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# Hashemite Kingdom of Jordan Development Policy Review

## Improving Institutions, Fiscal Policies and Structural Reforms for Greater Growth Resilience and Sustained Job Creation

(In Two Volumes) Volume I: Synthesis

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#### **ACRONYMS AND ABBREVIATIONS**

AE	Architectural and Engineering
BOT	Build-Operate-Transfer
DB	Doing Business
DFZC	Development and Free Zones Commission
DOS	Department of Statistics
DPR	Development Policy Review
EAP	East Asia and Pacific
ECA	Europe and Central Asia
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GAFTA	Greater Arab Free Trade Agreement
GDP	Gross Domestic Product
ICT	Information and Communication Technology
IMF	International Monetary Fund
JD	Jordanian Dinar
JEDCO	Jordan Enterprise Development Corporation
JEPA	Jordan Export Promotion Activities
JGATE	Jordan Garments, Accessories & Textiles Exporters Association
JIB	Jordan Investment Board
JTC	Jordan Telecommunication Company
JUMP	Jordan's Upgrading and Modernization Program
MENA	Middle East and North Africa
MFN	Most Favored Nation
MNSPR	Middle East and North Africa Region, Poverty Reduction and Economic Management Department
MoIT	Ministry of Industry and Trade
NES	National Employment Strategy
OECD	Organization for Economic Cooperation and Development
QAIA	Queen Alia International Airport
SMEs	Small Medium Enterprises
USAID	United States Agency for International Development
WBI	World Bank Institute
WTO	World Trade Organization

Vice President:	Inger Andersen
Country Director:	Hedi Larbi
Sector Director:	Manuela V. Ferro
Sector Manager:	Bernard Funck
Task Team Leader:	Ndiamé Diop

# HASHEMITE KINGDOM OF JORDAN

## Development Policy Review

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### List of contributors:

Volume 1 – Synthesis: Ndiamé Diop

Volume 2 – Individual chapters:

[Chapter 1](#) - Growth and Employment: Lessons from the past 30 Years – Ndiamé Diop

[Chapter 2](#) - Improving Institutions and State Organizations for Better Policy Making and Implementation – Ernest Sergenti and Lida Bteddini

[Chapter 3](#) - Strengthening Macroeconomic Stability through Fiscal Reforms – Wael Mansour and Ndiamé Diop

[Chapter 4](#) - The Challenge of Transforming the Economy and Creating Jobs – Ndiamé Diop and Derek Chen

[Chapter 5](#) - Trade Competitiveness and Export Promotion – Julien Gourdon, Ana Margarida Fernandes and Olivier Cadot

[Chapter 6](#) - Enabling Business Environment – Marc Schiffbauer

[Chapter 7](#) - Industrial Policy – Marc Schiffbauer

[Chapter 8](#) - Creating an Enabling Environment for Private Sector Innovation – Marjo Koivisto and Kurt Larsen



## Overview

**Jordan's quest for long-term, inclusive and sustainable growth has remained largely elusive. By the Growth and Development Commission's measure of success, namely, an average growth rate of 7 percent over 30 years, Jordan's growth record cannot be dubbed "successful".<sup>1</sup>** The country has experienced spells of high growth but it has always faced the challenge of sustaining them. In the first half of the 1980s, Jordan's GDP growth averaged 7.4 percent. Subsequently, however, as the regional economies entered into recession in the wake of a sharp fall in oil prices, Jordan's growth plummeted to -14 percent in 1988. It took about 18 years for Jordan's GDP per capita to revert to its level in the late 1980s. In 2000-2008, Jordan posted an average 6.7 percent growth. Then in 2009-10, when the global financial crisis hit Jordan, growth dropped sharply to 2-3 percent. Jordan's resilience to exogenous shocks has remained extremely weak over the last 30 years.

**Difficulties in sustaining growth have not only prevented Jordan from reaching a high income status today.<sup>2</sup>** They have also hindered strong job creation for Jordanians and, as a result, unemployment remains high, especially for the youth and women. Close to 1 young individual in 3 aged 15-24 years is unemployed; almost three-quarter of the pool of unemployed are young; close to one-fifth of women are unemployed; yet, only 15 percent of them participate in the labor market compared to 70 percent in East Asia. Moreover, unemployment disproportionately affects educated people: the unemployment rate is 25 percent for women with a university degree, while it is only 15 percent for women with less than a high school diploma.

**This Development Policy Review (DPR) shows that sustaining growth and reducing unemployment is possible:** Jordan has a strong human capital base, a large endowment in engineers, doctors, accountants, IT specialists and a substantial highly-skilled diaspora (500,000 educated Jordanians abroad, 8 percent of the population). Furthermore, the market-oriented reforms of the early 2000s have made Jordan one of the most open economies in the Middle East and North Africa Region and have led to the emergence of dynamic non-traditional sectors (e.g., information and communication technologies, health tourism and business services). What is missing are (i) an adequate and stable institutional framework for policymaking and long-term business development; (ii) good fiscal policies to manage shocks and maintain macroeconomic stability; good institutions and macroeconomic stability were identified by the Growth Commission as two of the five common characteristics of successful growth experiences<sup>3</sup> and (iii) further growth-enhancing structural reforms.

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<sup>1</sup> The Commission on Growth and Development, composed of twenty-two leading practitioners from government, business and the policymaking arenas worked for four years and gathered the best understanding there was about the policies and strategies that underpinned rapid and sustained economic growth and poverty reduction. Thirteen countries, which grew by an annual average growth rate of 7 percent were identified as successful cases.

<sup>2</sup> The World Bank classifies economies according to their GNI per capita, calculated using the World Bank Atlas method. According to the 2010 GNI, low-income countries are those with a GNI per capita of, \$1,005 or less; lower middle income countries, \$1,006 - \$3,975; upper middle income countries, \$3,976 - \$12,275; and high income countries, \$12,276 or more. Jordan's GNI per capita reached \$4340 in 2010 and the country retrieved its Upper Middle Income country status in 2010 which it lost to a Low Income one in the early 1990s.

<sup>3</sup> The others common "ingredients" of successful countries are high investment and savings rates, global integration and flexible product and factor markets.

## **Underlying analytical framework of the DPR**

**The DPR considers a ‘growth model’ in which growth (and, for that matter, any development outcome) depends on three key variables: policies, institutions and exogenous shocks (or luck).**<sup>4</sup> Both policies and institutions have an autonomous or direct impact on development outcomes and an indirect impact through the interaction between policies and institutions. For instance, the impact of a well-thought out policy can be totally muted by weak institutions. Two countries can adopt the same policies and obtain different impact because of differences in the quality of their institutions. The underlying reasons can take many forms, including poor implementation, lack of trust in the policymaker or implementer or a general lack of credibility of the reform. On the other hand, good institutions tend to encourage governments to pursue policies in the public interest and foster good implementation.

**The DPR takes a broad view of institutions to include the organizations directly implementing policies and the background institutions that affect policy making and economic activities.** These background institutions are the legal and political environment into which the bureaucracy and public implementing agencies are embedded. They include not just governmental organization of checks and balances on the discretion of organizations and on the government itself—but also rules such as the freedom of the press and the ability of citizens to organize. These background institutions are what establish the incentives and constraints on policymaking.

**The above framework can guide the analysis of growth performance in different settings, if care is taken to pre-identify the relevant binding constraints to sustainable growth.** Applied to Jordan, a large number of country case studies and discussions with stakeholders in Jordan point to the criticality of 3 main areas for sustaining growth and reducing unemployment: (i) the need for an adequate and stable institutional framework for policymaking and long-term business development; (ii) the need to improve fiscal policies to ensure macroeconomic stability, crucial for long-term growth and (iii) the need to enhance structural reforms for growth to reduce unemployment.

## **Institutions/Governance**

**In Jordan, the implementation of policies and strategies, including in the area of growth, has been frustrated by the** (i) frequent changes in governments (average life of a government is less than 2 years); (ii) the frequent changes in policy priorities; (iii) the relatively weak technical capacity and internal accountability of parts of the public bureaucracy and; (iv) weak background organizations and institutions that establish the incentives and constraints on policymaking (the Parliament and other institutions that ensure that the government is accountable). Meeting important strategic goals such as sustainable growth, structural transformation and employment require time consistency, continuity and frequent monitoring and evaluation, and this has been a key weakness in Jordan. The formulation and implementation of policies are strongly influenced by the background organizations and institutions of the State. The under each area are specific. But they will not take root until ongoing political reforms lead to greater external accountability. Such external accountability should engender the right incentives for the government and the civil servants to choose the right policies, implement them properly and be accountable for the results.

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<sup>4</sup> In other words, we posit that a given economic or social outcome (e.g., growth) Y, is a function of the policies designed to affect it (POL), the institutional framework within which the policies are implemented (INST) and luck or exogenous shocks (EXO):  $Y = f(POL, POL*INST, INST, EXO)$  (1)

## **Macroeconomic stability**

***While monetary and exchange rate policies have been sound, poor fiscal policies have often been a threat to macroeconomic stability in Jordan.*** Fiscal policies in Jordan have remained, over the last 30 years (i) overly pro-cyclical for a country so open and so exposed to exogenous shocks; (ii) too reliant on foreign grants, which creates a moral hazard problem and undermines fiscal discipline and; (iii) too focused on the short-term. Poor fiscal policies have been costly for growth. In 1988-1989, a severe fiscal crisis led to a 14 percent decline in growth and it took Jordan 18 years to retrieve the level of GDP per capita it reached in 1987 (see below). The country is currently facing a challenging fiscal crisis, driven partly by partly by fiscal policies and partly by exogenous shocks, including explosions of the Egyptian gas pipeline that provides Jordan with the gas needed to generate electricity. The fiscal deficit rose to 11.9 percent in 2011, from 7.7 percent in 2010. Following commendable efforts to reduce public debt in 2000-2008, the latter is on the rise again (71 percent of GDP in 2011 in gross terms, against 58 percent in 2010). Unfortunately, major downside risks emanating from the political situation in Jordan, the regional situation, and the impact of the euro zone crisis on the global economy weigh negatively on short-term growth.<sup>5</sup> Unfortunately, Jordan has no choice but to addressing the fiscal situation urgently. Indeed, with low growth and higher borrowing costs (risk premium in the region), a reduction of the primary fiscal balance is required to avoid public debt growing to crisis levels. The DPR discusses fiscal adjustment reform options but insists on the need to strengthen the institutional underpinning of fiscal policy for lasting results.

## **Structural reforms**

***Improved institutions and fiscal policies will need to be complemented by sound growth strategy and structural reforms if growth is to reduce unemployment significantly.*** In 2000-2008, growth was mainly underpinned by FDI to real estate and construction sectors which are intensive in foreign labor. The unemployment rate for Jordanians remained high. In recent years, the Government has been emphasizing promoting private investments in skill-intensive sectors where Jordan has a comparative advantage and has demonstrated real capacity for exports. High hopes are placed on growth of these sectors to reduce massive public sector queuing and the unemployment rate of educated Jordanians. The DPR finds that this approach is sensible. Simulations of different sectoral growth scenarios indicate that robust, above average growth of skill-intensive sectors would reduce unemployment by 2016. However, unemployment would still hover around 10-11 percent. Thus, continuation of cross-cutting growth policies will be crucial to ensure permanent discoveries of new activities and to promote growth in all sectors. Specifically, structural reforms should aim at improving the business environment for *all* firms in an *equal* manner, strengthening Jordan's trade promotion programs, improving the transparency and accountability framework of industrial policies, and adopting a modern and more comprehensive, private sector-led approach to innovation.

***The current context of Jordan Arab Awakening provides an opportunity to address political and institutional reforms in view of creating an enabling environment for sustained growth and macroeconomic stability.*** Satisfying the population's demands for political and governance reforms seems crucial to enhance the acceptance of the sacrifices required to advance fiscal consolidation reforms. In other words, political/governance reforms and fiscal consolidation reforms have become inseparable. Political/governance reforms are also a pre-requisite for restoring investor confidence and unlocking long-term growth if accompanied by structural reforms such as those highlighted above.

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<sup>5</sup> FDI (10 percent of GDP), remittances (10-15 percent GDP) and tourism (4 percent of GDP) are all expected to grow slowly or contract in 2012. Slowdown in these factors, combined with rising energy and import bills, have already led to declining reserves since September 2011 and an increase in financing needs. Jordan has lost about 1 billion dollars in reserves since then but fortunately still has about \$10 billion, or about 5 to 6 months worth of imports.

**The report is organized in two Volumes. Volume 1 provides a synthesis of the key findings and recommendations of the DPR.** Volume 2 is composed of the individual chapters. Chapters 1 and 2 focus on the immediate reforms needed to create an enabling environment for sustainable growth. Chapter 1 shows how political and governance reforms are crucial to sustain stability and enhance accountability, which conditions the quality of policy choices and their implementation; Chapter 2 analyses the key weaknesses in fiscal policy and outlines priority reforms to enhance fiscal sustainability and macroeconomic stability; Chapter 3 looks at why growth over the past decades has not significantly reduced unemployment. Using the lessons learnt from this past experience, Chapter 4 discusses different scenarios of structural transformation and their impact on jobs; finally, Chapters 5 to 8 respectively discuss challenges and reform options in the areas of trade integration, the business environment, industrial policy and innovation policy.

**The DPR builds on and complements Jordan's National Employment Strategy (NES) concurrently prepared.** The NES derives its vision from Jordan's National Agenda and provides a thorough analysis of Jordan's labor market.<sup>6</sup> Its strategic approach focuses on three pillars: (i) economic policies that generate economic growth and quality jobs for Jordanians; (ii) a well-trained and motivated labor force and (iii) social protection of all workers. The DPR focuses on the first pillar of Jordan's NES.

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<sup>6</sup> The National Agenda is a comprehensive, forward-looking blue print for Jordan's development elaborated in a participatory way in 2005.

### Matrix of Policy Objectives and Actions

Note: Short-term = up to one year, Medium-term = up to three years, Long-term = up to five years and beyond

Reforms	Policy Objective	Action	Time Horizon
<b>I. Strengthening institutions</b>			
	Align political institutions and policy-making incentives with promoting general interests of the population, and enhance political competitions and accountability.	<b>Greater External/Political Accountability:</b> <ul style="list-style-type: none"> <li>i. Continue with the reforms of the Electoral System and the Political Parties framework to enhance political inclusion and increase political competition</li> <li>ii. Move towards a system in which the Prime Minister and the government reflect the composition of the Parliament and are more accountable to the Chamber of Deputies.</li> <li>iii. Continue with the decentralization agenda where local governments are empowered with real administrative and financial powers.</li> </ul>	Short-term
	Ensure that civil servants have the right incentives and means to provide quality services to citizens.	<b>Greater Internal Accountability (within government) and Bureaucratic Empowerment:</b> <ul style="list-style-type: none"> <li>i. Strengthen the incentive framework within the public sector by adopting a human resource management framework that promotes excellence and merit.</li> <li>ii. Change recruitment practice by linking recruitment to specific skills and qualifications needed rather than recruiting on the basis of generic diplomas;</li> <li>iii. Improve coordination mechanisms at policy-making and technical levels to improve policy implementation; and engage in proactive government communication.</li> <li>iv. Establish technical multi-sector working groups with defined work programs and deliverables overseen by a public sector cabinet sub-committee.</li> </ul>	Medium-term

	Ensure that citizens have access to information and are free to organize and provide feedback to political leadership for external and internal accountability to work.	<b>Greater Voice to Civil Society Organizations:</b> <ul style="list-style-type: none"> <li>i. Broaden and formalize pre-existing evaluation mechanisms. One example is to broaden the KACE surveys to incorporate customer improvement suggestions and feedback, and inputs on simplification of forms, processes, workflow, and roles.</li> <li>ii. Institutionalize civil society initiatives such as:           <ul style="list-style-type: none"> <li>- Promoting greater information-sharing.</li> <li>- Reinforcing the availability of data and assessments more widely to the public.</li> <li>- Strengthening the Access to Information Law.</li> <li>- Adopting a government-wide public consultation policy.</li> </ul> </li> </ul>	Medium-term
<b>II. Improving fiscal policy</b>			
	Undertake fiscal adjustments to reduce budget deficit and ensure fiscal sustainability in Jordan.	<b>Addressing the Moral Hazard Problem:</b> <ul style="list-style-type: none"> <li>i. Reduce dependence on foreign grants.</li> <li>ii. Contain spiraling wage bill</li> <li>iii. Reduce price subsidies while improving the targeting of cash transfer to the neediest</li> <li>iv. Reduce tax exemptions.</li> </ul>	Medium-term
	Tackling macroeconomic instability through institutional reforms that changes the current procyclical fiscal policy.	<b>Improve Institutional Underpinnings of the Fiscal Policy:</b> <ul style="list-style-type: none"> <li>i. Make fiscal commitments clear via fiscal targets set out in a medium-term fiscal framework, with clear and transparent procedures for implementation and/or</li> <li>ii. Adopt fiscal rules (on both debt and expenditures) and/or</li> <li>iii. Create and independent fiscal body insulated from political pressure.</li> </ul>	Medium-term
<b>III. Implementing new generation of structural reforms</b>			
<b>III.1 Trade Policy and Export Promotion</b>			
	Diversify export destinations, deepen export sophistication, and enhance quality of exported goods.	<b>Revisiting Export Promotion Activities (EPA):</b> <ul style="list-style-type: none"> <li>i. Orient future export promotion programs more on established firms that know how to export as export promotion programs have a stronger impact on existing markets and products than new markets and products;</li> </ul>	Medium-term

		<ul style="list-style-type: none"> <li>ii. Future programs should identify specific markets (e.g., markets with which Jordan has signed a Free Trade Agreement) and assist established firms to penetrate them durably.</li> <li>iii. Revise the design of the JUMP program as to have a greater (indirect) impact on the intensive margin of export growth (greater exports of existing products in existing markets).</li> </ul>	
<b>III.2. Business Environment</b>			
	Minimize discretion in business environment policy implementation and in official's incentives to discriminate between firms.	<p><b>Business Environment-Related Public Administration Reforms:</b></p> <ul style="list-style-type: none"> <li>i. Transfer responsibilities and decision-making to lower tiers of the public administration; at the same time institutionalize the public administration by making (lower tier) civil servants accountable to a broader base instead of a single minister or high rank official.</li> <li>ii. Provide specialized training for government officials especially on regulatory issues.</li> <li>iii. All representatives from the different government agencies must have the authorities to grant the corresponding approvals in one-stop shops, while conflicts between regulators must be addressed in order to effectively speed up the length of procedures.</li> </ul>	Medium-term
	Boost investors (local and foreign) confidence in the stability of the business processes in Jordan.	<p><b>Reduce Policy Implementation Uncertainty:</b></p> <ul style="list-style-type: none"> <li>i. Transform temporary laws into regular legislation status.</li> <li>ii. Strengthen the dialogue between the government and the private sector on issues of new regulations, industrial policies, incentive schemes or other; and make them more frequent, systematic and on equal basis.</li> <li>iii. Streamline the number of authorities and institutions responsible for policy implementation, improve the communication between them, and remove overlapping responsibilities.</li> </ul>	Medium-term

	Enhance local government efficacy in providing better and faster services to businesses.	<b>Reforms at the Municipality Level:</b> i. The new municipality law to provide incentives for local administrations to improve their economic performance. ii. Review business processes at municipalities, especially Greater Amman Municipality, to reduce large variations in waiting times for services.	Short to Medium-term
<b>III.3. Innovation</b>			
	Create and enabling environment for private sector innovation.	<b>Broadening, re-calibrating and Increasing the Efficacy of Innovation Policy:</b> i. Develop and national innovation strategy. ii. Establish long-term innovation leadership that outlasts changing governments. iii. Establish sectoral priorities in the National innovation strategy with focus on competitiveness enhancing policies	Short -term
	Expand access to finance for innovative firms.	<b>Create a funding strategy and specific financing mechanisms for innovation activities across sectors in consultation with the private sector (e.g.: credit guarantee schemes).</b>	Short-term
<b>III.4. Industrial Policy</b>			
	Streamline current industrial policies and focus on enhancing inter and intra sectoral competitiveness.	<b>Provide support for sectoral priorities and cross-sectoral reforms:</b> i. Focus on competitiveness enhancing policies. ii. Breaking down monopolies in productive sectors to enhance competitiveness (e.g., ICT sector). iii. Retraining and further skills development, by the public and the private sectors.	Medium-term

## Jordan's Long-Term Growth Performance

*Jordan's performance from a historic and comparative perspective*

**Market-oriented reforms and an exceptionally favorable external environment in 2000-2008 propelled Jordan's economic growth to 6.7 percent over the last decade.** This performance was better than MENA's average, which stood at 4.5 percent in that period. As Figure 1 shows, Jordan has consistently outperformed MENA in terms of GDP growth since the late 1990s in spite of high oil prices, which increased growth in the resource-rich countries. The only exception was during the recent global financial crisis in 2009-2010 when growth fell much more sharply in Jordan, stopping the accelerated growth spells observed since 2004. This sharp decline in growth since 2009 is a sign of Jordan's weak growth sustainability, due to its strong ties to the Gulf economies (see below).

Figure 1. GDP Growth: Jordan, MENA Average (%)

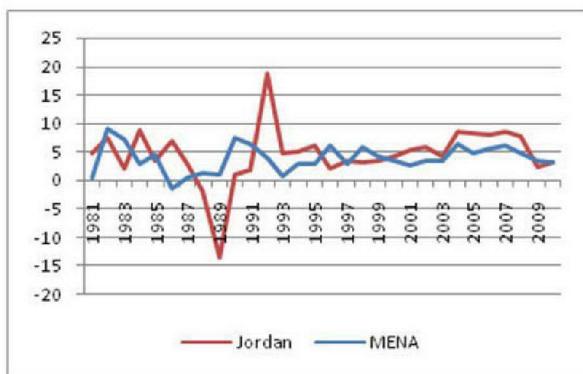
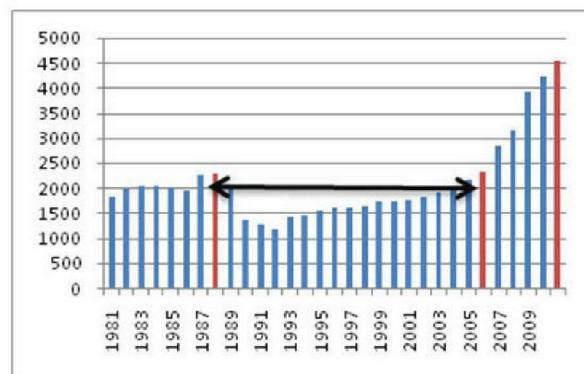


Figure 2. Evolution of Jordan's GDP per Capita (USD)



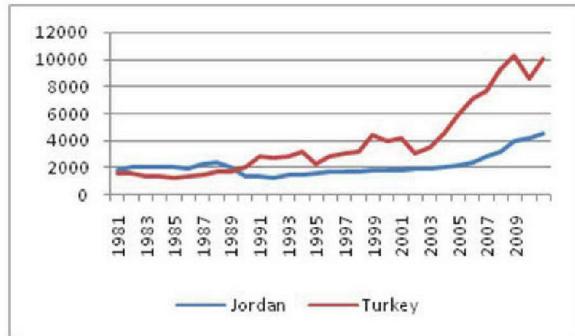
Source: World Development Indicators, World Bank

**Jordan has however a long way to go to make up for its lost ground and catch up with the best growth performers in the world.** Following a severe fiscal crisis in 1989, Jordan's GDP per capita dropped for a decade and the country descended from an upper middle income to lower middle income status according to the World Bank's income classification (Figure 2). Only after 20 years did Jordan revert back to an upper middle income status in 2010.

**Furthermore, as figures 3 to 7 illustrate, Jordan faces formidable challenges to catch up with the best growth performers in Europe and Central Asia and East Asia.** In 1980, Jordan and Turkey had similar GDP's per capita. In 2010, Turkey's GDP per capita was 2.2 times higher than Jordan's (\$10,000 versus \$4,500). The divergence between Jordan and Croatia until 2004 is even starker. The two countries had similar GDP per capita (around \$2000) in 1992.<sup>7</sup> Eighteen years later, Croatia's GDP per capita is 3 times higher. Jordan would have to grow much faster than Turkey and Croatia for a prolonged period to catch up with them.

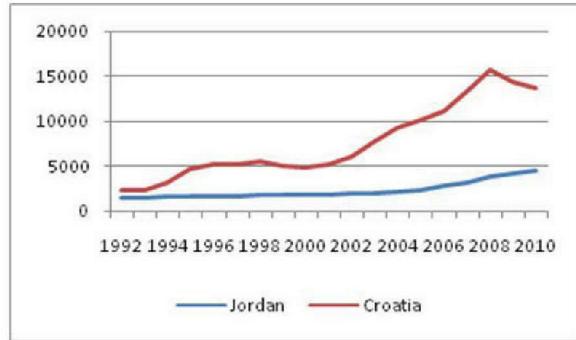
<sup>7</sup> The story holds when GDP per capita is measured in constant 2000 US \$ even the countries do not start with similar GDP per capita in constant US \$ terms.

**Figure 3. GDP per capita, Jordan versus Turkey (US\$)**



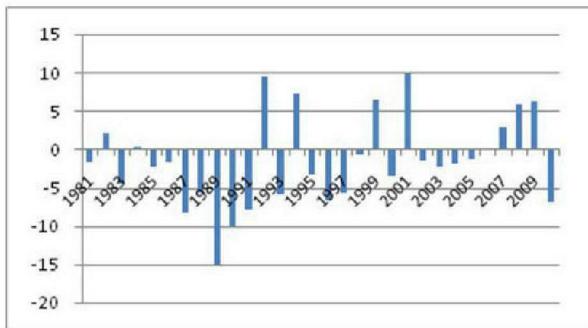
Source: World Development Indicators, World Bank

**Figure 4. GDP per capita, Jordan versus Croatia (US\$)**



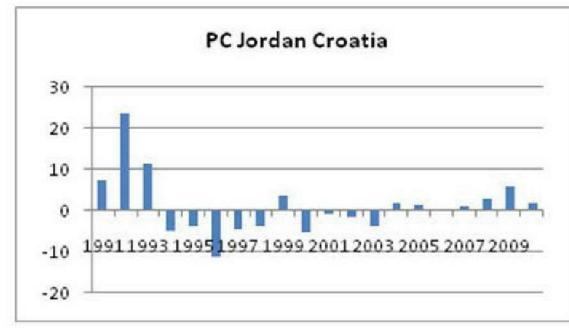
**Over the last decade, Jordan did grow on average faster than Turkey and Croatia, by 1.7 and 3.1 percentage point margins respectively** (Figure 5 and Figure 6). However, when observed in per capita terms, the difference in growth vanishes. This means that for Jordan to catch up with these countries, it needs an even higher growth in per capita terms, since its population growth is higher (+2.9 percent in Jordan versus 1.3 percent in Turkey and -0.17 percent in Croatia).

**Figure 5. Difference in GDP per capita growth, Jordan versus Turkey**



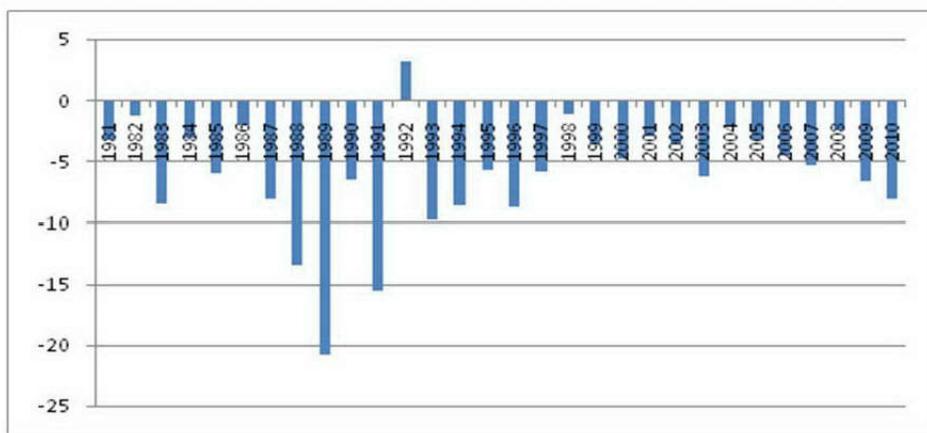
Source: World Development Indicators, World Bank

**Figure 6. Difference in GDP per capita growth, Jordan versus Croatia**



**Jordan's catch-up challenge is even more daunting when compared with East Asia** (Figure 7). Vis-à-vis East Asia, Jordan is actually not converging in growth, but diverging in growth with a shortfall of about 2.5 percentage points vis-à-vis East Asia. Catching up with East Asia in per capita terms would mean a per capita GDP growth rate 5 percentage points higher than its average rate in the 2000s. Thus, Jordan has a long way to go to match the best performers around the world such as Malaysia, Thailand, Indonesia, Singapore and Korea. It will take a generation of sustained good performance to catch up and become a high income country.

**Figure 7. GDP growth: Difference between Jordan and East Asia's average**



Source: World Development Indicators, World Bank

#### *Market-Oriented Reforms and Shifts in Growth Drivers*

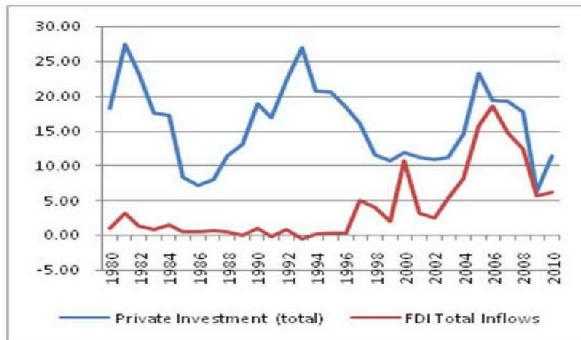
**Jordan decisively embarked on trade liberalization reforms and privatization in 2000.** Of particular importance were the reforms of property rights undertaken as part of the WTO adhesion (2000), reinforced with the signing of a Free Trade Agreement (FTA) with the EU (1997) and the United States in 2001. The FTA with the US followed the signing of an earlier “Qualifying Industrial Zone” agreement with the US that gave Jordanian exports from “qualified zones” quota-free and duty-free access to the U.S. market under advantageous rules of origin. Although non-tariff measures remain, Jordan has become one of the most open economies in MENA with a trade-to-GDP ratio above 100 percent and low tariffs (see Chapter 6).

**As a result of market reforms, FDI and productivity growth have become, since the early 2000's, the key drivers of growth in Jordan.** Net FDI inflows tripled to US\$2.8 billion in 2008 compared with US\$0.9 billion in 2000, and averaged 10.1 percent of GDP over the decade. This compares with an average of 2.4 percent of GDP for MENA countries, 3.1 percent of for ECA countries and 3.2 percent for East Asia countries. For Jordan, FDI has become a key component of capital formation, accounting for 44 percent on average over the past decade, much higher than the average in lower middle income countries (7.3 percent) and the rest of non-GCC MENA countries (6.1 percent). Jordan's large FDI inflow is behind the doubling of gross capital formation between 2000 and 2008 (US\$1.7 to US\$3.4 billion or 24 percent of GDP in 2008).<sup>8</sup> In turn, large increases in capital formation fueled GDP growth which, as Figure 9 shows, fluctuates strongly with the investment rate.<sup>9</sup>

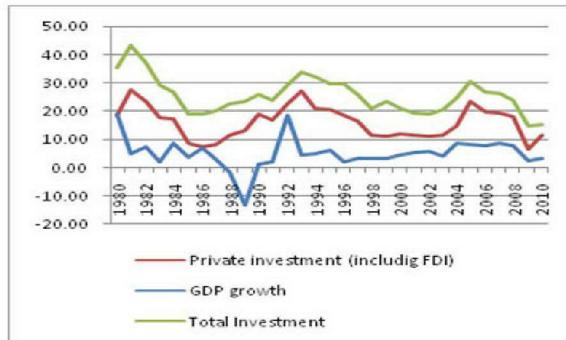
<sup>8</sup> FDI inflows average 10.6 percent of GDP in the period 2000-2008, among the highest in the region.

<sup>9</sup> The preeminence of FDI in Jordan's growth process in the last decade contrasts with the 1990s, during which FDI played no role as domestic investment was financed by domestic savings.

**Figure 8. FDI: A very high share of total investment in Jordan since the early 2000's (%)**

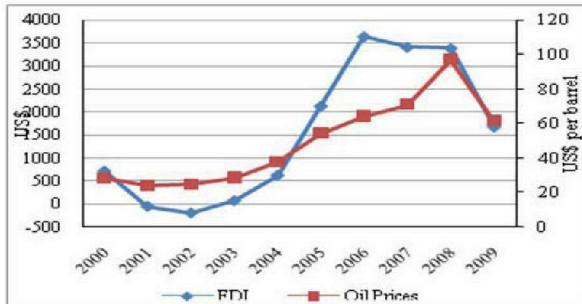


**Figure 9. Growth correlates strongly with changes in investment rates**



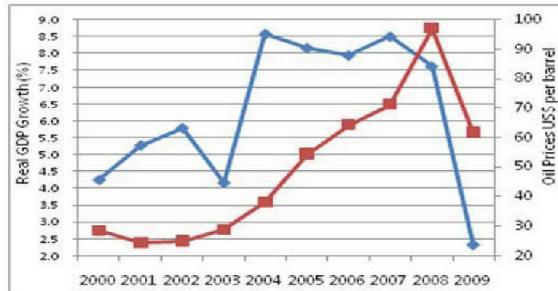
**The rapid increase in FDI reflects two main factors: the rise in oil prices and excess savings in Arab oil exporters.** More than 50 percent of FDI to Jordan comes from regional oil exporters, in particular countries of the Gulf and Iraq. The rise in oil prices and excess savings in these countries since 2003 has led to massive FDI outflows, a portion of which benefitted Jordan. Figure 11 shows the strong correlation between oil prices and FDI flowing to Jordan.<sup>10</sup>

**Figure 10. FDI inflows to Jordan and oil prices**



Source: World Development Indicators, World Bank

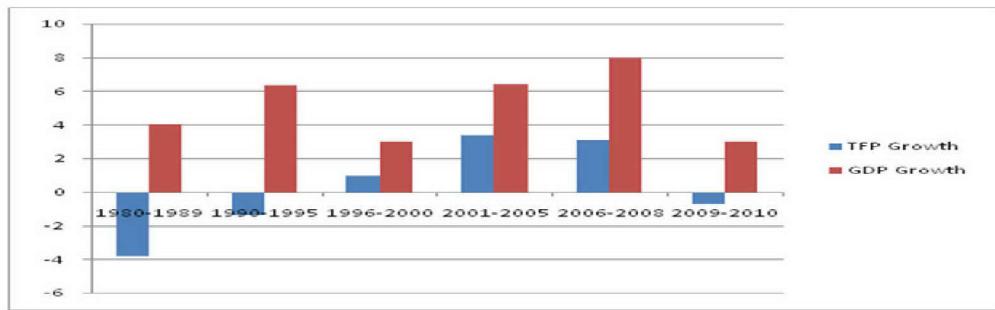
**Figure 11. Jordan's GDP growth and oil prices**



**As mentioned above, alongside FDI, total factor productivity (TFP) has emerged as a key driver of growth in Jordan since the early 2000's.** This contrasts sharply with the previous two decades, during which TFP was a drag on growth. The rise in TFP reflects a greater openness to trade and FDI and a greater role of the private sector in backbone services (finance, telecommunications, transports, the Aqaba port, etc.), traditionally managed inefficiently by the public sector prior to the 2000's. In contrast, the decline in TFP in the previous two decades was linked to the heavy control of the state on business, the pervasiveness of inefficient state-owned enterprises, the heavy regulation of factor markets and limited trade openness.

<sup>10</sup> At least a part of FDI inflows to Jordan is linked to the comprehensive privatization program implemented between 2000-2008. According to a recent World Bank report, privatized firms made over \$1 billion in capital investment during 2000 – 2007, which equates to 11.4 percent of overall foreign direct investment (FDI). The privatizations included the Jordan Telecommunications Company (JTC) (2000, 2002); the Arab Potash Company (2003); the Jordan Phosphate Mines Company (2005); seven aviation sector businesses, including Royal Jordanian Airlines (2000 – 2007); and three power sector companies (2007). In addition, two major public-private partnership transactions were concluded: a management contract for the Port of Aqaba container terminal and a build-operate-transfer (BOT) transaction to develop a new passenger terminal at Queen Alia International Airport (QAIA).

**Figure 12. Jordan GDP and Total Factor Productivity Growth (%)**

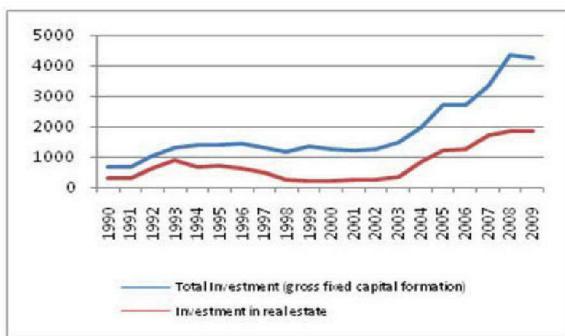


*Large Scope for Increasing Investments and Productivity Still Exist*

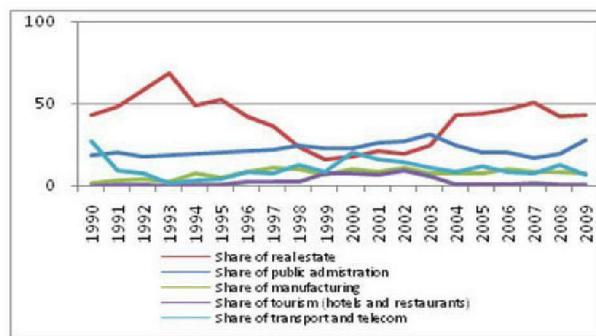
**FDI is likely to continue to contribute positively to overall growth once the current political situation stabilizes but Jordan's challenge is to diversify both their origin and sectoral allocation.** The high concentration of FDI origin –mainly from the Gulf Countries- has created a strong “covariance” risk between oil price and FDI and growth in Jordan. FDI to Jordan fluctuate with the vagaries of international oil prices as seen above. The risk of growth volatility is further increased by the narrow sectoral allocation of these investments. The real estate claims close to 50 percent of total investments in Jordan and drive aggregate investment (Figure 13 and Figure 14).

**Going forward, boosting domestic and foreign investments in non-real estate sectors, which are so far very low, should be a priority for Jordan.** As discussed below, the government's growth strategy focuses on putting in place policies to boost private investments in some emerging high-skilled sectors, where Jordan has demonstrated a strong potential for growth and where it has a comparative advantage. Jordan's economy has started to structurally change with greater openness and global integration and this process is quite recent (a decade or so). Jordan's challenge is thus competing with early and more mature reformers with more mature and developed private sectors (see below).

**Figure 13. Gross Fixed Capital Formation, total versus real estate (million Jordanian Dinars)**



**Figure 14. Share of Different Sectors in Gross Fixed Capital Formation (%)**



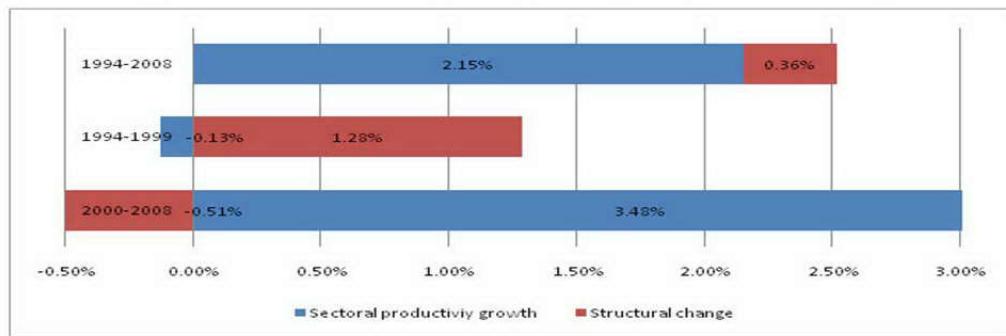
Source: Department of Statistics, Hashemite Kingdom of Jordan.

1. **There also exists a large potential for further productivity increases from the movement of labor from low to high productivity sectors.** The last decade has seen productivity growth driven by within sector productivity growth with a negative contribution of structural change (Figure 15).<sup>11</sup> In the

<sup>11</sup> Labor productivity in an economy grows in one of two ways (see McMillan and Rodrik 2011). First, productivity can grow within economic sectors through capital accumulation, technological change, or reduction of misallocation across firms. Second,

years to come more investments (including FDI) in the emerging sectors would not only accelerate the structural transformation of the Jordan economy (i.e., increase the size of emerging non-traditional sectors), it can increase productivity and GDP growth in a virtuous cycle. Although within sectors, one detects the emergence of a few new sub-sectors (such as ICT, medical tourism, etc.), at the aggregate level, Jordan's has undergone little structural change and the traditional sectors largely dominate the economy (see below).

**Figure 15. Labor Productivity Decomposition (annual growth rates in %)**



## Improving the Institutional Framework

**In addition to being important in their own right, political and governance reforms are needed to advance economic reforms in Jordan.** His Majesty King Abdullah II's statement at the World Economic Forum in October 2011 summarizes well the key links between political and governance reforms and economic reforms and outcomes: "Political reform is economic reform. For businesses to invest and expand with confidence, they need a predictable, level playing-field, transparency and accountability, the rule of law and a strong, stable foundation of inclusive political life." His Majesty King Abdullah provided further guidance for political reforms in his speech opening the 16<sup>th</sup> Parliament's second ordinary session on October 26, 2011: "Our priority today is political reform. Now, we need to build the legislative foundations on which political life can develop: new laws on election and political parties, independent election commission and constitutional court, as well as other legislation to implement the constitutional amendments.

**Political and governance reforms are particularly crucial to enhance political support for sensitive reforms.** The subsidy reform is an example. Greater transparency and credibility may help better convey the message that the fiscal crisis is severe and this can help contain popular pressure for keeping the subsidies. Addressing governance issues may also help increase the acceptance of sacrifices. A result of the "rent-seeking" literature is that if rent-seekers believe that a crisis that is reducing the availability of rents is severe, they are less likely to keep requesting rents, since they are more likely to believe that there is no rent for anyone else. The perception that some other members of society are getting rents is a key deterrent to reform. Opinion polls indicate a high level of dissatisfaction with Jordan's government and Parliament. One appropriate policy response is greater transparency and credibility.

**In this DPR, we examine many components of the political and public administration context, often lumped together under the general rubric of "institutions".** That is, we analyze both the foreground

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labor can move across sectors, from low-productivity sectors to high-productivity sectors, increasing overall labor productivity in the economy (structural change).

setting (the public bureaucracies charged with directly implementing policies) and the background setting (the political institutions, or rules that regulate how the different State organizations interact with each other and with the public). The technical capacity and internal accountability of the public bureaucracies are crucial determinants of their effectiveness. No less important are the background organizations and institutions, in which the public bureaucracies are embedded. Background organizations include the government and the Parliament; while background institutions include the level of checks and balances on the government, the degree of freedom of the press and the level of civil liberties. These background organization and institutions establish the incentives and constraints on policymaking.

***The formulation and implementation of policies, including the ones discussed in this report, are strongly influenced by the background organizations and institutions of the State.*** Given their importance, these background organizations and institutions, as well as their effect on the policy making process, are systematically examined in this report. We identify institutional and organization weaknesses over three stages of policymaking:

At the policy formulation level: A general public perception that past policies have failed; A lack of genuine consultation in the policy making process and a lack of a comprehensive reform plan which reflects that fact that the implementation of the National Agenda is partial and inconsistent;

At the implementation level: Blurred ministerial mandates, not enough coordination among Ministries, frequent changes in Government and Ministerial leadership, discretion and arbitrariness in implementation, and technical capacity weaknesses among technical Ministries' staff.

At the evaluation/accountability stage: Lack of impact evaluation, limited transparency and low contestability.

***The solutions recommended under each area are specific. But they will not take root until ongoing political reforms lead to greater external accountability.*** Such external accountability should engender the right incentives for the government and the civil servants to choose the right policies, implement them properly and be accountable for the results. In other words, Jordan needs a stronger and more representative Parliament, which holds the Government accountable, under the pressure of a freer civil society.

## **Strengthening Macroeconomic Stability through Fiscal Consolidation Reforms**

***Throughout the last decade, Jordan's fiscal situation worsened and fiscal policy proved unable to protect the country from large shocks.*** Fiscal policy has been largely pro-cyclical, expanding in booms and contracting in recessions—a pattern that has made it a major source of macroeconomic instability. For instance, while GDP growth averaged 8.1 percent in 2004-2008, the primary fiscal deficit excluding grants stood at 6.6 percent of GDP and the overall deficit excluding grants averaged 9.3 percent. In 2011, the sharp decline in growth coincided with a very large fiscal deficit (11.2 percent of GDP), preventing the government from undertaking countercyclical fiscal policy to restore growth. Following commendable efforts to reduce public debt in 2000-2008, the latter is on the rise again (71 percent of GDP in 2011 in gross terms, against 58 percent in 2010).<sup>12</sup> Because Jordan's capital account is open and the country is exposed to shocks, prudent macroeconomic management is crucial to reduce volatility.<sup>13</sup>

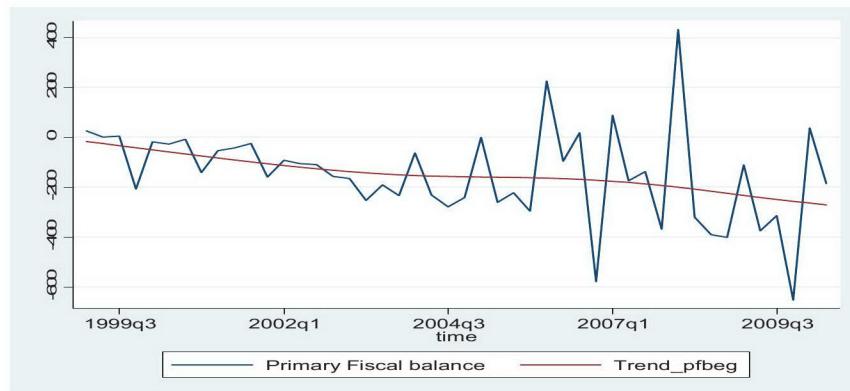
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<sup>12</sup> In contrast with fiscal policy, Jordan's monetary and exchange rate policies have favored macroeconomic stability. Monetary policy has been consistent with low and stable inflation and the real exchange rate has remained stable.

<sup>13</sup> Dell'Ariccia et al. (2007) document a number of country cases in which the implementation of prudent macroeconomic policies was an important factor in improving the growth benefits of financial integration, while minimizing potential risks.

2. **To ensure fiscal sustainability, fiscal adjustment needs to take into account the root causes of the country's poor fiscal outcomes.** In Jordan, the high popular pressure for public spending appears to be related to two factors: (i) a moral hazard problem created by easy access to foreign grants and (ii) political economy factors and short-term focus of frequently changing governments. Reducing the dependence on foreign grants through fiscal adjustment while strengthening the institutional underpinning of fiscal management can help address these problems.

**Figure 16. Primary fiscal balance (million JD)**



Source: Ministry of Finance, Jordan

#### *Addressing the Moral Hazard Problem of “Easy” Foreign Grants*

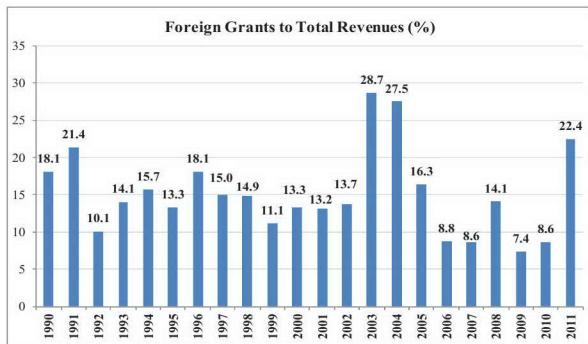
**Jordan is an important recipient of grants from the Gulf countries and the US thanks to its political stability and diplomacy.** The share of foreign grants in Government revenues is very high, averaging 15.2 percent between 2000 and 2011, with peaks in 2003 and 2004 (28 percent) and in 2011 (22 percent). This dependence on external grants creates a permanent fiscal policy risk, since foreign grants fluctuate with the price of oil and the economic fortunes of Jordan’s partners. For instance, external grants dropped from 14 to 7 percent of total government revenues between 2008 and 2009, causing a dramatic widening in government’s borrowing requirement.<sup>14</sup> The fluctuations in foreign grants generate additional uncertainty for fiscal policymakers in addition to the uncertainty related to economic activity in the region and the global economy.

**Foreign grants delay reforms by relaxing the country’s budget constraint through a “moral hazard” phenomenon.** They expose Jordan to changes in the political and economic fortunes of its partners also. The availability of large foreign grants encourages fiscal current expenditures and deficits, thus delaying important fiscal reforms. Figure 18 shows that over the last decade, only once did domestic revenues cover fully current expenditures. Except in 2006, domestic revenues have always fallen short of current spending, not to mention total spending (i.e., including capital spending). The persistence of this shortfall is a sign of a moral hazard, whereby foreign grants are counted upon to fill the gap. There is an established literature showing that capital inflows (including foreign grants) tend to contribute to a reduction in “precautionary” savings.<sup>15</sup>. Unfortunately, foreign grants are volatile and are mainly influenced by factors beyond the control of Jordanian authorities (Figure 17).

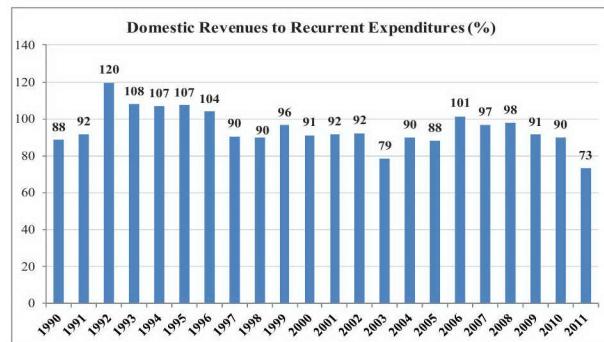
<sup>14</sup> External grants totaled US\$1 billion in 2008, US\$469 million in 2009, US\$565 million in 2010 and more than US\$1.5 billion in 2011.

<sup>15</sup> See Agénor and Montiel (2008).

**Figure 17. Share of Foreign Grants in Total Revenues**



**Figure 18. Ratio Domestic Revenues to Recurrent Expenditures**



Source: World Development Indicators, World Bank, and Ministry of Finance, Jordan.

**Reducing dependence on foreign grants requires decisive fiscal adjustment.<sup>16</sup>** For instance, one of the key sources of fiscal savings is subsidies. In 2011, they represented 22.4 percent of total revenues or 5.9 percent of GDP (the equivalent of foreign grants received that year). Subsidies in Jordan are regressive. Overall, the top income quintile receives over seven times more in subsidies than the bottom income quintile. Every dinar transferred to the bottom two income quintiles through price subsidies costs the budget 6.3 dinars (IMF 2012). The leakage of benefits is especially pronounced in the case of gasoline, where top income quintile households receive 32 times more in subsidies. Well designed safety net programs can substantially reduce this leakage of benefits to higher income groups and help protect the poorest households at much lower fiscal cost.

**Another avenue of fiscal reform is to contain the public sector's spiraling wage bill, i.e., to make sure that they grow at lower rates than the GDP.** Indeed the overall compensation of employees increased at 6 percent per annum since 2006, against 5.3 percent for GDP.<sup>17</sup> This rapid growth reflects successive wage increases granted to civil servants and military personnel in the past five years; along with generous pension and retirement packages offered to employees of the defense sector. Given the large size of the public sector in the economy (one-third of GDP and 38 percent of total employment), increases in the wage bill are bound to have significant impact on fiscal outcomes.

**Finally, fiscal adjustment should aim at reducing Jordan's large tax exemptions. The latter have increased significantly in the past decade (although no official estimate exists).** They have been used as instruments to stimulate foreign investments and subsidize some domestic sectors in bad times (e.g., real estate), and as a mechanism to enlarge the social safety net through reduced sales tax on products deemed important socially. There is a need to assess the amount of tax expenditures generated by these exemptions and to devise an overall framework or strategy or specific guidelines for granting and administering them.

#### *Improving the Institutional Underpinning of Fiscal Management*

**Fiscal adjustment is, however, not enough to ensure fiscal sustainability in Jordan.** The political economy factors that undermine fiscal management need to be addressed. This requires reforming fiscal institutions to foster fiscal discipline without undermining the Parliament's democratic control on the

<sup>16</sup> An ongoing Bank policy note is focused on identifying and examining the welfare distribution of various fiscal consolidation measures, considered by the Government.

<sup>17</sup> Both are measured in real terms. The compensation of employees includes the wage bill for civil servants and military personnel, pension contributions and allowances and social assistance.

budget. Indeed, a key strategy is to somewhat reduce the “politicization” fiscal policy (just as monetary policy was depoliticized by granting independence to the central bank) while enhancing fiscal transparency.

***International experience provides many examples of instruments that can be used to enhance the institutional context for fiscal policymaking.*** One option is to require that fiscal commitments be made clear via fiscal targets set out in a medium-term fiscal framework, with clear and transparent procedures for implementation. The key advantage of this approach is that budgets take into account the consequences of policies and help ensure adequate funding of medium-term programs. It has some flexibility since fiscal deviations can be corrected gradually but the Government is obliged to clearly explain departure from a prudent path and take corrective actions to avoid sanction from the Parliament. This approach was adopted by New Zealand and Australia.

***Another avenue is to adopt fiscal rules. There is evidence that when backed by sufficient political will, fiscal rules foster fiscal discipline (IMF 2009, Guichard et al. 2007).*** Fiscal rules are particularly suitable to situations where political commitment is weak or where governments change frequently. Fiscal rules have been adopted by a large number of countries. According to the IMF, in 1990, only seven countries worldwide had a fiscal rule; by 2009, they were in place in 21 developed countries, 33 emerging markets and 26 low-income countries (IMF 2009). Chile and Poland are known examples where fiscal rules worked.

***But fiscal rules present many shortcomings. For instance, rules can be harmful to the quality of fiscal adjustment, for instance, when growth-enhancing public investment is cut to respect an expenditure cap (Blanchard and Giavazzi 2003).*** Jordan’s situation illustrates this. The country has a debt law that stipulates that the public net debt to GDP should not pass 60 percent as a rule. In 2010, a short-lived fiscal adjustment of 3 percentage of GDP was achieved by cutting public investment while current spending increased; when political will is absent, rules can also motivate creative accounting and off-budget operations, undermining transparency and the democratic control of the budget; finally, if enforcement mechanisms are weak, rules cannot play their role of constraining policymakers.<sup>18</sup>

***Finally, a third potential instrument to foster fiscal discipline is to establish an independent fiscal body insulated from political pressure.*** For practical purposes, fiscal policy would be delegated to an unelected but accountable body. Two types of fiscal body exist, depending on the scope of the mandate and the way they function: (i) independent fiscal authorities, which, similar to central banks, have the mandate to achieve fiscal objectives (such as to lower medium-term deficits or create fiscal sustainability), with delegated authority over requisite instruments (taxes); (ii) fiscal councils, mandated to carry out budget formulation or monitoring.

***In brief, many options to address the weak institutional underpinning of fiscal policy exist. Unfortunately, Jordan’s experience with its debt law (a fiscal rule) has not been favorable.*** To more effectively ensure fiscal sustainability, advances in political and governance reforms are crucial.

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<sup>18</sup> Again in the case of Jordan, the general provisions of such a law stipulate that the specific debt limit rule article would come into force only if it is specifically and separately approved by the Council of Ministers. Such an approval has never materialized. So de facto, the 60 percent debt limit is not binding legally.

## **Structural Reforms for Robust Growth and Job Creation**

*Improved institutions and fiscal policies will need to be complemented by sound growth strategy and structural reforms if growth is to reduce unemployment significantly.* In 2000-2008, growth was mainly underpinned by FDI to real estate and construction sectors which are intensive in foreign labor. The unemployment rate for Jordanians remained high. In recent years, the Government has been emphasizing promoting private investments in skill-intensive sectors where Jordan has a comparative advantage and has demonstrated real capacity for exports. High hopes are placed on growth of these sectors to reduce massive public sector queuing and the unemployment rate of educated Jordanians. The DPR finds that this strategy is sensible. Simulations of different sectoral growth scenarios indicate that robust, above average growth of skill-intensive sectors would reduce unemployment by 2016. However, unemployment would still hover around 10-11 percent. Thus, continuation of cross-cutting growth policies will be crucial to ensure permanent discoveries of new activities and promote growth in all sectors. Specifically, structural reforms should aim at improving the business environment for *all* firms in an *equal* manner, strengthening Jordan's trade promotion programs, improving the transparency and accountability framework of industrial policies, and adopting a modern and more comprehensive, private sector-led approach to innovation.

### **Growth has not been sufficient to reduce unemployment**

*Annual growth reached 6.7 percent annually in 2000-2008. This growth “generated” a net employment growth of 2.9 percent annually.* In absolute terms, 457,000 net jobs were created. Yet, unemployment dropped only slightly, from 14.9 percent to 13.6 percent. A closer scrutiny of the data shows that 42 percent of the jobs were created in the public sector and 58 percent in the private sector. Among those created in the latter, more than half were captured by foreign workers. Job creation for Jordanian citizens in the private sector stood at a mere 28 percent of all the jobs created in 2000-2008.

*In the private sector, job growth was highest in “foreign worker-intensive sectors”, including tourism and hospitality (8.4 percent annually in 2005-2009), construction (6.6 percent) and retail trade, textiles and clothing.* Job creation in the above sectors was high but real wages were stagnant or declining (textiles).<sup>19</sup> In contrast, job growth was below average in the telecom and ICT-enabled services, non-textile manufacturing, mining and other industries (energy, water, etc.). In other words, apart from the financial sector, job opportunities in the private sector were lowest in these skill-intensive sectors which educated Jordanians predominantly “target” when seeking jobs.

*Queuing for public sector jobs has thus been massive with the public administration, defense, and security sector which registered a 7.1 percent annual growth rate in net job creation in 2000-2009.* In 2010, about 218,000 applicants were queuing for openings in the public sector according to the Civil Service Bureau. The queuing phenomenon reflects large distortions between public and private sectors wages and compensation. In 2010, the average monthly wage in the public sector was JD412 compared to JD338 in the private sector; the public sector pays about 70 percent of private sector wages for managerial and technical levels and about 150 percent of the private sector for unskilled and semi-skilled levels! (Jordan National Employment Strategy, 2012).

*This distribution of jobs between public and private sectors is unsustainable:* (i) a large number of educated people are under-employed in the public sector and a large number of people in the private

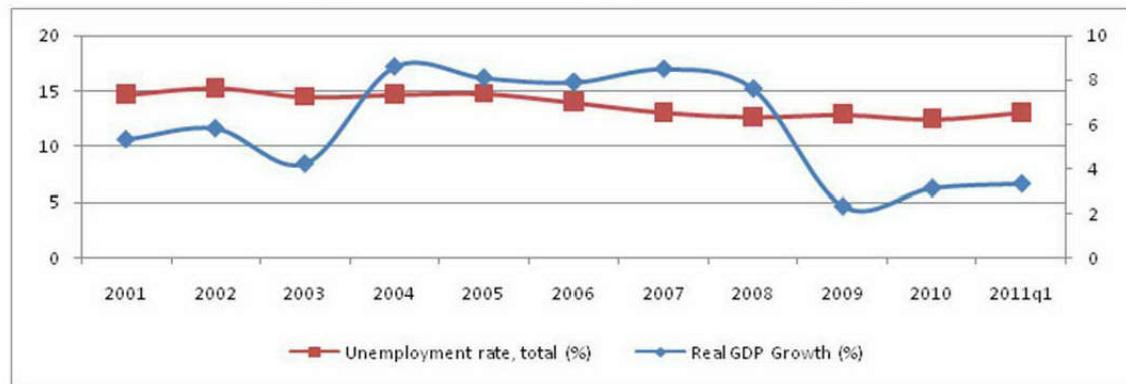
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<sup>19</sup> Foreign workers captured a significant share of the jobs created in these sectors. Foreign workers, who accounted for 13 percent of total labor force in 2009, are concentrated in construction (35 percent of workers in this sector), textiles and clothing (30 percent), hotels and restaurants (28 percent), wholesale and retail trade (12 percent). While these sectors absorbed a large number of jobs, they experienced the least growth in real wages over the last decade.

sector are frustrated with few job opportunities or stagnant or declining real wages; (ii) the public sector, including administration, defense and security already employs 38 percent of the labor force and is bloated.

***Thus it is imperative to enhance the scope for job creation in the private sector in the years to come.*** This requires a rapid growth of skill-intensive sectors which hold high hopes for employing educated Jordanians. The growth rate required is also high because Jordan's labor supply growth is high (youth bulge). Over the last 10 years, Jordan's labor force grew at an annual growth rate of 2.7 percent. Against this backdrop, Jordan's respectable 2.9 percent annual growth in employment was not enough to absorb the new entrants and significantly reduce the stock of unemployed in the labor market, leaving the overall unemployment at high levels. In the ECA and EAP regions, labor force growth stood at a mere 0.8 percent per annum between 2000-2009, implying that most countries in these regions need only a fraction of the employment growth realized by Jordan to reduce unemployment. Jordan's working age population has increased significantly in the last decade (reflecting high fertility rates in the 1980s) and is predicted to continue growing fast in the next decade. From 3.4 million in 2009 (or 57 percent of the population), the working age population is expected to reach 4.4 million in 2020 (or 67 percent of the population). Assuming a labor force growth rate of around 2.7 percent per annum, in order to reduce unemployment, employment growth would need to be greater than 3 percent.

**Figure 19. Growth and Employment, 2000-2010 (%)**



Source: WDI and Department of Statistics, Jordan

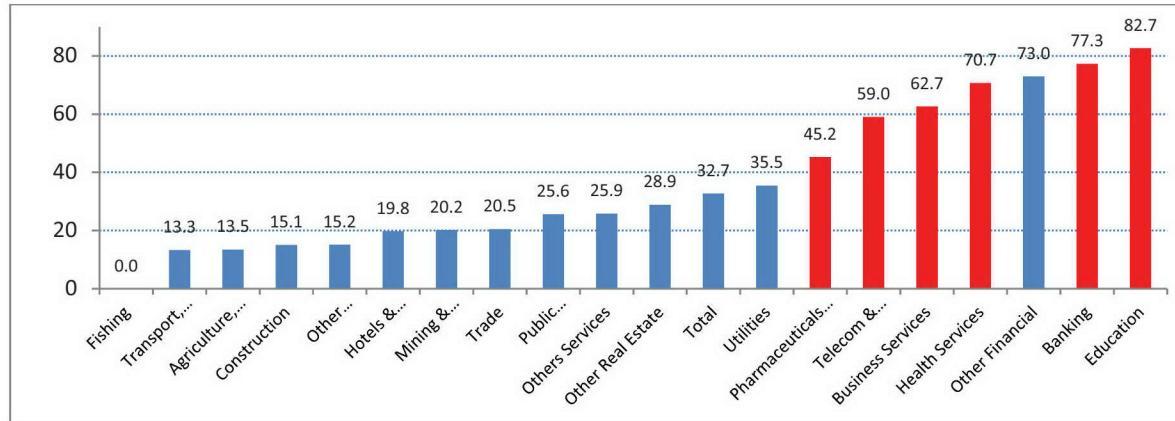
### The Recent Nuances Introduced in Jordan's Growth Strategy

***Jordan's growth strategy is traditionally based on trade openness and continuous improvements of the business environment through reforms of business regulations, enhancements of key infrastructures and strengthening the education system.*** In recent years, the Government has emphasized the need to promote investments and innovation in specific sectors in view of “redirecting the economy towards sectors and activities based on knowledge anchored on its vast pool of talent and expertise”. To that effect, following a very large number of sectoral studies (more than 30 in the last 6 years), a few sectors in which Jordan has comparative advantage were identified as holding high hopes for accelerating the economy's structural transformation. These sectors include information and communication technology services (ICT), the pharmaceutical sector, business services (including auditing, accounting, legal and architectural services), financial services, education services, and health services (including health tourism). The strong externalities (or social benefits) associated with growth in these strategic sectors, not captured fully by markets, provides a rationale for public support. Thus while emphasizing improvements in the business environment, trade and education reforms as well as infrastructure development benefiting all sectors, additional effort is deployed to remove the sector-specific obstacles and overcome the market failures that prevent the rapid expansion of specific sectors.

**The choice of the targeted sectors was based on two key factors.** First was Jordan's comparative advantage proxied by the skill-intensity of the sectors in the country. Figure 20 shows that ICT, the pharmaceutical sector, business services, financial services, education services and health services present the highest levels of skill-intensity in the economy. The share of workers with tertiary education in total employment varies between 45 percent in pharmaceutical industries and 82 percent in education services. It is hoped that growth in the skill-intensive sectors will contribute to enhancing the *employment* of skilled individuals which, all else being equal, should reduce overall *unemployment*. In 2010, these six sectors collectively represented about 20 percent of Jordan's GDP.<sup>20</sup>

**The second factor was the tradability status and the potential for growth through exports.** The chosen strategic sectors have all seen rapid growth in the past decade (8 percent on average in 2000-2008), largely driven by exports. To the extent that they expand their market shares in regional and international markets, their contribution to the balance of payment and foreign reserves of Jordan will be significant. Box E.1 describes in more details the performance and prospects in most of these sectors.

**Figure 20. Jordan - Skill Content of Total Employment by Sector (Share of tertiary educated employees in total, 2010)**

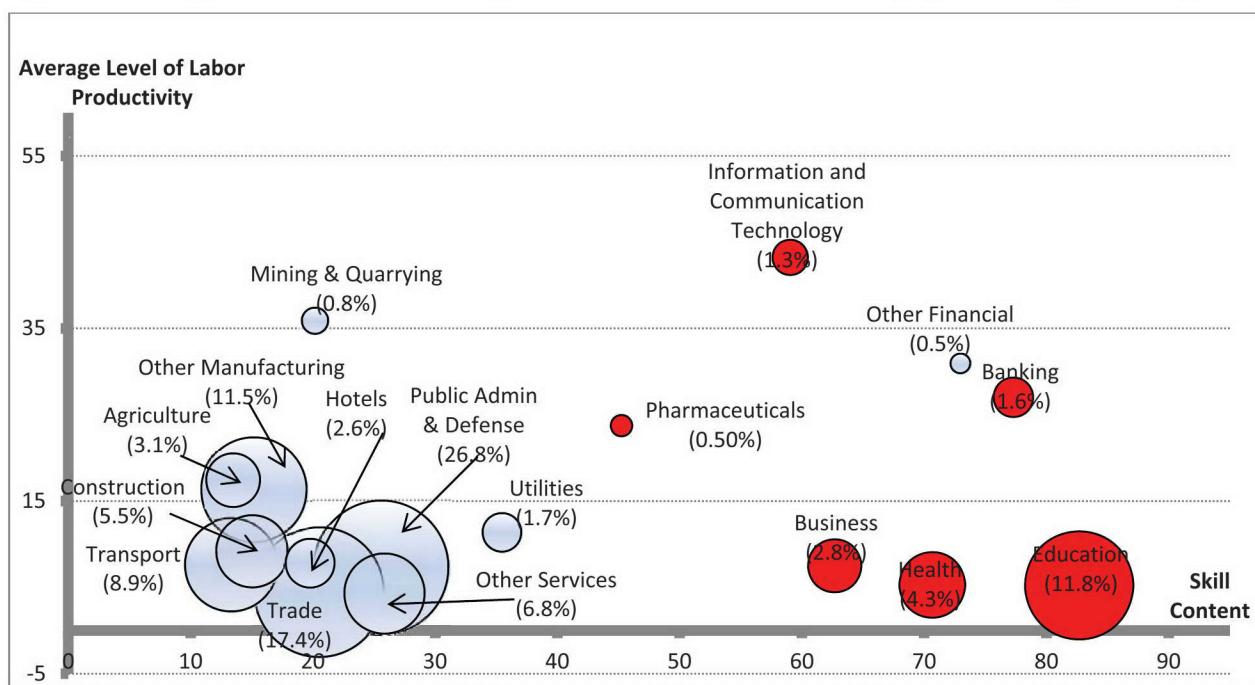


Source: DOS, Jordan

**It is noteworthy that not all the skill-intensive sectors display high levels of labor productivity.** As shown in Figure 21, while ICT, banking, pharmaceutical and, to a lesser degree business services are clearly above the country's average level of labor productivity, education and health services display a low level of productivity (despite their high skill content). This reflects the large presence of the public sector as a provider of these services and the government tendency to recruit massively in public schools. In fact, among the skill-intensive sectors, education and health are the only ones with large levels of employment (11.8 percent and 4.3 percent of total employment respectively). The other four sectors represent a very small share in total employment: 2.8 percent for business services, 2 percent for banking and other financial services, 1.3 percent for ICT and 0.5 percent for pharmaceutical (Figure 21).

<sup>20</sup> According to Jordan's recent input-output table, the size of each of these sectors in terms of their share in total value-added is the following: Education: 6.1 percent, Information and communication technology (ICT) services: 5.4 percent, Financial services: 4.7 percent, Health services: 2.3 percent, Business services: 2.1 percent and Pharmaceuticals: 1 percent. ICT services are composed of —post and telecom: 5.1 percent and information and communication technology (also called ICT-enabled services): 0.3 percent.

**Figure 21. Average Level of Labor Productivity vs Skill Content - Size of bubble is employment share (parenthesis) 2010**



Source: Bank Staff based on Jordan Input-Output Table and DOS data

### **Box E.1. Performance and Growth Potential of Some of Jordan's Key Strategic Sectors**

**The ICT sector** has been growing at a fast pace in Jordan throughout the last decade, and its magnitude is estimated at around 9.5 percent of GDP (2009). The ICT sector has seen the creation of about 65 new small companies every year between 2007 and 2010 according to the business association Intaj. The Arab countries, especially the GCC (more than 30 percent of total ICT exports), alongside the USA (22 percent) have been the major destination markets for the Jordanian ICT products. Jordan can tap further into the regional market and exploit such potential as it remains a fairly small player. The access to the Saudi market is a revealing example where the Jordanian exports to Saudi Arabia are less than 1.5 percent of total IT spending in this country.

**Health services** have grown by an average of 9.5 percent per year in the 2000's. This reflects the valuable reputation for excellence the country's health sector has gained and which has propelled the Kingdom to become a prime international destination for medical services. Ranked 1st in the MENA region and 5th on a global level (World Bank 2008), the sector shows promising potentials for growth in the future. According to the private hospital association, 234,000 patients (both in and out patients) from 102 countries were treated in Jordanian private hospitals, medical centers and private clinic in 2010. These constituted around 23 percent of total patients treated in the Kingdom. The sector generated US\$1.2 billion dollars in revenues in 2010 (4.5 percent of GDP). A growing number of foreign patients visit Jordan each year for medical treatment, making this service one of the nation's leading sources of income from foreign exchange. The average visitor to Jordan for medical treatment spends US\$5,500 per stay, which compares with the \$515 spent by a conventional tourist. Patients also usually arrive with family members and often extend their stay and expenditure through additional tourism and leisure activities. The majority of foreign patients come from the traditional neighboring markets, such as Yemen and Libya.

**The pharmaceutical sector** grew by 5-6 percent annually in the 2000's. The Pharmaceutical industry in Jordan is a pioneer exporting sector due to its high quality and excellent reputation. The sector exports its products to more than 60 countries thanks to its high quality, excellent reputation, and its affordable price. About 81 percent of production is exported to foreign markets, 90 percent of which to other Arab countries, mainly Saudi Arabia and Algeria. Jordanian pharmaceutical companies have joint ventures and subsidiaries in eight Arab and foreign countries. The pharmaceutical companies are primarily engaged in the production of branded generics ranging from many dosage forms such as solids, semi-solids, liquids, aerosols as well as producing various under licensed products for multi-national companies. Close to 90 percent of the total revenues is derived from branded generics, whereas under licensed products contribute a majority of the revenues of the remaining revenues.

**Education services.** Jordan's higher education setup is large and diverse, involves both public and private provision of education services, and has a few pockets of excellence. The number of international students attending Jordanian universities and colleges has risen by nearly 9 percent each year over the ten years to 2003, reaching a total of 19,669 students in 2004 (update). Foreign students spend an average of \$13,000 per year, including tuition, over their nine month stay in Jordan. Between US\$500 and \$1,100 per month is spent on living expenses. 75 percent of Jordan's foreign students are from the Arab World, primarily Palestine, Kuwait, Oman, Syria and Saudi Arabia; If the growth of this sector reaches an average of 10.5 percent, the result will be about 100,000 international students studying in Jordan by the year 2020, contributing around JD 929 million at current prices. An examination of the World's Top 500 Universities in 2003 reveals that none of the World's Top 500 universities are from Arab countries. There is therefore currently an opportunity for Jordan to emerge as an educational hub in the region. International student penetration in Jordan (one international student for every 303 residents of Jordan) is higher than the U.S. (one for every 495 residents of USA). Regionally, Jordan comes after the UAE (one for every 159 residents) and Lebanon (one for every 271 residents). Egypt comes last (one for every 6,380 residents). While Lebanon surpassed Jordan in both student penetration and economic significance, the high living costs in Lebanon and the strict regulations that countries are applying to graduates from Lebanon reduce its competitiveness. A greater threat to Jordanian university competitiveness, in attracting international students and even Jordanian and international faculty, is the UAE.

**Business services.** The provision of architectural and engineering (AE) services is Jordan's largest source of professional skilled services, both in terms of output and added value. About 70 percent of workers in this sector are engineers. Females make up about 30 percent of this workforce. It has close links with other productive sectors, such as construction. As a sector that is intrinsically creative and innovative, it is a key part of the country's drive to modernize and embrace a dynamic, knowledge and skills-based economy in the 21st century. The AE services sector in Jordan has experienced steady and continuous growth at an impressive average of 20.6 percent over 2000-2008. About 80 percent of the AE services sector is dedicated to servicing the local market, and the remaining amount is exported to about 30 countries, split fairly evenly between the regional and global markets. While regional markets present large export potential, the more sizable and sophisticated markets to enter are those in the U.S. and Europe. Jordan can easily become the AE services hub of the Middle East, by emphasizing its quality and well-priced service provision and by leveraging regional, bilateral and global trade agreements, all of which will help attract FDI in this sector.

*Source:* Jordan 2020 Vision Initiative (2007)

## **Can the New Growth Strategy Deliver on Jobs?**

***A priori, robust growth in the skill-intensive sectors should contribute to enhancing employment of skilled individuals, as argued above.*** However, whether this growth will be enough to reduce the unemployment of skilled individuals depends on the extent to which these sectors can suck up large pools of skilled unemployed as they grow, i.e., the elasticity of employment to growth. Employment elasticities show how growth in economic output and growth in employment evolve together over time. Once estimated, the elasticities determine the growth rate of value-added for any level of employment growth.<sup>21</sup>

***For policymakers and job seekers, a high elasticity of employment is highly desirable.*** However, from a firm perspective, high employment elasticity implies that increased output is associated with a large number of additional units of labor. This may mean that labor productivity has not improved as much. On the other hand, a low employment intensity of growth, on its own, may not be a bad thing. Because if output growth is associated with more or less the same units of labor, it implies that labor productivity has increased and in a competitive factor market, real wages should increase as well. In highly competitive markets, increases in productivity are often the only way for firms to remain competitive.

***Jordan's aggregate employment elasticity in 2000-2009, estimated at 0.53, is less than half its level in 1991-1999, when it was 1.16.*** In other words, while there was a 1 to 1 relationship between GDP growth and employment growth in the 1990s, in the last decade, a 1 percent increase in national output in the 2000s increased employment by only 0.5 percent. This decrease in Jordan's employment elasticity and the consequent improvement in aggregate labor productivity are in line with the experience of the other MENA countries, where the average employment elasticity fell from 1.00 in 1991-1999 to 0.65 for the 2000-2009.

***The employment elasticities of growth vary greatly by sector in Jordan.***<sup>22</sup> Not surprisingly, low productivity sectors have a higher propensity to create jobs when they expand than higher productivity sectors. Construction and real estate stand out as the most job-creating sectors of the economy. The other sectors with high employment elasticity are public administration, education, and transport. On the other hand, sectors such as pharmaceutical (chemicals), information and communication technologies, financial intermediation, health (including health tourism) all have low elasticity of employment to output growth. Because these sectors have a lower propensity to create jobs when they expand, it is imperative that they experience robust growth to mop up the available skilled labor in the market.

***Using the sectoral employment elasticities (Chapter 3, Volume 1), it is possible to project employment growth resulting from different assumptions of sectoral value-added growth.*** Our baseline scenario is the replication of the growth scenario of 2003-2008. In other words, in the baseline scenario, we assume that all 19 industries that constitute Jordan's GDP grow at the same rate as they did in 2003-2008. The subsequent scenarios single out the six targeted sectors and assume that they grow faster than the rest of the economy. In 2000-2009, banking intermediation registered an average annual growth rate of 16.7 percent, ICT 9.5 percent, health 9.5 percent, chemicals (which includes pharmaceuticals) 5.5 percent, education 3.5 percent and business services 1.4 percent.

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<sup>21</sup> For a given labor supply growth, they can thus be used to determine the growth in value added required to impact unemployment (see below).

<sup>22</sup> Jordan's input-output table (IO), highly disaggregated (89 sub-sectors) was constructed for 2010 only. Unfortunately, for the estimation of the employment elasticities, which required multiple years sectoral data (we used the years 1992-2009), we could not use the IO. We instead used more aggregated sectors as defined by DOS. For instance, we had to proxy the employment elasticity for pharmaceutical by using the sector "chemicals" (which includes pharmaceuticals but also other sub-sectors). Similarly, "Banking" could not be singled out, thus the broader category "finance" is used. Finally, as elaborated in Chapter 3, the employment elasticity for ICT, which was negative in 2005-2008 (because of the restructuration of the sector) was assumed to be similar to the national average (0.5) since it is unlikely to be negative in the projection years.

**The scenarios are as follows:**

Projection 1 (baseline) - Employment in all 19 industries are projected using the average annual value-added growth rates from 2003 to 2008.

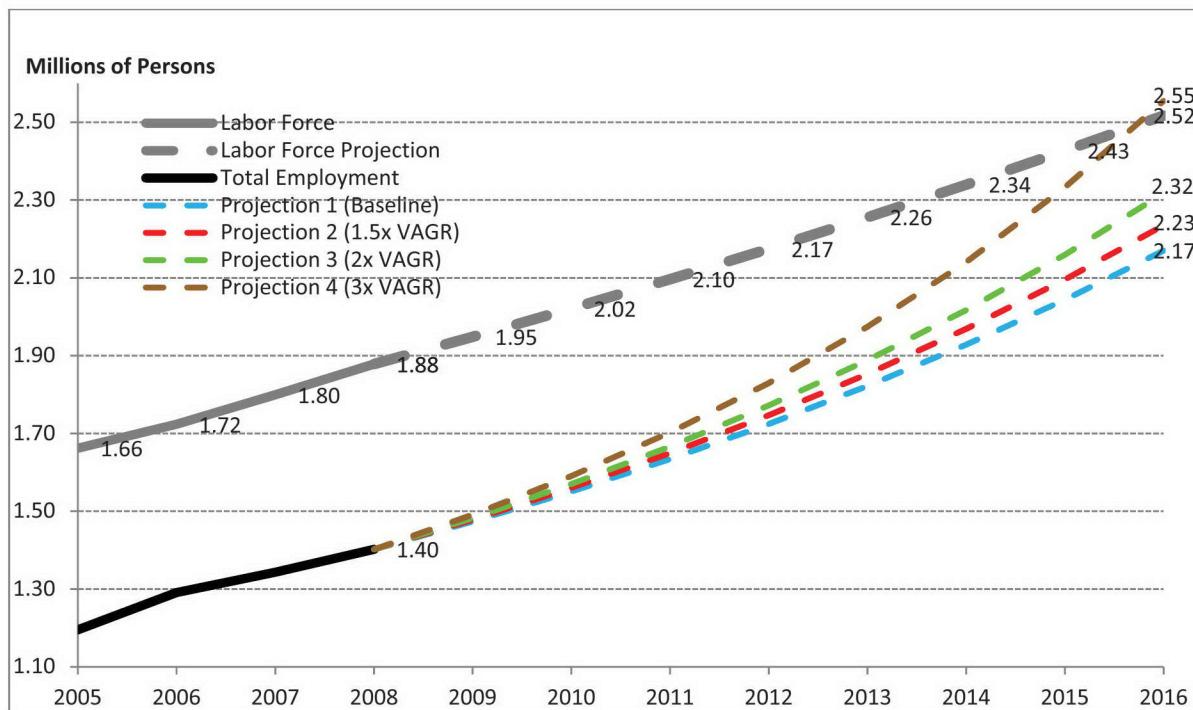
Projection 2 (1.5x VAGR) - employment in the 6 targeted industries are projected using 1.5 times the average annual real value added growth rate from 2003 to 2008; remaining low-productivity industries are projected using baseline projections (as in projection 1).

Projection 3 (2x VAGR) - employment in the 6 targeted industries are projected using 2 times (or double) the average annual real value added growth rate from 2003 to 2008; remaining low-productivity industries are projected using baseline projections (as in projection 1).

Projection 4 (3x VAGR) - employment in 6 targeted industries are projected using 3 times (or triple) the average annual real value added growth rate from 2003 to 2008; remaining low-productivity industries are projected using baseline projections (as in projection 1).

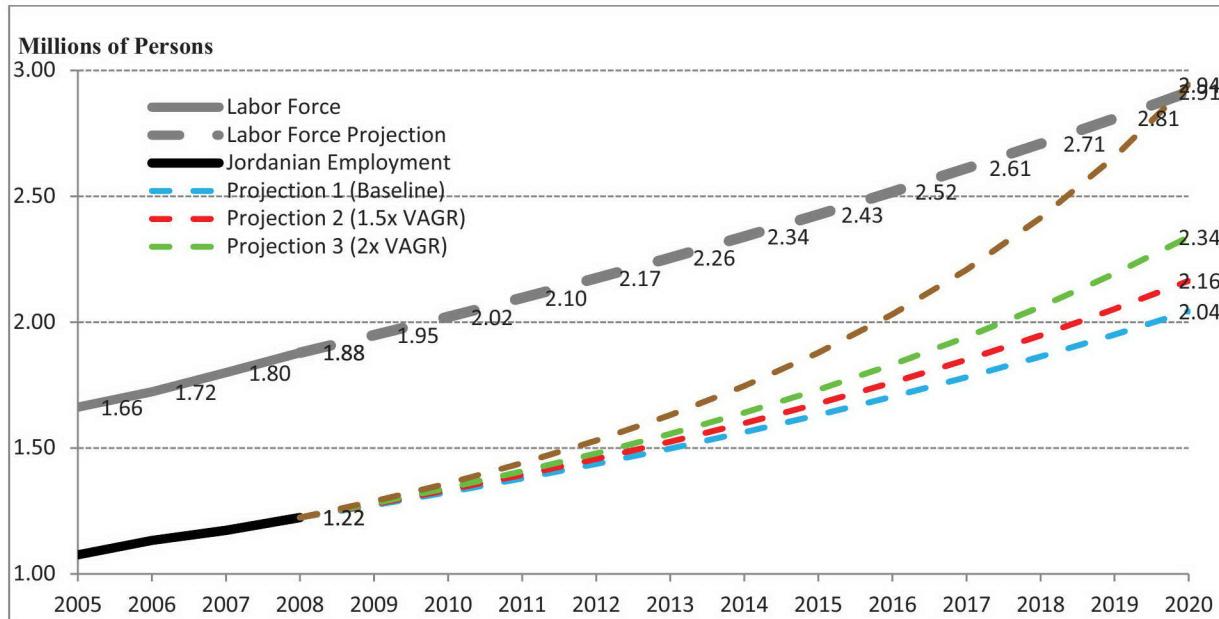
**Figure 23 shows how the trend in labor force growth compares with employment growth under each of the above scenario.** Clearly, if Jordan replicates the same growth performance as in 2003-2008, unemployment will remain significant by 2016: 350,000 individuals or 13.7 percent of the labor force, would remain unemployed in 2016. If the six targeted sectors grow at 1.5 times the rate they did in 2003-2008 while the rest of the economy performs as it did in the benchmark period, 290,000 individuals or 11.5 percent of the labor force would remain unemployed by 2016 (from about 13 percent today). If the 6 targeted sectors grow twice as fast as in the base period, 200,000 unemployed will remain (7.9 percent of the labor force). Jordan's unemployment gap would only be closed by 2016 under the highly unrealistic scenario in which the 6 targeted sectors grow 3 times as much as they did in 2003-2008.

**Figure 22. Employment Growth under Different Sector Growth Scenarios (2009-2016)**



**Figure 23 replicates the same growth scenarios as above but focuses on employment growth of Jordanians workers assuming the foreign labor content of the 19 sectors remain constant.** It is worth noting that under this assumption, even if the six targeted sectors hardly employ non-Jordanians, the largest number of jobs will still be created in the low-skill, labor-intensive sectors which employ a large number of foreign workers. Figure 24 shows that only by 2020 would the *Jordanian* employment gap be closed under the (unrealistic scenario 4). It appears clearly that reducing unemployment for Jordanians is a much bigger task than reducing total unemployment in Jordan.<sup>23</sup>

**Figure 23. Jordanian Employment - Alternative Projections (2009 - 2020)**



Assuming that Jordan's targeted sectors can grow even 1.5 times as much as they did in the past should not be taken lightly. Indeed, international competition is stiff and a large number of dynamic countries are putting together reforms to help the same sectors grow. Thus, focusing solely on promoting the Government's targeted sectors (or "knowledge-intensive sectors") is unlikely to solve Jordan's unemployment problem. Policymakers should not neglect addressing specific issues in "traditional, labor intensive" sectors where Jordan has a comparative advantage (e.g., tourism, retail trade and textiles and closing). For instance, over the last decade, labor-intensive sectors absorbed a large number of jobs, but experienced stagnant or negative growth in real wages. Without creating distortions in the market, specific reforms to improve working conditions may help attract educated and skilled Jordanians in these sectors (beside, the observance of minimum working standards is desirable as a human right).

**Furthermore, although the growth strategy's focus on tradable sectors where Jordan has comparative advantage is sound, there are some "implementation" risks worth noting.** In many countries, failures have come from a lack of a level playing field among the firms within the targeted sectors, state capture and "rent-seeking behavior" on the part of potential beneficiaries of government support and the absence of an accountability framework to reward success and sanction failure (example by rapidly stopping government support). Furthermore, it should be emphasized that just as some sector-specific

<sup>23</sup> It is difficult to predict the changes in the employment growth of Jordanians because statistics on migration are of poor quality and a large number of Jordanians prefer to queue for government jobs and may not be captured as job seekers by labor surveys. The simulations in Figure 24 are just meant to provide an idea of how the labor market for Jordanian could look like under specific assumptions.

interventions (e.g., supporting the establishment of venture capital funds for investors in the ICT sector) can be an appropriate response to limited business plans but no collateral, general investment climate reforms that promote entry and competition are crucial to the permanent process of discovery of new profitable activities in all sectors. Thus the continuation of cross-sectoral policy reforms is crucial. Implementation “risks” can however be mitigated by strengthening public-private partnerships. On that front, the Government’s recent initiative, which consists of partnering with the private sector within a strategic competitiveness framework that identifies and attempts to overcome specific market failures and public good shortages, is sensible.<sup>24</sup>

## **Trade Integration Reforms**

***Jordan stands out as one of the most open economies in the region thanks to decisive market and trade integration reforms implemented in the early 2000's.*** The Government has, over the past fifteen years, made great strides in liberalizing its trade and investment environment. Upon accession to the WTO in 2000, Jordan substantially reduced its simple average tariff rate (based on Most Favored Nation, or MFN, tariff rates) from 23.8 percent in 2000 to 10.2 percent in 2011. In addition, Jordan signed trade agreements with a number of bilateral and regional trade agreement, including the US (JUS FTA in 2001), EU (Euro-Med Agreement in 2002) and other European countries (EFTA in 2001), Singapore (2006), the Greater Arab region (GAFTA in 1998), as well as Agadir (2006) and, most recently, with Canada (2008).

***In parallel, Jordan stepped up its efforts to promote exports through specific programs managed by the Jordan Enterprise Development Corporation (JEDCO).*** Finally, major improvements were achieved in key backbone services such as port services, telecommunications and transport through regulatory reforms and privatization of state-owned enterprises. These reforms have contributed to the rise in total factor productivity in Jordan since the early 2000's. Annual growth in trade nearly doubled to 16.1 percent in the years 2000's, against 9.4 percent between 1990 and 1999.

***This impressive achievement notwithstanding, as shown in Chapter 5, Jordan can do better.*** Today, the competitiveness of the economy is driven by some key sectors namely textiles, pharmaceutical, chemical, phosphates and potash. While services sectors make up 70 percent of GDP, the promising exporters within services, ICT, medical tourism, and professional services are too small to have macroeconomic effects. Furthermore, export survival in new markets is among the lowest in the region. Jordan's performance for new products and new markets (“extensive margin”) is poor. The country tends to do well when established exporters export existing products to traditional markets (“intensive margin”).

**3. *The evaluation of the impact of Jordan's numerous trade agreements and export promotion programs conducted in this report shows a mixed performance.*** Regarding trade agreements, while the Jordan-US FTA has generated a large trade creation effect without trade diversion, the implementation of the regional agreements (GAFTA and AGADIR) has led to some level of trade diversion without much trade creation. In other words, Jordan has hardly increased its export to these partners as a result of these agreements. At the same time, the increase in duty-free imports from these countries has “replaced” imports from non-preferential partners that normally pay customs duties at entry. The net welfare impact is negative. Vis-à-vis the EU, Jordan has expanded its exports as the result of the FTA (trade creation), but to a very small extent. Jordan has not yet fully reaped the potential benefits of its trade agreement with the Europe.

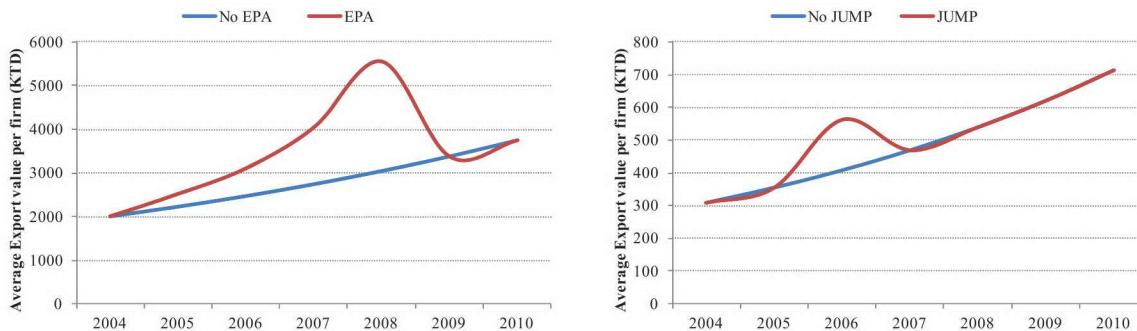
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<sup>24</sup> This sector-by-sector competitiveness compact whereby the private sector identifies the key obstacles to their competitiveness and works with the Government to remove them is supported by a Technical Assistance Program of the World Bank and IFC.

**Jordan's trade promotion (Jordan Export Promotion Activities, JEPA) and industrial upgrading programs (Jordan Upgrading and Modernization Program) have helped firms to increase their exports to overseas markets.** However, rigorous impact evaluation shows that this impact is positive only for established exporting firms and is short-lived. In other words, after only a few years, firms that have benefitted from the program perform as well as non-beneficiaries, consistent with the concurrent finding that export survival of Jordanian firms in foreign markets is very limited (Figure 24). Some key policy implications follow:

- Export promotion activities (JEPA) have a stronger impact at the “intensive margin” (export of existing products to traditional markets) than at the “extensive margin” (“export of new products and exports to new markets”) for Jordanian firms. Future programs should take this finding into account. After all, export promotion cannot be expected to transform “ducks into swans”.
- Export promotion (JEPA) has a stronger impact in terms of geographical diversification than in terms of product diversification. Future orientation of the program should strive to identify specific markets (e.g., markets with which Jordan has signed an FTA and where penetration is shallow, e.g., EU and Canada) and assist *established* firms to penetrate them durably.
- For the JUMP program which primarily aims at modernizing and upgrading SMEs and is not directly designed for export promotion, the impact on the intensive margin of export growth is weaker and less persistent, and the impact on the extensive margins is verified in terms of product diversification only. Future beneficiary criteria should take this into account.

**Figure 24. Additional exports for typical JEPA beneficiary and JUMP beneficiary**



## Business Environment Reforms

**Jordan has made important strides in improving regulations on businesses over the last decade. International benchmarking shows that one cannot attribute the economy's lack of dynamism and creative destruction (new, innovative firms replacing old ones) to doing business type of indicators focusing on the legal business environment** (Chapter 7). Although there are a few areas where legal reforms are needed right away, Jordan does more or less as well as comparators in more dynamic middle income countries or even OECD countries across most dimensions of the DB indicators. That is, the problem is not necessarily with the laws and regulations.

**The problem appears to be with how these laws and regulations are implemented and enforced.** The business environment is not the same for everyone. Rules and regulations are not applied equally to all firms. Hence many firms and potential investors perceive the implementation of business regulations as uncertain and unequal. This is an important deterrent to investment that should be addressed. The cost of uneven applications of business regulations has been found to have a negative impact on competition, innovation and employment (Chapter 7).

**Policymakers must acknowledge and account for the fact that legal regulations are not implemented consistently and might potentially even be used to discriminate or benefit certain groups of firms.** Hence, it is important to focus on institutional changes that minimize discretion in policy implementation as well as official's latent incentives to discriminate between firms. The institutional reforms outlined above focused on improving the accountability of the public administration are likely to help consistent implementation of rules and regulations as well.

**In addition, strengthening the dialogue between the government and the private sector would be equally important.** The dialogue between the government and businesses about new regulations, industrial policies, incentive schemes, etc. should be frequent and systematic. Permanent institutions such the economic and social councils can be a useful platform. The Government should engage in constructive dialogue with specialized business associations of the ICT (Intaj) or the pharmaceutical sector as well as the Chambers of Commerce and Industry to pragmatically remove the obstacles to a better business climate. Instead, firms frequently complain that the government does not consult the private sector appropriately when it issues or amends legislations, e.g., changes in tariffs (see USAID Fiscal Reform Project 2011).

## **Industrial Policies**

**Governments around the world play an active role to foster foreign technology transfers by promoting the capacity and providing incentives for domestic firms to engage in “new” (foreign) technologies, processes, or products through different industrial policy instruments in most emerging economies.** Emerging East Asian or Eastern European economies managed to achieve high sustained growth through a continuous process of successful foreign technology transfers in specific industries. The transfer of foreign technologies and their adaptation to local market and production conditions did not happen automatically since they are associated with market failures and externalities. Instead, governments provided incentives for domestic firms to diversify into new products and supported their access and capacities to adopt existing superior foreign technologies from foreign investors or exporters to local market and production conditions.

**For instance, China provided good infrastructure services, implemented straightforward regulations, and frequently granted tax incentives for foreign firms in special economic zones for selected industries in exchange for technology transfers through joint production networks or joint ventures.** Domestic firms and suppliers operating in these industries received government support to be able to keep up with foreign investors maximizing their ability to adopt foreign technologies. That is, China's openness to foreign investors was driven by a clear development strategy: to kick-start or upgrade domestic producers. Jordan seems to have similar ambitions, but has not put in place a consistent strategy to get there.

**The role of industrial policies in Jordan is not clear-cut; instead, several ministries and institutions have overlapping responsibilities with respect to fragmented investment promotion and industrial policy strategies** (Chapter 6). There exist different sector-specific incentive programs with varying objectives. The Ministry of Industry and Trade (MoIT) developed an industrial policy strategy focusing on SMEs. JEDCO is generally responsible for its implementation. The Jordan Investment Board (JIB) has the mandate to improve the business environment and provide (tax) incentives to investors.<sup>25</sup> The Development and Free Zones Commission (DFZC) developed a comprehensive strategy for four regional development zones, each of which aims to promote specific industries by granting substantial tax exemptions and providing other incentives. The Central Bank of Jordan implements a credit support

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<sup>25</sup> The new Investment Law (drafted in 2011) restricts the discretionary freedom to grant ad hoc tax exemptions somewhat (see below).

program for SMEs, .e.g., reducing reserve requirements for private banks equivalent to their total SME loans. Finally, the Council of Ministers can grant additional tax incentives for selected firms or industries.

*The industrial policy program of the MoIT assists SMEs in upgrading their technologies and knowledge base; however, it refrains from targeting specific industries or groups of firms with the highest potential to benefit and does not define clear-cut conditions linking government support to SMEs' performance.* The focus of the industrial policy program is consistent with East Asian best practices promoting the adoption of new (foreign) technologies. Chances of success could be further maximized by explicitly targeting specific industries or other characteristics for groups of firms with the largest potential to gain competitiveness from technology transfers. More importantly, appropriate monitoring and evaluation systems or clear-cut rules benchmarking the performance of benefitting firms are very limited. Donor funded programs are typically better designed including performance benchmarking of benefitting firms. However, these programs are often small and are not sustainable once the donor support is withdrawn. Perhaps because of the large number of institutions involved, the industrial policy program developed by the MoIT is underfunded. The program focuses on business incubation, training, or technology upgrading for selected SMEs. Reportedly, the MoIT demanded 115 million JD over five years for its implementation but only 14 million JD have been allocated. The program is exclusively funded by the government as the private sector does not contribute.

*The investment law (approved by the Council of Ministers in June 2011) includes provisions in the right direction.* It streamlines the number of tax exemptions. Article 4 of the new law stipulates that the Council of Ministers can grant any privileges to economic activities that create jobs for the Jordanians, increase local added value, or contribute to R&D, regional development, and the transfer of technology. Importantly, the privileges have to be published in an official gazette.

*However, the law refrains from the implementation of monitoring and evaluation systems to benchmark the performance of benefitting firms.* The accountability of industrial policymakers to the wider public or media can be improved by (i) measuring the performance of public agencies and making the results publicly available and (ii) monitoring and evaluating the performance of firms that benefit from public interventions (e.g., tax exemptions). Furthermore, apparently, agreements are negotiated with potential (foreign) investors or business associations of individual industries balancing the provision of incentives with the potential for job creation, local added value, or technology transfers.<sup>26</sup> This practice implies that the extent of incentives might vary with the negotiation skills or influence of individual firms, business associations, individual government decision makers and officials implementing the agreements.

## **Innovation Policies and Strategy**

*The following statistics illustrate the weaknesses of Jordan innovation system:*

- Only 24 percent of Jordanian firms offer formal training programs for their employees, including female employees, to advance on the organizational ladder;
- Only about 13 percent of service sector companies and 19 percent of manufacturing companies use technology transfers from other firms or parent firms as a source of support for innovation activities;
- There is virtually no seed, angel and VC funding for private firms;

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<sup>26</sup> For instance, the Ministry of Labor recently signed a cooperation agreement with the Jordan Garments, Accessories & Textiles Exporters' Association (JGATE), seeking to increase the share of Jordanians working in the sector (25 percent). Reportedly, 16 association company members committed to provide about 1,800 job opportunities while the ministry guarantees JD 45 monthly for each recruited worker for the first twelve months.

- The government and private sector agencies for innovation activities have underdeveloped capacities, monitoring mechanisms and information for them to effective support and implement innovation activities.

***There is a need for a broader, more private sector-focused national innovation strategy instead of the earlier near-exclusive focalization on science and technology.*** There is a large number of innovation related initiatives, institutions and policies in Jordan, but they are not always effective and are seldom strategically aligned with the challenges the country is now facing. Jordan needs to consider broadening, re-calibrating and seriously increasing the potency of its innovation policy – as opposed to just incrementally tweaking what is there. The new comprehensive innovation policy should address the content, scope and process problems of the current system. The World Bank and Korea Development Institute are supporting the development of this process. Innovation governance stream-lining, prioritization and financial support for innovation activities are the key areas to be focused on:

- Establish innovation leadership. To increase the visibility and priority status of innovation on the government’s agenda, the national innovation process needs a central anchor, long-term leadership which outlasts changing governments; there is a need to streamline the policy with the National Agenda, to ensure sustainability;
- Support of sectoral priorities as well as support cross-sectoral reforms. Cross-cutting actions will involve, for example, a focus on competitiveness enhancing policies. Part of this process in Jordan has already involved breaking down monopolies in productive sectors to enhance competitiveness (e.g., ICT sector). These actions may also involve retraining and further skills development, by the public and the private sectors;
- Develop specific financing mechanisms for innovation activities across sectors. For example a reliable credit guarantee system to support Jordanian start-ups and SMEs is needed, so is encouraging seed, angel and VC funding. Initiatives such as OASIS 500 can also greatly help transform new business ideas into viable businesses.

