

Review of Fiscal Outcomes

Massive Adjustment in the Early 1990s Was Not Sustained

Based on the evolution of the fiscal deficit excluding grants, the period under review can be divided into four phases (Table A9.1): (1) 1989–92, marked by a massive reduction in the deficit—reflecting strong contributions from both revenues and expenditures; (2) 1993–98, marked by steady increase in the deficit, driven mainly by lower revenues; (3) 1999–2001, when the fiscal balance improved modestly, notwithstanding continuing falls in revenue; and (4) 2002–04, which saw a reversion to deterioration in the fiscal balance, reflecting expenditure increases financed by increased aid.

Phase I (1989–92). The bulk of the 20 percentage points of GDP reduction in the fiscal deficit (excluding grants) during this phase occurred in 1992. The main factors behind this performance were discretionary tax measures (including taxation of imports brought into the country by “returnees”) and the impact of the rebound in real GDP (boosted revenues and reduced the expenditure/GDP ratio). Real GDP grew by over 14 percent in 1992 after declining by about 11 percent in 1989 and stagnating during 1990–91.

Phase II (1993–98). Major changes to the tax and tariff systems were implemented during this phase, including the introduction of the GST in 1994. A series of tariff reductions were also implemented as part of trade reform. Although attempts were made to compensate for short-term revenue losses associated with the tariff reforms by increasing other tax rates, these did not succeed.

Phase III (1999–2001). This phase coincided with the 1999 EFF, which sought to reestablish the credibility of the IMF-supported program after a belated recognition of serious slippages under the preceding arrangement. Current expenditures appear to have borne the brunt of the adjustment that occurred in this period, as revenues continued to decline. However, the overall fiscal adjustment was modest, especially in comparison to that targeted under the EFF.

Phase IV (2002–04). The last phase corresponds broadly to the period of the 2002 SBA. It was char-

acterized by a deterioration in the fiscal balance (excluding grants), reflecting increases in capital expenditure. The deficit was more than covered by increases in grants to levels that exceeded substantially the average levels of the preceding decade.

Revenues Were Restructured Broadly as Envisaged but Yields Have Fallen Substantially

The main structural reforms that affected government revenues were the replacement of the existing consumption tax with a more broadly based GST, attempts to improve the efficiency and equity of direct taxes, and tariff reforms (see Box A9.1). The coverage of the GST widened over time; initially it was levied only on imports, domestic manufacturing sector output, and a few services. By the early 2000s, coverage had expanded to include retail trade and a wider range of services. Amendments to the Income Tax Law lowered high marginal rates and reduced the number of tax bands, while also seeking to safeguard the tax base by eliminating most tax holidays and limiting tax exemptions and deductions. With respect to trade-based taxes, specific rates were converted to ad valorem rates and the tariff schedule was simplified and exemptions curtailed. Imported and domestic goods were to be taxed at the same GST rate and tariffs were to be used primarily for protection and not revenue generation.

Attempts to synchronize tax and tariff reforms in order to prevent erosion of total revenue failed to achieve their objective (Figure A9.1). Tax reforms were implemented with considerable delay, and reflecting political pressures from key domestic stakeholders, the final measures approved by parliament sometimes fell short of the proposals submitted by the government. Thus, for example, not only did it take about three years to implement the GST, but the introductory rate approved by parliament (7 percent) was lower than what the government had proposed (10 percent). Also, notwith-

Table A9.1. Fiscal Adjustment, 1989–2004*(In percentage points of GDP)*

	Cumulative Changes During			
	1989–92	1993–98	1999–2001	2002–04
Fiscal balance excluding grants	20.4	–6.8	2.4	–3.3
Revenue	9.2	–5.1	–2.5	0.9
Expenditure and net lending	–11.2	1.7	–4.9	4.2
Current expenditure	–1.3	1.1	–4.3	0.2
Capital expenditure	–3.5	0.2	–2.1	4.6
Other ¹	–6.4	0.4	1.5	–0.6
Memorandum item				
Grants	–4.8	0.0	0.4	5.9

Sources: IMF program documents and Ministry of Finance.

¹Net lending and residual (difference between the deficit calculated from financing data, and from “above the line”).**Box A9.1. Chronology of Tax and Import Tariff Reforms**

1989–93. Coverage of the consumption tax broadened while preparations are under way for introduction of a general sales tax (GST).

1989–92. Conversion of trade taxes to ad valorem bases (from specific rates). Maximum tariff rate reduced from over 300 percent to 70 percent.

June 1994. GST replaces the consumption tax; to be levied on imports, manufactured goods, and selected services. Basic rate set at 7 percent. The GST law imposed a moratorium on changes to the system; only changes of an administrative nature could be made before 1999.

September 1995. Increase in the GST basic rate to 10 percent.

September 1995. Amendments to the income tax law include elimination of most tax holidays, the lowering

of the maximum rates for corporate and personal income taxes, and reduction in the number of tax bands.

January 1996. Maximum tariff rate reduced from 70 percent to 50 percent.

1996. Creation of a separate GST Department; separated from the Customs Department.

June 1999. GST extended to the sale of goods at retail level, and the basic rate is raised to 13 percent.

1999. Maximum tariff rate reduced to 35 percent.

2002. Amendments to GST law to reduce exemptions and to extend the tax to essential consumer goods at a lower rate of 2 percent.

April 2003. GST basic rate increased to 16 percent, and lower rate increased to 4 percent.

2004. Merger of Income Tax and GST Departments.

standing attempts to curtail them, exemptions and special treatments to favored sectors are widespread (e.g., special tax privileges in “free zones” and reduction of GST rate on hotel accommodation intended to help boost tourism).

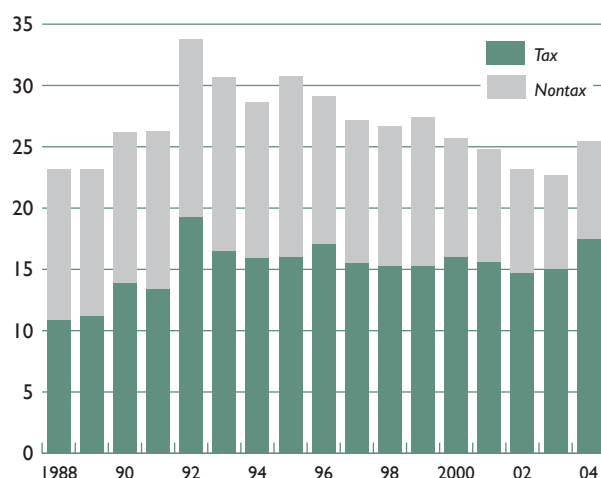
Nontax revenues—which tend to be less elastic with respect to GDP than tax revenues—continue to contribute a large share (more than one-third) of total revenues.

The composition of tax revenues has changed, broadly in line with the aims of fiscal structural reforms. As intended, the consumption tax/GST has become the main source of tax revenue and the contribution of trade taxes has been reduced considerably (Figure A9.2). The share of the consumption tax/GST has risen from about a quarter in the late

1980s to over half in recent years. Over the same period, the contribution of import duties has fallen from nearly 60 percent to about 25 percent. Income taxes have maintained their share of total taxes at about 20 percent, and exemptions and deductions remain a key feature of the direct tax system.

Weaknesses in revenue administration and in enforcement of the tax laws are widely acknowledged to have contributed to the poor performance of revenues. Recent measures to tackle revenue administration challenges include the merger of the GST and Income Tax Departments—in order to harmonize operations—and increasing staff on the enforcement side. To increase efficiency of collection, offices for medium and large taxpayers were created.

Figure A9.1. Government Revenues
(In percent of GDP)



Sources: IMF program documents and Jordanian authorities.

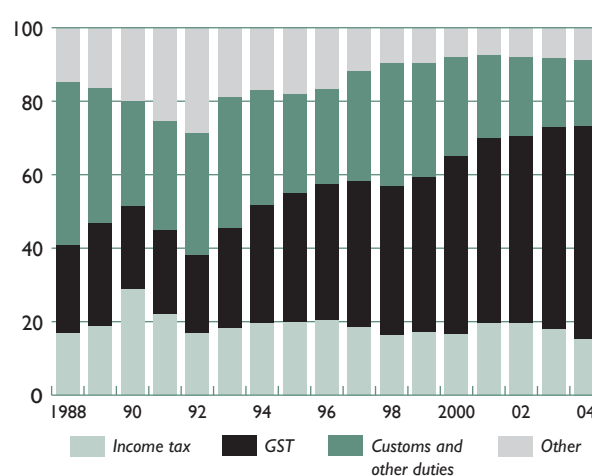
Limited Progress So Far on Expenditure Consolidation

For most of the period under review, total government expenditures have hovered around 35 percent of GDP—with recurrent and capital expenditures accounting for 30 percent and 5 percent of GDP, respectively. The structure of recurrent expenditures have remained rigid, with four items—wages and salaries, interest payments, pensions, and military expenditures—accounting for about 80 percent of the total (Figure A9.3). The most significant change has been a reduction in the share of interest payments (from nearly 30 percent of the total in the early 1990s to less than 15 percent in recent years), and an increase in the share of pensions (from less than 10 percent in the early 1990s to about 17 percent in recent years). Reform of food subsidies and, more recently, of the public pension system, were the most important expenditure-side structural reforms under the IMF-supported programs.

A system of open-ended food subsidies that developed in the aftermath of the large devaluations in 1988–89 was rationalized and eventually terminated. The subsidies arose when the authorities left the domestic sale prices of a range of food items unchanged, in spite of rising import costs, in order to protect the poor from the adverse effects of the adjustment program.¹ Budgetary outlays for the subsidies rose sharply from less than 0.5 percent of GDP in 1989 to

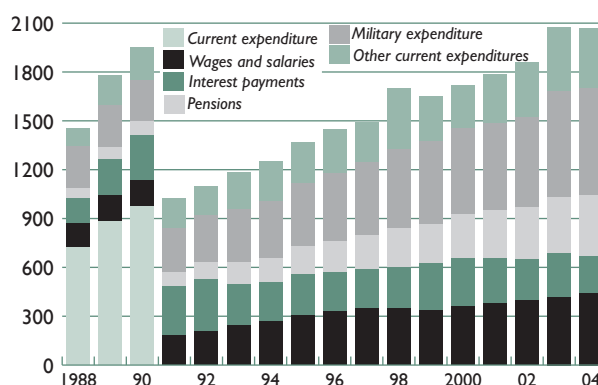
¹The items covered initially were wheat, barley, sorghum, rice, sugar, fresh meat, frozen chicken, olive oil, and lentils.

Figure A9.2. Composition of Tax Revenue
(In percent of total tax revenue)



Sources: IMF program documents and Jordanian authorities.

Figure A9.3. Composition of Current Expenditures
(In percent of current expenditures)



Sources: IMF program documents and Jordanian authorities.

3 percent in 1989 and 1990. A rationing scheme—covering sugar, rice, and powdered milk—was introduced in late 1990 to curtail the cost of the subsidies to the budget and to address the regressive nature of the system.² Means testing was introduced in 1994 to

²An IMF technical assistance mission estimated that the open-ended generalized subsidy system benefited the rich and middle classes much more than the poor; see Ahmad (1991).

better target the subsidies. With assistance from the IMF, the system was changed fundamentally in 1996; prices were raised to cover economic costs and compensatory cash payments were made to the poor through the National Aid Fund (NAF). In 1998, under the Social Productivity Program, NAF expanded its support to cover all the poor, whether working or nonworking.

Significant changes have been made to the two public pension systems (civil service and military), but the impact of these changes will be felt only in the medium term. In practice, the reforms have involved measures to make the public systems more like the program run by the Social Security Corporation (SSC) and to eventually integrate them into the SSC system. Thus, under the 1996 EFF, new recruits into the civil service were covered under the SSC system. Similar changes were made to military pensions under the 2002 SBA. Importantly, disability pensions for the military were adjusted to match those provided by the SSC, while eligibility criteria were tightened. For both military and civil service

employees, the length of service before eligibility for pensions was also increased.

Wages and salaries have remained at around 6–7 percent of GDP over the period under review. From time to time, the IMF-supported programs have discussed the need to contain the wage bill as part of a comprehensive civil service reform program.³ To date, not much has happened in this area. The level of expenditure on the other large item in the recurrent budget, namely military spending, has hovered around 8–9 percent of GDP since the early 1990s, down from about 11 percent of GDP in the late 1980s. The programs have had little to say about the scope for further reductions in military spending, presumably in recognition of the unstable regional security environment that Jordan faces.

³For example, structural reforms under the 1994 and 1996 EFFs included civil service reform, for which the authorities were said to be receiving technical assistance from the World Bank.