

TAXPAYERS AND TAX AUTHORITIES INTERACTING WITHIN THE MENA REGION: THE NEXUS BETWEEN TRUST, POWER AND COMPLIANCE

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Abstract: Any type of interaction climate, be it synergistic or antagonistic, is delineated by a tandem of dimensions: trust in authorities and power of authorities. Advocates for this assumption are the manifold of empirical studies testing the “slippery slope framework” which subsumes the two dimensions. A major proffer advanced by the framework is that tax authorities’ approach towards citizens poses great influence on compliance, either fuelling or hindering it. Irrespective of whether tax burden level is high (e.g., Scandinavian, Continental welfare states), medium (e.g., East European, Anglo-Saxon welfare states), minimum or completely lacking (e.g., tax havens), tax authorities and taxpayers establish a connection in which the former’s actions are mirrored in the latter’s perceptions about leadership’s benevolence in public good provisions (i.e., trust) and efficiency in deterring tax evasion (i.e., power). The tandem trust-power and the specific features of such connections within some countries of the Middle East and Northern Africa tax climate (i.e., Bahrain, Egypt, Iran, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, United Arab Emirates) are the thrust of the present study. The methodology spans a multidisciplinary approach, from explaining trust and power via governance indicators proposed by the World Bank, investigating economic development with chain base indexes and examining tax compliance process on country-level. The MENA region is source for novel and relevant insights on the nexus between trust, power and compliance, as it hosts countries which vary greatly in terms of economic development (transition to developed), fiscal policy (low to no taxes) or economy drivers (oil exporters, oil importers) and where tax compliance gains importance amid diminishing hydrocarbon resources. Nowadays economic realities constrain MENA authorities to refocus their governing strategies and perceive taxation as a viable future solution for budgetary expenses. Therefore, analyzing trust in authorities and power of authorities within MENA serves both national authorities in their quest to identify new strategies of financing state budgets and taxpayers in understanding the key role they play for securing the common good. Regarding both trust in and power of authorities, oil exporters are better off than oil importers, registering higher levels. Nevertheless, oil importers strive to improve perceptions of trust and power among citizens, benefiting from international assistance.

Keywords: tax behavior, MENA interaction tax climate, trust in authorities, power of authorities

JEL classification: F30; F62; G18; G28; H26.

1. Introduction

In the eleventh Surah (called “Hud”) of the Qur’an, the 85th verse advises that “in fairness, give full measure and weight” (Haleem, 2005). Considering the importance of the message and extrapolating it to the tax environment, one could opine that the verse’s piece of advice applies not only to individuals, but to authorities as well. The former are expected to pay their fair share in relation with the governing authorities. The latter are ultimately called to guide their decisions on equity principles when designing tax policies or interacting with citizens.

An equitable approach defines a tax climate where on one hand authorities serve taxpayers and on the other hand taxpayers follow legal prescriptions, perceive authorities as willing to supply quality public goods and capable of spotting, sanctioning and deterring noncompliance. In such a climate, acknowledged by the tax literature (Kirchler, Hoelzl and Wahl, 2008) as synergistic, contributors to the public budget invest high levels of trust in decision makers and regard authorities as having a high power to hinder tax dodgers. When interaction climates recede far from this set of prescriptions, they become antagonistic and display clear signs of mutual distrust and diminished power. Irrespective of whether taxation is burdensome (e.g., Scandinavian, Continental welfare states), moderate (e.g., East European, Anglo-Saxon welfare states), low or completely lacking (e.g., tax havens), the tandem *trust in authorities – power of authorities* delineates the type of interaction between contributors and decision makers.

The current research addresses the tandem within the Middle East and Northern Africa (MENA) tax climate defined by ten countries (i.e., Bahrain, Egypt, Iran, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, United Arab Emirates), because MENA region is source for novel and relevant insights on the nexus between trust, power and compliance. Both novelty and relevance stem from the great variety of countries it comprises in terms of economic development (transition to developed), fiscal policy (low to no taxes) or economy drivers (oil exporters, oil importers). As the topic of tax compliance gains importance amid diminishing hydrocarbon resources, MENA authorities are called to refocus their governing strategies and perceive taxation as a viable future solution for budgetary expenses. The assessment of trust and power within MENA serves national authorities in identifying new strategies of financing state budgets, but also taxpayers in understanding the key role they play for securing the common good.

The following sections are considered in the paper. Section 2 outlines the MENA tax systems. Section 3 discusses the tandem *trust in – power of authorities* via a set of governance indicators. Section 4 highlights concluding remarks.

2. MENA tax systems: A curt outline

Hosting a population of 355 million, out of which 8% dwell in high-income states, 85% in middle-income states and 7% in low-income ones (The World Bank, 2013: 23), the MENA region finds itself between two poles, in terms of tax systems. At one end, oil exporters drive economic growth through levers other than taxation: except for banks and oil/gas production companies which pay corporate fees between 35%-85%, regular businesses are taxed at the lower rates of 10-15% (where applicable), plus labor taxes and social contributions; personal income is not subject to levying. Moreover, some countries are deemed “tax havens” by international organizations. Table 1 displays the ranks of two MENA countries placed among the states with the most secretive financial systems, according to the Financial Secrecy Index.

Table 1: MENA tax havens, according to the Financial Secrecy Index developed by the Tax Justice Network

| 2009 | 2011 | 2013 |
|--|--|--|
| Bahrain (14 th) | Bahrain (10 th) | Bahrain (13 th) |
| United Arab Emirates (Dubai) (31 st) | United Arab Emirates (Dubai) (18 th) | United Arab Emirates (Dubai) (16 th) |
| | | Saudi Arabia (31 st) |

Source: www.financialsecrecyindex.com (Retrieved 01.03.2014).

At the other end, oil importers count on taxation to finance state budgets, but struggle due to narrow tax bases, nascent compliance systems and high shadow economy levels. Overall, the MENA region has one of the least demanding tax systems (*Paying Taxes* 2013).

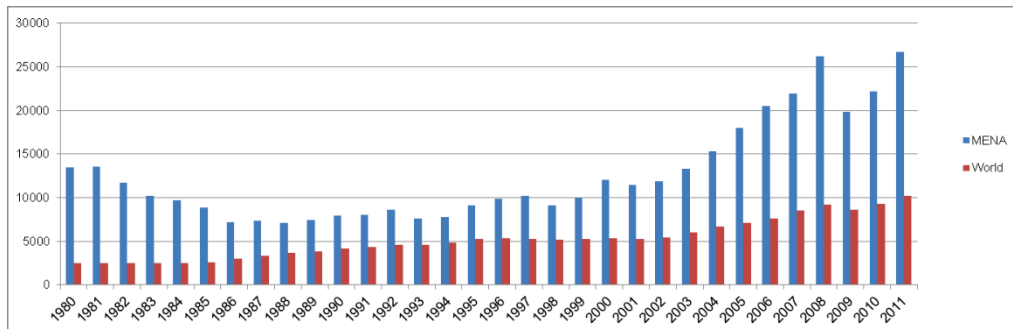
Regarding corporate taxpayers, Saleem (2013) notes that: 80-90% of businesses are micro, small and medium size, especially in countries with large underground economies; overall, there are 19-23 million formal and informal businesses in the region; non-GCC countries employ 67% of workers informally, while GCC members only 6% of workers. Limited access to finance hinders most of the times economic growth, as only 20% of small and medium size enterprises are credit eligible (Rocha, Arvai and Farazi, 2011: 9).

On the ground of dwindling monetary resources due to global financial crisis and political unrest, MENA countries face significant changes in terms of fiscal policies. Insufficient tax revenues which finance low levels of public good provision suggest there is considerable space for improvement. For example, according to a World Bank report (2013: 12), MENA tax systems have registered some of the lowest levels of government spending on health (8.2% of GDP) compared to education (18% of GDP), in the period 2006-2011, with taxpayers covering 40% of health costs by out-of-the-pocket money. As a first step, many countries have reduced governmental subsidies in the attempt to lower exceedingly high fiscal deficits. As a second step, they have broadened the tax base by lowering thresholds for minimum taxable incomes and taxing consumption through VAT and sales taxes (e.g., Egypt, Jordan).

Hypothetically, oil exporters have been considering taxing consumption as a viable solution to boost revenues and have been working to design a common VAT system (*Paying Taxes* 2013). Since 2008, it has been rumored that GCC members would introduce VAT, but until today no measure has been taken in this respect.

Regarding MENA tax climate, the country-sample comprises: Bahrain, Egypt, Iran, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, United Arab Emirates (UAE). As can be noticed, the economic and political alliance known as the Gulf Cooperation Council (GCC) is fully represented in the sample, the Mashreq region counts half of its members and the Maghreb region one member (IMF, 2013).

Because the majority of its countries harness substantial hydrocarbon resources, MENA tax climate has registered significant economic growth during the last two decades, surpassing world values, as shown by the average GDP per capita (graph 1).



Graph 1: Three decades of MENA GDP per capita with respect to world GDP per capita (current \$US)

Source: Author's calculus with World Bank data (1980-2011).

While the world GDP per capita has increased slowly but steadily, the GDP level of the MENA tax climate has been registering quite substantial gaps from one decade to another, mostly due to fluctuations of crude oil price caused by a manifold of crises.

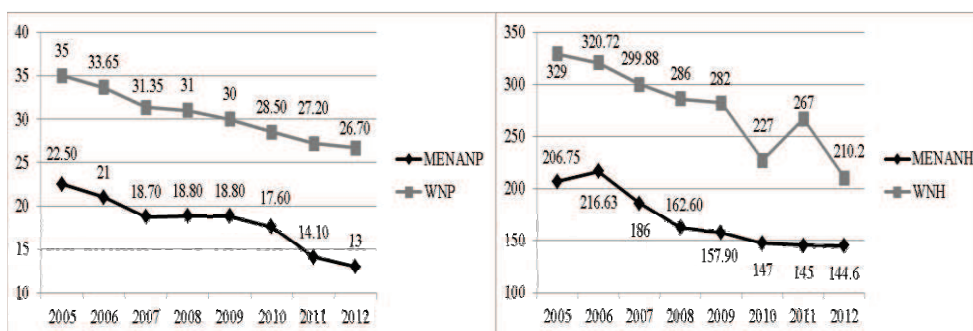
Table 2: Chain base indexes analysis regarding MENA and World average GDP per capita (1969-2011)

| | 1980-1989/ 1970-1979 | 1990-1999/ 1980-1989 | 2000-2011/ 1990-1999 |
|--------------|-------------------------|-------------------------|-------------------------|
| MENA | 72.96% | -8.67% | 107.13% |
| World | 106.21% | 68.25% | 52.25% |

Source: Author's calculus with World Bank data (1969-2011).

Table 2 displays variations across decades, computed through chain base indexes. While the world average peaked during the decade 1980-1989 (compared to the previous one), in case of the MENA countries the onset of the 21st century brought the highest economic growth, as the crude oil price increased fivefold between 2004 and 2008. Fluctuations during the remaining analyzed decades have been caused by other economic downturns, like the 1970s oil and energy crises, the 1980s "oil glut" (which dropped prices by 46%) and the 1998-1999 price collapse.

Within the MENA tax climate, a picture of tax authorities' approaches towards the economic environment and taxpayers' perceptions of these approaches is offered through the set of *Paying Taxes* indicators: number of tax payments (NP), number of hours to comply with principal taxes, namely corporate, labor, mandatory contributions, consumption taxes (NH); total tax rate (TTR). For the 10 countries pertaining to MENA region average values of NP, NH and TTR were determined and highlighted in three graphs, after selecting data from eight *Paying Taxes* reports (2006-2013).



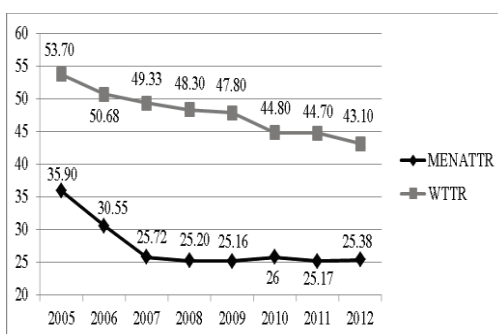
Graph 2: Average values for MENA and World Number of Tax Payments (NP)

Source: Author's calculus based on *Paying Taxes* reports (2006-2013).

Graph 3: Average values for MENA and World Number of Hours to Comply (NH)

Source: Author's calculus based on *Paying Taxes* reports (2006-2013).

With respect to the average number of tax payments (graph 2), MENA tax climate follows the global decreasing trend, reaching a total of 13 payments in 2012. The principal cause for the overall decrease of almost 50% is the introduction of electronic taxpaying systems in many countries. Specifically, during 2005-2012, mitigations exceeding the 50% threshold were registered in Morocco (from 28 to 6), Saudi Arabia (from 14 to 3) and United Arab Emirates (from 15 to 4). The average number of hours for the MENA sample follows the same declining trend. Except for Iran and Jordan which increased compliance time by 18% and 49% respectively, all the other countries have exempted their taxpayers from losing more time with bureaucratic procedures. Hence, Egypt mitigated it from 536 hours to 392, Kuwait from 118 to 98, and Morocco from 468 to 232 hours.



Graph 4: Average values for MENA and World Total Tax Rate (TTR)

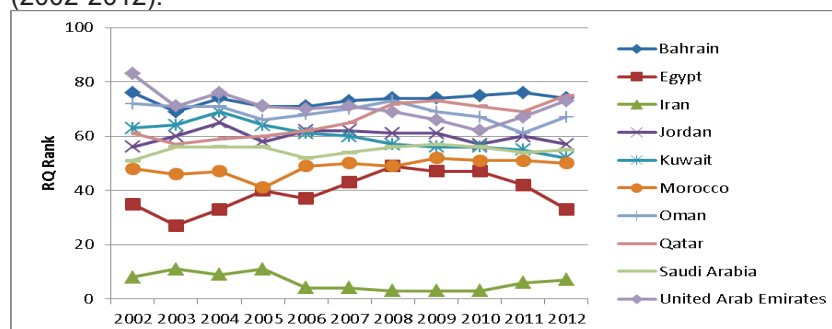
Source: Author's calculus based on *Paying Taxes* reports (2006-2013).

It is of note that MENATTR amounts for almost half the WTTR. Labor taxes and mandatory contributions account for the greatest component of the TTR over the eight years of study, fluctuating very little, from an average of 17.31% in 2005 to an average of 16.37% in 2012. Corporate taxes register a contraction, from an average of 16.35% in 2005 to 8.11% in 2012. The MENA governments' decisions of reducing profit taxes are based on the fact that these mitigations are conducive to business environment. The outlier is Kuwait, where the corporate tax abated from 44.7% in 2005 to 0% in 2012.

Among the top 10 economies from the world ranking concerning the easiness of paying taxes, determined by averaging percentile ranks of NP, NH and TTR, five countries belong to the MENA region (i.e., UAE, Qatar, Saudi Arabia, Bahrain, Oman) (*Paying Taxes 2013*: 15). It is a consequence of the fact that MENA countries have phased a number of reforms, like: 1) extending the tax treaty network; 2) training tax authorities staff to meet international tax requirements; 3) designing a common platform for the VAT regulation (within the GCC); 4) streamlining compliance systems through the introduction of electronic filing and e-payment (e.g., Oman, Qatar, Jordan, Kuwait, Saudi Arabia) (*Paying Taxes 2013, 2014*). Some of the aforementioned steps point out the endeavors made by MENA authorities to improve compliance via gaining taxpayers' trust. The current status of the strategies used to deter noncompliance leaves room for substantial improvement, as more taxpayers chose the informal sector to make ends meet.

3. MENA tax climate fashioned by trust in and power of authorities

In the present section, the tandem of dimensions *trust in authorities* – *power of authorities* will be considered following the path suggested by Batrancea and Nichita (2014), i.e., utilizing a set of world governance indicators (Kaufmann, Kraay and Mastruzzi, 2010). Namely, the trust dimension will be discussed in conjunction with regulatory quality and government effectiveness, while the power dimension will be tackled via rule of law and control for corruption. The values of the world governance indicators (i.e., percentile ranks among all countries) extend from 0 (lowest end) to 100 (highest end). The country-sample will be analyzed during a time span of eleven years (2002-2012).

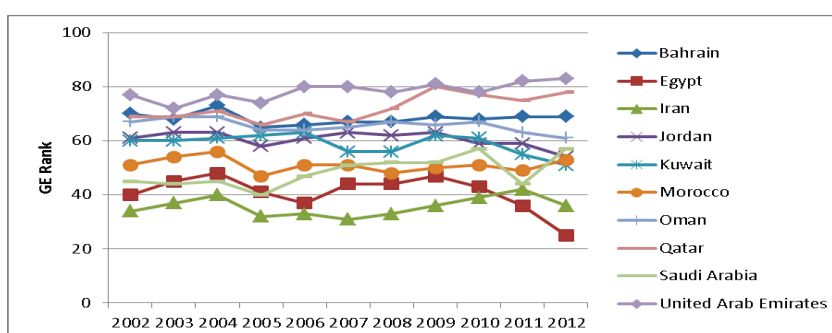


Graph 5: Evolution of the Regulatory Quality (RQ), 2002-2012

Source: World Bank data (www.worldbank.org).

In terms of regulatory quality, which measures perceptions of authorities' efficiency in supporting private sector, the majority of countries rank above the middle of the range. The outliers are Iran, with values approaching the minimum threshold, followed by Egypt, with ranks wavering between 20 and 50. The data represented in graph 5 reveals a wide variety. As stated before, MENA tax climate has witnessed extensive opinions: in some countries, taxpayers have credited authorities with low trust based on their reduced capacity to incentivize private sector businesses; in others, taxpayers have regarded decision makers worthy of high trust based on the fact that economies thrive. The end of the year 2010 constitutes a reference point, marking the onset of massive political unrest and changes in the MENA region (i.e., the revolutionary wave come to be known as the "Arab Spring" or "Arab Awakening") which triggered severe economic downturns characterized by high inflation and staggering fiscal deficits in several countries like Egypt, Jordan, Kuwait or Morocco.

Despite serious hardships induced by the unrest, MENA authorities are striving to resume the normal course of actions, regain citizens' trust and counterbalance weakened state budgets. Thus, redesigning tax policies has become a major priority on the MENA political agenda, with more and more governments appealing to taxation. On this line, Egyptian authorities will introduce a 10-12% Value Added Tax (VAT) by the end of 2014, set to replace the current Sales Tax and estimated to bring more than LE 126.5 billion (USD 18.2 billion) for the country's treasury. United Arab Emirates, a far more stable and thriving economy, has implemented fiscal measures to boost internal commerce and tourism. Namely, Dubai introduced on March 31, 2014, a daily tourist tax called "Tourist Dirham" of up to AED 20 (approx. USD 5), payable by any visitor depending on the accommodation category (i.e., hotel's star number). With a ten-million annual tourist inflow and 80,000 hotel rooms, Emirati authorities estimate to raise at least AED 330 million (approx. USD 90 million) for its budget.

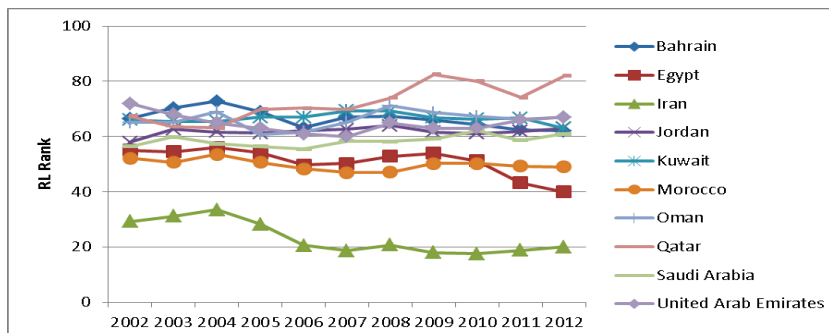


Graph 6: Evolution of the Government Effectiveness (GE), 2002-2012

Source: World Bank data (www.worldbank.org).

In the analyzed sample, citizens' perceptions related to the quality of public goods and to government's exactitude in implementing strategy sets (i.e., government effectiveness) extend between 20 and 90. Five members of GCC plus Jordan occupy the first positions in the ranking. In particular, United Arab Emirates is perceived as the country which provides the highest standards in the public sector from the whole sample. For the year 2012, the results are mirrored also by the Human Development Index (Human Development Report Office, 2013). According to it, two countries in the sample are rated with "very high human development", viz. Qatar ranks 36th and United Arab Emirates 41st, five countries are deemed as having "high human development" (i.e., Bahrain 48th, Kuwait 54th, Saudi Arabia 57th, Iran 76th, Oman 84th) and three nations are assessed with "medium human development" (Jordan 100th, Egypt 112th, Morocco 130th).

Improving the public goods' quality has increasingly gained importance also among less thriving MENA countries and current efforts are promising. With international assistance from the World Bank, several countries in the region including Egypt, Jordan and Morocco founded in 2013 the MENA Network of Public Procurement Experts. Members of the network advocate for enhancement of capacities among procurement staff and modernization of procurement instruments in order to ultimately boost accountability, transparency, public outlays' efficiency and good governance.

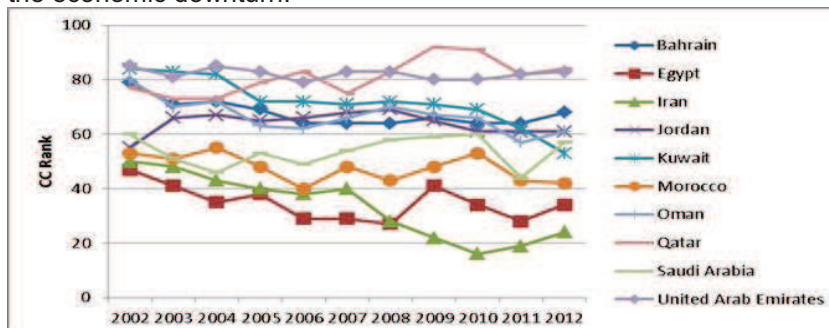


Graph 7: Evolution of the Rule of Law (RL), 2002-2012

Source: World Bank data (www.worldbank.org).

The rule of law indicator, measuring perceptions regarding compliance with the law for MENA, is captured in graph 7. Iran has registered the lowest values, substantially dropping towards the end of the period due to political instability and forthcoming change of power. As a general trend, during the eleven-year time span, the vast majority of countries (all GCC members and Jordan) have registered values from 50 to 90. These results suggest that oil exporters generally manage to ensure compliance better than oil importers, as they rely on and capitalize hydrocarbon resources more than taxation revenues. Therefore, tax evasion levels (if applicable) are low.

Egypt and Morocco are two countries depending on tax revenues, with state budgets seriously affected by tax evasion and which have to identify viable solutions of increasing tax compliance. In this respect, Moroccan authorities enacted in 2013 a tax amnesty and called on citizens to pay their fiscal obligations, in an attempt to alleviate the economic downturn.



Graph 8: Evolution of the Control for Corruption (CC), 2002-2012

Source: World Bank data (www.worldbank.org).

Citizens' perceptions regarding the extent to which MENA authorities use power for acquiring personal gains are measured by the indicator "control for corruption" displayed in graph 8. Mainly, two clusters stand out: non-oil vs. oil driven economies. As expected, non-oil driven economies are less better off than oil exporters. In almost all GCC countries (i.e., Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE) and Jordan, authorities are deemed more committed to mitigate any form of corruption, be it grand or petty, than in the rest of the MENA region. For that matter, the 2012 Transparency International Corruption Perceptions Index rates the analyzed countries in a parallel manner, assigning them scores from 28 (more corrupt) to 68 (less corrupt) on a scale between 0-100: Qatar and UAE score 68, Bahrain 51, Jordan 48, Oman 47, Kuwait and Saudi Arabia 44, Morocco 37, Egypt 32 and Iran 28.

In the MENA region, the corruption phenomenon is positively correlated with the large subsidy packages that have been granted for decades, especially for energy and food, as a measure of social protection but often assisted high-income earners than low-income ones. According to IMF (2013: 42), in 2011 the energy subsidies alone amounted to USD 237 billion (8.6% of regional GDP), namely 50% of global subsidies. Besides yielding huge costs of more than 5% of GDP (especially in GCC oil-driven economies), energy subsidies have exceeded those for basic food (0.7% of GDP) and have mitigated outlays on education (approx. 4% of GDP). As a result, the staggering fiscal deficits have determined national governments to enact subsidy reforms, i.e., especially lowering energy subsidies since 2011 and lessen the impact of such measures on the low-income groups.

4. Conclusions

This paper endeavors to explain the main dimensions of the “slippery slope framework” within the MENA tax climate comprising Bahrain, Egypt, Iran, Jordan, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, United Arab Emirates. Using the line of thoughts from Batrancea and Nichita (2014) as benchmark, trust in authorities is highlighted by the World Bank governance indicators “regulatory quality” and “government effectiveness”, while power of authorities via “rule of law” and “control for corruption”. MENA tax climate is underlined through a comprehensive methodological apparatus so that it pays benefits to all sides: tax authorities, in their quest of detecting new strategies to boost public revenues; taxpayers, in being aware of their role for the common good; investors in being acquainted with the regional market. Although taxes do not constitute the lifeblood of all economies within the MENA region, because of the staggering fiscal deficits, high inflation, inefficient public procurements and underfinanced basic needs (e.g., health, education, social security), national authorities turn to taxation as a means to overcome challenges. Despite substantial natural resources, GCC members do not disregard the introduction of consumption taxes in the upcoming years.

The tandem *trust in authorities* - *power of authorities* is regarded as a relevant tool which can be used by authorities to master tax compliance. Financing public goods and services of high quality leads ultimately to increased levels of trust and higher tendencies to pay the fair share. In this respect, the GCC national authorities are regarded as more trustworthy than authorities from non-GCC states. Nevertheless, oil importers join efforts via the MENA Network of Public Procurement Experts to boost accountability, transparency, public outlays’ efficiency and good governance. The significant levels of oil-based resources make the difference in terms of rule of power perceptions. Once again, GCC members are deemed as more efficient in deterring corruption and noncompliance than non-GCC members. The strategies used by taxation-based economies to reduce the tax-gap collection are amnesties or mitigation of government subsidies.

5. Acknowledgements

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