On the other hand, articles not in favor of the law were driven mainly by skepticism toward the role of the IMF and the World Bank in policymaking and the general perception that the GST was an external imposition.

The GST law was eventually enacted on June 1, 1994, after parliament changed several aspects of the draft submitted to it by the government. First, the GST was to be implemented gradually, starting with manufactured goods and proceeding to services in the second phase. Second, the list of exemptions was increased threefold—a concession to influential business and consumer groups. Third, the basic GST rate was reduced from the proposed 10 percent to 7 percent, and the rate on luxury goods was reduced from the proposed 25 percent to 20 percent. Parliament also recommended that the salaries and social security allowances for low-income groups be increased to compensate for the impact of the GST on their purchasing power.

¹This annex is an abridged version of a report prepared for this evaluation by Ibrahim Saif (Economic Studies Unit, Center for Strategic Studies, University of Jordan).

²The ECC is a consultative body that was created in 1986 as a forum for private sector–government interaction. Though the ECC has no constitutional or legal role, royal patronage gives it considerable credibility.

Amendments to the GST Law

During the first year of the GST, a number of problems were detected. The available institutional capacity was below what was required to implement the law effectively. The law had a number of loopholes arising from the imprecise nature of the legal provisions and the absence of a comprehensive list of exemptions—which allowed for a high degree of arbitrariness in determining them. There were also cases where domestic suppliers of intermediate inputs did not enjoy the tax exemptions available to direct importers of such goods.

The first amendment of the GST (1995) allowed the government to streamline the legislation and to simplify its administration. Overall, it sought to remove the numerous ambiguities that impeded the effective implementation of the GST, notably the definition of goods (manufactured or otherwise). In the short run, the most important outcome of the amendment was the increase of the basic rate from 7 to 10 percent, to partially compensate for revenue losses associated with the lowering of customs duties.³ The second (2000) amendment of the GST focused on the building of institutional capacities in order to make GST implementation more effective.

Passing the amendments through parliament proved to be less contentious than the initial introduction of the GST. The uncertainty that surrounded

the initial GST law had dissipated as it became clear that the GST was not as detrimental to producers and consumers as had been feared. In 2004 the government decided to further increase the basic GST rate from 13 percent to 16 percent. The government announced its intentions publicly and even went further to challenge critical stakeholders to propose alternative revenue sources. Debates and interviews between supporters and opponents of the GST were a common feature on national television. Interestingly, the focus was not so much on whether the tax should be increased or not but on how vulnerable groups would be best protected from the impact of the increase. The government went on to implement the increase with little public outcry.

Conclusions

The introduction of the GST was controversial, with a number of stakeholder groups seeing it as an imposition from abroad. In retrospect, the government had failed to adequately communicate the economic rationale of the GST to the public at large. Its initial strategy of co-opting certain stakeholder groups with lower GST rates and exemptions in order to smoothen the passage of the law proved costly. Subsequently, a number of amendments were required to remove the distortions introduced at initiation. Compared to its introduction, amending the GST was much easier. This had much to do with the lessening of the earlier uncertainty that surrounded its introduction.

³The GST rate was further increased from 10 percent to 13 percent in July 1999.