Jordan's Economic Prospects and Challenges[1]

9/30/2010

Jordan's small, resource-poor economy performed very well in 2004-2008 and has been able to weather the global and regional recession in 2009 and 2010 without disastrous effect. Jordan has no oil deposits, little arable land (only 10% of the total area) and one of the world's worst water shortages. It has had to absorb some 1.7 million refugees and other displaced persons (Palestinians and more recently Iraqis) into its population of approximately six million. Despite these disadvantages and the many political and economic disruptions that have plagued the surrounding region in recent years, Jordan's economy grew at an average of 7.6% per year in 2004-07 while GDP per capita almost doubled between 1999 and 2008. Economic growth in Jordan has been broad-based and led by the manufacturing, construction, real estate and service sectors. It was achieved by supplementing income from potash and phosphate exports with the emergence of the garment, pharmaceutical, tourism and financial services industries. Jordan has also benefited from one of the world's highest levels of unilateral financial transfers, including worker remittances and official grants. Although the external deficit widened during this period, sizeable inflows of foreign direct investment (FDI) covered three-quarters of the deficit. The remainder was officially financed by errors and omissions, which may reflect unrecorded remittances by overseas Jordanians and Iraqi immigrants. Foreign reserves increased, even though Jordan chose to retire $4.2 billion of official debt in early 2008 using proceeds from privatizations. Per capita income was $3,310 in 2008. Overall, Jordan has been an island of progress and stability in an unstable region.

The pace of growth slackened markedly in 2009 but is gradually recovering this year. Data from the International Monetary Fund (IMF) and Government of Jordan (GOJ) indicate that real GDP rose by 2.8% in 2009 and will accelerate to 3.5% or so this year. These growth rates are well below the economy's potential. Weak growth in government spending and the end of the construction boom remain depressing factors, but investor interest is now beginning to rise, partly in response to new investment incentives. FDI from the Gulf Arab states, which was important in earlier years but fell sharply in 2009, is starting to recover. Large FDI commitments were reported in the second half of 2009 and first half of 2010, but it remains to be seen how many of the projects involved (in industry, amusement parks and hotels) will actually materialize.

King Abdullah II appears to retain a strong grip on power, with backing from Jordan's loyal, well-trained and effective armed forces. The general threat to security is fairly low, although periodic outbursts of Islamist violence occur. The King dissolved parliament in November 2009, in part because it was slow to move on economic reform and was in low repute with the population and press. An election to choose a new parliament has been scheduled for November 9 of this year.

Over the past ten years, the GOJ has been very active in the design and implementation of structural reforms. Much of Jordan's favorable performance in the past can be attributed to

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[1] This report was prepared by Dr. Donald R. Snodgrass, Weidemann Associates, Inc. consultant, for USAID/EGAT's Business Growth Initiative Project, through a buy-in from USAID/ME/TS. The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

policy and administrative reforms, especially in education, privatization and budget management. The public sector has continued to improve the efficiency of its expenditure and has strengthened its financial controls. Results-oriented budgeting was introduced in 2008. Recently, however, further reforms have been put on hold as the government fights the recession.

Inflation was high in 2008, came to a sudden halt in 2009 and picked up again in early 2010. Inflation soared in early 2008 as world oil and food prices spiked. After consumer prices rose by 14.9% in 2008, they fluctuated throughout 2009, ending the year with a decline of 0.7% as world food and fuel prices fell. In the first half of 2010, however, inflation accelerated to 5% year-on-year as the prices of imported oil and foodstuffs rose along with shipping costs. The Economist Intelligence Unit (EIU) expects inflation to average about 5.5% over 2010 as a whole.

Temporary reform of the tax system and to control spending have been enacted through temporary laws. The reforms have introduced a flat 14% tax on nearly all corporate profits and simplified income taxation for individuals. As a measure to control social security spending, the minimum retirement age was raised. Making these changes permanent will require action by the new parliament to be elected in November.

The GOJ and Central Bank of Jordan (CBJ) have tried to shelter the banking sector from the fallout from the global financial crisis. In late 2008, the CBJ guaranteed all bank deposits as a way to maintain confidence in the banking system. It also cut interest rates and reduced reserve requirements. The deposit guarantees were originally due to expire at the end of 2009 but have been extended to the end of 2010. Bank profitability and soundness indicators have remained favorable so far. Jordanian banks had little exposure to the mortgage-backed securities that have brought about chaos elsewhere. However, problems have arisen with Arab Bank, Jordan's largest commercial bank, because of its exposure to troubled borrowers in Saudi Arabia and Dubai. Although Jordan's banks are well capitalized and have amassed precautionary cash over the past year, the GOJ would find it difficult to rescue a bank the size of Arab Bank should the need arise.

To combat local banks' reluctance to lend, the CBJ has modified its usual conservative monetary policy by reducing its policy interest rate. The latest cut was made in February 2010. It has also lowered banks' reserve requirements. The EIU expects interest rates to remain very low through 2010, and then begin to rise slowly in 2011.

The global economic slowdown poses several medium-term challenges for Jordan. Lower world oil prices have had a positive impact on Jordan's balance of payments but have hurt inflows of remittances and private capital. Sharply lower growth rates in other Middle Eastern countries have also harmed Jordanian exports. Sectors that have experienced the greatest slowdowns are those that relied most on remittances and foreign investment in the past: financial services, community and personal services, wholesale and retail trade, and manufacturing. Despite gradual recovery from this year forward, Jordan's economic growth rate is expected to remain far below the high rates attained in 2004-2008.

Despite efforts to keep government spending in check, the EIU expects the fiscal deficit to remain large, averaging 10% of GDP in 2010 and 2011. The GOJ's efforts to keep government spending in check were endorsed by an IMF mission that visited Jordan in July. The mission observed that recent measures such as raising indirect taxes on petroleum and other commodities and removing the general sales tax exemption for coffee should at least partially offset other commitments, such as increasing National Aid Fund spending, retaining subsidies on liquefied petroleum gas (LPG) and bread, and raising teachers' salaries. The IMF urged the government to maintain a tight fiscal policy while keeping government borrowing under control. The GOJ hopes to reduce the fiscal deficit to 3% of GDP by 2013, which appears to be a major challenge. Fiscal policy continues to be constrained by political objections to trimming the government's bloated payroll. In July, efforts were announced to trim spending in Jordan's 61 government entities by requiring them to follow civil service regulations on travel and transportation. Given the continued deficit and in view of cutbacks in Saudi and U.S. assistance, increased borrowing from local banks is likely.

The Minister of Finance recently announced a plan to go to the international financial market with a $500 million bond issue. The government is considering offers from banks and international financial institutions to handle the bond issue. According to the Minister, the GOJ will borrow abroad to avoid crowding out the private sector in the local market and hopes to take advantage of current low interest rates.

The peg of the Jordanian dinar to the U.S. dollar is likely to be maintained. The peg has helped maintain confidence in the currency and has not unduly harmed competitiveness. Jordan's foreign exchange reserves appear adequate to defend the fixed exchange rate vis-à-vis the dollar for the foreseeable future.

The trade balance is expected to improve. Imports fell by 17% in 2009 but the EIU expects them to increase by about 5% a year in 2010 and 2011 as global commodity prices and domestic demand start to recover. Exports, meanwhile, should grow by almost 12% a year as rising exports to Asia and growing re-exports to Iraq offset sluggish U.S. demand. Worker remittances and tourism receipts are expected to recover gradually. The overall result should be a decline in Jordan's trade deficit as a share of GDP.

Special tax incentives have recently been offered to the information and communication technology (ICT) sector. Jordanian companies are playing a prominent role in the development of internet services in the region and the GOJ sees great potential benefit in the further development of Arabic-language internet services and content. The ICT sector already generates about 14% of Jordan's GDP and is regarded as vital for the growth of employment and exports. Exported ICT services, including computer services, economic feasibility studies and legal, engineering and auditing services are now exempt from income tax. The sales tax on internet services has also been reduced.

A major challenge for Jordan is managing its more than 90% reliance on foreign oil. The GOJ adopted a policy of developing alternative energy sources in 2007. Since 2004 Jordan has had an agreement with Egypt to supply 2.4 billion cubic feet of natural gas per year at preferential rates. This could meet 32% of Jordan's energy needs from natural gas, but the quota has not always been filled. The government is now hoping to sign a new agreement with Egypt to ensure that it gets that much natural gas in 2010 and 3.3 billion cubic feet in 2011. The energy strategy formulated in 2007 aims to develop more indigenous and renewable energy sources, including oil shale, nuclear energy, wind and solar power.

Job creation is another major challenge. Unemployment in 2008 was officially reported to be 13% of the labor force. Unofficial estimates run as high as 30%. Pressure on Jordan's educational institutions is building.

Yet a young, relatively well educated, population is a potential asset for Jordan's future economic development. Thirty-eight percent of the population is below the age of 14. Education and literacy rates and indicators of social wellbeing are relatively high compared to other countries with similar income levels. Population growth, previously high, has dropped to 2.2%. Life expectancy is 71 years for men and 74 years for women. The population is highly urbanized (estimated at 80%). King Abdullah II's long-term vision for Jordan sees this population profile as a demographic asset that can be used to transform the country into a modern knowledge-based economy. The long-term vision involves modernization of the country's economic, institutional and political infrastructure, based on the enhancement of its human capital and the elimination of poverty. Education, improving the business environment and attacking poverty are at the core of this vision.

Jordan's business enabling environment is relatively favorable and has improved in recent years, although further improvements are needed to help advance private sector development. In 2009, efforts were made to reduce the regulatory burden on firms, improve the tax system, cut entry costs, facilitate business registration, rationalize entry and exit regulations, improve the contract enforcement process and enhance electronic tax systems. As a result, Jordan's ranking in the World Bank's Doing Business Indicators improved from 104^{th} in 2009 to 100^{th} out of 183 countries and territories for 2010. However, Jordan still ranked only 125^{th} in starting a business (which reportedly involves eight procedures, takes 13 days and costs nearly 50% of GNI per capita), 124^{th} in enforcing contracts, 127^{th} in getting credit, 115^{th} in registering property and 119^{th} in protecting investors. Areas in which Jordan achieved better ratings are trading across borders (71^{st}), employing workers (51^{st}) and paying taxes (26^{th}).

Jordan has received strong donor support. The World Bank reports having lent Jordan US$2.4 billion through 2008 and a new loan of US$300 million was negotiated recently. World Bank Group assistance focuses on improving the investment environment, promoting public-private partnerships and providing better financial packages for projects in water and energy. USAID, a major donor, works to increase the competitiveness of Jordan's private sector, attract more investors and create more jobs and higher incomes. One of its principal emphases is institution building for trade facilitation. USAID's activities include efforts to spread the benefits of development by reaching small businesses and improving the social safety net. It also supports the development of the Aqaba Special Economic Zone, which is regarded as a model framework for private sector development. In October 2006 the Millennium Challenge Corporation (MCC) signed a Threshold Program Agreement with the GOJ in support of reform efforts in municipal governance and customs administration. In November 2006 Jordan was selected as one of the countries eligible for additional MCC assistance. The GOJ has since begun the process of applying for MCC Compact Assistance.

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