

Impact of introducing tax system in Saudi Arabia: A CGE Modelling Exercise

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Draft Version

Abstract

In this paper, a dynamic multi-sector computable general equilibrium (CGE) model called SAUMOD has been used, in order to examine the effects of Saudi's fiscal reform plan. The model distinguishes the economic behaviour of four institutional sectors: firms, households, government and the rest of the world. Production is disaggregated into 24 sectors. A reference baseline is established up to 2015. The model is solved dynamically with annual steps. SAUMOD is used to evaluate the economic impacts of three policy scenarios. The first scenario is increasing government saving by 5% and finance it by an increase in household taxes. The second scenario is increase government saving by 5% and imposes 10% value-added tax on both domestic and imported products. Two cases have been performed: the first case involves imposing a uniform VAT across all sectors. The second case excluded some sectors from the value-added tax. The final scenario is increase government saving by 5% and impose 5% sale tax rate. They all aim to diversify government income flows and increase government revenue.

The outcome is that, the overall growth performance of the economy from direct income tax scenario is positive. Introducing other forms of taxes can, in principle, raise government revenues without causing major distortions. The least negative impact on current real household consumption is from sales tax scenario where it generates revenues with minor impact on incentives. A broad-based VAT scheme has negative effect on the overall growth performance of the economy. Given the large share of services, which is difficult to tax, in Saudi Arabia's non-oil GDP, it is recommended to apply non-uniformly VAT across the economy.

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