Annex 5
Review of the Fiscal Structural Content Under IMF Arrangements

This annex provides further details on structural actions in the fiscal area in support of the discussion in Chapter 2 on how effectively they addressed underlying fiscal rigidities. As noted in the main text, the targeted fiscal adjustment was to be achieved largely by expenditure reductions. In addition, under the EFFs, it was also recognized that some of the structural reforms being undertaken on the trade regime side would lead to revenue losses, to be partly compensated by tax reforms to move to consumption taxes with a broad base and improved tax administration.

The Early SBAs

The main structural actions on the fiscal side were increases in administered prices (fuel prices, steel products), increasing specific excise taxes (cigarettes, alcoholic beverages, telephone services, etc.) and the reduction of budgetary subsidies to basic food products. These measures were targeted to account for about 4 percent of GDP in fiscal savings. Beyond this, the programs contained relatively little structural reforms designed to contribute to the sustainability of public finances. Some of the pricing actions (e.g., for petroleum products) consisted of one-off increases rather than putting in place market mechanisms or institutional arrangements that would allow for automatic adjustment in administrative prices. IMF staff did push for such mechanisms but the authorities were reluctant for reasons of political sensitivity.

The Three EFFs

The first two EFFs started to introduce a more comprehensive set of medium-term reforms: the

Box A5.1. The 2002 Fiscal Strategy Paper[1]

The paper contained a comprehensive analysis of the dynamics of public debt and the necessary structural underpinning of the fiscal adjustment. It suggested a more gradual and, hence, realistic reduction in fiscal deficits than the one advocated by the 1999 EFF but emphasized that even a revised fiscal adjustment would require significant policy efforts. The paper's contribution is to identify and cost out many of these policy efforts, including the impact of the PSET plan on the budget.

The paper suggested an adjustment path as follows:

- Composition of the adjustment: A fiscal effort between 2002 and 2006 involving increases in tax revenues equal to 3 percent of GDP and reductions in noninterest current expenditures by 4 percent of GDP. About half of the decline in expenditures would be the result of a decline in PSET expenditures as grants associated with the PSET are projected to end after 2006.
- Increased privatization revenues to help reduce public debt along with selective debt buy-back and debt-for-development swaps to reduce further the external debt.
- Revenues: Expand the GST to energy products and water. Convert oil surplus into a system of specific taxes. Income tax rates for corporations to be unified and eliminate income tax exemptions.
- Expenditures: Measures to focus on keeping wages, purchase of goods and services, and military spending constant in real terms—which will require substantial adjustments. Pension reform should equalize retirement ages for men and women, increase retirement age for the military, and full-scale pension reforms should start in 2003 with the objective to limit growth of pensions to nominal GDP growth. These measures will allow to protect basic social spending and on core transfer programs while allowing for some moderate increase in capital spending.

[1]The strategy paper was an internal staff briefing paper (i.e., shared with management but not the Board). Part, but not all, of the assessment in the paper was summarized in an annex to the first review of the 2002 SBA.

gradual introduction of the new general sales tax (GST); attempts to amend the income tax laws to reduce exemptions and increase the base; and a rationalization of the system of food subsidies in order to target better the subsidy. Tax administration was to be enhanced by increasing the number of assessors and auditors. Nevertheless, progress was not easy: attempts to adopt a strategy for domestic petroleum pricing (instead of ad hoc adjustments in administrative prices) and eliminating exemptions to the income tax were not successful.

Important structural measures started to be supported by the last (1999) EFF. These included beginning a dialogue to reform the pension system and agreements to start restructuring and divesting public enterprises and utilities.

The large wage bill in the public sector stemming from the high level of public employment and wages for middle-level personnel (relative to the private sector) was diagnosed as a major issue for longer-term fiscal sustainability in almost all the programs. However, the various programs contained little discussion of options for addressing the problem through civil service reform. One of the few specific references is in the Schedule of Implementation of Structural Reforms attached to the Letter of Intent for the Second Review under the 1994 EFF, which refers to "implementation of civil service reform program, as appropriate, in the context of the 1995 budget." It also states that "further work is being done in consultation with the World Bank." But the initiative did not yield any concrete results.

Developments from 2002 Onward

The fiscal strategy paper suggested a more gradual fiscal adjustment accompanied by greater emphasis on specific reforms to address key rigidities (see Box A5.1). It proposed a greater effort on the revenue side than was programmed in the previous EFF, through stronger efforts at eliminating tax exemptions and improving collections. A major contribution of the paper was to identify more precisely specific policy efforts and their contributions to the projected fiscal adjustment—taking into account the need to protect certain spending items. Furthermore, it called attention to the future recurrent expenditure implications of present investments in the PSET plan—particularly if grant funding for the plan were to fall sharply in the next several years.

The medium-term projections in the program supported by the 2002 SBA aimed for a fiscal adjustment similar to that set out in the fiscal strategy paper. However, the program addresses only a subset of the structural areas raised in the strategy paper (see Table A5.1). Given the strong expenditure adjustment envisaged between 2001 and 2003, one would have expected that issues regarding the wage bill and military spending, representing about 45 percent of total public expenditures, would have received some discussion, even though they were obviously politically sensitive.

The 2004 monitoring paper does not address the structural reforms required to reduce public expenditures and its rigidity, in spite of projecting 10 percentage points of GDP reduction in such expenditures over a three-year period.

Table A5.1. Follow-Up on Specific Suggestions for Reforms Contained in the 2002 Fiscal Strategy Paper

Suggestions	Follow-Up in the 2002 SBA or in the 2004 Monitoring Paper
Broadening of the tax base and improving elasticity	
• Further reform the income tax law.	Partially addressed.
• Broadening the GST tax base through elimination of most tax exemptions.	Partially addressed.
• Expansion of GST to petroleum products.	Addressed in SBA.
• Significant number of nonstandard customs exemptions should be eliminated.	Not addressed.
• Tax leakages in the Aqaba Special Zone.	Not addressed.
Tax administration	
• Check whether GST registrants are fi ing.	Addressed in SBA.
• Undertake minimum number of audits.	Addressed in SBA.
• Lack of coordination across tax departments.	Addressed in SBA.
Public pension system	
• FAD mission to provide recommendations regarding retirement age, adjusting military disabi ity entitlements, and bringing military pensions more in line with the civilian scheme.	Addressed.

Table A5.1 *(concluded)*

Suggestions	Follow-Up in the 2002 SBA or in the 2004 Monitoring Paper
Wage and employment policies	
• Jordan has a relatively large civil service for its level of development and there is evidence of overstaffing. Low-level civil servants are paid above their opportunity cost in the private sector, while higher level civil servants are paid less. The government should review its wage and employment policies. The aim should be to keep the wage bill constant in real terms, hence, declining as a share of GDP. This could be achieved by freezing the size of the civil service.	Not addressed.
Military spending	
• Total military spending (including pensions) equal to 13 percent of GDP—extremely high even by the standards of the region. Even if real military outlays are kept constant in real terms, the authorities could save 1.8 percent of GDP over the medium term.	Military pensions were addressed but not other aspects.
Poverty reduction and safety nets	
• Untargeted subsidies on food have been replaced by targeted cost transfer and then by a faulty income supplement scheme, training and employment support programs, and country infrastructure. The fiscal paper suggests these expenditures should be maintained.	Not explicitly discussed but incorporated into framework.
Capital spending	
• According to the strategy paper, there are number of areas where the government can undertake projects with high social returns. Present expenditures at 5–6 percent of GDP should not be reduced.	Not explicitly discussed but incorporated into framework.

Sources: IMF (2003b and 2004b).