7 Towards smarter use of investment incentives

MENA governments widely use tax and financial incentives to attract investment and direct it into certain sectors, activities and locations. This chapter presents original research mapping investment incentives granted in the eight MENA focus economies, including the types of instruments used and the extent to which they target certain sectors, activities and locations. It also explores the level of discretion involved in granting incentives. The results reflect tax and financial incentives detailed in national tax codes, investment laws, and in publicly-available documents published by investment promotion agencies, ministries of finance and economic zones. The chapter also draws on discussions with practitioners from investment promotion agencies and finance ministries in the region.

Summary and policy considerations

Governments in the Middle East and North Africa, as in most developing and emerging economies, widely use tax and financial incentives to attract private investment and direct it into certain sectors, activities and locations. Investment incentives are measures that seek to influence an investment project through favourable tax treatment or other benefits that affect the relative cost of the project. But the costs of incentives, particularly tax incentives, could outweigh the benefits. Tax incentives may subsidise firms that would have invested without favourable treatment and can constitute a significant cost for governments in terms of revenue forgone. However, carefully designed and targeted incentives may help correct market failures and advance certain development goals, such as supporting renewable energy or skills and technology upgrades, enhancing the positive impact of investment (Chapter 2). Many governments have recently sought to incentivise investment in the health sector to respond to the challenges of the Covid-19 pandemic. Better understanding the scope of incentives offered and how they are administered is essential to analyse their effectiveness and efficiency.

This chapter provides an overview of the types of investment incentives offered in the MENA region, the instruments used and their stated goals (targeting), as well as how they are governed. The eight MENA governments covered in this report (MENA focus economies) grant fiscal and financial incentives primarily to investors in agricultural, tourism and industrial sectors (broadly defined), export-oriented activities, and under-developed regions.[1] Also common are incentives to investors that advance environmental protection, as are fiscal benefits to hydrocarbon industries. Several of the focus economies give tax breaks or grants to firms that create jobs or enhance skills. Fewer give incentives to firms that use new technologies or support technology transfer and R&D activities, unlike OECD countries.

Benefits to eligible investors are often generous. Among the eight MENA focus economies, all offer tax holidays – total exemptions from corporate income tax (CIT) – to investors in certain sectors and locations. All but two countries (Jordan and Tunisia) offer permanent CIT exemptions to eligible investors, and half grant permanently reduced CIT rates. Several governments have taken steps to reduce the length of tax holidays and number of firms eligible for them. But profit-based incentives (tax holidays and CIT rate reductions) remain widespread and are often easy for firms to receive, with broad eligibility requirements. Investment incentives in the MENA focus economies are often open to interpretation and discretion of implementing authorities (in many cases investment promotion agencies or councils of investment composed of representatives from different ministries), increasing the risk of corruption and aggressive tax planning by firms.

Tax incentives to firms are one, and often not the determining, factor for their investment decisions. Some investors (such as those that are efficiency-seeking) may be more sensitive to incentives than others (such as market- or natural resource- seeking), but surveys suggest that most firms would invest even without incentives (IMF-OECD-UN-World Bank, 2015[1]) (James, 2013[2]). On average, MENA economies offer more permanent exemptions and longer tax holidays (14.6 years) than ASEAN countries (11 years), yet receive lower levels of FDI. This highlights the importance of the overall investment climate for attracting firms, and raises questions about the merits of generous, broad-based incentives.

MENA governments grant incentives through multiple pieces of legislation, decrees and executive orders, and often more than one agency is responsible for administering incentives. The spectrum of incentives is thus subject to frequent amendments. Many governments in the region plan to add or revise incentives to respond to the economic and social costs of the Covid-19 pandemic. Disruptions to supply chains and economic activity have prompted some governments to re-assess their investment promotion strategies. As governments seek swift measures to advance their economic recovery, assessments on the effectiveness and efficiency of incentives will be key to support already strained state budgets, and to ensure incentive design matches its goals.

Policy considerations

- Consider how widely to offer tax and financial benefits, if these incentives are necessary to attract investment, and if their costs – in terms of revenue forgone and economic distortions – outweigh their benefits. Cost-benefit analysis prior to introducing incentives, and monitoring ex-post, would help governments assess the extent to which, and at what cost, incentives meet their intended objectives. Such monitoring and evaluation is challenging, requiring data and resources that may not be available. In such cases, simple tax incentive reports, identifying and describing all available incentives, their policy goal, and legal reference, is an important first step to create accountability and transparency. Replacing permanent incentives with temporary benefits would also encourage evaluation.
- Consider moving gradually from broad-based tax holidays to more targeted, cost-based incentives in line with government priorities. The type and generosity of tax incentives play an important role in their effectiveness and efficiency. Profit-based incentives are more likely to be redundant than cost-based incentives. Because the latter reduces the costs of investment (rather than benefiting firms already profitable), it may make marginal investment profitable, increasing the chances of creating additional investment. The more targeted the incentive, the more likely it is to reach its stated goal.
- Ensure that incentives are specific, with clear eligibility criteria that reduce room for excessive discretion by implementing authorities. This will allow for more fair competition, lower corruption and easier evaluation. Investment incentives in the MENA focus economies often have vague eligibility criteria, while investment laws often note the option of undefined additional benefits to investors that meet unspecified criteria. This creates uncertainty for investors over what they are eligible to receive, and raises the risk of aggressive tax planning by firms, as well as the risk of corruption by administering authorities (see Chapter 11).
- Consolidate all tax incentives in tax laws – rather than in investment laws and executive regulations, legislation governing specific industries or one-off agreements with firms – to enhance transparency and reduce potential redundancies and confusion over the administering authority. The Ministry of Finance is often best placed to grant incentives and monitor their costs. Other ministries may be more inclined to offer fiscal benefits as they are not in charge of tax collection or necessarily aware of the state's fiscal needs.
- Assess whether the goals of tax incentives (directing investment in particular sectors or activities), align with investment promotion strategies and national development goals (see chapter 6 on promotion strategies). Simple tax incentive reports (described above), can help policymakers make this assessment, while more in-depth monitoring of firms compliance with the terms of the incentive (for example, jobs created, value of exports), can assist in determining if the incentive is contributing to development goals.

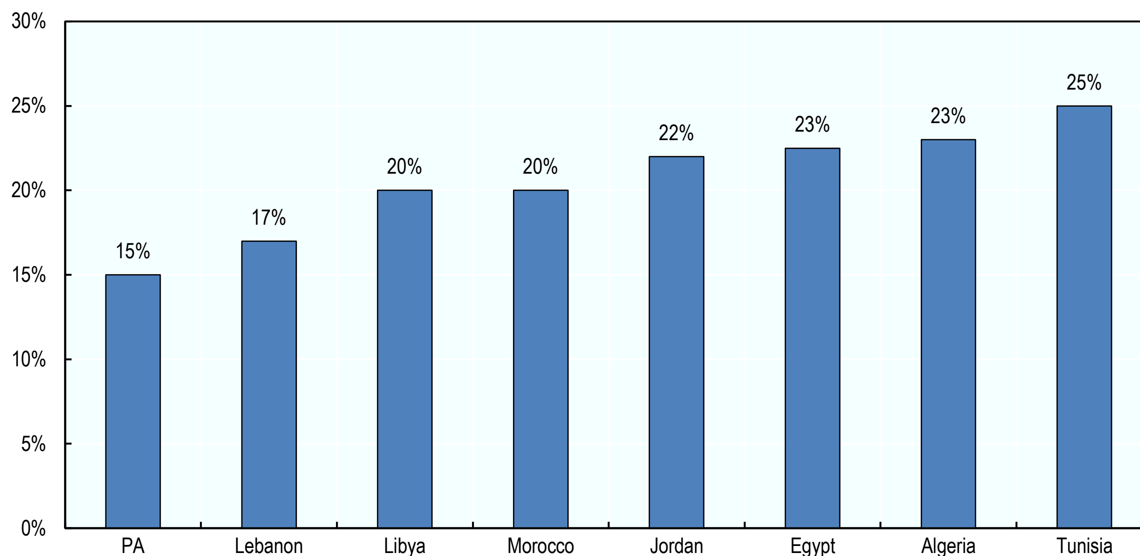
Investment incentive instruments

Statutory corporate income tax (CIT) rates are the first reference point for foreign and domestic investors when evaluating the tax treatment of a jurisdiction. But it is the entire tax regime – including various forms of tax incentives – which determines the tax liability of businesses or incentives to invest. The most common types of tax incentives used in the MENA focus economies, and in developing and emerging markets, are: corporate tax holidays (periods during which an investment is fully exempt from corporate taxation), reduced corporate tax rates, and tax deductions (or allowances) and credits (provisions to deduct

certain expenditures from taxable income or directly from tax liability). Beyond incentives directly affecting corporate income taxes, exemptions from indirect taxes, including import and export duties and value added tax (VAT), are commonly used (OECD, 2019[3]).

The average statutory CIT rate in among the MENA focus economies is 21%, ranging from 15% (Palestinian Authority) to 25% (Tunisia) (Figure 7.1).[2] This is slightly lower than the average CIT rate in OECD (25%) and ASEAN countries (23%) (OECD, 2019[3]). Algeria and Jordan set different rates for different sectors and activities, and Morocco uses a progressive rate (between 10-31% depending on revenue).

Figure 7.1. Statutory CIT rates in MENA focus economies



Note: Rates as of 2020. Standard CIT figures for Algeria and Jordan show the simple average of standard rates for different sectors (excluding rates that only apply to one sector), Morocco shows the simple average of progressive rates. PA: Palestinian Authority.
Source: OECD based on national legislation and (EY, 2020[4]).

All MENA economies provide income tax holidays

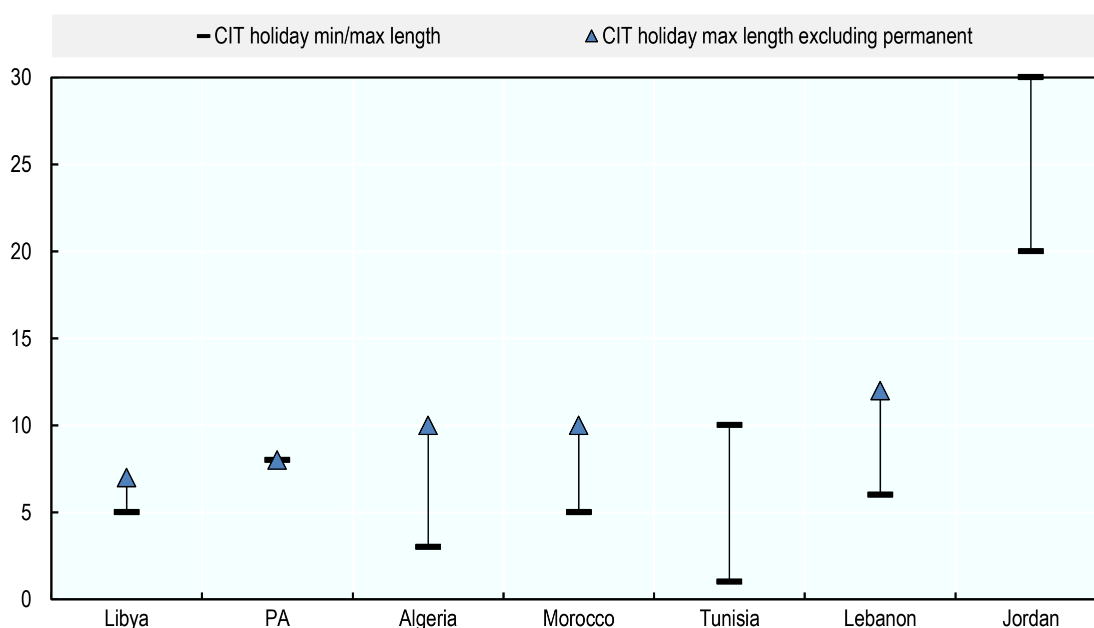
A corporate tax holiday is a complete exemption from taxation of corporate incomes, usually over a defined period of time, starting at the beginning of the investment lifecycle. The broad consensus among international institutions is that tax holidays are one of the most distortive tax incentives (IMF-OECD-UN-World Bank, 2015[1]) (OECD, 2015[5]). Along with corporate income tax reductions or partial income exemptions, tax holidays are profit-based incentives: they are determined as a percentage of profit and benefit firms that are already profitable. These firms are more likely than firms with a longer profit horizon to have invested without the incentive (IMF-OECD-UN-World Bank, 2015[1]). Profit-based incentives also support projects with low up-front costs, which tend to be mobile (i.e. able to easily change their location to seek better conditions), raising the risk of profit shifting. Profit-based incentives do not necessarily provide impetus for firms to stay and contribute positive spillovers to the economy (Klemm and Van Parys, 2012[6]). These incentives remain prevalent in part because they are easy to administer, and politically difficult to remove once in place.

All eight MENA focus economies offer tax holidays to eligible investors. All but two (Jordan and Tunisia) grant permanent CIT exemptions to select firms. Projects that are eligible for tax holidays include in agriculture (Algeria, Morocco and Palestinian Authority), export-oriented sectors or in free and economic

zones (Algeria, Egypt, Lebanon and Libya), and capital risk, offshore and holding companies (Lebanon and Morocco). Excluding indefinite exemptions, the maximum length of tax holidays (including extensions) is similar across countries at around 10 years. Jordan offers the longest exemptions at 30 years (Figure 7.2). In comparison, tax holidays in ASEAN countries vary between four and 20 years (including extensions), though no countries offer permanent exemptions (OECD, 2019[3]).

All MENA governments (except the Palestinian Authority) grant tax holidays based on the location of the investment, including in under-developed areas, and, more frequently, in economic or free zones. The majority (except Egypt and Libya) offer tax holidays based on sector, and half of the countries grant holidays based on certain economic activities (e.g. skills development, R&D, environmental protection). Algeria, Lebanon and Morocco provide tax holidays based on all three criteria. Libya gives five-year tax holidays to all investors as part of its standard tax regime.

Figure 7.2. Length of CIT holidays in MENA focus economies (years)

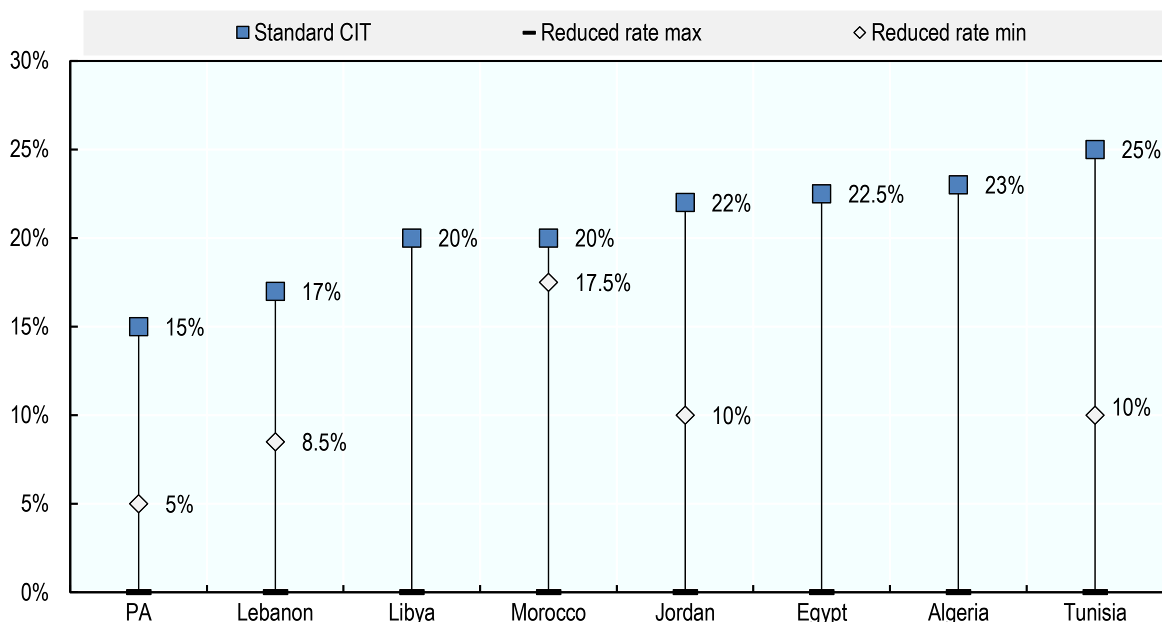


Note: Minimum and maximum lengths of CIT holidays offered to investors shown. Arrows indicate the country also grants permanent CIT exemptions to some investors. Only Tunisia and Jordan do not offer permanent CIT exemptions. Egypt gives permanent CIT holidays to some investors, with no minimum or maximum length, therefore is not included in the graph below. PA: Palestinian Authority.
Source: OECD based on national legislation.

CIT rate reductions in MENA economies are often permanent

Reduced CIT rates are preferential, non-zero tax rates below standard CIT rates. Often firms are eligible for reduced CIT rates after a tax holiday has expired. Five out of the eight MENA focus economies offer reduced CIT rates. Those that do tend to offer fewer tax holidays, and conversely, MENA countries that use tax holidays widely (such as Algeria, Lebanon and Libya) have fewer or no CIT reduction schemes. Generosity of reductions varies. Figure 7.3 shows the maximum and minimum reduced CIT rates offered to investors (i.e. the most and least generous CIT reduction the country grants) compared to the average standard rate in each country. These benefits are often permanent, or lengthy. Lebanon offers the shortest reductions at 5 years, compared to 20 years for certain investors in Morocco and Jordan. All of Tunisia's CIT reductions are permanent. Eligibility criteria are more varied than for tax holidays, with no discernible concentration in certain activities or sectors across the region.

Figure 7.3. Statutory and reduced CIT rates in MENA focus economies



Note: Standard CIT figures for Algeria and Jordan show the average of standard rates for different sectors, Morocco shows the average of progressive rates. Minimum reduced rate depicts the least generous CIT reduction offered to investors. If none, the country does not offer CIT reductions less than 100%. All countries provide tax holidays, shown as maximum reduced rates. PA: Palestinian Authority.
Source: OECD based on national legislation and (EY, 2020[4]).

Tax deductions and credits used less frequently than profit-based schemes

Tax deductions (or investment allowances) allow firms to deduct certain expenditures from taxable income. Tax credits are similar but enable investors to deduct an expense directly from their tax liability (versus their taxable income), reducing the amount of taxes due. Unlike the profit-based incentives described above, tax deductions and credits are cost-based. They reduce the cost of the investment for firms, such as upfront expenses, profits reinvested or more targeted costs like training programmes and research and development (R&D) activities (IMF-OECD-UN-World Bank, 2015[1]) (James, 2013[2]).

Half of the MENA focus economies provide tax deductions to investors. Egypt for example revised its investment scheme in 2017 to adopt wider use of such cost-based incentives rather than tax holidays. It allows deductions of up to 50% of investment costs from taxable income for projects in areas most in need of development, and up to 30% for investment in specific sectors and activities (including renewable energy and labour-intensive projects) (OECD, 2020[7]). Tunisia offers the greatest number of tax deduction schemes, including for reinvested profits in agriculture, “innovative sectors” and exporting firms. Algeria gives unspecified tax deductions for investments in R&D. While most countries in the region allow for accelerated depreciation of assets and loss-carry-forward schemes (allowing firms to deduct losses made in a previous year from income made in a given fiscal period), these are often part of the general scheme applied to all investors, rather than used as an incentive, i.e. as a benefit to investments in a particular sector or activity. There is limited accessible information on these schemes, necessitating further research. Tax credits are used much less frequently across the MENA focus economies.

Overall, cost-based incentives are much less common in the MENA focus economies than profit-based benefits, as is the case in most developing and emerging economies. This may be due in part to higher administrative costs involved in granting such incentives (Andersen, Kett and Von Uexkull, 2017[8]). But

cost-based incentives are less biased toward firms that are already profitable. They depend instead on the size of the investment or its use toward certain activities, so are more likely to encourage new business and specific policy objectives (OECD, 2019[3]). Recognising these benefits, other emerging countries like Thailand have initiated a gradual, albeit still moderate, move towards providing more targeted incentives based on the "merits" of the project (Box 7.1).

Box 7.1. Tax incentives in Thailand: adopting cost-based approaches

Tax incentives are at the core of the investment promotion strategy of Thailand. The incentive framework operated by the Board of Investment, the Thai investment promotion agency, consists of a basic scheme and, since 2015, a merit-based scheme. Basic incentives include CIT exemptions granted to nearly 300 sub-sectors specified in a list updated to reflect wider changes in government strategy (for instance new sub-sectors in the health industry were added following the Covid-19 crisis). The sub-sectors are grouped into five categories that set the generosity of the incentive. The most generous category includes sub-sectors of special importance to the economy and those with no or little existing investments in the country.

Merit-based incentives are additional tax incentives (i.e. on top of basic incentives) which are granted to stimulate investment or spending on activities that benefit the country or industry at large. These incentives are cost-based: businesses spending on skills development and R&D are eligible to include the investment value for CIT exemption (e.g. expenditures on in-house or joint R&D with overseas institutes, donation to technology or human capital development funds, or intellectual property acquisition/licensing fees). To promote business linkages, projects are granted additional incentives on taxable income for spending on the development of local suppliers in advanced technology through training and technical assistance.

Other merit-based incentives are granted with the objective of attracting investment in less developed regions of the country. These consist of enhanced tax deductions from the costs of transport, electricity and water supply for 10 years and additional 25% deductions of the investment cost of installation or construction of facilities.

Source: (OECD, 2021[9]).

Exemptions from other taxes, duties and fees widespread

MENA countries offer a broad range of exemptions on other taxes that do not directly affect CIT, but form part of the cost of investment. These include exemptions on customs duties, VAT, sales tax, and other fees, such as land registration, stamp duties, and work/residence fees.

All countries in the region offer incentives related to costs of trade, i.e., exemptions or reductions on import and export duties and other customs charges. These are sometimes specific to certain inputs, such as raw materials not available domestically. But in many cases MENA countries give blanket exemptions. For example, in Morocco large investment projects receive complete import duty exemptions for three years. These schemes are almost universal in free zones and economic zones, designed to encourage exports and prevalent across the region. Two countries (Egypt and Libya) offer all investors reductions or exemptions on customs duties on imported machinery or other equipment required to execute the project. All countries but Libya offer exemptions or reductions on VAT or sales tax. Similarly, these benefits are ubiquitous in economic zones, and are often granted alongside customs duties exemptions.

The majority of MENA economies also provide certain investors with reductions or exemptions on other fees, most notably land and building registration fees, stamp duties and professional activity taxes. These

benefits are often permanent. Algeria is one exception, offering benefits on customs duties and other taxes and fees to firms only during their set-up phase. It is also notable that legislation often does not specify the length of time firms can receive these incentives, allowing for the interpretation that they are permanent benefits.

Financial incentives offered in the majority of MENA economies

Though offered less frequently than tax incentives, financial benefits, such as grants for investment costs, are used throughout the region in an effort to attract investment in particular sectors, activities and locations.

Libya is the only of the focus economies that does not detail specific financial benefits in its legislation. All the other MENA focus economies offer grants for, for example, infrastructure costs, staff training, land/building or equipment costs, and/or utility expenses. With the exception of Tunisia, the specific details of these incentives – such as the amount of funds eligible firms can receive – are not specified in legislation. Most countries are also vague about eligibility requirements. For example, executive regulations often do not detail how investors can spend grants, such as for staff training, leaving them open to interpretation.

Several MENA economies offer financial support for investment costs in activities related to sustainable development, environmental protection or renewable energy (Tunisia, Morocco, Egypt and Algeria). Loan guarantees and interest subsidies are other financial incentive tools, used for example in Algeria to promote tourism projects, and in Lebanon for firms that relocate to underdeveloped areas.

Targeting of investment incentives

All of the MENA focus economies use incentive schemes to promote investment in certain sectors, activities and locations, and in so doing, encourage economic and social spillovers through investment. Notably, Algeria adopts a negative list approach to incentives; more than 100 sectors and activities are not eligible for tax benefits. In most MENA countries, the criteria to receive the incentive tend to be unspecific and broad, covering multiple sectors or categories such as industrial projects. Incentives that target specific investment expenditures (as opposed to profits), or certain, well-defined activities are more likely to attract investment that would not otherwise have been made, can help achieve specific policy goals, and make it more difficult for firms to conduct aggressive tax planning (IMF-OECD-UN-World Bank, 2015[1]). Any incentives scheme requires regular evaluation and review to limit abuse and market distortions.

This section summarises the extent to which incentives in the MENA focus economies are targeted to support economic and development goals. The majority of incentives offered seek to direct investment into certain locations, followed by key sectors, and types of activities (including export-oriented and job-creating projects). More than a quarter of incentives are eligible to firms that meet a combination of these criteria (for example, sector and location). Investment size is also often a requirement, though rarely the only one. MENA policymakers could consider whether these targets align with their investment promotion strategies and national development goals (Chapter 6). As for the types of incentives used, these largely depend on the country. Some countries, like Algeria, tend to use tax holidays broadly, whereas Morocco and Tunisia provide more grants to investors than other countries in the region. Incentives for investment in sectors, activities and locations are examined in turn.

Incentives target agriculture, tourism and industrial sectors

More than a third of incentives mapped across the eight MENA focus economies seek to direct investment into particular sectors. Among sector-specific incentives, a third are further targeted toward sectors in certain locations (excluding zones) and/or performing particular activities. Table 7.1 summarises the six

sectors that receive the most tax and financial incentives in region: agriculture, hydrocarbons, information and communications technology (ICT), industry, renewable energy, and tourism.[3]

Some countries detail a specific list of priority sectors within executive regulations to investment laws or in tax codes, whereas others list broader categories. A notable example is the industrial sector; around 40% of all sector-specific incentives in the region target industrial projects. Investment legislation in Tunisia for example lists automotive manufacturing and pharmaceutical industries as among its targeted sectors, whereas Lebanon and the Palestinian Authority's Investment legislation and regulations refer more broadly to investments in industry.

More targeted incentives in specific segments of a sector could better support the expansion and upgrading of priority sectors in MENA economies. For instance, Thailand specifies around 280 sub-sectors that are eligible for tax incentives. They fall under a broader group of sectors considered to be strategic for the wider economy (Box 7.1) (OECD, 2021[9]).

Table 7.1. Incentives for investment in select sectors in MENA economies

	Agriculture	Hydrocarbons	ICT	Industrial	Renewables	Tourism
Algeria	Tax holiday, customs/sales tax exemption			Tax holiday		Tax holiday, customs/sales tax exemption
Egypt	Tax deduction, customs/sales tax exemption, grants	Tax deduction, customs/sales tax exemption		Tax deduction, customs/sales tax exemption, grants	Tax deduction, customs/sales tax exemption, grants	Tax deduction, customs/sales tax exemption, grants
Jordan	Tax holiday, CIT reduction, customs/sales tax exemption	Tax holiday, CIT reduction	CIT reduction, customs/sales tax exemption	Customs/sales tax exemption	Customs/sales tax exemption	Tax holiday, CIT reduction, customs/sales tax exemption
Lebanon	Tax holiday, CIT reduction, land/property tax exemption		Tax holiday, CIT reduction, land/property tax exemption	Tax holiday, CIT reduction, land/property tax exemption		Tax holiday, CIT reduction, land/property tax exemption
Libya						
Morocco	Tax holiday	Tax holiday		Tax holiday, grants		Tax holiday, CIT reduction
PA	Tax holiday			CIT reduction, customs/sales tax exemption	CIT reduction, customs/sales tax exemption	CIT reduction, customs/sales tax exemption
Tunisia	Tax holiday, CIT reduction, customs/sales tax exemption, tax deduction	Tax deduction, customs/sales tax exemption	Grants	Grants	Grants	

Note: Does not include incentives granted to specific sectors in economic zones or free zones. *Tax holiday* = total income tax exemption over defined period; *CIT reduction* = corporate income tax reduction over defined period; *tax deduction* = deductions of certain expenses from taxable income; *customs/sales tax exemption* = exemption from import duties, export taxes, VAT or sales tax; *land/property tax exemption* = exemption from land/property registration fees, stamp duties; *grants* = financial support towards specific investment costs. Table does not include other categories of benefits.
Source: OECD based on national legislation.

In addition to the industrial sector – and with the exception of Libya, which does not use investment incentives to target specific sectors – all countries offer incentives for investment in the agricultural sector. Agricultural projects tend to be eligible for the most generous incentives, including permanent CIT exemptions in Algeria, Morocco and the Palestinian Authority. The tourism sector, however, is eligible for the greatest number of distinct incentives in the region. For example, Jordan, Lebanon and Morocco offer tax holidays followed by CIT reductions to tourism investments. Half the countries in the region offer incentives to renewable energy investments, and only Jordan, Lebanon and Tunisia provide specific incentives to the ICT sector. It is worth noting that other countries may promote these sectors indirectly through incentives that target certain activities. For example, firms that use new technologies or advance environmental protection are often eligible for separate incentives, described below.

Half of the countries in the region provide tax benefits to investment in hydrocarbons – though it is likely that the data presented vastly underrepresent the extent of fiscal support to the industry. This chapter only considers incentives explicit in tax codes and investment-related laws and regulations. Many oil and gas firms receive additional exemptions in specific contracts with national governments. For example, in Egypt, specific decrees govern each petroleum agreement, which override domestic law for tax purposes (PwC, 2017[10]). Studies and investor surveys consistently suggest that natural resource-based incentives are redundant; as the resource is location specific, it raises the question of the necessity of incentives in attracting extractive firms (IMF-OECD-UN-World Bank, 2015[1]) (James, 2013[2]).

All MENA economies incentivise export activities, many incentivise environmental protection

All of the eight MENA economies use investment incentives to target investment in certain activities, such as job creation, skills development, export, or environmental protection. These incentives are often designed to help advance the positive impact of investment on sustainable development (Chapter 2). Activity-specific incentives are only slightly less frequent than sector-specific incentives, and comprise around a third of all incentives offered by the focus economies. Similar to sectoral benefits, a third of these incentives target activities in specific sectors and/or locations.

As summarised in Table 7.3, exports are the most encouraged activity across the region. Every country offers incentives to investors that primarily export or seek to increase their share of exports. Table 7.2 includes incentives granted to firms in free zones that have minimum export requirements. But all of the MENA focus economies except Jordan also offer incentives to exporting firms irrespective of their location. In addition to trade tax exemptions, most countries offer tax holidays and/or CIT reductions to exporting firms.

Several studies suggest that exporters respond more to incentives than domestic market-seeking investors, due to high international competition to attract such firms and their demands to keep costs low (James, 2013[2]) (Andersen, Kett and Von Uexkull, 2017[8]). But this varies by country. In Jordan, a 2009 survey of investors found that exporters were only slightly more attracted by incentives than non-exporters: around a third of exporters reported that they would not have invested in the country without incentives, compared to 20% of non-exporters (James, 2013[2]). The survey found that the majority of investors would have entered the market regardless. Incentives to export-only firms may contribute to integrating the country in global value chains, but might not help forging linkages with local business (see the case of Tunisia Box 8.2 in Chapter 8). Moreover, tax benefits contingent on export performance may run counter to World Trade Organisation rules against export subsidies, raising concerns about their use (WTO, 2019[11]).

Also common across the MENA economies are incentives to investors that advance environmental protection. For example, Tunisia offers firms in recycling and waste treatment CIT rates at less than half the standard rate, and Libya and Algeria grant tax holidays to investments that preserve the environment and protect natural resources. Aside from these two trends, there is wide variation in activity targeting

across the focus economies. Half provide incentives to firms that create jobs, usually with a specific threshold requirement, or enhance skills (though as noted above, other countries provide grants for skills training). The Palestinian Authority is one of the only governments to give tax benefits to firms that use local content in their production, a policy that could incentivise foreign investors to forge stronger business linkages with local SMEs (see Chapter 8 for more on linkages programmes). Few countries give incentives to firms that use new technologies or support technology transfer and R&D activities, unlike OECD countries, which primarily grant incentives for R&D activities. This may be because MENA governments focus more on attracting FDI in labour-intensive industries, but it may also reflect a broader trend in the MENA region, and indeed in many emerging economies, of targeting a wide range of investors.

Table 7.2. Incentives for investment in certain activities in MENA economies

	Environmental protection	Exports	Job creation / skills	Technology / R&D	Local sourcing
Algeria	Tax holiday, grants	Tax holiday	Tax holiday	Tax holiday, tax deduction, grants	
Egypt		Tax holiday, tax deduction, customs/sales tax exemption, grant	Tax deduction, customs/sales tax exemption, grant		
Jordan		CIT reduction, customs/sales tax exemption, land/property tax exemption			Customs/sales tax exemption
Lebanon		Tax deduction			
Libya	Tax holiday, customs/sales tax exemption, land/property tax exemption	Tax holiday, customs/sales tax exemption			
Morocco	Grants	Tax holiday, CIT reduction, customs/sales tax exemption	Grants	Grants	
PA	CIT reduction, customs/sales tax exemption	Unspecified			CIT reduction, customs/sales tax exemption
Tunisia	CIT reduction, customs/sales tax exemption, grants	CIT reduction, tax deduction, customs/sales tax exemption, land/property tax exemption, grant	CIT reduction, tax deduction, customs/sales tax exemption, grants	Tax deduction, grants	

Note: Benefits to exporting firms include incentives given to firms in free zones with minimum export requirements. *Tax holiday* = total income tax exemption over defined period; *CIT reduction* = corporate income tax reduction over defined period; *tax deduction* = deductions of certain expenses from taxable income; *customs/sales tax exemption* = exemption from import duties, export taxes, VAT or sales tax; *land/property tax exemption* = exemption from land/property registration fees, stamp duties; *grants* = financial support towards specific investment costs. Table does not include other categories of benefits.
Source: OECD based on national legislation.

Location-based incentives most widely used in the region

The majority of incentives offered to investors in the MENA focus economies seek to direct investment into particular locations. Half of these incentives are reserved for investors in economic, development or free (trade) zones, geographically defined areas that often have special regulations, administration, fiscal incentives, and/or infrastructure. Zones often have other eligibility requirements, including specific sectors and activities (notably exports). The scale of location-based incentives offered is indicative of a zone-based development strategy in many MENA economies, and the shared aim of regional development. Table 7.3 lists the types of incentives offered to investors in underdeveloped areas, economic zones (including zones labelled development zones, industrial parks and special economic zones), and free zones. The latter tend to have special export requirements or offshore status and thus are separated from economic zones for analytical purposes, though some countries have zones that cross the boundary between the two categories (Libya and the Palestinian Authority).

Table 7.3. Incentives for investment in specific locations in MENA economies

	Areas for development	Economic Zones	Free Zones
Algeria	Tax holiday, customs/sales tax exemption, land/property tax exemption, grants		
Egypt	Tax deduction, customs/sales tax reduction, grants	Tax deduction, customs/sales tax reduction/exemption, grants	Tax holiday, customs/sales tax exemption
Jordan	Tax holiday, CIT reduction, customs/sales tax exemption	CIT reduction, customs/sales tax exemption, land/property tax exemption	CIT reduction, customs/sales tax exemption, land/property tax exemption
Lebanon	Tax holiday, CIT reduction, customs/sales tax exemption	Tax holiday, customs/sales tax exemption, land/property tax exemption	Customs/sales tax exemption
Libya	Tax holiday, customs/sales tax exemption, land/property tax exemption	Tax holiday, customs/sales tax exemption	
Morocco	Grants	Tax holiday, CIT reduction	Tax holiday, CIT reduction, customs/sales tax exemption
PA	CIT reduction, customs/sales tax exemption	CIT reduction, customs/sales tax exemption, grants	
Tunisia	Tax holiday, CIT reduction, tax deduction, grants		CIT reduction, tax deduction, customs/sales tax exemption

Note: Economic zones include Development Zones, Special Economic Zones (SEZs) and industrial parks/zones. Free Zones refer to zones with specific export requirements. *Tax holiday* = total income tax exemption over defined period; *CIT reduction* = corporate income tax reduction over defined period; *tax deduction* = deductions of certain expenses from taxable income; *customs/sales tax exemption* = exemption from import duties, export taxes, VAT or sales tax; *land/property tax exemption* = exemption from land/property registration fees, stamp duties; *grants* = financial support towards specific investment costs. Table does not include other categories of benefits.
Source: OECD based on national legislation.

Economic zones or free zones tend to provide the greatest number of different tax incentives available to firms. As discussed under activity-based incentives, free zones often have export requirements, and are indicative of an emphasis on promoting export-driven growth, although this objective is not always compatible with wider development goals (Box 7.2). Economic zones usually target certain activities, including manufacturing, or more specific industries such as textiles or finance. Every zone (free and economic) offers CIT reductions or exemptions. These range from permanent CIT exemptions (Egypt's Free Zones, Lebanon's Tripoli Economic Zone, Libya's Misurata and Taminhenet Free Zone) to permanent

CIT reductions (at 5% in Jordan's Aqaba Special Economic Zone) or temporary CIT reductions (at 5% for 5 years and 10% for 3 years in the Palestinian Authority's Industrial Parks). Nearly every free and economic zone offers trade tax and VAT exemptions, and most provide exemptions on land/property tax.

Box 7.2. Tax incentives in zones, exports and wider development goals: are they compatible?

Zone-based tax incentives may impede fair competition between firms inside and outside of zones. This can be particularly the case for zones providing CIT holidays, a type of incentive that raises two concerns. The first is that CIT holidays attract investors that are already profitable, and may have invested anyway, as described above. A second concern, which directly relates to the impact of zones on wider development, is the possibility for zone-based firms to sell to the domestic market while they enjoy a competitive advantage over peers outside of zones, due to tax relief. Countrywide productivity growth may be adversely affected by zone-based firms' sales on the domestic market. By having access to the domestic market, zone-based firms can avoid export markets and related competitiveness pressures while benefiting from tax incentives.

In Egypt, for instance, firms in free zones are awarded a wide array of tax breaks, including CIT holidays, conditional on their export performance – this practice also exists in Morocco's free zones and the offshore regime in Tunisia. The large amount of production sold by firms in free zones on the domestic market reveals zones' challenge in meeting their development objectives, however. Over the last five years, free zone projects in Egypt sold half of their production on the domestic market and the other half abroad, below the 80% export share requirement. There are several reasons behind these large domestic sales. Access to a large domestic market pushes firms to sell imported goods (instead of using imported inputs in the production process) or to discharge an excess of production that they cannot export. At the same time, the lack of competitiveness and adequate knowledge of foreign markets reduces the capacity of businesses in free zones to export.

The design of zone-based policy should consider the potential adverse impacts of zones on the wider economy. Zone-based policy could further shift from relying on CIT incentives to facilitating a more effective business environment that promotes competition, integrates targeted sectors with the rest of the economy, and adequately protects the environment. Governments may consider policy reforms that align the country's import tariffs, import procedures and corporate income tax incentives with those in zones to cut the detrimental comparative advantage gap between firms inside and outside of zones. Levelling the playing field between zones and the rest of the country may be an even more pressing priority in light of many MENA governments' strategy to expand the number of zones.

Some countries have successfully managed to address challenges inherited from their zone-based tax policies. Zones in Poland discriminated against SMEs. As a remedy, Poland aligned in 2018 zones' incentives with those granted in the rest of the territory and shifted criteria from geographical and investment scale to sustainability and innovation. The Dominican Republic phased out export share requirements related to CIT incentives in export-processing zones. With the country joining the Central American Free Trade Agreement (2004) and the WTO deadline to comply with the Agreement on Subsidies and Countervailing Measures (2015), it became necessary for the country to phase-out such incentives. Zones in the country remained attractive locations for exporters, with no impact on exports levels.

Source: (OECD, 2020[7])

All economies in the region offer incentives to investors that operate in less-developed regions of the country, outside of zones. The location of these areas are often specified in national decrees, though sometimes are listed in investment promotion laws. Most countries map areas of territory from less to least developed, offering progressively more generous incentives to firms in more underdeveloped areas. Jordan and Lebanon divide the whole country by level of development, providing incentives in nearly every location. Governments tend to require that the investor meet other criteria in more developed areas, such as listing shares on the national stock exchange (Lebanon). Benefits to firms in least developed regions tend to be the (or among the) most generous offered by the country. Algeria and Tunisia offer 10 year tax holidays to firms in designated areas, Jordan a 20 year holiday with possible extension of 10 years. Half of the focus economies also offer financial support, including grants for infrastructure and utilities (Algeria, Egypt, Morocco and Tunisia), and training and land costs (Egypt and Morocco).

Discretion in awarding incentives

An important element of incentive policy is the level of discretion involved in granting incentives to investors. That is, whether the details of the incentive, such as the generosity of the tax incentives or length of exemption, are made explicit in legislation, and whether eligibility criteria to receive the incentive are specific and automatic, or require interpretation or approval from an administering authority.

There is broad consensus among international organisations that consolidating all tax incentives in tax laws – rather than in investment laws, legislation governing specific industries or one-off agreements with firms – enhances transparency and reduces potential redundancies and confusion over the administering authority (IMF-OECD-UN-World Bank, 2015[1]). The Ministry of Finance is often best placed to grant incentives and monitor their costs. Indeed, other ministries or investment promotion agencies (IPAs) may be more inclined to offer fiscal benefits as their priority is to attract investors; they are not in charge of tax collection or necessarily aware of the state's fiscal needs (James, 2013[2]). In tax laws, any incentives offered should be specific, with clear eligibility criteria and little room for discretion by authorities. This reduces the risk of corruption as well as unfair competition between firms (IMF-OECD-UN-World Bank, 2015[1]).

The majority of the MENA focus economies grant investment incentives through investment laws and decrees. Only Morocco has consolidated most of its tax incentives in its tax code. Half of the countries list some benefits in the tax code or budget/finance laws (Algeria, Jordan and Lebanon) or publish amendments to the incentives regime in finance laws (Tunisia) – a step towards consolidation. In every country, the spectrum of incentives offered are dispersed in multiple pieces of legislation (including sectorial and SEZ laws), decrees and executive orders. This makes compiling a complete picture of incentives offered difficult, and may create confusion among investors regarding their entitlements. Not all MENA IPAs detail all incentives offered on their websites, for example. When incentives are granted in a range of laws (and administered by different authorities, see below), it may allow investors to shop around for incentives, while the government may lack a clear view of the full spectrum of incentives it provides.

A quarter of all incentives offered among the eight focus economies are not explicitly detailed in national legislation. That is, the law does not specify the length or amount of a tax exemption/reduction, amount of grant/financial support, or other details about the benefit. Often, both the conditions for receiving the incentives ("national interest") and the benefits available are imprecise. To receive these incentives, investors usually have to apply to the authority administering tax incentives (in the MENA region, often to the IPA or a council for investment, composed of representatives from relevant ministries). Some MENA IPAs (including in Lebanon and the Palestinian Authority) have wide discretion in determining which investors receive incentives and the generosity of the benefit. As IPAs' role is to attract investors, they may not take into account the cost of the incentive, in terms of foregone revenue to the state, or assess whether

investors would have entered the market without the incentive (see chapter 6 for more on the implications of the wide range of responsibilities held by MENA IPAs).

Many incentives granted in MENA region, and indeed across countries, are given to firms on an ad-hoc, contract-based manner. Specificity in laws and regulations, rather than wording that allows open interpretation by officials, helps reduce opportunities for corruption (see chapter 11 for more on the corruption risk involved in administering incentives and during market entry). Moreover, rules that are applied in an ad hoc manner across taxpayers creates unfair competition. It is often not clear whether investors can appeal against an administrative decision not to grant the incentive. Uncertainty over eligibility, the cost of bribes, and scope for an uneven playing field all pose a deterrent to investors (OECD, 2020[7]).

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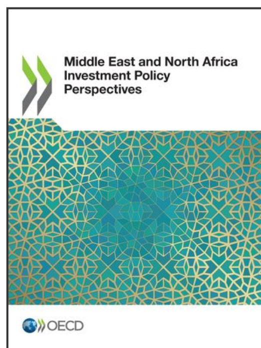
Notes

[1] This chapter presents original research mapping investment incentives granted in eight MENA economies, collected in mid-2019. The results reflect tax and financial incentives (defined as grants, loans or other expenditure to lower the cost of investment) detailed in national tax codes, investment laws, and in publicly-available documents published by investment promotion agencies, ministries of finance and economic zones. Tax guides from PwC, EY and Deloitte were also consulted. The data do not take into account any additional benefits firms may receive through one-off contracts with national governments, as these are not publicly available. It also does not reflect investment incentives taken in response to the COVID-19 pandemic.

[2] The calculation uses average rates of different sectors in Algeria and Jordan, and Morocco.

[3] This summary is not a complete picture of the extent of incentives received by specific sectors, as it does not take into account benefits granted to firms in economic or free zones. These incentives are summarised under location-based incentives and, in the case of free zones, also under activities.



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