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# COMPARATIVE ASSESSMENT: INVESTMENT INCENTIVES IN JORDAN

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Final Report

*Bureau for Private Enterprise  
U.S. Agency for International Development*

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and USAID/Jordan*

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## Table of Contents

	<u>Page</u>
Preface . . . . .	i
Executive Summary . . . . .	1
Introduction. . . . .	7
Investment Climate in Jordan . . . . .	9
Investment Licensing . . . . .	14
Price Controls . . . . .	18
Government Participation in Enterprise . . . . .	18
Protection of Industry . . . . .	20
Summary . . . . .	21
Law 11 Investment Incentives in Jordan . . . . .	23
Implementation and Procedures . . . . .	26
Other Investment Incentives . . . . .	30
Free Zones . . . . .	30
Industrial Estates . . . . .	32
Export Incentives . . . . .	34
Regional Headquarters . . . . .	34
Private Sector Opinions on Investment Incentives . . . . .	35
Assessment of Incentives and Procedures . . . . .	37
Effect of Incentives on Investment in Jordan . . . . .	40
Comparative Analysis of Jordanian Investment Incentives . . . . .	43
Recommendations . . . . .	54
Short-term Recommendations . . . . .	59
Medium-term Recommendations . . . . .	62
Long-term Recommendations . . . . .	65
Highlights of the Investment Climate in Turkey . . . . .	69
Highlights of the Investment Climate in Tunisia . . . . .	85
Highlights of the Investment Climate in Taiwan . . . . .	101
Highlights of the Investment Climate in Cyprus . . . . .	114
Highlights of the Investment Climate in Greece . . . . .	132
Highlights of the Investment Climate in Egypt . . . . .	151
Highlights of the Investment Climate in Bahrain . . . . .	163

## List of Tables and Figures

	<u>Page</u>
Table 1	Operating Costs in Jordan and Competitor Countries . . . . . 12
Table 2	Investment Incentives in Jordan . . . . . 24
Figure 1	Investment Climate Recommendations for Jordan . . . . . 2
Figure 2	The Investment Approval Process in Jordan . . . . . 29
Figure 3	Foreign Investment Inflows Into Jordan . . . . . 42
Figure 4	Length of Income Tax Holiday . . . . . 51
Figure 5	Time Required for Incentive Approval . . . . . 53
<b>Turkey</b>	
Table 1	Fields of Production and Investment That Do Not Receive Incentives in Turkey . . . . . 73
Table 2	Investment Incentives in Turkey . . . . . 76
Figure 1	Foreign Investment Inflows into Turkey . . . . . 71
<b>Tunisia</b>	
Table 1	Investment in Tunisia . . . . . 88
Table 2	Investment Incentives in Tunisia . . . . . 96
<b>Taiwan</b>	
Table 1	Investment Incentives in Taiwan . . . . . 106
Figure 1	Foreign Investment Approvals in Taiwan . . . . . 112
<b>Cyprus</b>	
Table 1	Investment Incentives in Cyprus . . . . . 126
<b>Greece</b>	
Table 1	Investment Incentives in Greece . . . . . 137
Table 2	Investments Eligible for Incentives in Greece . . . . . 138
Table 3	Law 1262 Investment Incentives in Greece . . . . . 141
Figure 1	Industrial Sector Incentive Areas . . . . . 140
Figure 2	Foreign Investment Inflows into Greece. . . . . 149

List of Tables and Figures (cont'd)

	<u>Page</u>
<b>Egypt</b>	
Figure 1 Foreign Investment Inflows into Egypt . . . . .	152
Table 1 Investment Incentives in Egypt . . . . .	155
Table 2 Activities Eligible for Investment Incentives In Egypt . . . . .	156
<b>Bahrain</b>	
Table 1 Investment Incentives in Bahrain . . . . .	168

## PREFACE

The report presents investment climate and incentive recommendations to the Ministry of Planning of Jordan and the U.S. Agency for International Development Mission to Jordan. The work was conducted by the International Policy Center of SRI International, and The Services Group, under contract to Arthur Young, as part of the Private Enterprise Development Support II Project (Project Number 940-2028.03).

The Project team consisted of Kathleen Heffernan, International Economist at the International Policy Center, James Emery, Vice-President of Operations of The Services Group, and John A. Mathieson, Director of the International Policy Center. Ms. Heffernan and Mr. Emery made field visits to Jordan, Cyprus, Tunisia, Greece and Turkey in February 1988 to collect information and interview investors. Research on Egypt, Taiwan and Bahrain was conducted in Washington, based for the most part on material collected during recent country visits by the project team.

This report is intended to be of use to the Ministry of Planning of Jordan and USAID/Jordan in the short-term, as they prepare for the upcoming trade and investment missions to the United States and Japan, and in the longer-term, as they continue to work to improve the investment climate, incentives, and approval mechanisms in Jordan. The findings and conclusions in this report are solely those of the authors.

All values presented in the report are in U.S. dollars, represented by "\$," unless otherwise indicated.

## EXECUTIVE SUMMARY

In the face of a recession in regional markets, downturns in Arab aid and worker remittances, and nearby political disturbances, Jordan is looking increasingly toward the private sector, and in particular foreign investment, as a source of growth, jobs, technology and foreign exchange. This review of the Jordanian investment climate and incentives has identified a number of policy changes that will make Jordan a more attractive site for foreign investment.

The incentive regime Jordan offers is competitive with that offered by other countries, and is even more generous in certain areas. Jordan is notable for its lack of restrictions on foreign ownership in industry, agriculture and tourism, especially compared to Bahrain, Greece and Cyprus. Jordan's 5-15 year tax holiday is more generous than that of Taiwan, Egypt or Cyprus. For regional headquarters, Jordan's incentives are on a par with Greece, Bahrain and Cyprus, and other principal regional sales sites. Exporting firms will find that Jordan's incentive package is competitive with most other countries, although Tunisia offers a tax holiday in perpetuity.

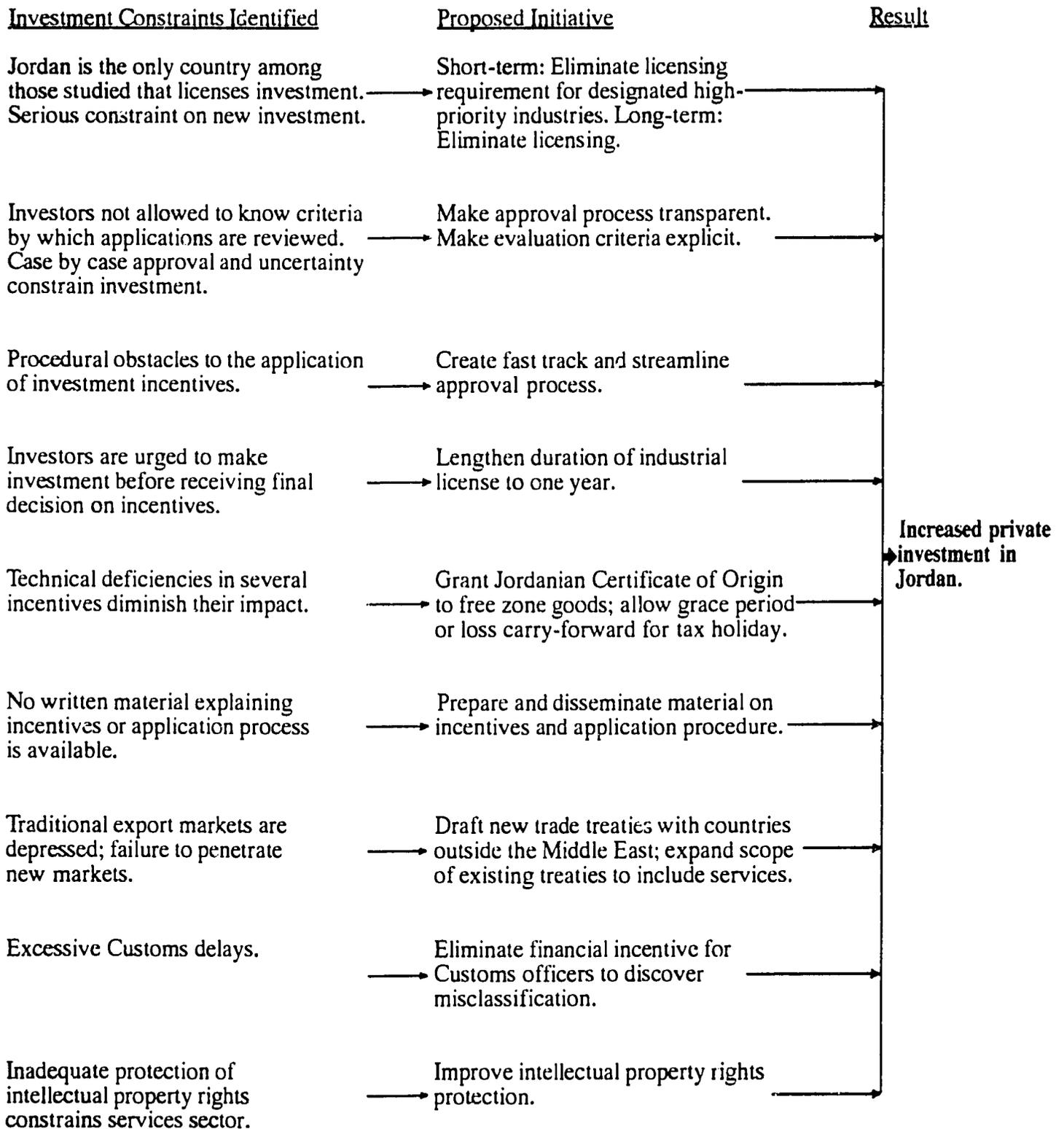
There are no striking differentials or deficiencies which suggest the need to introduce additional incentives in Jordan. The underlying causes for the relatively low level of foreign investment in Jordan are the government's control over business activity through the licensing of firms, depressed regional markets, and the political instability in the Middle East. The government of Jordan can reduce this first constraint through policy reform and can make important strides to address the second variable, but can do little, at least in the short-term, about the third impediment to investment. Below, we outline a policy program to remove, gradually at first and then more radically, the policy constraints to investment in Jordan. The policy recommendations are presented schematically in Figure 1.

### Short-term Recommendations

Jordan can significantly improve its investment climate and increase the effectiveness of the existing incentive measures by adopting reforms in its overall regulation of investment. The measures identified below were designed to be implemented within the current policy environment and represent a series of incremental steps, the cumulative impact of which will be the gradual liberalization of the treatment of investment.

**FIGURE 1**

**INVESTMENT CLIMATE RECOMMENDATIONS FOR JORDAN**



Create a "fast track" investment approval procedure for priority industries. The government should remove the licensing requirement for designated priority industries, thus eliminating a constraint on investment in areas it is trying to promote and a serious disincentive compared to other countries.

Unify the incentive regime. The current two-tiered system of "economic" and "approved economic" projects is based on the Ministry's assessment of their economic contributions. In order to simplify the incentives review and approval process, the system should be unified, and all projects should receive "approved economic" benefits. Nearly all other countries have blanket incentives which are granted on the basis of explicit criteria.

Make the investment approval process transparent. The Ministry currently uses a complex ranking mechanism for determining the application of incentives. These criteria should be simplified, and the actual ranking mechanism should be publicized to indicate the economic priorities of the government, and to encourage the initiation of projects which reflect those priorities. Other countries have established and published simple qualifying criteria regarding export production, job creation, introduction of new technology, and other key objectives.

Implement a "fast track" incentive approval process for small investments. The Ministry should establish a ceiling, higher than the current JD10,000 (\$30,000), below which projects would not require interministerial evaluation and approval. In practice, small projects require less evaluation and merit less scrutiny. Business expansions, which now receive the same evaluation as major projects, should also be eligible for "fast-track" approval.

Negotiate additional trade agreements and expand existing programs. Bilateral trade agreements have proven effective in opening regional markets. Their scope can be further expanded, and new markets outside the depressed Middle East explored.

Issue Certificates of Origin to goods produced in free zones. Free zones (Export Processing Zones) are major manufacturing centers in many countries, and zone products are regularly granted Certificates of Origin under most regulatory systems. This measure would substantially increase the incentives for exporting in Jordan, as the existing free zone regime offers greater incentives and streamlined procedures.

Improve protection of intellectual property. In order to encourage the promising software development sector, more stringent protection of intellectual property rights is necessary.

Increase the industrial license to a minimum of one year. The Ministry is currently granting only 6-month licenses. This short duration has led to a serious misunderstanding among investors, who mistakenly believe that investments must be implemented quickly, even before final decisions on investment incentives are reached.

Prepare and disseminate printed material in Arabic and English detailing the investment incentive regime. No adequate guide to the incentives themselves and the procedures for application currently exists.

Offer an optional grace period prior to the application of the tax holiday, or allow tax loss carryforwards from the holiday period. The current impact of the tax holiday, which lasts 5 years in most cases, would be significantly enhanced by offering a grace period, at the investor's choice, prior to its application. At a minimum, tax loss carryforwards from the tax holiday should be allowed, so that a company with significant start-up losses is not penalized.

Proceed with planning for a high-technology project to promote technology-intensive services and industries, but consider relocating the project. The current plans for development of a high-technology project deserve further examination, but the plans to locate the project in Aqaba will unnecessarily handicap its potential. In addition, private sector participation in the project development should be sought.

Continue the promotion of regional headquarters. Jordan has significant potential to attract foreign investment in regional headquarters. The incentive regime is competitive, and the only disadvantage appears to be the relatively high cost of living in Amman. This sector requires active promotion to major companies doing business in the Middle East.

### Medium and Long-term Recommendations

In the long-term, Jordan needs to redefine an appropriate role for the government vis a vis investment, a role that is congruent with the country's goal of stimulating private sector growth and foreign investment. As part of this redefinition, the following measures should be undertaken:

Streamline the entire investment approval process. The current procedure is cumbersome and excessively long. Every effort should be made to streamline the process, by shortening the application form, simplifying the criteria, reducing the number and level of officials required for review, and reducing the total time from submission to determination. If licensing is

retained in its current form, it should be integrated into the incentive qualification process, provided it does not prejudice the proposals of investors not seeking incentives.

**Eliminate or reduce the scope of investment licensing.** Over the long term, as the reforms outlined above are implemented, the function of investment licensing should be reduced to registration. At the very least, the Ministry should not concern itself with the commercial viability of a project, but review proposals only for their compliance with existing laws and regulations. The government, through the approval of incentives, will still exercise direction over investment in the economy.

**Reduce Customs delays.** The current procedures for clearing goods through Customs are cumbersome. Without negatively affecting enforcement, Customs could become more efficient. Specifically, the financial incentives to individual officers for finding misclassifications is counterproductive and should be decreased or eliminated.

**Consider legal guarantees of incentives.** Jordan can ensure the attractiveness of its incentives, and enhance its reputation for stability by introducing provisions for irrevocability of incentives. In Greece, for example, they are accorded constitutional protection.

**Expand the list of activities eligible for incentives.** The natural extension of instituting reforms to make the incentive criteria explicit and streamline procedures for priority industries would be to expand the range of eligible activities, for example to the services sector.

**Develop an investment promotion institution.** Once the investment climate has been improved, and licensing has been eliminated or reduced, the government should examine the options and evaluate alternative institutions for investment promotion. The promotion function should be separate from the regulatory function exercised by the Ministry of Industry and Trade.

**Encourage the formation of an association of foreign investors.** Such an association can be a valuable forum for expressing the concerns of the foreign investment community, and can also be an effective promotion organization. A successful model is the Foreign Capital Association in Turkey.

**Encourage exports.** Jordan has pursued an industrial strategy oriented toward import substitution and production for regional markets. Jordan has a number of comparative advantages which can be exploited on a much larger scale by focusing on export markets, both regionally and globally. A handful of leading firms now export limited products to major markets in Europe. As constraints on investment and business activity are

removed, Jordan should be able to develop its export potential to a much greater degree. In particular, Jordan should seek to expand to Far East and European markets to supplement sales to the Middle East.

In order to encourage exports, Jordan should evaluate its general economic policies for their impact on export manufacturing and services, particularly such elements as exchange rate policy and the high and discriminatory tariff structure. With the general policy environment creating an economy more open to world market forces, additional incentives for exporting industries may be appropriate. For example, extending "free zone" status to individual enterprises regardless of their location is often used to encourage industries that prefer a location outside the available zones. However, specific incentive measures such as this will prove ineffective without a macroeconomic policy environment conducive to export production.

These measures, if adopted, will go far toward improving the administration of existing incentives, which are largely competitive with other countries in the region. They do not involve significant costs, either to the economy or to the government in terms of lost revenues. They do involve a relaxation of control over individual investment decisions, but not a forfeiture of the role of the government in providing direction to the economy and to private investment.

## INTRODUCTION

This study assesses the investment climate in Jordan and evaluates the incentives the government offers for investment relative to those offered by seven other countries: Bahrain, Cyprus, Egypt, Greece, Taiwan, Tunisia, and Turkey. The evaluation is pertinent to current economic policy concerns and initiatives being undertaken by the government of Jordan, including trade and investment missions to Japan and the United States.

The attractiveness of a nation as an investment location depends on a number of factors: External factors, such as world and region-wide political and economic conditions; the investment climate within the country, including macroeconomic and political stability and operating costs and conditions; and legislated investment incentives. These factors are listed in order of importance to firms. External factors are prime determinants of if and where companies invest. Internal macroeconomic conditions and the operating environment are key factors in an investor's locational decision. Legislated incentives generally are regarded as "icing on the cake." While they will in some instances function as a tiebreaker when a company is considering two similarly endowed sites, they do not have a large enough impact on firm profitability to substantially alter foreign investment flow patterns.

When addressing the issue of investment incentives, an important first step is to gain a clear understanding of the basic nature and goals of incentives. The strategic goal of incentives is to provide inducements in the form of tax or other concessions or some other form of "special treatment" to stimulate the introduction of productive activities that might not be undertaken in the absence of incentives.

Investment incentives constitute either defensive or offensive strategies. In their "defensive" form, incentives represent "exceptions to the rule" in cases where prevailing rules and regulations for standard activities are deemed excessively onerous to the point of precluding new ventures. The provision of "exceptions to the rule" is necessary only when the overall system governing private investment is inadequate and requires eventual reform. In this case, the provision of incentives can represent the initial introduction of reforms which can be extended to the economy as a whole over time.

The "offensive" application of incentives refers to the need for countries to offer concessions equivalent to those being extended by competitor countries. "Offensive" incentives are a necessary evil in an environment of investment "wars" and competition for scarce levels of international investment. Clearly, levels of incentives provided are related directly to the overall attractiveness of a given country's investment climate. The more attractive the climate, the less important are incentives. The United States does not provide incentives at the national level, for example, but states engage in incentives "wars" to attract new ventures away from competitors.

The provision of incentives bear costs. Most important are the cash outlays needed for direct grants and the tax revenues foregone. Indirect costs are incurred for the administration of promotional programs. However, the benefits derived from investment incentives are often great, and are found in increases in employment, income, and foreign exchange earnings. These in turn lead directly or indirectly to increased standards of living and eventual rises in government revenues.

## THE INVESTMENT CLIMATE IN JORDAN

Jordan is facing a number of economic challenges. The depressed economy of the region has affected the Jordanian economy adversely in many respects, and current policies have not proved responsive to the new environment. The government has recognized the need for new approaches, and has made attempts to encourage private investment in particular as a means of stimulating a resumption of economic growth. These efforts have not to date generated significant results, with both domestic and foreign investment stagnating or declining. While a number of "external factors," factors originating outside of Jordan's borders, affect the climate for investment, the government is itself a major factor, and is appropriately concerned with improving the incentive regime and other policy-related aspects affecting investment.

The downturn in the petroleum-driven economy of the Arab Middle East has placed a number of demands on Jordan, greatly affecting the external environment for investment. This has been manifest in a number of ways. The flows of foreign assistance money from the oil surplus states, previously an important source of balance of payments assistance and general financing for the government, have decreased substantially. The general economic slowdown has affected Jordan through the lack of demand for Jordanian goods and services from these regional markets, which had paced much of the growth in the economy in the decade preceding the mid-1980s. The employment of skilled Jordanian workers and professionals in the Gulf in the height of the oil boom has tapered off, and many have returned to the country, causing problems of reabsorption into the Jordanian economy. Many businesses which expanded in the early 1980s are now faced with severe business downturns and insolvency as they have been unable to pay off major investments undertaken in earlier years.

These problems associated with the general economic climate in the region are compounded by the continuing political instability of the Middle East. The growing insurrection in the Israeli-occupied territories brings a new urgency to the Arab-Israeli conflict; the Iran-Iraq war has dragged on without resolution, and appears headed for new escalation with direct attacks on population centers; and many regimes face latent or overt challenges to their rule from radical domestic factions. All of these factors have served to fracture rather than unite the Arab countries, and regional harmony remains an elusive goal among Arab nations. Jordan's aspirations of becoming a regional economic center, based on its stability and skilled labor force, are now increasingly challenged in this new environment of economic retrenchment and political instability.

These external factors make it particularly difficult for new initiatives to generate investment, especially from foreign sources. In other regions, where external factors are more favorable, many countries are also reorienting their economic policies to attract foreign investment. The financial crises in many countries have ushered in a new appreciation for the contribution that foreign direct investment can make, a realization of the need to encourage domestic private investment, and a need to stimulate non-traditional exports as other sources of foreign exchange have not kept pace with new demands. For example, all of the countries included in the comparative analysis in this survey have recently introduced measures aimed at improving their international competitiveness in attracting investment, stimulating exports, and removing barriers to the expansion of the role of the private sector and market forces in the economy. Jordan is thus entering an increasingly competitive world, where the climate for investment, to the extent that it is determined by policy actions, will be an important component of economic policy and a strategy for stimulating economic growth.

The factors influencing investment are numerous and interdependent, and encompass a mix of external, internal, policy-driven, factor endowment, market-access and other determinants. External factors may be affected by policy initiatives over the long run, but for the purposes of this analysis must be treated as largely "exogenous," or outside the framework of new policy initiatives. As briefly outlined above, most of these external factors have deteriorated with respect to Jordan. Similarly, aspects of factor endowment may be important determinants of competitiveness, but are subject to change only slowly, as with, for example, the impact of improved education on the quality of the labor force. As Table 1 illustrates, operating costs in Jordan are competitive with costs in the rest of the region. The importance of the policy environment, then, becomes paramount as Jordan considers new measures to stimulate investment and undertakes representative missions overseas.

The specific incentives governing investment are an important component of the policy environment, and perhaps the most direct expression of the government's attitude towards investment. However, other aspects of economic policy and the treatment of investment are often of equal or greater importance when they are all taken together. In many countries, including Jordan, the incentive regime evolved over time as a series of individual measures or responses to identified constraints. Many governments have adopted mechanisms for ensuring that new investments are channelled into priority areas or are in line with the economic objectives of the country. These mechanisms, including investment approval requirements, protection for new industries, regulation of prices and output, and direct government participation in key sectors, often result in a climate uncondusive to new private investment. Incentive measures are typically then introduced to stimulate new investment in an attempt to counteract the cumulative effect of these disincentives and constraints. The net result is a

Table 1  
Operating Costs in Jordan and Competitor Countries

Item	Cost (US\$)							
	Jordan	Cyprus	Greece	Tunisia	Turkey	Egypt	Bahrain	Taiwan
<b>Labor Costs (1)</b>								
Unskilled	\$150 - \$210	\$392 - \$436	\$346	\$138	na	\$32	\$265 - \$398	na
Skilled	\$300 - \$360	\$589	na	na	\$370	\$72	\$398 - \$1055	\$429
Technician	\$750 - \$900	na	na	na	na	na	\$794 - \$1988	na
Secretary	na	\$347 - \$870	\$324	na	na	na	\$663 - \$1723	na
Supervisor	\$600 - \$750	na	\$439	na	na	na	\$2120 - \$4240	na
Manager	\$2100 - \$3000	na	na	na	na	na	\$3180 - \$6625	na
<b>Utility Costs</b>								
Water (2)	\$0.36 - \$1.20	\$0.76 - \$1.10	\$0.17 - \$0.25	\$0.10 - \$0.55	na	na	\$0.93	\$0.23
Electricity (3)	\$0.07 day, \$0.05 night	\$0.14 - \$0.19	\$0.11	\$0.05 day, \$0.03 night	na	na	\$0.04	\$0.156
<b>Construction, Lease and Land Costs</b>								
Construction Costs	\$150 - \$240	\$130	na	\$105 - \$150	na	na	na	na
Cost of Land	\$15 - \$90	na	na	\$5.63 - \$35.40	\$50	na	na	na
Cost of Land in Industrial Est.	\$36	\$87.18 - \$262.00	na	na	\$14	na	\$95.00	na
Rent in Industrial Est.	na	\$0.65	\$2.25 - \$10.00	\$12.00 - \$18.88	na	na	\$13.80	na
Other Costs	Cement cost high due to protection from imports.							

(1) US\$ per month

(2) US\$ per cubic meter

(3) US\$ per kilowatt hour

(4) US\$ per square meter for standard, steel-sided shell on normal, even terrain.

(5) US\$ per square meter per year

(6) US\$ per square meter, including services

na Not available

negative investment climate composed of an incentive regime which may be, on a prima facie basis, extremely attractive, superimposed a complex series of controls and regulations.

This framework of a set of specific investment incentives superimposed on a general policy environment characterized by a relatively high degree of control and regulation of business activity applies to Jordan as well as many other countries. The attractiveness of the resulting investment climate depends at least to an equal extent on the impact of the mechanisms for control and regulation as well as the incentives. This, in turn, is largely a function of how the government implements the controls. Important determinants of the attractiveness of the investment climate include the predictability of government actions, the implementation of investment licensing, and the impact of direct government participation on private business enterprises.

Both foreign and domestic entrepreneurs look for stability and equal treatment by the government in its policies and decisions that affect their operations. The predictability of the "rules of the game" is an often underrated aspect of government policy and its effect on the investment climate. Successful businessmen cope with changing market conditions, new technologies, developments in consumer tastes or end-use requirements, competition, and other commercial risk factors as part of their strategic planning and management. It creates an additional level of uncertainty to incorporate into their investment decision-making process potential government decisions which directly affect their operations. Flexibility in reviewing investment proposals or the application of regulations, and their treatment on a case-by-case basis may be an effective means of ensuring that the priorities of the government are addressed. However, this approach often creates an environment of

uncertainty where a premium is placed on political influence and an insider's knowledge of the process.

In Jordan, a lack of predictability is evident in many areas affecting investment. The licensing procedure, the application for incentives, the provision of protection through tariffs and other controls, the impact of price controls, and actions by parastatals and other government controlled or influenced enterprises are all subject to a high degree of discretionary authority. While this discretion may be appropriate in many cases as the prerogative of the government in exercising its economic policies, its impact on the investment climate must be considered.

### Investment Licensing

Any investment in industry in Jordan requires a license from the Ministry of Industry and Trade. For small enterprises (less than JD 10,000 in capital investment, approximately \$30,000) the procedure is routine and licenses are granted with minimal review, normally the same day. Otherwise, the licensing process involves a substantial review by the Ministry and approval is not automatic. This includes any investment for the expansion of existing enterprises. The proposed project must be described on a standard 23 page license application form, which outlines the products to be manufactured, the equipment required, processes to be used, financing, and so forth. The industry specialists within the Ministry and other relevant regulatory authorities (i.e. Ministry of Health for drugs, Public Works for construction materials, Agriculture for food processing, etc.) review the license application. The project is evaluated for its compliance with standards and regulations, technical feasibility, commercial viability, and a number of economic factors such as the value added, introduction of new technologies, and overall concordance with industrial priorities. Licenses are not granted

for investments in sectors which are considered saturated or suffering from excess capacity. Proposed projects must be very attractive to be approved for other sectors in which existing firms are having difficulties or for which the Ministry does not perceive a need for additional investment.

The licensing of investment is a principal means of providing direction for the industrial sector in Jordan. The Ministry is particularly conscious and perhaps overly zealous of the potential waste of resources represented by investments that may fail, because they are poorly conceived, utilize poor production methods, do not have adequate markets, are insufficiently financed, etc. The Ministry sees its role not just as a regulatory one, but as assisting potential investors in the licensing process, and providing an overall evaluation of the feasibility of the project. The screening of poorly defined projects is the principal rationale for the denial of a license, as well as the protection of existing producers who may be facing difficulties in industries with excess capacity.

To the degree that the Ministry denies only those license applications for projects which would fail anyway, its effect may be beneficial by directing investment to industries where it is most productive. To the degree that the licensing procedure enforces compliance with defined standards for product safety and other performances, it accomplishes a necessary regulatory function. However, inasmuch as the industrial licensing controls the allocation of investment in the economy, it probably is counterproductive and certainly negatively affects the overall investment climate for several reasons.

Investors and businessmen themselves are probably the best judges of commercial viability, and do not look to Ministry officials, even their industry specialists, for evaluation. Their investment decisions are based on their own knowledge of

their products, methods, and markets, and do not require the oversight of the Ministry from the standpoint of commercial viability.

The protection of existing enterprises may be justifiable under some rationale, but the policy of not allowing additional investment at all has perverse effects. The primary cost is a loss of efficiency and competition. For example, several firms reported being unable to invest in new machinery to modernize their production and increase their efficiency. Even though this would inevitably lead to increased production, the investment would not be undertaken if the firm did not think that it could recover its costs through enlarging its markets. If that is done at the expense of competitors, then the net effect is to increase the productivity of industry and remove inefficient units from production. While this may cause short-term dislocations, the policy response should be not to discourage innovation, but rather to assist those most directly affected, normally the employees.

The process of industrialization itself provides a powerful arguments against "market share" licensing. In many successful exporting countries, producers of specific goods initially invested for the purpose of meeting local demand. Once they became efficient and competitive (they had to if they wished to survive), they often reached a productive capacity in excess of that required to satisfy the domestic market. Naturally, they began to seek markets in other countries. For example, producers of textiles and garments in Taiwan were initially oriented solely toward the local market, and only later entered into exporting. If the government had suppressed investments in this sector in an effort to "protect" existing producers, then the industry might not have been able to expand sufficiently to undertake exporting.

The process of licensing, then, to the degree that it is effective in allocating investment, replaces the normal "market" allocation mechanism, that of the combined effect of the individual decisions by firms willing to risk their own resources in the business activities they pursue. In some measure, the control exerted by the licensing of investment reduces the impact of incentives, which would otherwise change the profitability of individual investment decisions and redirect that investment in the desired manner, without the need for direct control. It is important to note that the absence of licensing or control does not imply a lack of direction, but merely that the direction arises from the perceived risks and rewards associated with each investment decision by private firms.

To the extent that the Ministry, in the application and review process, provides technical, market, or other information relevant to the feasibility of a project, this is again a potentially positive impact. However, when it is provided after the basic structure of the project has been defined by the investor, it is not particularly useful. This informational function is important and is a common activity undertaken by investment promotion agencies. If it is to be valuable as input to the investment decision, the information needs to be available well before the licensing stage.

Through its ultimate control over investment decisions, the licensing process directly affects the overall climate for investment. In addition to the factors mentioned above, the requirements of industrial licensing mean that an investor cannot operate in the certainty that he will be able to change his production methods, expand into related business or products lines, modernize his plant, or otherwise decide the fate of his enterprise. While the government needs to exercise control over businesses to insure they operate in compliance with Jordanian law, and even in accordance with the expressed priorities of the

government's economic plans, the all-encompassing nature of the investment licensing process results is counterproductive.

### Price Controls

The government imposes price controls on a number of products, and indirectly affects the prices of others through a variety of means. While a detailed discussion of the impact of these controls and of price regulation in general is beyond the scope of this study, they deserve mention as a factor in the overall investment climate. Price controls serve a number of functions and are employed by all governments in various guises. In Jordan they are principally imposed on foodstuffs and other basic essentials. The Ministry of Supply controls the markets for many products, either through setting reference prices or acting as the marketing agent.

The impact of this regulation of product prices is to introduce another element of uncertainty for the producers in the markets for the goods affected, even though the attempt is to create stability and certainty. For potential investors, the possibility of fixed prices means that they may not be able to recover costs which increase unpredictably, or that they may not be able to reap increased margins when they achieve greater production or lower costs. Additionally, they may not be able to charge increased margins reflecting quality differentials, which discourages improving product quality. These factors constitute a constraint on investment in those products directly affected by price controls, but also in general due to the uncertainty of the imposition of new controls.

### Government Participation in Enterprise

The government of Jordan is a direct participant in the economy through its ownership of enterprises. This is true not

just in industry, but in many services sectors and other areas of the economy. It is common for governments to directly own and operate enterprises it deems vital to the public good. However, the government of Jordan is also a direct participant in many areas in competition with private enterprise.

The government's ownership and operation of businesses on a monopoly basis raises a different set of questions concerning whether they could be more efficiently operated by the private sector. The issue is currently being addressed in discussions of privatization of, for example, Royal Jordanian Airlines, the Port of Aqaba, and the Amman Public Transit Company. While the transfer of these and other state-owned enterprises to the private sector creates immediate investment opportunities and enhances the overall climate for investment through establishing a larger role for the private sector, it is the latter aspect of government ownership of enterprises in direct competition with private firms which is important for the current evaluation of the policy environment for private investment.

The government of Jordan owns shares in companies directly and indirectly through financial entities such as the Social Security and Provident Funds. In addition to parastatals and majority-owned firms, the government also holds minority interests in a wide variety of industrial and service firms (at least 70, not including parastatals.) The origin of these minority investments varies, from the desire to have some influence over the company's operations through representation on the board of directors to the prevention of insolvency. The impact on other firms which compete directly or indirectly depends on the degree to which those firms with government representation receive favored treatment from other government agencies in a regulatory capacity or from other private firms through the exercise of influence, such as in the provision of finance. A number of firms indicated there was not a "level

playing field," or comparable treatment of publicly and privately-owned firms, in several respects. One was the protection of government-owned enterprises through the denial of industrial licenses to private competitors for new investments in plant and equipment. Another was the privileged access to finance for government owned firms or firms with minority government ownership through influence over private banks.

The element of uncertainty which direct government participation creates is an immediate disincentive to private firms in the affected sectors. The willingness of the government to exercise its interests to protect those firms poses a constant threat to the survival of private firms, but the effect is perhaps greater in terms of the perceived threat and the uncertainty over government actions. In a broader sense, the potential entry of the government as a competitor to private industry on a privileged basis poses a less definable, but perhaps equally pervasive, constraint on new private investment. In its readiness to invest directly in enterprises to ensure that economic priorities are met, and in its willingness to invest to save financially troubled firms, the government has perhaps unwittingly exacerbated the problems of industries and sectors it is otherwise trying to assist by altering the ground rules for otherwise successful private firms. To the extent that government involvement in a sector becomes a dominant factor, then competing firms may also seek direct investment from the government as a means of protection, thereby increasing the dimensions of the problem.

### Protection of Industry

The government of Jordan has followed a policy of "import substitution" industrialization, encouraging investment in manufacturing for the domestic market by insulating producers from import competition. In addition, as noted above, the

Ministry of Industry also controls entry into sectors where existing producers are facing difficulties or there is excess capacity. While the evaluation of this strategy for industrial growth is outside the current concern, there are several aspects which deserve notice as they affect private investment decisions.

The willingness of the government to protect and otherwise support Jordanian producers is a positive incentive for those firms directly concerned -- their competition is limited and they are reasonably assured of a captive domestic market. However, for other firms, including prospective projects, the willingness of the government to protect domestic producers introduces another element of uncertainty affecting their operations. In several cases, the establishment of a Jordanian producer meant the end of access to imported goods at a lower price, and insulation from technological advances that originate overseas. The resulting rigidity in supplier relationships and the increased cost to those users of protected products affects their viability and places them at a disadvantage relative to producers of competing products in export markets, and domestically unless they too are afforded equal levels of protection. Thus, import substitution policies tend to increase the prices of goods produced locally, decrease their quality, and decrease the competitiveness of local producers in overseas markets.

### Summary

These factors highlight aspects of government policy related to investment which introduce either a constraint or an element of uncertainty into the investment decision. As such, they constitute an important component of the overall investment climate in which the incentives for investment operate. In addition, other aspects of government involvement in the economy also affect the investment climate indirectly. For example, the government's willingness to intervene on behalf of financially

troubled large corporations in order to prevent their insolvency or bankruptcy has the effect of placing a premium on political influence, and diverts financial resources to companies or sectors which may not merit them on commercial or more broadly based economic grounds. While all governments pursue such policies (such as the U.S. government investment in Chrysler and the British in Rolls Royce) the Jordanian government has pursued this on a widespread front to prevent business failures.

These policy measures designed to direct investment and the economy in general negatively affect the climate for new private investment. This is not to say that the objectives are not sound, but rather that the methods used to achieve them may be counterproductive to promoting a strong private sector and increasing private investment. There are many areas where the policy environment in Jordan has been extremely positive, such as in the creation of a stable macroeconomic environment. With respect to the investment climate, however, the effect of the microeconomic management and intervention imposed by the government has been on balance to discourage investment, and decrease the impact of the incentives introduced for its encouragement.

## LAW 11 INVESTMENT INCENTIVES IN JORDAN

Investment incentives for businesses that locate in Jordan are outlined in the Encouragement of Investment Law (Law 11) of 1972, subsequently amended in 1987. Additional laws specify incentives that are available for companies operating in duty-free zones (Law 32 of 1984, the Free Zones Corporation Law) and in industrial estates (Law 59 of 1985, the Jordan Industrial Estates Corporation Law), and for regional headquarters (Law 46 of 1975, the Registration of Foreign Companies Law).

The Encouragement of Investment Law offers a number of attractive incentives (see Table 2). First, the Law states that domestic and foreign capital is treated equally under the law, a provision that is highly valued by foreign investors. In addition, the Law allows wholly-foreign owned enterprises in industry, services and tourism, although not in purely commercial (trade) ventures.

## Table 2

### INVESTMENT INCENTIVES IN JORDAN

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#### Treatment of Foreign and Domestic Capital

Equal treatment under Jordanian Law 11.

**Restricted sectors.** Foreigners (except for Arabs, who are treated as Jordanian nationals) may not own more than 49 percent of any commercial (trading) enterprise. Phosphate mining, oil refining and cement production are reserved for the government.

**Repatriation.** Capital may be repatriated in three annual installments beginning two years after production commences. Dividends may be remitted annually.

#### Customs Relief

**Import duty exemption.** Enterprises are exempted for an unlimited amount of time from customs and import duties on fixed assets and spare parts used for start-up, expansion or improvement.

#### Tax Incentives

**Tax holiday.** Ventures judged to be "approved economic projects," are exempted from corporate income and social security taxes for 5 - 15 years depending on the project's location.

Exemption from building and land taxes are granted for 5 - 7 years depending on the plant's location.

#### Export Incentives

**Export tax credit.** Firms that export more than 20 percent of annual sales may deduct export earnings from taxable income up to 10 - 30 percent of taxable income.

#### Other Incentives

Land leases are available at concessionary rates.

Protection from similar projects establishing in the country for a negotiated period of time may be provided.

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Additional inducements are granted to projects depending upon various criteria, including the proposed location of the plant, the size of the investment, the quantity of labor that will be employed, the extent to which local raw materials are to be used, expected foreign exchange earnings, the type of technology to be employed, and whether the project is the first of its kind in Jordan. The law divides Jordan into three zones, and offers varying incentives for investment depending on the plant's location. Higher incentives are given to projects outside of the developed zone A (which covers Amman and the surrounding villages, Aqaba and the Jordan Valley) and zone B (Irbid, Madaba and Salt). The minimum investment required to establish eligibility for incentives is as follows.

	<u>Minimum Value of Fixed Assets</u>		
	<u>Development Area A (JD)</u>	<u>Development Area B (JD)</u>	<u>Development Area C (JD)</u>
Industry and Mining	75,000	35,000	20,000
Farming, animal husbandry, and fishing	20,000	15,000	10,000

The Encouragement of Investment Committee within the Ministry of Industry and Trade grades prospective projects using a point system. The project's job generation capability, its technology, and other factors are each assigned a point value. Depending upon its total point value, each project is assigned to one of three categories: No incentives, "economic project," and "approved economic project." Projects that receive more than 60 percent of all possible points are granted "approved economic" status, while those that receive from 40 to 60 percent of the total are classified as "economic" projects. Those that receive fewer than 40 percent of the total possible points are denied incentives.

Projects classified as "economic" are eligible for several inducements, the most important of which are customs duty and building and land tax exemptions, and the right to repatriate capital in three annual installments after two years and to remit dividends annually.

Projects which in the Ministry's opinion will offer even more benefits to the country are classified as "approved economic" projects. In addition to receiving all of the benefits open to "economic" projects, "approved economic" projects are exempted from income and social security taxes on corporate income for 5 - 15 years, depending on the plant's location. Approved economic projects of over \$3 million are also eligible to obtain protection from the government in the form of an agreement that no similar project will be allowed within Jordan for a specified period of time, set by negotiation.

#### IMPLEMENTATION AND PROCEDURES

In order to apply for incentives, firms must first obtain an industrial license from the Ministry of Industry and Trade. The industrial license is valid for six months and is renewable for several additional six-month periods. To renew its license, companies must take steps to prove to the Ministry of Industry and Trade that they are "serious" about making the investment, through actions such as registering the venture with the Registrar of Companies, applying for incentives, and opening a letter of credit.

Once they have obtained a license, investors seeking incentives apply to the Foreign Investment Department of the Ministry of Industry and Trade. They are asked to fill out a 23-page prefeasibility study, in Arabic. The standard format requests the usual financial and planning information that most

investors will probably have already gathered in the course of deciding whether to undertake the project.

Industry specialists within the Ministry review the application and make a preliminary recommendation to the interministerial Encouragement of Investment Committee. The Committee is headed by the Minister of Industry and Trade, and is composed of 14 other public sector members, including representatives from the Department of Customs and the Department of Tariffs within the Ministry of Finance, the Ministries of Tourism, Planning, and Labor, the Central Bank, and the Industrial Development Bank. The Committee meets every four to six weeks on average. The composition of the Committee varies each session, as the Ministries often send different delegates, with the unfortunate result that the sessions and the decisions reached lack continuity.

Each Committee member examines the prospective investment from his own perspective. The Customs delegate obtains the list of equipment for which the investor is seeking duty-free status, and submits it to industry specialists within Customs for review. The Customs department approves or disapproves duty-free status for imported machinery and equipment according to three criteria: Availability of the same or a similar item locally; need for the item; and whether the item is a capital good or a consumer good. These criteria are applied to encourage use of local materials and minimize abuse of the duty-free privilege. Duty-free status is awarded if Customs determines that the item is not available locally, is necessary to undertake the project, and is a capital and not a consumer good. For example, in one case in which a hospital which had requested 15 air conditioners, Customs judged that some were for personal use and allowed duty-free entry of only some of the units. Thus, the Committee can grant a project "approved economic" status yet not allow duty-

free importation of all of the machinery and equipment requested.

The Committee forwards its recommendation regarding incentives for investment projects to the Council of Ministers, which in turn advises the Prime Minister, who makes the final decision. The Council of Ministers and the Prime Minister rarely overturn the Committee's decision, and usually confine their involvement to requesting clarification as to why certain decisions were made. An investor who is dissatisfied with the status granted to his project can request a review, and/or can alter and resubmit the project.

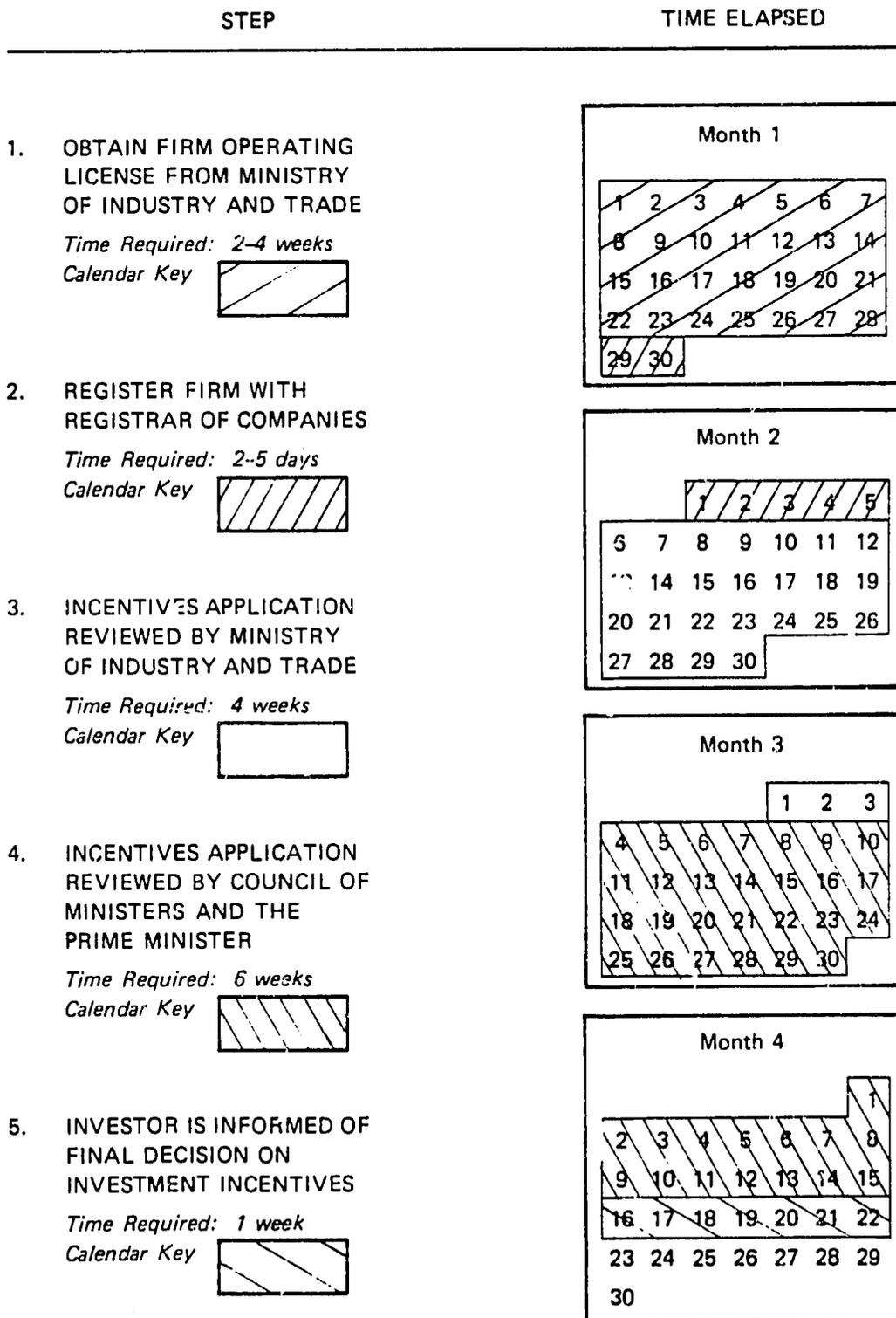
The investment incentives approval process takes approximately three to four months, as Figure 2 illustrates. The fastest segment in the decision chain is company registration, which takes only two to five days. The lengthiest segment is review by the Council of Ministers and the Prime Minister, which takes six weeks.

After the investor has been informed that the final decision on incentives has been reached, he applies to the Ministry of Industry and Trade for import licenses for plant, equipment, and spare parts. The items imported must correspond exactly to those items for which duty-free status was granted, and an import license must be obtained. If any items are substituted, or if their prices differ substantially from the price listed on the license, the entire approval process must be repeated.

The approval process must also be repeated each time a business seeks to expand or produce a new product. Ongoing businesses receive no expedited service: Their applications are included with those from new ventures for Ministry review.

Figure 2

THE INVESTMENT APPROVAL PROCESS IN JORDAN



## OTHER INVESTMENT INCENTIVES

### Free Zones

A separate set of investment incentives and procedures govern firms operating in duty-free zones in Jordan, which to date have not elicited much investor interest. There are two duty-free zones in Jordan, in Aqaba and in Zarqa with several more zones planned for future development. The existing Aqaba free zone is used only for storage. The Zarqa zone, located 35 kilometers from Amman, is primarily used for storing and showing automobiles prior to their sale. Six manufacturing and assembly firms are located in the Zarqa zone, and sell their production both locally and to Middle East markets. All six manufacturing firms are 100 percent locally owned, although some of the owners are Jordanians who previously lived abroad but returned to operate the business.

Perhaps the most valuable incentive offered to free zone firms is an exemption from onerous Ministry of Industry and Trade licensing requirements. Firms seeking to locate in a free zone need only apply to the Free Zone Corporation, which can approve their operations. Firms operating in these zones are also entitled to the following incentives.

- 1) Exemption from corporate income and social security taxes for 12 years;
- 2) Exemption from income and social security taxes on expatriate salaries for an unlimited period;
- 3) Exemption from all import and export duties for goods destined for export;
- 4) Exemption from all building licenses and building and land taxes;
- 5) No restrictions on repatriation of capital and profits other than those in force outside of the free zones; and

- 6) Easy access to Customs offices, which are located on the free zone premises.

Free zones in Jordan are owned and operated by the Free Zone Corporation, an autonomous governmental body. The Corporation is able to cover current expenses with revenue generated from rent payments, but the revenue is insufficient to service its debt. Businesses located in Jordanian free zones are required to pay 0.5 percent of the value of all exports from and imports to the Free Zone Development fund to support capital expansion of the free zones. Since the zones are used predominantly for storage, the tax is unlikely to generate enough revenue to support an expansion of the zones.

The Free Zone Law and its accompanying regulations are quite detailed, and specify how storage fees are to be calculated, and what annual rents will be charged. By legislating what are essentially administrative matters, the government has severely restricted the ability of the Free Zone Corporation to develop flexible, responsive internal procedures, and set fees and charges at appropriate, competitive rates.

A second problem facing firms operating in the zones is that goods manufactured in a Jordanian free zone do not receive a Jordanian certificate of origin. Such goods are not eligible for duty-free access to the Arab market, or for access to Iraq and Egypt under bilateral trade quotas. In free zones in the rest of the world, goods produced in zones are regarded as exports of the host country even though the firms are not subject to all of that country's laws. In granting certificates of origin to free zone exports, countries such as Singapore and Korea, as well as Caribbean countries, have greatly stimulated the growth of free zones' exports and employment, because the zone exports are eligible for special market access under programs such as the

Generalized System of Preferences, T.S.U.S. 806 and 807. and the Caribbean Basin Initiative.

The government should be commended for exempting free zone firms from onerous Ministry of Industry and Trade licensing procedures. In order to locate in a free zone, a business applies only to the Free Zone Corporation for a license. The Corporation makes a preliminary recommendation to a Committee composed of members from the Corporation, the Central Bank, and the Ministry of Industry and Trade. The Committee reviews the application, and then passes it on to the Board of Directors of the Free Zone Corporation for a final decision. To date, no license application has been denied. This "fast track" start-up procedure is a strong advantage for Jordanian free zones.

#### Industrial Estates

The government has specified a more limited set of incentives for firms located in industrial estates in Jordan. As specified in Law 59 of 1985, the Jordan Industrial Estates Corporation Law, these firms receive, in addition to any incentives they may already have received under the Encouragement of Investment Law, the following benefits.

- 1) Exemption from income and social security taxes on corporate profits for 2 additional years;
- 2) Exemption from building and land tax.

Firms already operating in Jordan may relocate into an industrial estate and receive the two year tax holiday extension.

Only one industrial estate has been established in Jordan--the Amman Industrial Estate at Sahab, located 30 kilometers from Amman. The Estate covers 250 hectares, and is being developed in three phases. The first phase of development, the construction

of administration offices and approximately 150,000 square meters of industrial space on 78 hectares of land, was completed in 1984, and work on phase two has begun. Phases II and III are the preparation of additional sites and construction of more industrial shells. The industrial estate deserves credit for pursuing development in a rational, planned manner although several buildings remain unoccupied from Phase 1. The estate has been responsive to the firms' preference for constructing their own buildings, and offers an array of land and building rental options.

The industrial estate is managed by the Industrial Cities Corporation, an autonomous public sector corporation. The Chairman of the Board is the Minister of Trade and Industry. Rents collected by the Corporation cover operating expenses other than for debt service. The Corporation posted a \$180,000 profit (before subtracting debt service) in its second year of operation, and these funds will be used for expansion.

Industrial estate occupants do not benefit from a fast track start-up procedure as do free zone tenants. Industrial estate firms must first obtain an operating license from the Ministry of Industry and Trade. If a firm desires investment incentives offered by the Encouragement of Investment Law, it must file an application with the Foreign Investment Department as described above. To receive the two additional years of benefits associated with operating in an industrial estate, the firm applies to the Industrial Cities Corporation, which has the final authority to grant the incentives. The Corporation acts like a one-stop shop for businesses operating on the estate premises. All municipality requirements such as building licenses are handled by the Corporation. The Corporation does not act as a liaison with Customs, however, and there is no Customs office in the estate.

As of February 1988, 75 percent of the available industrial space in the estate had been leased. The 70 firms operating in the estate have invested \$135 million in industrial shells, plant and equipment, and employ 2,100 workers. Of the 70 firms, one is wholly foreign-owned, and several are joint ventures with some foreign participation. Approximately one half of the firms located in the industrial estate export at least some of their production, most of it for Middle East markets -- Syria, Iraq, Egypt and Saudi Arabia -- although gelatin capsules produced in the estate are sold in Canada and the United Kingdom. Three additional industrial estates, including a Science and Technology Park near Irbid and new estates in Aqaba and Salt are in various stages of planning.

#### Export Incentives

In addition to incentives for foreign investment, Jordan also offers export incentives for firms, whether they are located in industrial estates, free zones, or other sites. An August 1985 decree set out the following fiscal incentives for exporters:

<u>Annual Exports as a Percentage of Annual Sales</u>	<u>Tax Exemption as Percentage of Taxable Income</u>
Less than 20	0
Equalling 20	10
Over 20 but less than 40	20
40 or more	30

#### Regional Headquarters

In order to attract regional headquarters, the Jordanian Government promulgated Law 58 of 1985, the Registration of Foreign Companies Law. Regional headquarters are defined as offices which do not engage in business activity within Jordan, but rather serve as sales offices for other markets such as the

Middle East or Europe. Companies that receive approval from the Minister of Industry and Trade are entitled to the following incentives:

- 1) Exemption from income tax on profits earned outside of Jordan;
- 2) Exemption from registration and licensing fees;
- 3) Duty-free import of office furniture and equipment; and
- 4) Exemption from income and social services taxes for expatriates.

According to the Registrar of Companies, as of February 1988, 374 companies had established regional headquarters in Jordan. Some 23 regional headquarters were opened in 1987 alone.

#### Private Sector Opinions on Investment Incentives

One of the main goals of this study was to assess the attractiveness of Jordan as an investment site from the point of view of private investors. To that end, we interviewed dozens of business people in the United States with Jordanian subsidiaries, in Jordan itself, and in competitor countries. Our findings offer several insights into the advantages and disadvantages of Jordan's current incentive regime.

The opinions of Jordanian national businessmen differed noticeably from those of foreign businessmen. The Jordanians, owing to their greater understanding of the system and familiarity with the officials involved, and the lack of exposure to other incentive regimes, were more satisfied with the inducements that Jordan offers, and less disturbed by inconveniences. In contrast, foreigners tended to be more critical, since they had experienced other less bureaucratic systems in other countries. For example, while foreign

entrepreneurs were highly critical of Customs delays, the Jordanian businessmen interviewed did not, in general, complain. A number of local businessmen commented that the business environment had greatly improved in the last five years. Foreign executives tend not to compare a location with its past, but with other alternative locations, thus "improvements" are valuable to them only if the improvements place a country on a competitive basis with other investment sites.

Both national and foreign business participants expressed concern that the personnel within the Ministry of Industry and Trade assigned to evaluate proposals had an insufficient understanding of their industries, markets, products and technologies. This problem was mentioned by nearly every executive interviewed. The difficulty is particularly acute in the case of technologies and products that are new to Jordan, which is a high-priority area for the government. Thus, investors are faced with the greatest misapprehension and the most additional questions, clarifications and "hassles" in precisely that area in which the government is seeking to expand. The approval process is serving as a disincentive in an area the government wishes to encourage.

Business executives interviewed did consistently make one very positive comment about investing in Jordan, a comment that should be played up in promotional materials about Jordan. They soundly agreed that companies seeking to sell to the Middle Eastern markets should establish either a regional headquarters or a production site within the Middle East itself. For both psychological and pragmatic reasons, a Middle Eastern location is very beneficial. A Middle East location sends the message to buyers that a company has made a serious commitment to the region, and that it knows its market. In addition, a site in the Middle East offers a host of support services in Arabic, an important consideration. Among Middle East countries, the

executives point to Jordan as the country that is the most receptive to private and foreign investment. Thus, Jordan has a niche to fill. In order to fill it, it should take important strides toward improving its investment incentive regime.

#### ASSESSMENT OF INCENTIVES AND PROCEDURES

While the incentives that Jordan offers to investors appear to be generous, their value to investors is seriously eroded by obstacles in the application process. The main problems with the system are the licensing of firms, which has already been discussed, the failure to make known the criteria used in evaluating investment incentive proposals, and the pressure put on the investors to import a substantial amount of capital before they are informed about the level of incentives they will receive.

The Encouragement of Investment Committee does not inform potential investors except in a very general manner as to the criteria against which their projects will be measured. The Ministry of Industry and Trade will not divulge to those outside the Ministry the point value of different factors, asserting that the evaluation system is for internal use only. Thus investors are unable to formulate potential investments in the most advantageous way because they are unaware of the precise nature of the rating system.

This system of withholding valuable information from potential investors is costly in terms of foregone investments. While government officials were reticent to provide the project team with statistics on the number of applications turned down, private investors interviewed indicated a number of projects have been abandoned by investors after they were turned down for investment incentives. Some of those investments could have generated substantial benefits for Jordan by providing

employment opportunities and new technologies, and substantial profits for the private sector. Unfortunately, the projects were not undertaken because investors were unaware that the government would have granted substantial incentives to the project if it had been structured somewhat differently. It should be relatively easy to estimate the value of investments not made in Jordan by reviewing applications for license and for incentives that were turned down, and determining assumptions about the percentage of those investments that would have been both acceptable to the government and viable if structured differently. Estimating this "opportunity cost" could be a valuable exercise, and would underscore the substantial costs to Jordan of the restrictive investment licensing and incentive approval procedures.

Lack of transparency in the incentive approval process has led to charges of unfairness and preferential treatment. Whether or not the charges are true, the secretive nature of the review system leaves investors with clear doubts regarding the objectivity and legitimacy of the process. One can question the value and benefits of a secretive process, especially in view of the opportunity cost of foregone investments.

The current secretive review process not only reduces the effectiveness of the government's plan to attract investments to high priority sectors, it undermines the plan and is counterproductive. Private companies are literally left in the dark regarding the path the Jordanian Government would like them to follow. The Ministry of Industry and Trade has stated that the need and responsibility to direct economic growth is the fundamental force behind the investment licensing and incentive approval programs. If indeed the government of Jordan desires to direct economic growth, the more effective means of accomplishing this is to provide clear, explicit direction for firms seeking to grow and expand.

A second serious problem with the approval process is the pressure that the Jordanian government places on foreign investors to bring a substantial portion of their capital into the country before they receive a decision on investment incentives. Technically, the Ministry of Industry and Trade will make a determination on incentives based on a feasibility study, and does not require that a substantial portion of the investment be undertaken before passing judgement. In practice, however, considerable pressure is exerted on the foreign investors. The pressure is a result of the temporary nature of the operating license.

The six-month validity of the license forces companies to act quickly to convince the Ministry of Industry and Trade that they are serious, even though the company would prefer not to make substantive moves toward implementing the project until the incentives are granted. Potential investors are told both to "hurry up" and to "wait." The incentive approval process is slow due to the need to pass the application through four successive decision-making levels. Therefore, investors feel that they are being required to make the investment before receiving final approval on incentives. The result has been the widespread perception that the company must be registered, with capital paid up (i.e., money deposited in Jordan or machinery imported), prior to the determination of incentives. This removes the incentives from the investment decision-making process, and decreases their effectiveness in stimulating new investment. Although Ministry officials attested that a complete determination on incentives could be made on the basis of the 24-page feasibility study, actual practice and the perception of investors does not support this.

## EFFECT OF INCENTIVES ON INVESTMENT IN JORDAN

The stock of foreign investment in a given country is the result of a large number of factors, the most important of which are political and regulatory stability, local operating conditions, and access to markets. Investment incentives are often regarded as "icing on the cake." Generous incentives will not attract investment to a country with a poor investment climate, as the experience of Egypt and El Salvador will attest. In the same vein, the lack of incentives will not keep investment away from a country that offers political stability and large markets. The U.S. federal government offers no incentives to investment (although individual states sometimes do), yet the United States consistently receives the largest inflow of gross private direct investment of any country in the world.

Unfortunately for Jordan, regional political unrest and depressed neighboring markets combine with the flawed investment incentive regime to detract from the country's attractiveness as an investment site. As a result of these factors, both the stock and the flow of investment into Jordan are low. The stock of foreign investment in Jordan consists of only approximately \$50 million from Western Europe and \$23 million from the United States (of which \$17 million is Citibank).

Arab investment in Jordan is substantially larger than investment originating in western countries, but very little is known about it. Members of the Jordanian banking community estimate that the stock of Arab investment in Jordan is approximately \$1-2.5 billion, but are unable to assign a more precise figure, or disaggregate the total investment by sector, since the Arab nation traditionally maintain a high degree of secrecy around financial and economic data. Arab investment is clearly an important force in the Jordanian economy.

According to IMF statistics, direct foreign investment in Jordan has slowed dramatically from its peak in the early 1980s when the price of oil and demand in the region's markets was high (see Figure 3). Foreign investment inflows reached \$148 million in 1981, but has fallen each year since 1984, to only \$18.8 million in 1986.

Gross fixed domestic investment has also declined during the 1980s, and private capital has been contributing an increasingly smaller percentage of total capital formation. Domestic investment fell at an average rate of 8.0 percent per year from a high of JD 597 million in 1982 to JD 419 million in 1986, according to IMF statistics. As a percentage of Gross National Product, gross investment diminished from 40 percent in 1981 to only 21 percent in 1986. Over that same period, the private sector share in investment decreased from 54.7 percent to 44.9 percent. The Ministry of Industry and Trade reported that industrial investment declined by one quarter from 1986 to 1987, to JD 15 million.

With workers' remittances and Arab aid declining, Jordan is looking increasingly to private investment, both domestic and foreign, to boost growth and fund development. There are several serious constraints to increasing investment in Jordan which are not subject to Jordanian government control, the most important of which are unrest in the Middle East and the depressed state of Arab markets. Nonetheless, a number of policy decisions could be made to improve the Jordanian investment climate. Below, we examine the investment incentives that other countries offer, analyze the strengths and weaknesses of the Jordanian investment incentives, and suggest a number of policy recommendations that would increase the attractiveness of Jordan as an investment site.

# Foreign Investment Inflows into Jordan

1978 - 1986

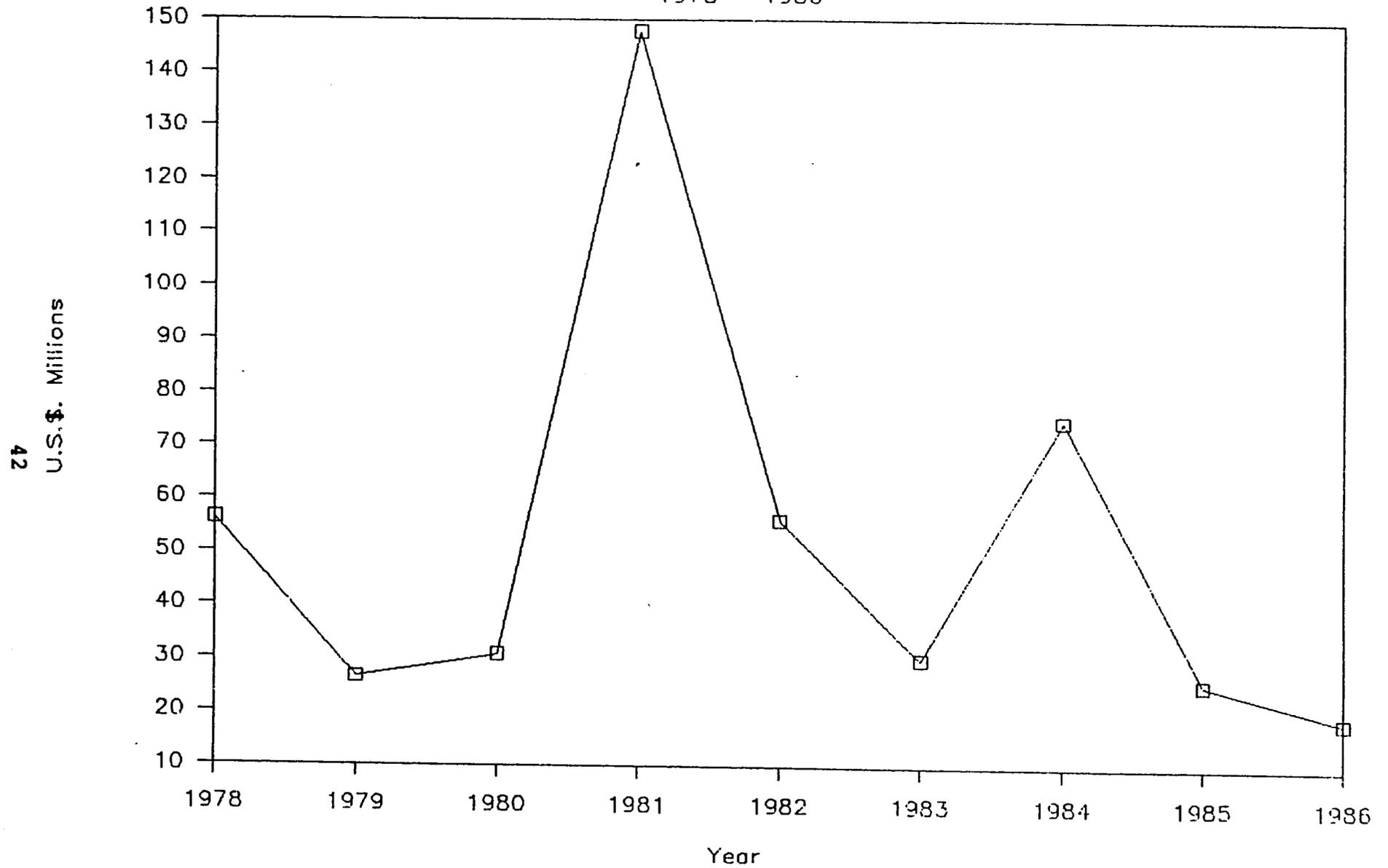


Figure 3

## COMPARATIVE ANALYSIS OF JORDANIAN INVESTMENT INCENTIVES

The incentive package Jordan offers is quite competitive in comparison with other packages. In fact, Jordan offers a longer tax holiday, and more incentives for regional headquarters, than do competing countries. However, Jordan taxes imported capital goods at a higher rate than in most of the other nations. With some provisions offering larger than usual incentives, and others embodying smaller than usual benefits, the sum result is a competitive set of inducements for investment.

Taking the incentive application process into account, however, Jordan's competitiveness drops substantially. Jordan has one of the most time-consuming, onerous incentive approval processes among all the countries studied.

The seven tables presented on the following pages facilitate cross-country comparisons by summarizing the investment incentives offered by each nation. An item-by-item, cross country analysis is rendered difficult by the fact that tax and incentive codes are complex, unique legal documents. In this discussion, we compare only the main features of the incentive regimes.

Figure 4 illustrates the duration of the corporate income tax holiday each nation offers. Jordan occupies a middle position in the provision of the tax holiday, offering more years of freedom from taxes than Taiwan, Egypt or Cyprus, but fewer than Tunisia or Bahrain. Tunisia offers the tax holiday in perpetuity to firms which export all of their production, and Bahrain does not impose any taxes on firms. In offering a tax holiday of up to 15 years, Jordan meets or betters the holiday offered by its serious competitors.

## INVESTMENT INCENTIVES IN TURKEY

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### Treatment of Foreign and Domestic Capital

Equal treatment of foreign and domestic capital.

Guaranteed supply of foreign exchange to cover import requirements.

### Customs Relief

Customs exemption for imports of capital goods.

### Tax Incentives

Investment tax credit. The credit varies from 30 - 100 percent of the investment, depending on plant location and industry.

Income tax exemption for workers in undeveloped regions or high-priority industries, including high-technology, tourism, energy, education, aquatic products, and most agricultural and related investments.

Value added tax postponement.

### Export Incentives

Export drawback. Exporters may claim a drawback ranging from 20 - 50 percent of indirect taxes paid, depending on the product (most foods, fresh fruits and vegetables are excluded). Large exporters, with earnings over \$2 million, may claim an additional 6 - 12 percent drawback.

Export tax credit. All taxpaying manufacturers are granted an allowance against taxable income of 20 percent of all export sales.

### Other Incentives

Low interest domestic and foreign investment credit. A small amount of credit is available at 38 percent annually, much less than the commercial rate of 65 - 78 percent. Some credit is available at even more favorable terms. The Tourism Development Fund offers loans at 15 percent for up to 60 percent of the total investment cost, for 20 years with a 6 year grace period. The Central Bank will assume the foreign exchange risk on some foreign-currency denominated loans.

Incentives premium on capital goods purchased from local sources.

Accelerated depreciation; State allocation of land; Exemptions from various (minor) taxes, duties and fees.

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## INVESTMENT INCENTIVES IN TUNISIA

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### Treatment of Foreign and Domestic Capital

Equal treatment of foreign and domestic investment.

Guarantee of repatriation of capital (including capital gains) and profits for non-residents. Control of capital outflows by residents.

### Customs Relief

In proportion to export sales only.

### Tax Incentives

Partial exemption of tax on reinvested profits.

### Export Incentives

Full Exemption from income tax in perpetuity, pro-rata for partial exporters.

No investment approval required -- automatic incentives for 100 percent exporters.

Refund of duties on capital goods, and turnover tax on domestic purchases, in proportion to exports.

Four expatriate managers per enterprise with no clearance required; tax on their salaries at 20 percent.

Refund of duties on imported inputs, refund of turnover tax for domestically produced or sold goods.

Up to 20 percent of export sales allowed to local markets.

### Other Incentives

Investment in decentralization zones receives state assumption of infrastructure costs and employers' social security contribution for first five years (ten for exporters.)

Tourism investments receive partial exemption on reinvested earnings, refund of duty or turnover tax on capital goods, and on inputs into locally made capital goods.

Additional incentives for multiple shifts, restart of operations by closed companies, technology intensive investments.

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## INVESTMENT INCENTIVES IN TAIWAN

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### Treatment of Foreign and Domestic Capital

Foreign and domestic capital are treated equally under the law.

Guaranteed remittance of yearly income, net profits and interest.

Right to repatriate 20 percent of the total invested principal after one year's operation.

Protection against government expropriation or requisition for 20 years, provided the foreign investment in the enterprise is maintained at or above 45 percent of the total registered capital.

### Customs Relief

Exemptions from or installments payments of import duties on capital equipment.

### Tax Incentives

Five year tax holiday on corporate income tax, or accelerated rates of depreciation on fixed assets. Capital or technology intensive industries, at their option, may defer the application of the tax holiday by one to four years after startup.

Corporate tax on productive enterprises is only 25 percent, and only 22 percent for specified capital and/or technology intensive industries.

### Export Incentives

Refund of import duties for imported raw materials used in export products.

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## INVESTMENT INCENTIVES IN CYPRUS

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### Treatment of Foreign and Domestic Capital

Foreign capital controlled. Investment approval, participation limited by sector and project; domestic investment largely unregulated.

Repatriation of capital and profits guaranteed even with other exchange restrictions in effect.

### Customs Relief

Exemption from Customs duties for all imports of Capital Goods.

### Tax Incentives

Corporate Profits Tax. Ten-year tax holiday for investment in manufacturing of "new products." Lower tax rate (25 percent vs. 42.5 percent) for public companies, and on earnings retained for internal financing. 4.25 percent tax rate for offshore companies.

Fixed Assets. Immediate depreciation; investment allowance of up to 45 percent in addition to depreciation.

Personal Income Tax. Taxation at 50 percent of the normal rate for expatriate employees of offshore companies, and companies operating in free zones.

### Export Incentives

Customs Relief. Exemption from duty for most inputs into export products. Duty drawback for other inputs.

Tax Deduction. 3-6 percent of export proceeds is deductible from income.

Services. 30 percent of foreign exchange proceeds from services is deductible from income; 90 percent for employment services.

### Other Incentives

Financing. Long term, low interest credit available through special fund at Commercial Banks.

Offshore Companies. Additional incentives for regional headquarters and other offshore companies, such as duty free importation of cars, personal effects and office equipment. Rapid (several days) approval process, ease of operations.

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## INVESTMENT INCENTIVES IN GREECE

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### Treatment of Foreign and Domestic Capital

Equal treatment of foreign and domestic capital. Greeks living abroad are eligible for additional incentives.

Bank of Greece guarantees foreign exchange availability to meet repatriation and remittance requests.

### Customs Relief

Reduction or exemption from import duties on machinery and spare parts for up to 10 years.

### Tax Incentives

Reduced tax rate of 39 percent as opposed to 44 percent for eligible investments.

Investment tax credit worth from 40 - 70 percent of total investment depending on plant's location, transferrable indefinitely.

Reduction or exemption from every tax or levy imposed by local government, port funds or other agencies, for up to 10 years.

### Export Incentives

Interest rate subsidy of up to 26 percent of interest on loans taken out by exporters, to be phased out by 1992.

Exemption from Value Added Tax.

Duty-free import of raw materials and semi-finished goods for re-export.

### Other Incentives

Investment grants in cash and state equity for up to 50 percent of investment.

Integrated Mediterranean Program cash grants for up to 20 percent of Law 1262 benefits.

Increased depreciation rates from 20 - 150 percent of standard annual rates depending on number of shifts employed.

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## INVESTMENT INCENTIVES IN EGYPT

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### Treatment of Foreign and Domestic Capital

Domestic investments receive some incentives not available for foreign investments.

Foreign investors have right to acquire foreign exchange for repatriation.

Investors protected against expropriation or nationalization.

### Customs Relief

Low 5 percent import duty on capital assets, construction materials and components.

Duty exemption for capital assets and imported inputs for firms located in free zones.

### Tax Incentives

Corporate income tax. Tax holiday for 5 years for investments in eligible fields, and up to 8 - 10 years for projects related to the establishment of new cities and land reclamation.

Personal income tax. Foreign employees exempted from general income tax, but must pay schedular tax.

### Export Incentives

Egypt does not offer export incentives.

### Other Incentives

Firms exempted from requirement to distribute 10 percent of annual profits to employees.

USAID funding for reconnaissance visits for investors, and feasibility studies.

Subsidized credit for up to 12 years with a 3-year grace period.

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## INVESTMENT INCENTIVES IN BAHRAIN

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### Treatment of Foreign and Domestic Capital

Foreign investment in Bahrain companies limited to 49% percent.

Free repatriation, no currency restrictions.

### Customs Relief

No duty on capital goods or raw materials used in production.

Generally low duties on other items.

### Tax Incentives

No taxation on corporate and personal income.

### Export Incentives

Duty exemption for re-exported goods.

### Other Incentives

Regional Headquarters and Offshore Financial Institutions. One hundred percent foreign ownership allowed for Exempt (offshore) companies and Offshore Banking Units.

Subsidized utility rates.

Streamlined registration and application procedures.

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## Length of Income Tax Holiday in Jordan and Competitor Countries

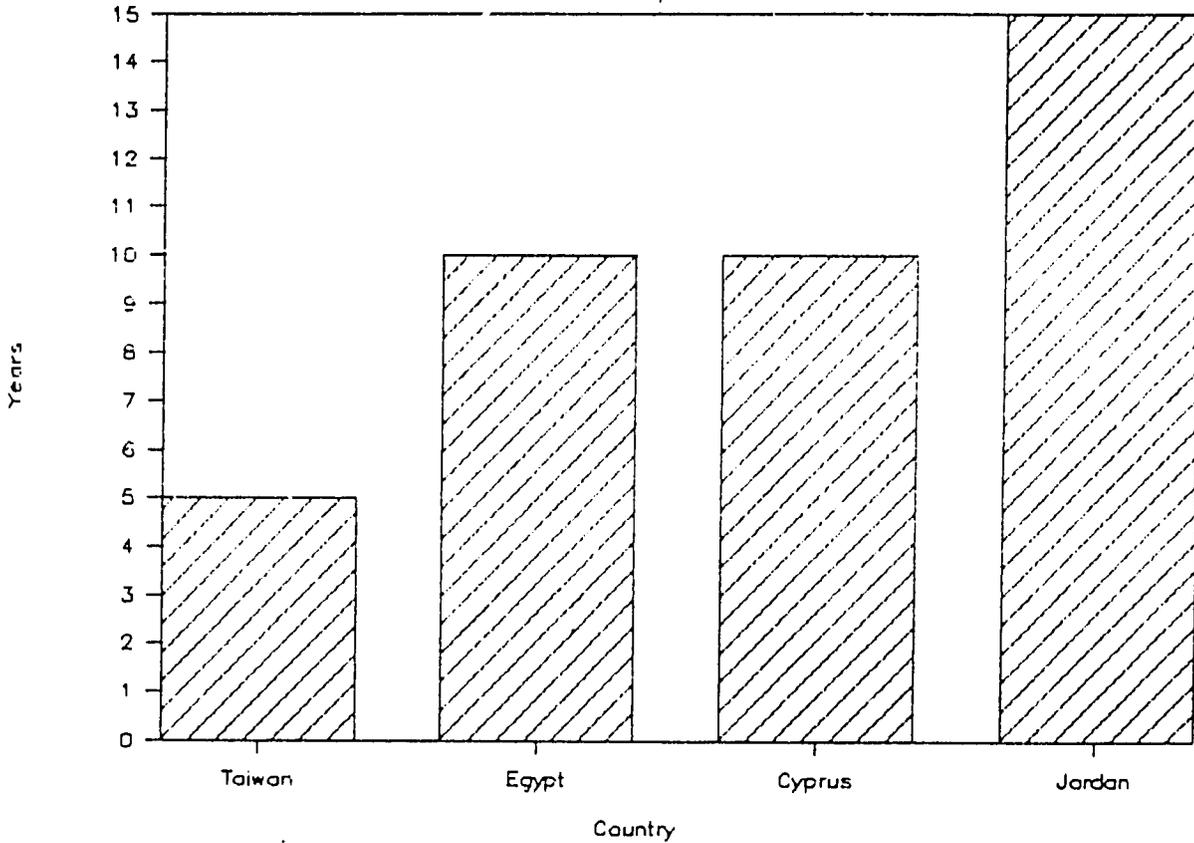


Figure 4

Tunisia offers a 100 percent tax holiday in perpetuity for firms that export all of their production. The tax exemption is proportional to the percentage of production exported.

Bahrain imposes no taxes on firms.

Turkey and Greece offer investment tax credits for all or a portion of the investment, transferrable forward indefinitely.

Jordan also offers regional headquarters a competitive incentive package. Greece, which has attracted more regional sales offices than any other country included in this survey, offers essentially the same incentives as Jordan. Jordan is more generous than either of its other serious competitors in this field, Turkey and Cyprus. Turkey imposes income taxes on the salaries of expatriates working in headquarters; those salaries are tax exempt in Jordan. Similarly, Cyprus taxes headquarter profits (at a low 4.25 percent rate), even if they are earned on operations outside of the country's borders, but Jordan does not. Thus, Jordan has developed a package of incentives for regional headquarters that is as attractive or more attractive than packages offered by competing nations.

Jordan's competitiveness does not extend to the incentive approval process. The Jordanian government requires four months to review an application and reach a final decision on granting investment incentives. In contrast, in Taiwan and Tunisia, by law all completed applications are processed within thirty days. Investors who submit applications to the government of Cyprus are assured by law of receiving a final decision within sixty days. Jordan, Greece and Egypt, share last place in a ranking of duration of incentive approval procedures (see Figure 5).

This cross-country comparison suggests that Jordan has crafted an incentive package that is on par with other packages offered in the region, but that Jordan's approval mechanism is deficient. If the government wants to improve the investment climate, the first step should not be to offer additional tax incentives, because the current provisions are sufficiently generous. Instead, the government should simplify and shorten the application procedure.

# Time Required for Incentive Approval

in Jordan and Competitor Countries

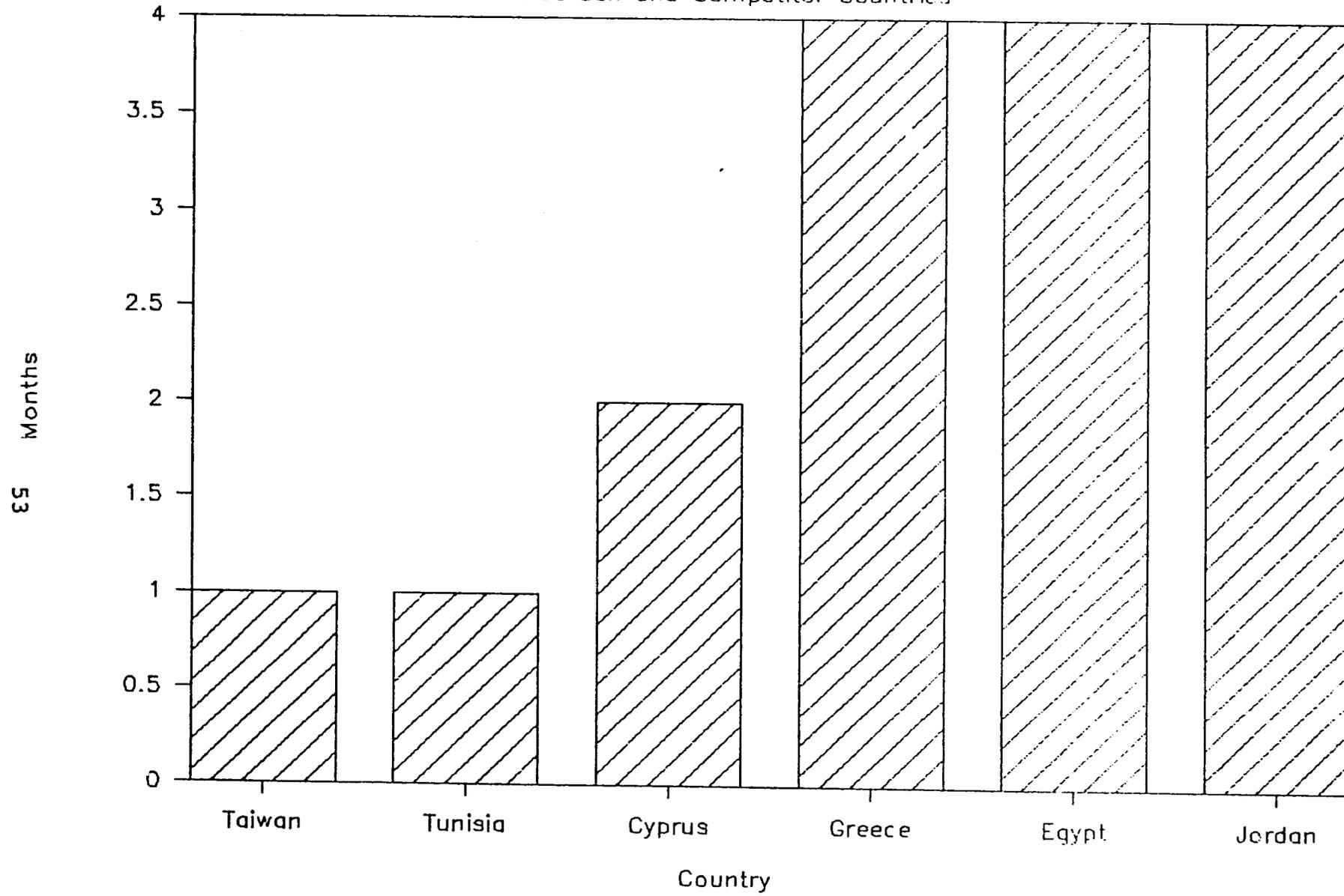


Figure 5

## RECOMMENDATIONS

Four main recommendations and several more narrow but still important suggestions can be drawn from the comparative assessment of investment incentives. At the outset, however, it is important to acknowledge the clear consensus among the dozens of business executives interviewed in the United States, in Jordan, and in the competitor countries, on the fact that most legislated investment incentives play only a marginal role in locational decisions. The major factors in any decision to locate in a given country are access to a large domestic or export market, a stable government and currency, ease of entry and operation, and competitively priced labor, raw materials and other inputs. Thus, policy-makers must also direct their attention to these determinants of investment flows, and the policy measures which can improve the business environment and cost competitiveness of Jordan.

The basic incentive regime for investment in Jordan is reasonably competitive when examined in comparison to other countries: The allowance for a tax holiday, duty exemption on capital goods, duty relief for exporters, and certain financial incentives for exporters are common to most countries. Several of the recommendations below are concerned with minor technical changes to improve the functioning of these measures, such as the tax holiday or the treatment of free zone exports. We do not recommend many new incentive measures, as such, but instead suggest the removal of constraints on investment and business activity and the implementation of the incentives. These measures will be much more important than adding a few years to the tax holiday, or otherwise adding to the face value of the standard incentive package.

The principal recommendations are intended to be implemented in the short term without a radical redirection in economic

policy or strategy: As such they are incremental in nature and designed to improve the existing regime. However, Jordan will do well to consider the example of countries such as Tunisia and Turkey, where as a companion to broader economic reforms the overall investment control mechanisms were largely abandoned or relaxed. Several of the recommendations adopt this premise: that the government will not be able to encourage investment without removing itself from decisions governing each project, such as investment licensing or a case-by-case evaluation of the merit for incentives. The specific recommendations are designed to begin a move in this direction, and were purposely developed to be achievable without igniting a major policy debate. Faster, more dramatic steps should be taken as attitudes change and these more strategic orientations are included as long-term recommendations.

The changes in the investment regime that are likely to do the most to improve the attractiveness of Jordan as an investment site would be changes along the following lines:

1. Create "fast-track" company start-up procedures for certain high priority industries, with no operating license requirement.

The licensing requirement is probably the greatest constraint to growth in investment and employment in Jordan, yet the government has been reluctant to abandon their mechanism for controlling and directing investment in the economy. An incremental approach which will allow a careful assessment of the impact of removing industrial licensing is to free firms from this limitation for particular industries in which the government is seeking growth, the government would be taking an important step toward attracting firms, jobs and technology to Jordan.

The government should carefully assess the effects of freeing specific industries from the licensing requirements, and explore the possibility of successively removing additional sectors from the need to license. This measured liberalization would control the pace of any possible dislocations that may occur, and allow the government to judge the costs and benefits of the open policy. This measure would be a strong expression of the government's support of priority sectors, by removing constraints rather than introducing additional incentives without addressing the negative factors.

2. Unify the incentives offered in order to simplify the application and approval process.

The current incentive regime distinguishes between "economic" and "approved economic" projects. The principal difference in the incentives offered is the tax holiday, available only to approved economic projects. These two incentive categories should be combined, to make one for approved projects. Eliminating the economic project designation and making it easier for projects to qualify as approved economic projects would greatly simplify the application procedure and reduce the need for extensive review by the Ministry of Industry and Trade. The actual difference between the criteria for economic or approved economic projects is one of degree, and does not represent a fundamental difference in the types of projects receiving different incentives. Therefore, in combination with the following recommendation to make the criteria for evaluation explicit, the use of a single set of incentives would improve the application process as well as the attraction of the incentive package.

3. Expand the coverage of the "fast-track" investment incentive approval process for small investments.

Currently the government routinely approves investments under \$30,000. By channeling medium-size projects (say those under \$500,000) into the fast track, or creating a "medium track" that has fewer steps and involves fewer high-level government decision-makers than does the present process, the government of Jordan could focus high-level attention on large projects that require more careful scrutiny and time for evaluation. Among other measures, the government may wish to emulate the practice in competing countries such as Turkey, where Council of Minister review and approval is required only for investments over a certain size.

A two or three-track approval process that distinguishes between various-sized projects could reduce the time required for decisions for all investments. By truncating the decision process for smaller projects by removing the final Council of Ministers review, investors seeking incentives for smaller proposals would receive decisions approximately six weeks earlier than at present. With a smaller case load, the Council of Ministers could also reduce the amount of time required to approve large-scale proposals. The bifurcated approval process would offer the added benefit of focussing the time of the Council of Ministers on larger, more important investments.

4. **Make the incentive approval process transparent by informing investors of the value assigned to the criteria used in approving investment incentives.**

The rationale behind investment incentive regimes in Jordan or in any country is to direct and encourage economic growth. Jordan, like other nations, desires certain types of industries and technologies. Jordan actively seeks particular qualities in new firms, such as employment generation or regional development. If Jordan desires to direct economic growth, and attract jobs, technology and investment, it must provide

specific direction to those entities that are the source of jobs, technology and investment.

5. Negotiate additional trade treaties, and expand the scope of existing trade agreements.

U.S. business executives interviewed ranked "market access" as the number one criteria for investing overseas. Investors who have located in Turkey point to its large domestic market of 50 million as the magnet that attracted them to that country. Greece is able to offer potential investors access to the 320 million strong European Common Market, although the highly bureaucratic investment approval system has substantially negated this market access advantage.

In order to compete successfully for investment, Jordan should consider reviewing the scope of current bilateral and multilateral trade agreements, and devising a strategy to expand that scope by encompassing new trade partners and additional products and services. For example, one additional trade provision that could open the large Egyptian market to further penetration by Jordanian exports would be the inclusion of overnight accommodation in the bilateral treaty with Egypt. The resulting large purchases of tourism services by Jordanians would allow additional purchases of Jordanian goods in Egypt.

In addition to these four major recommendations, the project team has devised a number of other recommendations, which fall into short-term, medium-term, and long-term categories. Short-term recommendations address immediate constraints, and should be evaluated and, where appropriate, implemented in the next few months in order to improve the attractiveness of Jordan as an investment location. Medium and long-term recommendations address more ingrained obstacles to investment that will take more time and effort to overcome.

## Short-term Recommendations

1. Grant Jordanian Certificates of Origin to goods produced in free zones.

The lack of a Jordanian Certificate of Origin, and therefore preferential access to several important markets opened up by bilateral trade treaties, including Iraq, is one of the main reasons why light manufacturing activities have not "taken off" in Jordanian free zones. Decisions by both the Secretariat of the GATT and the Customs Coordinating Council have approved the certification of origin by countries for goods manufactured or processed in export processing zones, duty free zones, bonded factories, and other areas outside the normal customs regulations, but within the defined geographic borders of that country. Jordan would just be acceding to normal international trade practice by granting goods manufactured or substantially transformed in free zones a Jordanian Certificate of Origin. Jordan could greatly encourage labor-intensive assembly activities and stimulate investment and job generation by granting the certificates to free zone tenants.

2. Lengthen the industrial operating license to one year.

Investors charge that they have only six months (the current duration of the operating license) to import capital or take a similar step to prove to the Ministry of Industry and Trade the seriousness of their intention to locate in Jordan. However, six months is not sufficient time to obtain approval of incentives, obtain import licenses, open letters of credit for imported goods, or otherwise prove to the Ministry the seriousness of the investor's intent. The short duration of the operating license gives investors the impression that they must

make the investment prior to receiving a decision on the availability and extent of investment incentives, which in essence negates the usefulness of the incentives. If the licenses were valid for a year, investors would have time to wait for the incentive decision before beginning the process of making the investment. One year should be considered the minimum time period of the initial license. Alternatively, the Ministry could simply grant the licenses in perpetuity, subject to review and the continuing operations of the company.

3. Prepare printed material in both Arabic and English outlining the investment incentives, the application process, the requirements for industrial licensing, and make brochures available to potential investors at the offices within the Ministry of Industry and Trade, at the Amman Chamber of Commerce and Industry, and embassies overseas.

The lack of printed material explaining the investment incentives is a serious problem. In each of the other countries visited and researched as part of this effort, material in English was readily available. The booklets need not and should not be elegant or expensive. Rather than spend money on glossy pages and color pictures, the Ministry of Industry and Trade should commission flawless translations of the incentives regimes into the major languages used in business. Without printed material, investors are often unable to understand the various benefits Jordan offers, or to compare them with those offered by other countries.

4. Offer an optional grace period before the tax holiday begins; or allow tax loss carryforward from the holiday period.

Investors value tax holidays very highly, but the holidays are worth even more if the investor can take advantage of the tax relief once his tax bill is large, usually only after several years of operation. An optional grace period such as the four year optional grace period offered by Taiwan would enhance the value of the incentive for investors, although it would also reduce tax revenues.

As currently implemented, investors receiving an exemption from taxes cannot carry forward losses from the holiday period. At a minimum, this should be allowable, otherwise the incentive can work in reverse. Most new projects incur costs in the early years; by the end of the tax holiday period, they normally will be operating at a profit. However, their net worth may still be negative. Normally, firms can offset those losses against income in later years, but not in Jordan. The current incentive can be counterproductive: Some firms are made worse off by having received the exemption.

5. Proceed with planning an industrial park for high technology activities, but reconsider the location and attract private sector interest in ownership, construction, and management.

In order to provide jobs appropriate to the relatively high level of education and skills of the Jordanian workforce, the government is beginning to plan a project for high technology ventures near Aqaba. The location is too far from the main source of skilled labor, in Amman, for the project to be viable, and an alternative site near Amman should be considered. In addition, rather than constructing and operating the project itself, the government should attempt to elicit interest from private sources. In other countries around the world, the private sector has shown itself to provide higher levels of services and tenant satisfaction, and a greater capacity to

market successfully and to finance expansion, than most governments have been able to, without overburdening government budgets.

6. Provide adequate protection of intellectual property rights to encourage the nascent "Arabization of software" industry.

Because of the software development industry's ability to employ Jordan's trained workers, it is a service industry that Jordan would like to attract. However, the prospects of software industry growth are severely constrained by the lack of protection for intellectual property rights. Firms are loath to spend large sums of money on software development without adequate protection for the final product. The current legislative provisions should be reviewed for completeness, and funds should be allocated for the enforcement of the law.

7. Continue to capitalize on the "Gateway to the Middle East" theme, because investors indicated a clear need for a gateway location.

Many investors interviewed as part of this study indicated that a Middle Eastern location is a definite advantage for firms attempting to sell in the Middle East. While the market for large scale construction projects has greatly contracted, consumer goods markets in the Middle East remain important. Before launching any promotional campaigns, however, Jordan should continue to make the indicated improvements in its investment incentive regime and climate.

#### Medium-term Recommendations

1. Streamline the entire investment approval process, and shorten the application form. An appropriate

goal is to reduce the total amount of time required to within one month, as in Taiwan.

In addition to bifurcating the approval process according to the size of the project, the Ministry of Industry and Trade should take other steps to make the process easier and faster. To the degree that investment licensing is retained, it should be incorporated into a streamlined application process for investment incentives. In the process itself, the Ministry should shorten the length of the application form, and shorten the duration of the process and the number of decision-makers involved. Ministry officials should review the criteria used in evaluating proposals, and remove any that are unnecessary. Egypt's experience since its 1983 streamlining illustrates that facilitating the investment incentive approval process can draw additional foreign investment.

2. Reduce Customs delays by removing financial incentives for Customs Agents to find misclassifications.

While the current system has probably been useful in discovering errors and increasing customs revenues, it creates large negative side effects on the ease and duration of customs clearances. Local businessmen accept lengthy delays in customs clearances as a standard practice, but foreign businessmen name customs as a serious obstacle to doing business in Jordan. Fraud detection and maximization of revenue are laudable, important goals and should be pursued, but not to the point where agents are so zealous that they represent an obstacle to importing, exporting, and economic growth.

3. Consider constitutional protection to some or all investment incentives, as in Greece.

One feature of investment regimes that investors value over nearly all others is stability in the "rules of the game." Jordan could enhance its reputation as a stable location in an unstable area by providing additional legal protection for its investment incentives from shifting political tides.

4. Expand the scope of industries eligible for investment incentives, based on a review of comparative advantage and labor force skills and supply, and with a clear vision of the kinds of industry Jordan would like to attract.

Jordan should work toward encouraging growth in additional industries and sectors by making them eligible for incentives. Both Egypt and Turkey offer incentives for practically all industries. In doing so, they promote economy-wide development.

5. Provide merger incentives to assist local businesses to compete with new local and foreign investments, and assistance for workers of businesses unable to compete.

Local industry, accustomed to protection from new ventures, will need assistance in making the transition to a competitive environment. The Government should review the costs of mergers under current law, and craft a series of exemptions and reductions in taxes and fees to encourage mergers, as Greece and Cyprus have done. Given the high degree of concentration in the Jordanian economy that has resulted from the licensing restrictions, the government should promulgate merger incentives only if it also substantially lessens the scope of licensing and opens the economy to local and foreign competition. The government should also provide financial and retraining assistance to workers laid off by firms unable to compete successfully.

**6. Encourage the formation of an association of foreign investors.**

While membership would be small initially because of the limited pool of foreign investment in Jordan, the experience in other countries indicates that this type of association bestows a number of benefits on a country seeking to attract additional foreign investment. For example, Turkey's Foreign Capital Association serves as an informal promotion agency, providing information and guidance to potential investors. Organizations of this type also bring pressure to bear on government decisions and assist to shape a set of public policies conducive to the private sector.

Long-term Recommendations

**1. Eliminate investment licensing.**

In the long term, Jordan needs to decide on an appropriate division of roles and responsibilities between the private and public sectors. Currently, the roles are ill-defined: The nation is encouraging private investment and exports, but at the same time licensing firms and owning and operating important industries. Experience in many countries around the world has showed that the most dynamic economies are those where the government regulates, supports, and provides direction to private business in a clear and defined framework, but does not burden the private sector with excessive requirements and constraints on operations. Taiwan has averaged a 10 percent annual real growth rate over the past 30 years by giving private enterprise free rein to produce and export. Turkey attracted five times the foreign investment in the five years following its economic liberalization of 1980 than it had in the twenty-five preceding years. If Jordan sincerely seeks to increase foreign

investment within its borders, it will need to redefine a smaller, less interventionist role for government. This does not mean the abandonment of the role of giving direction to the economy, which is an important role of economic policy. It does mean a shift in policy instruments and implementation strategy. The government needs to set the basic parameters governing economic activity, including the incentives for different types of activity, so that the collective impact of the individual business decisions by private entrepreneurs is in accord with government objectives for the economy and society. However, the government should directly influence each decision as a participant. The elimination of investment licensing will be an important indication of the government's intention of facilitating new investment.

## 2. Look beyond Jordan's border to export markets.

The Ministry of Industry and Trade has expressed skepticism about the ability of firms to produce only for export. With a home market of only 3 million, Jordan will need to look to other markets to support growth. In a world increasingly characterized by international trade and specialization, Jordan will need to reorient its production and its development strategy toward exports, including exports outside the region to Europe, the United States, and other major markets. Jordan's most advanced firms now export outside the Middle East and compete in world markets; in the future, in an environment more conducive to private investment and initiative, most of Jordan's industry can be expected to achieve similar results.

## 3. Establish an Investment Promotion Function.

Once Jordan has established an attractive policy climate, one that is in large part free of licensing requirements, it should begin active investment promotion. In the short term,

promotional materials should be prepared and disseminated, in order to provide potential investors with information. In the long term, a Jordanian institution should develop the capability to act as an informational and assistance-oriented promotion agency.

There are a number of models which can serve as examples, from wholly public sector, to parastatal agency, to the private non-profit sector to the private business sector. The only public agency which currently exhibits any evidence of the importance of the promotion function was the Industrial Estates Corporation: They have promotion materials in English and Arabic and a video show to prospective clients. Particularly if the Free Zones Corporation is merged with the Industrial Estates, the combined entity would probably be the most suitable public sector organization to undertake a promotional role.

Alternatively, the government could support and encourage a private institution to undertake this role, such as the Amman Chamber of Commerce and Industry. AID has successfully assisted a number of private sector investment promotion organizations, some of which have been able to generate substantial revenues from their operations. Good examples for review are CINDE in Costa Rica and the Investment Promotion Council in the Dominican Republic. Private business organizations have stepped into the breach in other countries to prepare promotional material and encourage investment, particularly foreign investment. In Cyprus, private accounting firms prepare the most widely used guides to investment, use their own funds to undertake surveys of investor attitudes, and make representative missions to attract new investors from overseas. They do this because a great deal of their livelihood has been associated with the growth of the offshore business sector. The identification and support of a similar group of firms in Jordan may also be possible. Whatever institutional form is chosen, promotion should not be the

responsibility of the agency which regulates investment, the Ministry of Industry and Trade.

# TURKEY

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## Highlights of the Investment Climate in Turkey

### THE INVESTMENT CLIMATE IN TURKEY

During the 1980s, Turkey generated a substantial amount of interest among potential foreign investors. The country's relatively large domestic market of 50 million people, who have been experiencing rising standards of living, is considered a substantially untapped markets for consumer goods. The government is considered politically stable, and, since 1980, has maintained a very generous set of investment incentives and a streamlined, "one-stop" investment incentive approval process. Located strategically at the edge of the Middle East, the nation is generally regarded as a good alternative to locating within the troubled region.

However, recent restrictions on foreign exchange throw doubt on the government's commitment to liberalization, and have dampened interest among potential investors. The more restrictive government attitude toward the economy is reminiscent of pre-1980 Turkey. Until that year, the Turkish economy was relatively closed. Production was oriented toward substituting locally-produced goods for imports. Balance of payments difficulties and rising inflation forced a change beginning in 1980. In a striking break with past policies, on January 24, 1980, the Turkish government announced a comprehensive economic stabilization and liberalization program that came to be known as the "January 24 decisions." As part of this program, the government moved to reduce its role in the economy, sell some state-owned enterprises, remove price controls, liberalize exchange controls, reduce protection against imports, and adopt foreign investment incentives.

The new policies successfully stimulated exports, which rose from \$2.9 billion in 1980 to \$4.7 billion in 1981 and \$7.6 billion in 1986. However, the government was unable to reign in the value of imports. While the trade imbalance contracted somewhat during the first two years of the liberalization, it then began to expand. In February 1988, the government reacted to the resulting shortage of foreign exchange reserves by increasing the cash guarantee required on imports, mandating that exporters exchange export earnings into local currency within six months, and ruling that companies could no longer maintain 20 percent of their export revenue in overseas accounts. The policy shift has caused noticeable concern among current and potential foreign investors.

The liberalized policy climate also stimulated foreign investment in Turkey. Foreign investment more than tripled from its 1980 level of \$97.0 million to \$337.5 million in 1981 (see Figure 1). Foreign capital inflows from 1980-1985 were five times higher than inflows during the preceding 25 years. At the end of 1985, cumulative foreign investment in Turkey was estimated to be \$1.44 billion.

Turkey maintains a number of policies that are very attractive to investors, both foreign and domestic. Foreign investment is accorded equal treatment under the law with domestic investment. Investors are encouraged by the liberal economic policies and positive government attitude toward private sector growth and foreign investment.

Nonetheless, several problems face investors in Turkey. Inflation averaging 50 percent in 1987 has resulted in nominal interest rates that have reached 80 - 85 percent per year, while interest rate controls have reduced the amount of credit available. The current foreign exchange shortage has caused delays in obtaining hard currency from the Central Bank. In

# Foreign Investment Inflows into Turkey

1979 - 1986

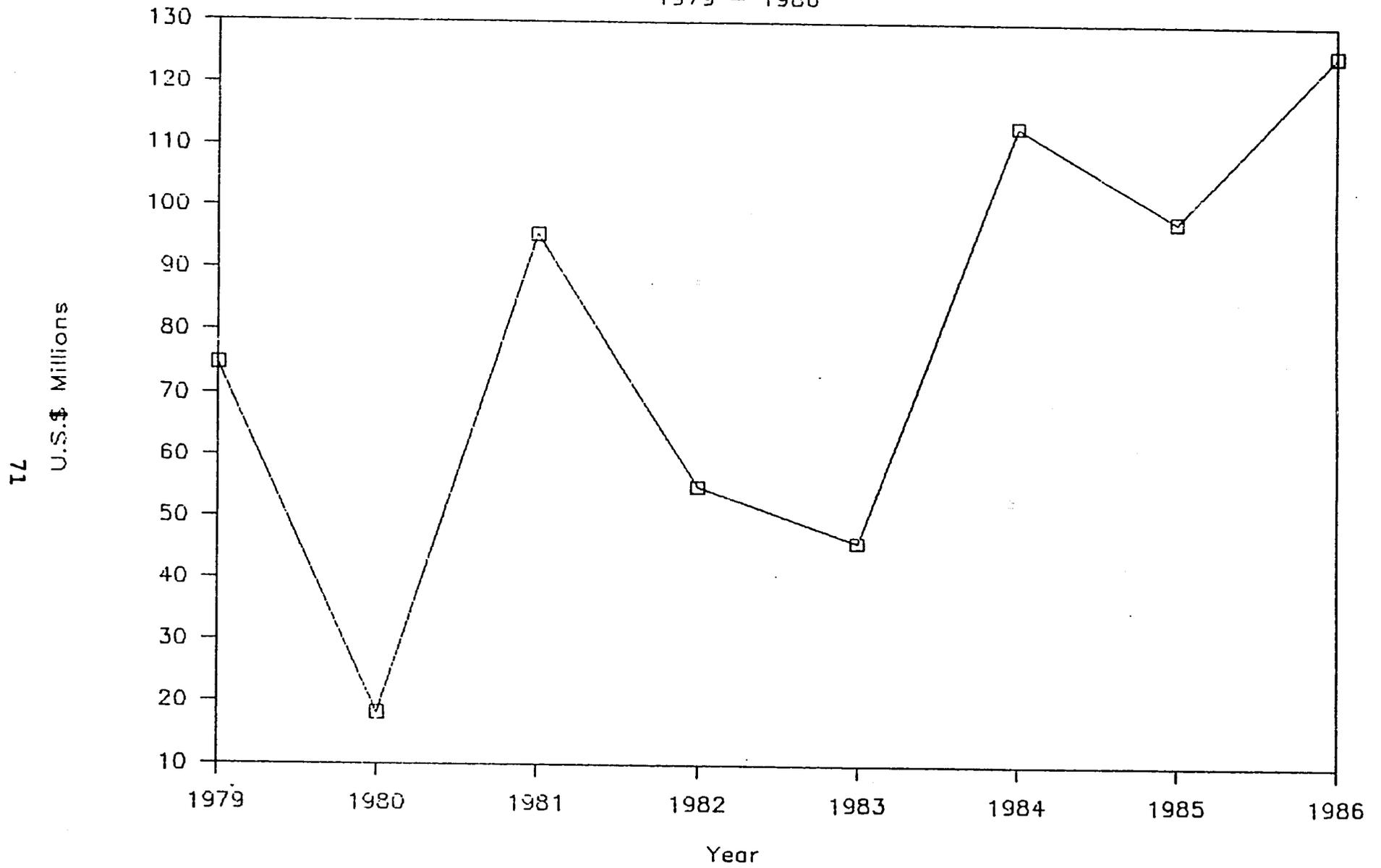


Figure 1

addition, while patent registration is required, it is not enforced, leaving many industries vulnerable to piracy of patented or trademarked goods.

#### INVESTMENT INCENTIVES IN TURKEY

Turkey offers a number of different investment incentives, dispersed throughout many laws and decrees. The most important laws and decrees granting incentives are: Law 6224 of 1980 concerning the Encouragement of Foreign Capital, which covers investment in a wide range of manufacturing industries; Decree No. 86/10353, the "Foreign Capital Framework Decree;" Decree 30 for service and marketing operations and regional headquarters; Law 2634 on the Encouragement of Tourism; and the Free Zone Law 3218 of 1985. The plethora of laws and decrees makes it difficult for investors to sort out exactly what benefits they can receive.

While originally the investment incentives were offered only for a few, specified industries, since October 1984, the incentives have been available to all industries except for a few non-eligible sectors that are listed each year in the Official Gazette. The current list is reproduced in Table 1.

The investment incentives that Turkey offers are listed in Table 2. From the investors' point of view, the most valuable incentives are the exemption from customs duties, the subsidized credit, and the investment and export tax credits. The customs duty exemption reduces duties on imported plant and equipment from the level of 65 - 75 percent to only 5 - 8 percent (the level is not zero because a few small taxes are still levied). Subsidized credit costs only 38 percent annually, far below the going commercial rate of 76 - 85 percent. However, the low-cost funds are scarce.

Table 1

FIELDS OF PRODUCTION AND INVESTMENT  
THAT DO NOT RECEIVE INCENTIVES IN TURKEY (1987)

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(Excluding priority development regions)

**I. AGRICULTURE**

**(a) Animal husbandry**

1. Investments in double-hooved, non-ruminating animals (including priority development regions)

**II. MANUFACTURING**

**(a) Food & Beverage**

1. Production of pasteurized milk and dairy products of less than 2500 tons of milk p.a. capacity
2. Flour
3. Animal feed (excluding integration with animal fattening, meat or milk production)
4. New fish meal and fish oil plants

**(b) Wood products**

1. Pressed wood panels

**(c) Rubber**

1. Automobile tires

**(d) Chemicals**

1. Sodium bichromate, sodium sulfate
2. Carbon dioxide gas (natural sources and production of dry ice are excepted)
3. Petrochemical investments with lower than 300.000 tons p.a. capacity for production of ethylene and final products through polymerization of intermediary products
4. Nitrogenous fertilizer with a capacity lower than 450 tons per day  
a phosphate fertilizer with a capacity lower than 600 tons per day
5. Ammonia with a capacity below 1000 tons/fertilizer

**(e) Iron and Steel**

1. Wire drawing and nail manufacturing
2. Rolling mill investments (excepting continuous rolling mills with more than 400.000 tons p.a. capacity)
3. Iron and steel complexes with oven capacity of less than 2000 cubic metres
4. Porous iron plants with less than 400.000 p.a. capacity in three shifts
5. Steel complex investments producing molten steel for the purpose of making rods and continuous rolling with less than 500.000 tons p.a. capacity
6. Plants that produce less than 2000 tons p.a. in one shift of steel cast pieces; plants that produce in one shift less than 3500 tons p.a. of tempered white and grey cast iron pieces

**(f) Non-ferrous metals**

1. Aluminum extract products
  2. Casting to produce less than 500 tons p.a. metals and compounds
-

Table 1 (Continued)

FIELDS OF PRODUCTION AND INVESTMENT  
THAT DO NOT RECEIVE INCENTIVES IN TURKEY (1987)

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**(g) Automotives**

1. Passenger cars
2. Tractors
3. Trucks, pick-ups, mini-buses with capacity of less than 15.000 units p.a. in two shifts
4. Buses with capacity of less than 2000 units p.a. in two shifts

**(h) Metal products**

1. Fixtures of low quality steel
2. Steel construction of less than 20.000 tons p.a. capacity
3. Steel mesh of less than 5000 tons p.a. capacity

**(i) Cement and ceramic items**

1. Lime powder with less than 30.000 tons p.a. capacity
2. Plaster of paris with less than 10.000 tons p.a. capacity
3. Prefabricated building components and buildings with less 200 housing units p.a. capacity

**III. SERVICES**

**(a) Transportation**

1. Importing of ships
    - Smaller than 5000 gross tons or 7500 DWT
    - Special purpose and specially constructed boats of less than 499 gross tons (factory fishing boats, cold air and cold storage equipped boats for chemicals)
    - Boats older than 9 years for dry goods freighters and for special purpose and specially constructed boats; 5 years for tankers  
Age and capacity limits on imports of ships purchases with 85 per cent foreign credit chose purchasing cost, will be paid by its own foreign exchange earnings:
    - Boats smaller than 5000 gross tons or 7500 DWT and for special purpose and specially constructed boats of less than 499 gross tons
    - Boats older than 12 years for special purpose and specially constructed and for dry goods freighters and 8 for tankers
  2. Dry docks (ship construction and repair yards)
    - Ship construction and repair yards with less than 4000 tons p.a. steel working capacity
    - Ship construction and repair yards with less than 5400 tons p.a. steel working capacity
    - Moveable ship repair yards with less than 80.000 tons p.a. DWT capacity and tugboats, fishing boats, research boats, provisioning boats, touristic boats and other service and special purpose boats and dry docks which will be located on dry dock yard of Tuzla; are not under above restriction
  3. Investments in trailers and towing vehicles (including priority development regions)
  4. Investments in transportation vehicles (excluding municipal investments in buses and investments involving incoming tourism and travel agencies guaranteeing \$ 500.000 foreign exchange earnings)
-

Table 1 (Continued)

FIELDS OF PRODUCTION AND INVESTMENT  
THAT DO NOT RECEIVE INCENTIVES IN TURKEY (1987)

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IV. TOURISM

1. Lodging establishments with less than 100 bed capacity
2. Yacht investments of less than 45 bed capacity. Investments to expand, modernize or enhance the quality of existing plants may receive incentives through an investigation of individual projects even if they are on this list.

PRIORITY DEVELOPMENT REGIONS ACCORDING TO THE TABLE OF  
INCENTIVE

1) REGIONS WITH FIRST DEGREE PRIORITY IN DEVELOPMENT	2) REGIONS WITH SECOND DEGREE PRIORITY IN DEVELOPMENT
1. ADIYAMAN	1. AMASYA
2. AĞRI	2. AĞRI
3. BİNGÖL	3. ÇANKIRI
4. BİTLİS	4. ÇORUM
5. DIYARBAKIR	5. ELAZIĞ
6. GÜMÜŞHANE	6. ERZİNCAN
7. HAKKARİ	7. ERZURUM
8. KARS	8. KASTAMONU
9. MARDİN	9. MALATYA
10. MUŞ	10. K. MARAŞ
11. SİİRT	11. SİNOP
12. TUNCELİ	12. SIVAS
13. VAN	13. TOKAT
	14. ŞANLIURFA
	15. YOZGAT

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Source: "Investment and Export Incentive in Turkey: An Evaluation of Their Advantages," Association for Foreign Capital Coordination, 1987.

Table 2

INVESTMENT INCENTIVES IN TURKEY

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Treatment of Foreign and Domestic Capital

Equal treatment of foreign and domestic capital.

Guaranteed supply of foreign exchange to cover import requirements.

Customs Relief

Customs exemption for imports of capital goods.

Tax Incentives

Investment tax credit. The credit varies from 30 - 100 percent of the investment, depending on plant location and industry.

Income tax exemption for workers in undeveloped regions or high-priority industries, including high-technology, tourism, energy, education, aquatic products, and most agricultural and related investments.

Value added tax postponement.

Export Incentives

Export drawback. Exporters may claim a drawback ranging from 20 - 50 percent of indirect taxes paid, depending on the product (most foods, fresh fruits and vegetables are excluded). Large exporters, with earnings over \$2 million, may claim an additional 6 - 12 percent drawback.

Export tax credit. All taxpaying manufacturers are granted an allowance against taxable income of 20 percent of all export sales.

Other Incentives

Low interest domestic and foreign investment credit. A small amount of credit is available at 38 percent annually, much less than the commercial rate of 65 - 78 percent. Some credit is available at even more favorable terms. The Tourism Development Fund offers loans at 15 percent for up to 60 percent of the total investment cost, for 20 years with a 6 year grace period. The Central Bank will assume the foreign exchange risk on some foreign-currency denominated loans.

Incentives premium on capital goods purchased from local sources.

Accelerated depreciation; State allocation of land; Exemptions from various (minor) taxes, duties and fees.

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The amount of the investment tax credit depends on the geographical location of the plant and the industry; it ranges from 30 percent in developed areas to 100 percent for first priority development areas and high technology, energy, tourism, educations, and aquatic products investments in any region. An investor with a project in a developed area can subtract 30 percent of the cost of the investment, which includes buildings, machinery, equipment, instruments and other depreciable capital assets from taxable income. The tax credit may be carried forward as needed.

As Table 2 indicates, Turkey also offers a number of other incentives. For example, the government guarantees the availability of foreign exchange to cover import requirements. One unique, innovative incentive to encourage both industries and workers to locate in outlying regions is an income and social security tax exemption on salaries for workers in undeveloped areas.

The Committee for the Coordination of Foreign Investment, a private, non-profit group composed of foreign investors in Turkey which represents its members views in public policy debates, has estimated the value of the investment incentives for typical investments in various regions. According to the Committee, the incentives lower the cost of making an investment by approximately 40 percent in a developed region, and by 50 percent in undeveloped regions. These estimates are somewhat exaggerated, since the Committee assumes that companies can receive generous amounts of subsidized credit, which in fact is in short supply. Nonetheless, the calculation illustrates that the incentives can substantially affect firms' financial performance. An executive of one large firm interviewed estimated that the combined investment incentives lowered its costs by 30 percent.

## Light Manufacturing

The Free Zones Law 3218 of 1985 grants firms operating in free zones an exemption from all taxes, duties and charges (employees must pay social security tax, however). Strikes and lockouts are prohibited for ten years after the zones begin operating. Firms are required to pay 0.5 percent of the value of all exports and imports to the Free Zones Establishment and Development Fund set up to build and maintain free zones.

Investors cannot yet take advantage of these attractive incentives to date. There are no free zones in Turkey. Two have been planned, but implementation is running several years behind schedule. One reason for the delay is the extensive state involvement in building and operating the free zones. Nearly all aspects of the zones are regulated, including the number of gates into each zone. The free zones are to be operated by joint stock companies, with 35 percent of the shares belonging directly to the state or public institutions, and 51 percent to the private sector. Bechtel is currently negotiating to build, operate and then transfer a large free zone and port complex in Yumurtalik.

A second reason why free zones have not expanded rapidly is the fact that firms need not locate in a specific area to benefit from customs exemptions. The government treats the whole country as a duty-free export processing zone, and exempts from customs duties all raw materials or semi-finished goods needed for export goods. This is a highly attractive policy stance, since it stimulates export-related growth throughout the nation. Nonetheless, experience in other countries has indicated that free zones greatly facilitate export processing because of the convenience afforded by having on-site customs inspections and facilities.

## Regional Headquarters

While Turkey offers some incentives to regional headquarters, the benefits are not as attractive as those offered by Jordan. Regional sales offices may import office furniture and equipment duty-free, and are not subject to Turkish corporate income tax. However, all employees, including expatriates, are subject to income and social security taxes. The income tax burden is particularly high in Turkey because all benefits, such as housing allowance, cars, etc., are considered taxable by the fiscal authorities.

The restrictions that Turkey places on regional headquarters are standard. As outlined in Decree 30, the sales offices may not sign contracts or conduct business in Turkey. In addition, the offices must pay all local expenses with imported foreign exchange.

The Turkish government encourages the regional headquarters to make a stronger commitment to Turkey and invest in plant and equipment if feasible. The permit to operate a regional headquarters lasts for two years, and is renewable. While renewal is not generally difficult to obtain, nonetheless the government does favor a direct investment.

## Tourism

Turkey offers the same incentives for tourism projects that it extends to industrial projects. As specified in the Tourism Encouragement Law No. 2634, overnight accommodations of more than 100 beds that require an investment of at least 120 million Turkish lira (\$107,000) are eligible for the incentives, which include exemption from customs duties, an investment tax credit, and subsidized credit. In addition, overnight accommodations benefit from a cash premium, the Resource Utilization Support

Fund Premium, that ranges from 5 to 20 percent of the total investment, depending on the size of the investment and the percentage of equity in the total investment. Investments in marinas receive a 20 percent cash premium.

#### IMPLEMENTATION AND PROCEDURES

The application procedure to undertake investment in Turkey was greatly simplified by the incoming Ozal government in 1983. A number of administrative functions were unified in a single agency, the Foreign Investment Directorate (FID) within the State Planning Organization of the Prime Ministry. This Directorate's responsibility was enlarged to review and process investment applications, review and approve licenses, royalty and management agreements, foreign investment tax credits, and working permits for expatriates. In addition, the Directorate was empowered to approve foreign investments under \$50 million, to allow the Council of Ministers to focus only on the larger projects. Previously, the Council of Ministers approval was required for all foreign investments.

All new companies must register in Turkey, but industry is not licensed as it is in Jordan. After registering, a foreign investor seeking incentives must submit a prefeasibility study to the FID that includes 11 exhibits detailing personnel requirements, operating expenses, product type and a cash flow analysis. Investors must submit a detailed list of equipment to be imported, including model numbers and prices. The information requested would usually have been accumulated in the course of analyzing the feasibility of the project, although perhaps it would not have been collected in as much detail as the application requires. The length of the form and the amount of detail mandated is a point of contention among the investors.

Industry specialists within FID review each application. The review takes from two weeks to two months depending on the complexity of the proposal and the length of the negotiations between the investors and the FID. The FID decision on incentives is final for investments under \$50 million. The FID forwards its recommendations on larger investments to the Council of Ministers, which very rarely overturns the Department's suggestion. The Council meets each month to evaluate proposals. One great advantage of Turkey's one-stop foreign investment shop is that when the FID informs the investor of the incentives that will be offered to him, it also acquires many of the necessary permits, including expatriate work permits and municipal permits.

Local investors are eligible for the same incentives as foreign investors, but they apply for them at a different department within the State Planning Organization. Turkish nationals apply for inducements with the Investment Encouragement and Incentives Department. The application form is basically the same for both types of investors and requires approximately the same amount of time for processing.

#### IMPLICATIONS FOR JORDAN

Turkey offers several interesting lessons for other countries interested in promoting foreign investment. First, companies interviewed repeatedly stressed that the prime draw to locate in Turkey is the large, untapped Turkish market. Providing access to new markets is perhaps the most cost-effective measure any government can offer to foreign investors, in that it does not decrease duty or tax revenue, and does attract companies, jobs, investment and technology. Jordan, which lacks a large domestic market, must look outside of its borders for new markets for firms that locate in Jordan. The government may want to consider negotiating additional bilateral

and multilateral trade agreements and expand the scope of existing treaties.

Second, Turkey's economic liberalization in 1980 dramatically illustrated that reducing government intervention leads to growth and investment, both foreign and domestic, as long world market conditions are healthy and sufficiently open to support that growth. Foreign capital inflows into Turkey in the five years following the liberalization totalled approximately \$1.2 billion, which was five times higher than foreign investment inflows during the preceding 25 years. As long as Jordan persists in severely restricting the entry and expansion of firms, it is foregoing substantial opportunities for growth, employment generation and technology transfer.

Turkey's policy of offering incentives for all industries except for a few dozen can serve as a model of investment liberalization. Jordan could extend its incentives to additional industries, or preferably follow Turkey's example and allow all industries except for those specifically excluded to benefit from the inducements. Given the manpower costs for both the public and private sector of applying for and approving incentives on a case-by-case basis, both Jordan and Turkey could consider reducing tax and duty rates either across the board or for given items, thereby reducing the cost of doing business across the economy.

A third important point to be learned from the Turkish experience is the two-fold value that an association of foreign investors can offer to a country that is attempting to attract additional foreign investment. YASED, the private, non-profit Association for Foreign Capital Coordination located in Istanbul, provides valuable information to potential investors. The group is small, with a paid staff of only two, but it meets with potential investors to offer advice, as well as prepares highly

professional publications outlining Turkish investment incentives. With the exception of the Sahab Industrial Estate located 20 kilometers outside of Amman, Jordan currently has no single source of comprehensive, accurate information on incentives, either in Arabic or in other languages.

In addition, the foreign investment group carefully monitors government policymaking on issues related to investment, and serves as an advocate for the interests of foreign investors. The Turkish group legitimately claims partial credit for setting in motion a positively-reinforcing phenomena: As the foreign investment base grew following the 1980 liberalization, the advocacy power of the group increased, laws and regulations became increasingly pro-private investment, and the foreign investment base enlarged further. Jordan may want to consider encouraging its foreign investors to form a similar group.

Turkey's one stop investment approval shop is highly touted by the country in its promotional literature. While this is an ideal worth pursuing, Jordan should probably not try to create a similar institution in the short term. Restructuring government agencies takes a great deal of administrative resources as well as several years. It is extremely difficult to wrest bureaucratic control from its current owner. While Turkey's experience appears to be fairly positive, the experience in most other countries has been that creating a "super agency" is not always worth the effort.

An important message for Jordan from Turkey's experience is the imperative to streamline the investment incentive approval procedure -- to reduce the number of approvals needed and the time required to process applications. It is not necessary to centralize decision making in a single unit, but it is necessary to offer investors a relatively quick, unfettered approval process. Investors in Jordan have not signaled that dealing with

multiple bureaucracies is a serious obstacle, but have expressed concern about the lengthy delays and the lack of comprehension of their proposal within the Ministry of Industry and Trade. Rather than seeking to centralize decision-making, Jordanian authorities could consider focusing their efforts on streamlining the functions that are already within the Ministry of Industry and Trade.

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# TUNISIA

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## Highlights of the Investment Climate in Tunisia

### THE INVESTMENT CLIMATE IN TUNISIA

Tunisia has experienced a number of changes in the external economic environment, and has responded with a series of policy reorientations which are now beginning to show positive results. A number of these policy changes affect the investment climate, including several recent enhancements to the basic incentive regime embodied in a new law governing investment passed in 1987. Perhaps more importantly, though, these changes reflected a shift in economic strategy to open up the economy through increased international trade and investment, to increase the role of the private sector, and develop an industrial strategy encouraging exports based on comparative advantage rather than import substitution. The introduction of these reforms was followed by a change in leadership in late 1987, as the former Minister of Interior Zine Abidine Ben Ali replaced the aging Habib Bourguiba, who had been President since 1957.

As an oil producer and exporter, Tunisia has been directly affected by the developments of the oil market in the 1980s. However, by most standards the country is a minor producer and reserves are expected to be depleted to a point where Tunisia will become a net importer in the 1990s. The economy of Tunisia is also significantly more diversified than other oil producers in the Middle East and North Africa. The value of oil exports has fallen steadily from \$1.27 billion in 1981 to \$690 million in 1985 and only \$350 million in 1986. During this period, manufacturing has grown slowly but steadily and assumed a key role in the economy and in export earnings.

In 1986 the financial impact of cascading oil prices was compounded in other sectors to create a full blown financial

crisis. Earnings from phosphate declined with world market prices; worker remittances decreased as over 32,000 expatriate Tunisians workers were expelled from Libya at the end of 1985; Libya defaulted on over \$130 million of contracts; a severe drought devastated agricultural production; and earnings from tourism dropped 40 percent in response to increased tension with Libya. GDP declined by 3 percent, the first year of negative growth since independence. As a result, Tunisia was unable to meet international payments obligations and negotiated a standby agreement with the IMF. As part of the framework for this agreement, Tunisia also began a process of structural adjustment and liberalization which brought the financial support of the World Bank and major bilateral creditors and trading partners.

The program of structural adjustment involves a fundamental policy reorientation for Tunisia. Since independence, the government has followed policies of tight government control over the economy and insulation from world market forces through a maze of mechanisms including administered prices, production controls, an over-valued exchange rate and rationed foreign exchange, a dominant role for state-owned enterprises, and an investment approval process similar to the licensing of investment in Jordan. The impact of these policies over time was the erosion of productivity in industry, as more and more resources were channelled into an inefficient state-owned sector, and rigidities throughout the economy due to the lack of market mechanisms and administration of prices. The financial crisis of 1986 was to a great degree predicated by the inability of the economy to respond to new developments represented by external factors, as much as the impact of those factors themselves. The movement toward a more open economy has involved a devaluation of the dinar, reduction of tariff levels, an end to most systems of price administration, a reduction in deficit spending and resources allocated to parastatals (and the prospect of widespread privatization,) and a liberalized investment approval

regime, among others. This type of policy redirection often entails severe short run adjustments as resources are shifted out of non-productive or inefficient sectors and enterprises. However, the structural adjustment program has won widespread praise from creditors, trading partners and multilateral institutions, mobilizing significant sources of adjustment assistance.

Notwithstanding the short-term negative impact of the reforms, positive impacts are already becoming evident and are reflected in terms of overall economic indicators. In spite of continued sluggishness in the world oil markets, preliminary results for 1987 indicate a positive growth rate of 6 percent in GDP, paced by strong growth in export manufacturing of 13.7 percent, a resumption of earnings from phosphate exports, increased tourism, and an end of the impact of the drought on agriculture. Indeed, export earnings from manufactures and tourism both outpaced oil as foreign exchange earners in 1987. The response of the economy, particularly in the export sector, has been encouraging and is expected to continue. The actual implementation of the reforms, and their percolation through the economy, will take a period of time.

There are no direct investment statistics available for 1987, and it may take some time for investment flows to noticeably change in response to the policy liberalization. Overall, foreign direct investment has been dominated by the large investments in the petroleum sector, and has declined every year since 1982. Table 1 below shows overall investment flows for these years. In 1986, for example, of the \$89.0 million in foreign investment, only \$4.3 million was in tourism and real estate, and \$2.7 million in manufacturing. For investment in joint ventures, financial institutions predominate with an average of two thirds of the total flows in each year, representing the capitalization of a number of joint development

banks and other institutions with regional capital bases. Only in 1984 was there a substantial investment, \$26.7 million, in joint ventures in the manufacturing sector. Foreign investment remains a small component of overall investment, which has steadily declined in proportion to GDP over this period.

Table 1

INVESTMENT IN TUNISIA  
(US \$ Millions)

	1982	1983	1984	1985	1986
Total Investment	2,607	2,395	2,471	2,220	2,222
Agriculture	344	349	342	379	422
Manufacturing	453	510	469	329	321
Other Industry	703	482	538	459	407
Services	911	853	914	857	889
Infrastructure	197	200	208	196	183
Foreign Direct Investment	372	211	144	143	88
Foreign Investment in Joint Ventures	73.8	62.8	103.4	42.6	44.8
Total Investment as Percent of GDP	32.0	29.8	30.8	26.8	24.6

Source: API, Central Bank Statistics

The light manufacturing sector has been the most promising in terms of industrial investment. It is these types of exports, also including leather goods, toys and some electronics, which are extremely price sensitive and have responded to the devaluation of the dinar. Assembly operations are attracted to Tunisia primarily because of its relatively low cost labor, proximity to European markets, and favorable access to the EEC. German firms have been a strong presence in Tunisia since the early 1970s, with about 90 firms operating in light

manufacturing, primarily garments and electronic assembly. In a recent survey, German firms reported average productivity levels of over 70 percent that of operations in home country facilities, and a generally high level of satisfaction with Tunisian operations.<sup>1</sup> Additionally, representatives of the German-Tunisian Chamber of Commerce indicated that Tunisian affiliates compared well with those in Portugal producing similar goods. There has been little new investment since 1980, however; although additional expansions and new investments are expected to come in the wake of the recent reforms.

#### INVESTMENT INCENTIVES IN TUNISIA

The principal law governing investment in Tunisia, the Industrial Investment Code (Law Number 87.51) was introduced in August 1987, replacing earlier legislation. The primary changes embodied in the new law were an increased emphasis on export industries and a streamlining of the investment application and approval process. Under the new law, industries which export 100 percent of their production do not need approval -- the information requested is for registration purposes only. The Industrial Promotion Agency (API, formerly the Investment Promotion Agency) remains as the government agency responsible for both the regulation and promotion of foreign and domestic investment, and under the new law assumed the functions of two formerly independent agencies responsible for industrial economic analysis and management of industrial land. However, under the new law API is to focus on promotion rather than regulation and approval. This focus, along with the streamlining of the approval process, represents the institutional embodiment of the new thrust to encourage investment undertaken in the reforms associated with the structural adjustment program.

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<sup>1</sup> German-Tunisian Chamber of Commerce, Survey of German Exporters, 1985.

Under the law, investments are treated equally whether they are foreign or domestic. Foreign investors are given a transfer guarantee allowing for repatriation of the original investment and income or profits. The guarantee covers the proceeds from sale or liquidation even if this is greater than the amount of the original investment. However, transfers of capital abroad by Tunisian residents are subject to control by the Central Bank.

The specific incentives are grouped roughly around the classifications of 100 percent exporting and partial exporting, with additional incentives for investments in outlying regions. Separate incentive regimes apply for other sectors, and a few incentives under the new law apply to all other investments provided certain conditions are met regarding financing. Tunisia does not offer specific incentives for regional headquarters or offshore businesses: There has been no investment of this type except for a limited amount in financial institutions under the banking regulations.

### Export Industry

Investment in export-oriented industry receives generous treatment under the new law. The specific incentives applicable include:

- Full exemption from all taxes on profits, in perpetuity
- Exemption of tax on profit distributions
- Refund of customs duties on all imports of capital goods, raw materials and intermediate goods used in production
- Refund of turnover tax on purchases from local distributors of capital goods and production inputs

- Suspension of turnover tax on purchases from bonded warehouses
- Recruitment of up to four expatriate managerial personnel without approval; more by application and demonstration of plans to utilize Tunisians at some point
- Flat rate of 20 percent personal income tax for expatriate managers
- Exemption of social security contributions for expatriate employees
- No clearance required for importation of capital goods (customs declaration only)
- Up to 20 percent of output may be sold domestically with full payment of duties
- No investment approval required, registration only

Additional incentives for location in a designated "industrial decentralization zone," an area outside main population centers are:

- Assumption by the state of infrastructure costs associated with the project
- Assumption by the state of the full cost of the employers' social security contributions for up to ten years

Taken together these provisions constitute an extremely attractive set of incentives for export industry, comparable to that available in some of the most aggressive export manufacturing centers and free zones in other countries. Tunisia has no free zones per se, having made a conscious decision to make the typical incentives associated with free zones available to any export manufacturer wherever the enterprise is located. Perhaps more notable than the specific exemptions from taxation noted above is the express stipulation in the law that the only

taxes due by firms that export all of their production will be those for duties on imports of passenger vehicles, maintenance and sanitation charges, and contributions to the social security fund except as exempted for expatriates or for investments in decentralized zones. This definition of the taxes payable in the law is remarkable, in that it presumably limits the introduction of new taxes not expressly exempted or forgiven in the incentives.

### Partially Exporting Industries

Enterprises exporting a portion of their production are in general entitled to a similar set of incentives on a pro rata basis related to the percentage of production for export. These incentives include:

- Fixed registration fee for incorporation, and any subsequent increases in capital or amendments
- 70 percent exemption on reinvested profits
- Partial exemption on tax on profit distributions
- Suspension of turnover tax on local purchase of capital goods, on construction of facilities, and on goods purchased for export production
- Refund of duties on capital goods used for export production
- Refund of customs duties for imported inputs used in export production, and simplified deposit requirements for temporary admission under the Customs Code
- Exemption from the profits tax on earnings from exports, including sales to firms that export 100 percent of their production
- 20 percent flat tax rate on expatriate managers salaries
- Exemption from Tunisian social security contribution for expatriates

Similar incentives are available for firms locating in decentralization zones, whether they export or not. These include either a 50 or 100 percent assumption of infrastructure costs by the state, depending on the location, assumption of the employer's contribution to social security for five years, and a flat tax rate of 5 percent on corporate profits. The latter can be extended for an additional three years if exports exceed 20 percent of output during the previous four years.

### Other Incentives

A handful of miscellaneous measures were also introduced in the new law to provide a marginal incentive for particular activities. These include the partial assumption of social security costs for firms introducing multiple shifts; similar treatment for the resumption of operations by firms which had closed down; assumption of training costs and royalty payments for the introduction of new technology; and exemption from duties on imported inputs used in the manufacture of capital goods.

### Tourism

Investments in the tourism industry are governed by separate legislation, the Law Encouraging Investment in the Tourism Sector, introduced in September 1986. Foreign investors are guaranteed equal treatment, and again are allowed full repatriation of capital and profits, which is controlled for Tunisians. The principal incentives are a partial exemption from tax on reinvested profits; fixed registration duties; exemption from duty on imported capital equipment; suspension of turnover tax on locally produced capital goods; a refund of import duties on imported inputs in their production; and special considerations for acquisition and preparation of land for

tourism projects. To qualify, projects must be in defined tourism zones, although exceptions have been made.

### Other Sectors

Foreign investment outside manufacturing and tourism is generally strictly controlled and subject to case-by-case determinations. Foreign investment in agriculture is generally allowed only in joint ventures with Tunisians, and in that case cannot purchase land but only lease it for a maximum of 30 years. Mining is basically a monopoly of the state, and petroleum concessions are governed by special legislation with the national oil company normally taking a majority position.

### IMPLEMENTATION AND PROCEDURES

The new Industrial Investment Code streamlined investment application procedures, especially for export-oriented firms. API has a standard six-page application form, which is for notification purposes only in the case of exporting firms -- no approval or qualification is required. The same is true for enterprises not requesting incentives under the law. Otherwise, the application procedure is relatively straightforward, and is handled entirely within API. Notification of approval is required within 30 days. Significantly longer periods may be required in the case of special exemptions or applications requiring substantive determinations by API. API monitors the operations of investment projects to ensure compliance with the original terms of the application, for example to verify the portion of output exported.

This streamlining of procedures has yet to be fully tested. The new procedures were just recently implemented, and the required forms were only made available in January 1988. The streamlining of procedures was explicitly implemented in the new

law in recognition of the counter-productive effects of the control and regulatory function exercised by API in the past. It used to take up to one year to establish a new enterprise. API's perspective had been one of control and extensive scrutiny over domestic as well as foreign investment. The private sector generally operated with the required minimum of contact with the Agency, and its operations were largely regarded as a nuisance only marginally offset by the incentives it could bestow. Whether API can really reorient its activities to become a true promotion agency and assist the private sector remains to be seen. There are plans for undertaking market research to assist firms, and for increasing the promotional presence overseas. First, however, it appears that API will have to earn the confidence of private investors through the efficient administration of its newly defined responsibilities as a promotion and investment assistance organization.

Many foreign manufacturing firms reportedly operate in entirely vertically integrated operations, with a minimum of local sourcing and subcontracting, even for services such as transportation. However, for firms selling in local markets, an association with a Tunisian partner or representative is a virtual necessity, due to the maze of regulations and aspects of local customs and business practices. The presence of a large informal sector is evidence of the large extent of control and regulation in the economy.

On the surface, the new investment incentives offer an extremely attractive package to both foreign and domestic investors in export manufacturing. The major incentives are summarized below in Table 2. To the degree that they are efficiently administered by API, their success in attracting new investment will be limited more by other factors affecting the economy and the constraints to doing business inherent in the remaining controls and regulations on economic activity. Tunisia

Table 2

INVESTMENT INCENTIVES IN TUNISIA

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Treatment of Foreign and Domestic Capital

Equal treatment of foreign and domestic investment.

Guarantee of repatriation of capital (including capital gains) and profits for non-residents. Control of capital outflows by residents.

Customs Relief

In proportion to export sales only.

Tax Incentives

Partial exemption of tax on reinvested profits.

Export Incentives

Full Exemption from income tax in perpetuity, proportional exemption for partial exporters.

No investment approval required -- automatic incentives for 100 percent exporters.

Refund of duties on capital goods, and turnover tax on domestic purchases, in proportion to exports.

Four expatriate managers per enterprise with no clearance required; tax on their salaries at 20 percent.

Refund of duties on imported inputs, refund of turnover tax for domestically produced or sold goods.

Up to 20 percent of export sales allowed to local markets.

Other Incentives

Investment in decentralization zones receives state assumption of infrastructure costs and employers' social security contribution for first five years (ten for exporters.)

Tourism investments receive partial exemption on reinvested earnings, refund of duty or turnover tax on capital goods, and on inputs into locally made capital goods.

Additional incentives for multiple shifts, restart of operations by closed companies, technology intensive investments.

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has a great deal to offer in terms of a base for light manufacturing, which has been successfully developed even in the relatively unfavorable atmosphere prevailing prior to 1986. This sector has been the most responsive to the recent reforms, particularly the devaluation of the dinar, and should mobilize substantial new investment in the future. Tunisia is likely to become even more successful as an offshore manufacturing base for European markets. The questions will be the extent to which this activity penetrates the economy through backward linkages in the form of increased sourcing of local products and services.

#### IMPLICATIONS FOR JORDAN

The Tunisian example is constructive for Jordan in a number of ways. Although its factor endowment and resource base are different, and favor labor-intensive light manufacturing for export markets, the recent policy reforms are instructive. Tunisia is in the process of a major policy reorientation, one which was undertaken only under the pressure of a severe financial crisis. Yet it is beginning to show results in the export sector and should put the country on a sound economic basis for the future. An important component of the reforms introduced was the liberalization of the investment regime. Equally important as the introduction of new incentives was their simplification and extension on an entitlement basis to the priority sector -- export manufacturing. While the government still retains discretionary authority over a number of areas of investment, the simplification represented an acknowledgement of the importance of streamlining procedures and eliminating control over specified areas of economic activity which the government wishes to promote. This approach will do much more to stimulate investment in those priority areas than a complex scheme of evaluating each investment and deciding which ones are to receive favored treatment.

While Jordan may not wish to proceed with widespread liberalization and relaxation of control in the same manner, the Tunisian experience points to a means of accomplishing this for defined priority sectors. By defining which types of economic activity will qualify for increased incentives according to easily recognized characteristics such as export-oriented manufacturing, the most effective means of encouraging investment in those activities is simply to grant the incentives on an entitlement basis without lengthy review, analysis, submission of proposals, etc. This does not remove the prerogative of government policy to direct economic activity. It merely codifies it in a predictable, clear way which removes the obstacles to new investment and makes the actual incentives offered that much more meaningful.

With regard to the incentive measures themselves, most noteworthy is the entire exemption from taxation on export manufacturing. While this may result in a revenue loss to the government, the encouragement of exports and the need for foreign exchange was viewed as having greater priority. The indirect revenue generated through related taxation may eventually recover some or all of the lost revenue; this will depend on the magnitude of the response to the package of measures. The effectiveness of tax holidays is subject to some debate, particularly for foreign investors, as they pay taxes on income repatriated in their home countries unless there is a specific provision in a double taxation treaty allowing for credit against taxes spared. However, the provision of a tax holiday in perpetuity is employed by a number of countries in attracting investment, and needs to be examined in the context of the overall incentive package and that offered by competitors.

The emphasis on exemptions from social security contributions is a meaningful incentive in Tunisia where those costs are relatively high for employers. API estimates that the

overall fringe benefit factor exceeds 40 percent, of which 15 percent alone is attributable to the social security contribution. In other respects, some of the incentives are also related to identified obstacles to investment or acknowledged high costs. The provision for four expatriate managerial staff, for example, was raised from two in the prior legislation and reflects a recognition that the difficulty in applying for expatriate work permits was a real constraint. Here again, the approach was to simplify and streamline the procedure by guaranteeing at least a minimum on an entitlement basis. It is most relevant to Jordan in terms of the approach than the substance of the incentive, as Jordan is relatively open in its acceptance of foreign managerial and technical staff.

The Tunisian example is also relevant from an institutional perspective. The regulation and promotion of investment is centralized in one agency, yet API's ability to function both as a regulatory body and a promotional organization assisting investors is open to question. It will involve a reorientation of priorities and attitudes, which may take some time and may not even develop. It will first have to earn the confidence of private investors by providing them with services and assistance they need and value, rather than with constraints, obstacles and objections to their activities which has been its effect in the past. The situation is somewhat analogous to that of the Ministry of Industry and Trade, if they were to undertake a strong promotional function to encourage new investment.

In summary, the investment incentive regime in Tunisia is most important from a comparative perspective in that it has emphasized the removal of constraints as well as the provision of strictly financial incentives. The fact that control and bureaucratic delay associated with investment approvals was an important constraint is directly relevant to Jordan's investment licensing procedure and the discretionary application of

incentives. The Tunisian reforms also indicate an alternative means of applying blanket incentives on a non-discretionary basis that is in complete accord with government policy priorities: That of defining the qualifying activities on easily identifiable parameters and granting the incentives on an entitlement basis.

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# TAIWAN

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## Highlights of the Investment Climate of Taiwan

The Republic of China on Taiwan is hailed universally as one of the world's true "paradigms" for successful development. The country has achieved average real growth in output of nearly 10 percent for three decades, and is now the world's tenth largest trading nation, despite its population size of under 20 million. Taiwan boasts one of the most dynamic economies known in modern history.

Those who marvel at Taiwan's economic success and prowess often forget that this small island once represented one of the true "basket cases" of the world economy. Over the decades prior to the 1950s, Taiwan was subjected to a successive series of military, political, and economic calamities which in combination ravaged the island's productive capacity. At one point Taiwan suffered from rampant inflation in excess of 1,000 percent annually, declining output, widespread unemployment and political instability, and a total absence of foreign exchange reserves. From this low point, Taiwan has emerged to become a formidable power among developing countries. The causes behind this success are many and varied, but a major contributing factor has been the continuous, careful nurturing of private sector investment.

Briefly stated, Taiwan's highly successful development strategy has been implemented in several discernible phases. The decade of the 1950s was dedicated to the reestablishment of economic stability. Government budgets were brought into balance, the foreign exchange regime was unified, and a major land reform was put into effect. This laid the groundwork for the "takeoff" period of the 1960s, in which the foundation for future growth was established -- laws and institutions for promoting private investment were created, and the government shifted from an import substitution regime to an export promotion

strategy. During this period, the manufacture of labor-intensive consumer goods began to take hold.

In the 1970s, emphasis was placed on coping with the domestic impacts of international economic instabilities, and on renovating and improving the nation's basic infrastructure. In the current decade, Taiwan is learning to live with the consequences of its success, and development policies aim toward the development of high technology production and exports.

Throughout this period, the government took an active role in nurturing Taiwan's basic comparative advantage of a productive labor force. In the early 1950s, the government controlled as much as 80 percent Taiwan's productive capacity. Over time, the government did not divest significant amounts of its holdings, but rather reserved certain industries (primarily in the export sector) for private enterprise. These more dynamic activities eventually grew to the point of overtaking the government share of the economy, which is now around 15 percent of the total.

#### THE INVESTMENT CLIMATE IN TAIWAN

Investors have been drawn to Taiwan because of two centrally important characteristics -- a highly motivated and skilled work force, and a set of economic and investment policies which have been stable over time but have been continuously improved to the benefit of private entrepreneurs. While the country's advantage of low wage rates has eroded continuously, the productivity and skill base of the labor force has more than kept pace. Although the majority of business ventures were initiated to serve Taiwan's internal market, which is small by international standards, most firms quickly outgrew this market and progressively targeted their activities toward exports, primarily to the United States and other industrial countries. Entrepreneurs found that Taiwan possessed the ingredients

necessary to support a profitable base of production, and oriented their operations accordingly.

The government has actively encouraged foreign and domestic investment in Taiwan through a combination of tax benefits, accelerated depreciation, export processing zones, unlimited repatriation of profits, capital and interest, and other incentives for approved manufacturing industries. In 1980, the Statute for the Encouragement of Investment (initially enacted in 1960) was extended for ten years, and extra advantages were offered to firms engaged in priority areas.

Overall, investors see Taiwan as offering a broad range of advantages, including a moderately generous incentive package, a disciplined and well-educated labor force (although unskilled labor remains in short supply), a prohibition against strikes, and an absence of independent labor unions. Instead of striking, unhappy workers "vote with their feet" by leaving for other employment opportunities, which are readily available given the rapid growth of the economy.

Taiwan has combined rapid economic growth with increasing economic equality, which is a noted exception to the general experience of most countries, in which the distribution of income worsens before it eventually improves. The basic needs of the people have long been met, and income is widely and relatively evenly dispersed among the population.

The export-oriented development strategy employed in Taiwan has yielded impressive results. Exports have risen by an average of about 20 percent annually in recent years, to the point where in 1986 Taiwan's trade surplus amounted to 22 percent of GNP. This in turn has led to an amassing of foreign exchange reserves, which totalled as much as \$70 billion by year-end 1987. These reserves are unprecedented in the world, and are sufficient to

cover nearly three years' worth of imports, in contrast to the three-month coverage most major countries have as central bank reserves. This performance has led to increasing pressures for Taiwan to liberalize its import policies and effect a major appreciation in the Taiwan dollar. Over the past year, the Taiwan dollar has risen by nearly 40 percent against the U.S. dollar.

#### INVESTMENT INCENTIVES IN TAIWAN

The legal basis for all private enterprises operating in Taiwan is founded in a body of law covering incorporation, income taxes, customs, patents and trademarks, and labor practices. These laws, as well as those described below, are revised periodically as business climate opportunities and constraints evolve. Over time gradual changes have tended to be in favor of private business interests, particularly in reducing government controls and regulations. Investment in Taiwan has been promoted by three important statutes:

The Statute for Investment by Foreign Nationals, first enacted in 1954, governs foreign investment in Taiwan by individuals other than Overseas Chinese. In substance, the statute covers exchange settlements, repatriation of capital, and protection against expropriation. Under this framework, the only legal grounds for nationalization is national defense. To date, there have been no cases of nationalization. Twenty-year guarantees against nationalization are available for firms in which foreign investors hold equity of 45 percent or more. Firms with less than 45 percent foreign ownership are offered guarantees of reasonable compensation.

The Statute for Investment by Overseas Chinese was enacted in 1955 and is essentially the same as that described above, except that it relates to investments made by Chinese living

outside Taiwan. Authorities make this distinction as a result of political and foreign relations considerations.

The Statute for Encouragement of Investment, first enacted in 1960, constitutes the centerpiece of Taiwan's incentive system. Foreign or local firms which qualify for eligibility under this statute may negotiate a range of incentives. The major benefit is a five-year corporate income tax holiday with an optional four-year grace period before the holiday begins. Other incentives include accelerated depreciation and other tax benefits, exemption from import duties, and preferential land site arrangements. This statute guarantees equal treatment of foreign and local businesses. It also stipulates the right to obtain foreign exchange in order to remit profits, interest, and other earnings, as well as the right to repatriate capital.

Under the various statutes for investment, foreign investors may enjoy a number of specific incentives and privileges which are summarized in Table 1. One of the most important inducements is a five-year tax holiday on corporate income tax or accelerated rates of depreciation on fixed assets. Capital or technology intensive industries, at their option, may defer the application of the tax holiday by one to four years after startup. In addition, firms may repatriate 20 percent of the total invested principal after one year's operation and are eligible for drawbacks of duties paid on imported inputs.

Eligibility for treatment under this statute is determined by the government, which maintains a list of qualifying industries and other business activities. This list changes over time, focusing on industries considered of particular value to the Taiwan economy. In recent years, emphasis has been placed on investments which increase exports, the flow of technology to Taiwan, the exploitation of natural resources, and the development of local infrastructure. The previous focus on basic

Table 1

INVESTMENT INCENTIVES IN TAIWAN

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Treatment of Foreign and Domestic Capital

Foreign and domestic capital are treated equally under the law.

Guaranteed remittance of yearly income, net profits and interest.

Right to repatriate 20 percent of the total invested principal after one year's operation.

Protection against government expropriation or requisition for 20 years, provided the foreign investment in the enterprise is maintained at or above 45 percent of the total registered capital.

Customs Relief

Exemptions from or installments payments of import duties on capital equipment.

Tax Incentives

Five year tax holiday on corporate income tax, or accelerated rates of depreciation on fixed assets. Capital or technology intensive industries, at their option, may defer the application of the tax holiday by one to four years after startup.

Corporate tax on productive enterprises is only 25 percent, and only 22 percent for specified capital and/or technology intensive industries.

Export Incentives

Refund of import duties for imported raw materials used in export products.

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industries and labor-intensive production activities has been superseded by high technology, high value added, and low polluting industries. The current list of "priority" industries includes over 100 products, many of which fall into the following categories.

- Nuclear power, fuels and boilers.
- Computer peripherals and terminals.
- Heavy duty trucks.
- Motors and turbine generators.
- Pollution control equipment.
- Sophisticated machinery and machine tools.
- Precision testing equipment.
- Communications apparatus.

Investors may seek incentives for products not included on the list of "priority" commodities. They would simply offer a rational justification for why their commodity or activity should be eligible for incentives.

Through eligibility for incentives and other policy mechanisms, the government seeks to direct the industrial development of Taiwan away from activities in which Taiwan is losing its international competitive edge and toward industries which fit into the nation's long-range economic plans.

#### IMPLEMENTATION AND PROCEDURES

Investment related activities -- promotion, approval and regulation -- are all housed organizationally within the Ministry of Economic Affairs (MOEA). The Industrial Development and Investment Center (IDIC) has served as the locus of investment promotion activities for nearly three decades. It maintains active links between private investors and government agencies,

and formulates proposals and coordinates government activities to encourage investment.

The Investment Commission represents the governing body overseeing all investment in Taiwan, including the approval of investment applications. Housed within the MOEA, the Investment Commission is staffed by representatives from all government bodies concerned with investment. These include the IDIC (which serves as a secretariat) and Industrial Development Board of the MOEA, the Ministries of Finance and Interior, the Central Bank, the Taiwan Construction Department and the Board of Foreign Trade. The Investment Commission meets bi-weekly to render final judgments on investment applications. The time required for screening and approving applications is normally less about one month.

There is no standard form for applications for investment incentives. The IDIC provides a ten page document describing the information required in applications, which may vary in length. Prospective investors must provide information regarding their qualifications, including balance sheets and references. Most important is the presentation of a business plan for the venture, including data on the product and production method envisioned, projected employment and exports, machinery import requirements, capital requirements, and timing of the investment. To this must be added a justification of the investment, which essentially describes the economic benefits to be generated by the venture.

The Investment Commission maintains four in-house departments which carry out ongoing screening activities. These include the Foreign Exchange Department (staffed by representatives from the Central Bank), the Export/Import Department (Board of Foreign Trade) and the Industrial and Commercial Department. After these departments have granted their approval, the Foreign Investment Application (FIA) is

passed to the IDIC, which works with the investor to obtain a final approval by the full Investment Commission.

In terms of investor assistance (but not approval), the IDIC acts as a "one stop shop" for investors, coordinating investment related activities such as applications for approvals and incentives, land purchases, tax and foreign exchange settlements, or problems associated with the establishment of factories. The staff also serves as "trouble-shooter" for investors with projects already in operation.

In spite of the relatively efficient system described above, many investors have complained that the government's bureaucratic structure for governing investments can be sufficiently burdensome to discourage potential investors. Therefore, the IDIC has been established to serve as an advocate for investors, assisting them in dealing with regulations and other forms of red tape. Many of the IDIC's core staff have been recruited from the ranks of the business community.

In addition to the incentive system described above, Taiwan promotes investments through several other mechanisms, as described below.

Industrial Estates. To facilitate the acquisition of land by investors for industrial purposes, the government has designated land at over 120 sites throughout Taiwan as industrial land. These sites are all accessible to transportation links and are located in areas with available labor supplies, water and sewage systems, power and other services.

Export Processing Zones. Taiwan was a pioneer in the development of export zones, establishing its first zone at Kaohsiung in 1966. Additional zones have been created in other urban centers. Potential investors in zones are offered tax

concessions, exemption from customs duties, simplified application procedures, preferential financing, and warehousing and transportation services. The zones have been instrumental in Taiwan's initial export push, but have declined in importance as investments have been made and incentives granted for ventures throughout the economy.

Investors in processing zones receive exemptions from customs duties on imported machinery, equipment, spare parts and raw materials; exemptions from sales and commodity taxes; a five-year tax holiday on corporate income tax or accelerated depreciation on fixed assets; simplified procedures to enable investors to handle all phases of operation expeditiously within the zones, such as investment applications, company registration, construction licensing, import and export licensing, foreign exchange settlement, etc.; a choice of building on leased land or purchasing a standard factory building on a 10-year installment plan; and complete and inexpensive warehousing and transportation facilities in the zones.

Hsinchu Science-Based Industrial Park. This industrial park is the first developed in Asia exclusively for high technology industries. It is essentially an extension of the export processing zones, and is oriented toward serving Taiwan's current objective of implementing a structural change toward high technology activities. The park was established in 1980 in an area where a number of higher academic institutions of science and technology are located. Industries sought include electronics, computers, information systems, precision instruments, and advanced materials. Approved firms receive a battery of incentives similar to those offered in export processing zones, but augmented in certain respects, primarily in access to local capital and loan funds.

## IMPLICATIONS FOR JORDAN

The success of the Taiwan "model" for development has been the result of painstaking policy reform, hard work, and an increasing priority placed on private enterprise. Over time, the government gradually unleashed the creativity and energy of private entrepreneurs, both domestic and foreign through the dismantling of policy-induced constraints to investment. Foreign investment approvals have climbed steadily over time to levels approaching \$1 billion annually (see Figure 1).

Several characteristics of Taiwan's experience are relevant for consideration in Jordan. One is the sound strategy to establish incentives for "priority" activities and areas, and then to extend these incentives to encompass increasing spheres of activities. The government first established "exceptions to the rules" to stimulate investment, and eventually made the incentives the norm instead of the exception. The economic activity generated by new investments was sufficient to offset the cost of foregone tax revenues.

In the past, the power of the Chinese bureaucracy was renowned by world standards, and the red tape encountered for investors was enormous. While bureaucratic inertia remains a problem in other areas, the authorities in Taiwan have acknowledged the fact that an efficient investment approval system is vital to attracting foreign investment. This has led to the creation of a system in which decisions are reached in approximately one month. Applications require no more information than that which any serious investor would prepare in a standard business plan.

The incentives package offered by the authorities in Taiwan is no more attractive than that offered in most countries, and some would suggest that incentives are at lower levels than in

# Foreign Investment Approvals in Taiwan

1978 - 1985

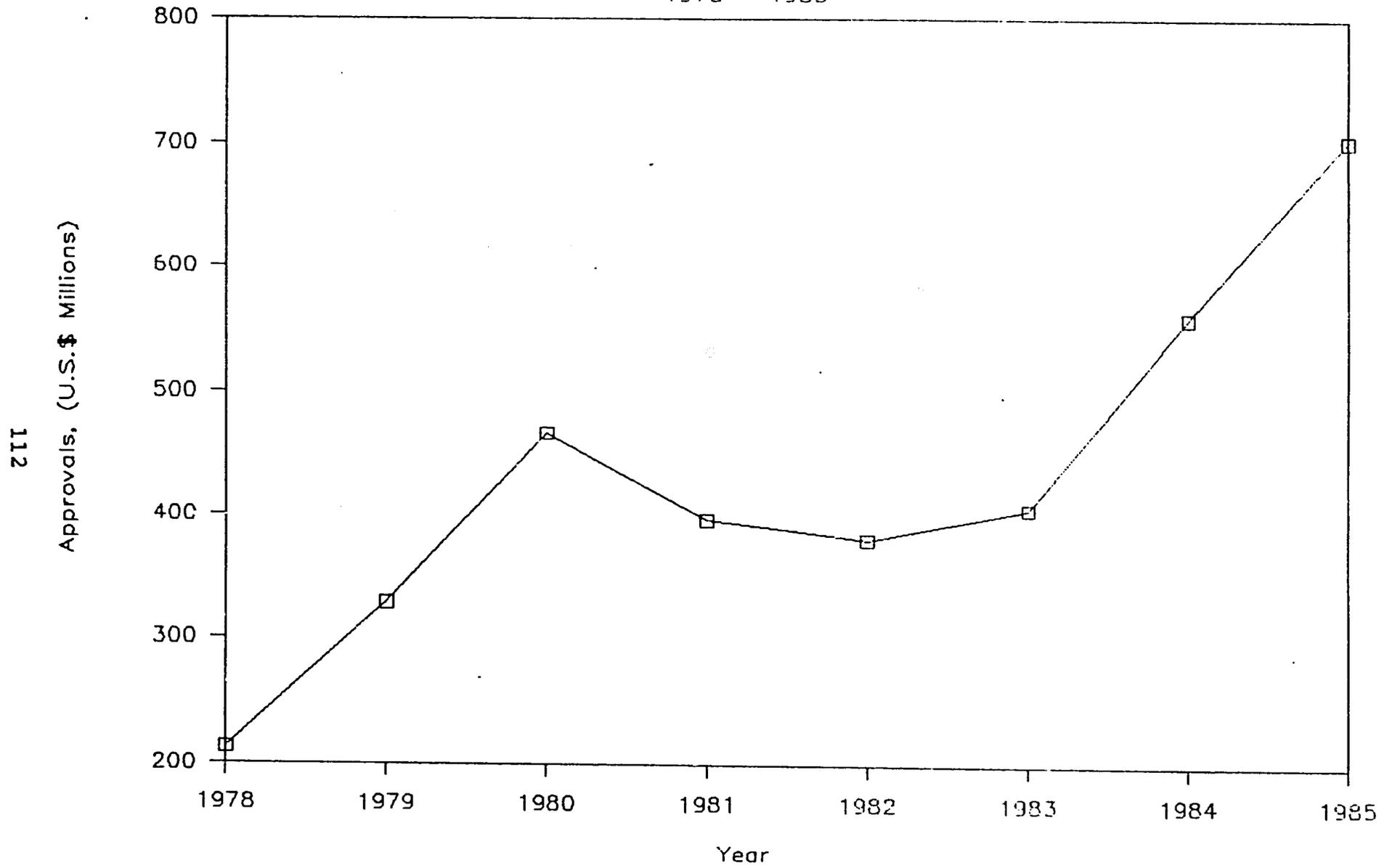


Figure 1

regional competitor countries. Jordan should consider the inclusion of a grace period prior to the initiation of tax holidays, since many operations do not achieve positive returns during startup periods. However, the basic lesson is that investors are attracted to Taiwan for sound business reasons rather than simply the form and level of incentives provided.

Perhaps the most instructive inference to draw from the Taiwan experience relates to attitude and approach. In its early stages of development, the government felt -- with some legitimacy -- that it should control or regulate almost all forms of economic activity. Over time, the government gradually extended more freedom of action to the private sector, and let business "carry on with business." This attitude allowed the nascent entrepreneurship of the Chinese people to take hold and flourish. To be sure, serious problems remain, such as widespread tax evasion. However, the benefits generated by private enterprises in the form of productive employment, foreign exchange earnings and higher standards of living have far outweighed the costs.

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# CYPRUS

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## Highlights of the Investment Climate in Cyprus

A small island nation off the coast of Turkey in the Eastern Mediterranean, Cyprus has long been subject to bitter rivalry between ethnic Turkish and Greek populations. The island has been a source of controversy for those two nations since its independence from England in 1960. The Turkish Army occupied the northern third of the country in 1974, leading to outright civil war. Efforts to work out a permanent solution to the political bifurcation of the nation have stalled since that time, although troop levels of both Greek and Turkish armies on the island have been reduced. A United Nations peacekeeping force still polices the border zone between the two sectors.

Although the Turkish sector proclaimed an independent "Turkish Federated Republic of Cyprus" in 1983, it has been recognized only by Turkey. This investment climate analysis deals only with the Republic of Cyprus, or Greek Cyprus, which is referred to simply as Cyprus in this report.

The economy of Cyprus has only recently recovered from the civil strife that dominated its history in the 1970s, paced by a resumption of growth in tourism, the exploitation of Middle Eastern markets for manufactured goods, and the burgeoning services sector. Preliminary results for 1987 indicated a growth rate of 7.0 percent, an unemployment rate of 3.5 percent, and a current account surplus. The trade deficit continued to narrow, as exports increased by 24 percent, with manufactured exports growing by 36 percent (75 percent for clothing). The deficit was more than offset by a surplus on the invisible account of almost \$900 million, consisting largely of earnings from tourism, but also including remittances and services earnings. Cyprus recently negotiated an agreement for a full customs union with

the EEC, to be implemented over a 15-year period beginning January 1988. The impact the customs union will have is not yet clear, but it is evidence of the increasing orientation of trade to Europe and away from the Middle East.

The government of Cyprus maintains an open policy regarding private investment in general, while controlling or otherwise directing foreign investment to reflect defined economic priorities. With the exception of the offshore companies and tourism, there has been very little foreign investment, especially in manufacturing. Domestic investment is largely unregulated, with the provisions of the Companies Law and the tax code being the principal governing pieces of legislation. Indeed, even the introduction of zoning legislation governing land use raised questions of unconstitutional interference in private property decisions. In general, the climate for private investment is extremely open and liberal, and the economy is characterized by a strong private enterprise orientation, with a minimum of control and direction from the government.

The direction provided to both foreign and domestic investment is accomplished through the provision of financing and through investment incentives, primarily through exemption from taxation. In this sense the incentive regime more closely resembles that of a developed industrial economy as it comprises a complex and overlapping series of finely-tuned adjustments to the tax code. One area of significant control over both foreign and domestic investment has historically been close regulation of foreign exchange by the Central Bank. Foreign investment is controlled primarily through limitations on the degree of foreign ownership of enterprises, which vary depending on an evaluation of the economic benefits of the proposed projects. Domestic industry is protected from foreign competition through import tariffs, the control of foreign investment in "saturated"

sectors, and the lack of incentives for new ventures competing with existing producers.

## INVESTMENT INCENTIVES IN CYPRUS

Cyprus offers a number of incentives to new investment through tax holidays and other exemptions. These vary according to several groupings: Those applicable to all investment, those for foreign investment, those for investment in free zones, and those for offshore companies. The combined effect of the incentives comprises an extremely competitive regime governing new investment.

### All Investment

New Products. Domestic and foreign investment in the production of "new" products receive a 10-year exemption from taxes on profits. Dividend income paid out of exempt profits is also not taxable. A new product is one not being produced in Cyprus at the time of the investment. The Ministry of Commerce and Industry publishes a list of products which are considered "new."

Fixed Assets. Investment in fixed assets is encouraged through the provision of generous write-offs for capital equipment and other fixed assets. An "investment allowance" can be taken for up to 45 percent of investment in plant and machinery above the amounts depreciated or otherwise expensed. This amount is deductible against taxable income in the year of the investment, according to the following schedule:

	<u>Public Companies</u>	<u>Other Businesses</u>
Plant and machinery	45%	30%
Industrial buildings	30%	20%
Other buildings	15%	10%

The "other buildings" category does not include residential housing. Tourism investment allowances differ according to the region and class of facility, with up to a 25 percent allowable for five-star facilities or facilities outside the areas already developed. The differential for public companies corresponds to other incentives where a marginal incentive is granted for publicly held companies, as part of an effort to encourage the development of traded shares and the stock market.<sup>1</sup> In addition to the investment allowance, capital expenditure in manufacturing and agriculture can also be entirely expensed in the year of the investment. This measure, along with several others, was originally set to expire in 1987; however, the government has made a practice of routinely extending the deadline for additional periods. The effect of these two measures is that up to 145 percent of the cost of capital investments may be expensed in the year of the investment. Capital goods are also exempt from import tariffs and any sales or other taxes, as are non-capital but "durable goods" imported for use in tourist facilities. Income which is used to finance new investment is taxed at a lower rate of 25 percent, instead of the standard corporate rate of 42.5 percent. In order to qualify for this lower rate, the money must be deposited in a specially earmarked account which is to be used only for reinvestment.

Exports. Raw materials and intermediate inputs used in the production of exports are normally free of duty, excluding goods produced locally. Duty drawbacks may be allowed for certain goods not qualifying for exemption. Three percent of the amount

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<sup>1</sup> Public companies are defined as having at least 200 voting shareholders; where no one entity holds more than 40 percent of the equity and the total of shareholders with more than 10 percent of the equity do not collectively hold more than 70 percent; and the issued and paid-up capital is more than CP 300,000. A wholly-owned subsidiary of a public company is also considered a public company.

of net foreign exchange earnings from exports is allowable as a deduction against taxable income. This may be increase to 6 percent for priority goods, which in practice has meant all categories of locally produced and manufactured products. Thirty percent of the income (remitted to Cyprus) from services exports is exempt from taxation; 90 percent for employment services to private firms overseas. Similarly, 90 percent of any profits or dividends remitted to Cyprus from overseas is exempt. Income from merchant shipping is entirely tax exempt.

Financing. The Central Bank administers the "Fund for Financing of Priority Projects" which makes long term funding available to local investors. The terms and rates vary according to the project and with general conditions in the financial markets, but are more favorable than those available from standard commercial sources. This fund is financed by a mandatory allocation of 7 percent of all deposits in commercial banks, and is available for new projects in sectors other than those designated as traditional or saturated. For this purpose or for general borrowing from local banks, a company with up to 24 percent foreign capital is considered eligible. Otherwise, foreign firms may borrow locally only for working capital needs.

In addition to these incentives, there are a number of other very specific or closely defined tax incentives. These include incentives for mergers (an additional investment allowance of 25 percent); public companies (a tax rate of 25 percent, CP 600 dividend exemption, deduction of 30 percent of share purchases for new investments or conversion of an private company); mining companies (investment allowances of 25 percent); and other less relevant incentives. The tax code also contains numerous provisions which are generally encouraging to investment, although they may not normally be considered incentives. These include indefinite loss carryforwards and avoidance of double taxation of corporate profits and dividends.

## Foreign Investment

Foreign investment is controlled and encouraged in priority sectors principally through restrictions on the degree of foreign ownership. Other than this differentiation, foreign investment is generally treated equally with respect to the tax incentives outlined above. (The other principal arena for foreign investment, Offshore Companies, is treated separately.) The Cypriot government has also adopted a number of tax exemptions aimed at attracting investment from current or former Cypriots with assets abroad.

The government announced a new policy to encourage foreign investment in November 1986. The importance of these new policy guidelines was not the introduction of new incentives as much as the rationalization and codification of the existing set of regulations, and an attempt to streamline the procedures for approval. The stated purpose of the restrictions on foreign investment is to direct that investment to areas considered economic development priorities. In actual fact, the effect of the restrictions may not be all that great as they concern areas which may be of little interest to foreign investors. For the purpose of determining the degree of foreign participation, there are seven basic categories with standard allowances.

1. New products: Up to 49 percent foreign participation is routinely approved, with a higher percentage if the project is desirable and involves an investment in equipment of at least CP 100,000.
2. Export manufacturing, companies operating in the Larnaca free zone or with bonded factories: Up to 100 percent.
3. Tourism: Up to 49 percent, but the investment must be in accord with the tourism development priorities of the Cyprus Tourism Organization.

4. Traditional activities: Up to 24 percent is routinely granted. This group includes most manufacturing currently undertaken in the country. Up to 49 percent may be granted for particularly attractive projects.
5. Saturated activities: No foreign investment is allowed, except under special circumstances. This category includes trade, construction, restaurants, real estate, and certain other services.
6. Specific Treatment: This grouping includes activities which are subject to extensive specialized regulation or government operations, and foreign participation is reviewed on a case-by-case basis. This group includes banking, public utilities, insurance, telecommunications, education, radio, and television.
7. Residual activities: Up to 49 percent is routinely granted in any other sectors not specifically covered by this breakdown. The residual activities includes the majority of the services sector, and certain manufacturing activities which are considered neither new or traditional.

As with the category of "new" products, the government publishes lists of what sectors, industries, or services comprise each of these categories. In order to secure approval for a higher degree of foreign ownership than that routinely allowed, the following criteria must be addressed in the project proposal:

- the introduction of manufacturing of new products;
- manufacturing for export, or expanding into new export markets or extending existing ones;
- the introduction of new technology and production methods;
- the improvement of the production structure and quality standards of products; and
- the extent of positive and negative effects on existing firms.

If these criteria are met, approval for up to 100 percent foreign ownership may be granted. There is no strict formula for evaluation, and these exceptions are handled on an individual basis.

Exchange Controls. Although overseas investment by Cypriot citizens is closely controlled, repatriation of capital and profits by foreign investors is allowed. Unless otherwise exempted, as noted above, profits will be subject to taxation.

### Free Zones

Companies locating in the Larnaca Industrial Free Zone benefit from several incentives in addition to the others for which they qualify. One-hundred percent foreign participation is routinely allowed, and free zone firms receive the typical exemption from customs duties for any imports. While these incentives are also available to export manufacturers outside the zone, they are combined as a standard package for any firm operating in the free zone. Two principal additional incentives are offered:

- dividends paid to expatriate shareholders are taxed at the lower of the rate which would apply to either the corporate profits or the dividend. This has the effect of ensuring that exemption from taxation is passed on to the shareholder.
- income of foreign employees of free zone firms is taxable at 50 percent of the otherwise applicable rate.

Although these may be powerful incentives to certain specific investors, their marginal effect has not been evident: Only seven firms have located in the zone to date and the zone itself has not been a particularly successful development.

## Offshore Companies

An offshore company is defined as a Cyprus company owned by foreign persons which has no operations in Cyprus (i.e., which derives no income from Cyprus.) A typical offshore company is a sales or management headquarters operation for the Middle Eastern region.

Cyprus has had a great deal of success in attracting companies who operate headquarters covering business operations elsewhere in the region. Beginning in 1977, the government adopted a series of incentives and special tax treatment for what are referred to as "offshore companies" in an attempt to capitalize on the many advantages the island had as a center for offshore business in the wake of the departure of many such companies from Beirut. Cyprus has not attempted to establish itself as a total "tax haven" and does impose a nominal tax on the profits of offshore companies.

The principal incentives for offshore companies are as follows.

- taxation of profits at 4.25 percent (one-tenth the normal corporate tax rate);
- taxation of profits of overseas branches managed and controlled from Cyprus at 4.25 percent, and full exemption if control is outside Cyprus;
- no withholding tax on dividends remitted overseas;
- exemption from estate duties, capital gains taxes (except for real property located in Cyprus), and stamp tax;
- exemption from social insurance taxes for expatriate employees;

- taxation of income of foreign employees at one-half the normal rate, or one-tenth if working overseas but paid from Cyprus;
- duty-free importation of cars, office and household equipment for use by both the corporation and foreign employees;
- freedom from currency restrictions, and the right to maintain bank accounts in foreign exchange; and
- expedited work permits for expatriate employees.

In addition, offshore partnerships and offshore branches of overseas companies are fully exempt from taxation on profits.

#### IMPLEMENTATION AND PROCEDURES

For domestic investment, there is no approval process per se, nor is there a specific registration process beyond the normal steps taken to establish a company or other business organization. The Central Bank is the principal government agency generally responsible for approval of all foreign investment. The Central Bank has assumed this role in Cyprus because foreign investment is controlled under the exchange control law. The Central Bank seeks the guidance of relevant Ministries of the government for evaluation of foreign investments submitted for approval, but this is largely an advisory role. However, its role covers all aspects of evaluation of proposed projects, not just the foreign exchange considerations, and the Central Bank is truly the one institution governing foreign investment. There is a formal Advisory Committee on Foreign Investment which consists of representatives of the Central Bank, the Ministry of Finance, the Ministry of Commerce and Industry, and the Planning Bureau. This committee handles any projects which cannot be assessed by the Central Bank through its normal consultative process. Companies investing in the Larnaca Industrial Free Zone do not apply to the Central Bank

but rather to the Ministry of Commerce and Industry which manages the zone.

Foreign investors must submit an application describing the project and the investor group. The Central Bank uses a standard six-page, 32 question form which solicits information on the background of the proposed enterprise, the capital structure and financing requirements, project costs, projected employment, and a description of the activity proposed. The Central Bank must respond within 30 days to the application. The Bank may request additional information and clarification, which can raise the total time for decision on the approval to 60 days. The referral of cases to the Advisory Committee is only for exceptional projects. The principal determination the Bank makes is the degree of foreign ownership allowed, in accordance with the guidelines and criteria described above.

The qualification for incentives is not subject to determination by the Bank as such, as this is determined by the character of the project, i.e. export-oriented, new products, etc. The application to the Bank does serve, however, as the basis for describing its character and classification. The Bank does reserve the right to reject applications in "saturated" sectors and will routinely do so. The same holds true for tourism investments that do not fall into the priority guidelines issued by the Tourism Organization. The Bank also will regard investments by Cypriots living abroad more favorably than others.

The approval of Offshore Companies is also regulated by the Central Bank. In this case there is no standard form or application, and the procedures are relatively simple and fast. Information on the parent company and the intended operations in Cyprus, along with Bank or other references, is normally sufficient for approval. For a publicly-held company with published annual reports and references from major banks, the

approval can be effected in two days. Most offshore companies engage Cypriot accounting and legal firms to assist in the formation of the Cyprus company.

No single agency or group in Cyprus is responsible for the promotion of foreign investment. The major informational publications are issued by the Central Bank, but also by local accounting firms. The government is currently exploring options for establishing a promotional function, as distinct from the regulatory and informational one.

## CONCLUSIONS

In general, the climate for investment in Cyprus is extremely attractive. The government has implemented a series of incentives designed to allocate resources in a manner consistent with its economic development priorities, and has done so without extensive controls on the economy or on private investment decisions. The incentives discussed above are summarized by sector in the Table 1 below.

Perhaps most importantly, the implementation of the incentives is efficient and predictable. The concentration of the review and approval function for foreign investment in the Central Bank has streamlined the process, and there appears to be a minimum of bureaucratic delay. However, Cyprus has not succeeded in attracting large flows of foreign investment, and the government still maintains controls on outward capital flows. Foreign direct investment inflows into Cyprus have fallen steadily, from \$78.4 million in 1981 to \$46.5 million in 1986. This investment has been dominated by investments made by Cypriot expatriates and has been mostly in the tourism sector.

Table 1

INVESTMENT INCENTIVES IN CYPRUS

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Treatment of Foreign and Domestic Capital

Foreign capital controlled. Investment approval, participation limited by sector and project; domestic investment largely unregulated.

Repatriation of capital and profits guaranteed even with other exchange restrictions in effect.

Customs Relief

Exemption from Customs duties for all imports of Capital Goods.

Tax Incentives

Corporate Profits Tax. Ten-year tax holiday for investment in manufacturing of "new products." Lower tax rate (25 percent vs. 42.5 percent) for public companies, and on earnings retained for internal financing. 4.25 percent tax rate for offshore companies.

Fixed Assets. Immediate depreciation; investment allowance of up to 45 percent in addition to depreciation.

Personal Income Tax. Taxation at 50 percent of the normal rate for expatriate employees of offshore companies, and companies operating in free zones.

Export Incentives

Customs Relief. Exemption from duty for most inputs into export products. Duty drawback for other inputs.

Tax Deduction. 3-6 percent of export proceeds is deductible from income.

Services. 30 percent of foreign exchange proceeds from services is deductible from income; 90 percent for employment services.

Other Incentives

Financing. Long term, low interest credit available through special fund at Commercial Banks.

Offshore Companies. Additional incentives for regional headquarters and other offshore companies, such as duty free importation of cars, personal effects and office equipment. Rapid (several days) approval process, ease of operations.

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The one sector which has been successfully developed in Cyprus is that of offshore business.<sup>2</sup> Since 1977, over 4,500 companies have received approvals to operate offshore companies; 1,200 have actually set up operations in that time and 630 are now operational. Of these 630, approximately 100 are regional offices of large multinational companies, about 120 are shipping companies, and a large portion of the remainder are small trading operations. The offshore companies employ 1,350 expatriates, with 2,500 dependents resident in Cyprus, and 1,200 Cypriots. The average number of employees is 4 per company. However, this figure is misleading, inasmuch as the regional offices of multinationals typically employ 20-30, whereby many of the small private offshore companies are one-man operations. Offshore companies recorded direct expenditures of CP 26 million in 1987, not including living expenses which raises the total to around CP 39 million (\$87 million.) The Central Bank estimates total direct tax revenues from offshore businesses, including tax on employee salaries, at CP 3 million (\$7.0 million) in 1987.

The principal advantages of Cyprus as an offshore business center are its proximity to the Middle East, the relatively low cost of living, good communications and transportation links, and ease of operation. One executive interviewed indicated that his offshore company moved one year ago from Bahrain, and produced indicated savings of over \$1 million in its first year of operations in Cyprus. The companies contacted all indicated a high degree of satisfaction with Cyprus as a site for offshore business, including a number which had recently moved from other locations, including Greece, Lebanon, and Bahrain. A typical reaction from firms contacted was that one could operate in an

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<sup>2</sup> The information on offshore companies is based on data from the Central Bank from its annual survey of offshore companies, and from a survey on offshore companies undertaken by Coopers & Lybrand, Developing Cyprus as an International Financial and Commercial Center.

essentially European environment, be close to markets or operations in the Middle East, and conduct business with maximum freedom and less cost than either the alternatives in Europe or in the Middle East. A recent survey of offshore companies revealed that only four general factors out of 26 thought to affect offshore business were ranked as unsatisfactory--exchange controls, the need for bank references, the need to disclose the names of bearer shareholders, and economic and political instability.<sup>3</sup> The majority of tax and non-tax factors were ranked satisfactory, with only the cost of living ranked excellent. Several disadvantages, such as the lack of embassies for some Middle Eastern nations and therefore the inconvenience of obtaining visas for travel, also pose constraints to the further development of offshore business. However, Cyprus is well positioned to continue to attract investment of this type.

#### IMPLICATIONS FOR JORDAN

Cyprus serves as an important contrast to Jordan in a number of respects. Cyprus has not been overly successful in attracting investment in industry: It is likely to be directly competitive only in the area of offshore business. However, there are a number of exemplary policies which deserve notice. The first is the lack of restrictive controls on domestic investment, which is governed principally by the provisions of the Companies Law and the Tax Code. Firms are entitled to the tax exemptions, and there is a presumption of freedom to establish new enterprises in accordance with the law rather than a presumption of control. The incentives are complex and multifaceted but are clearly spelled out in the tax code. Perhaps for this reason accounting firms play a strong role in assisting new businesses, as their specialized assistance is often necessary to ensure that the

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<sup>3</sup> Coopers and Lybrand, Developing Cyprus as an International Financial and Commercial Centre, October 1987, p. 10.

advantages allowed are realized, and to put together accurate business plans. For offshore business, the simplicity of the procedures for establishing an offshore company was essential: Several firms indicated that for a reputable company with a good local accounting firm the procedure could literally be completed 24 hours.

This ease of establishment and transparency of the incentive regime contrasts directly with Jordan, where the outcome of the procedure is uncertain and subject to the determination of the Ministry of Industry and Commerce; the procedure can be lengthy; and a number of steps are involved. In Cyprus the principal evaluative determination by the Central Bank is the degree of foreign participation -- other than that it is a straightforward and predictable process, whose aim is to establish the legitimacy of the proposed enterprise, not a full evaluation from a technical, financial, commercial standpoint. In this sense the Central Bank is performing a straight regulatory function, whereas the Ministry of Industry and Commerce in Jordan takes a much more active role in the feasibility aspect of the evaluation.

Cyprus, perhaps even more than Jordan, has been plagued with political instability. Cyprus has been able to counter this perception with a relatively stable legal and institutional framework for domestic and foreign investment. The past ten years have seen a steady liberalization of the incentives for investment, within an essentially stable regulatory and institutional framework. Cyprus' success in attracting offshore business is in some part due to the nature of that sector, which does not involve large investments in fixed assets nor a long-term commitment to the local market, other than that for skilled labor and services, as well as Cyprus' perceived stability relative to other nations in the Middle East. Its success is also directly related to those factors mentioned above in

contrast to Jordan -- the Central Bank has tried to make it easy for offshore companies to locate in Cyprus, streamlining the application and approval procedure and allowing, in effect, automatic incentive qualification. Cyprus' success is even more notable compared to Jordan in that the incentive regime is not, on a prima facie basis, as attractive as that in Jordan: profits are taxed on a world-wide basis and employee income is taxable, albeit both at reduced rates.

The future of investment in Cyprus will depend to a great extent on the impact of the accession to the customs union with the EEC. This will involve the gradual dismantling of the protective tariff structure and other means of protecting local industry, while at the same time opening up new markets for Cypriot manufacturing and services. Several firms had recently visited Cyprus with the idea of using it as a manufacturing base to enter the EEC market, in electronics and other light manufactures. This may well be the next wave of investment in Cyprus, whose competition will be the other new entrants to the EEC who are able to offer similar cost savings to manufacturing.

The accession to the EEC customs union will continue the process of opening up the economy to trade and world market forces. This should have the effect of creating new demand from investors for operations in Cyprus, while at the same time taking resources out of inefficient domestic manufacturing through attrition. The net effect will be to improve the efficiency of the Cypriot manufacturing sector while opening new markets. The option of joining the EEC customs union does not exist for Jordan. Without that external impetus for mutual tariff reduction with a group of industrial countries, it is unlikely that Jordan or many other countries will be able to endure the short term dislocation that reducing levels of domestic protection often entails. However, in the long run, it will only serve to improve the climate for investment through the

increased opportunities that the improved and guaranteed market access will entail, and through the increase in efficiency and productivity through specialization and investment in areas of comparative advantage. It will be a constructive example for Jordan to monitor closely in terms of the impact of reducing levels of protection, and the possibility of introducing similar liberalization into Jordan as a means of increasing investment.

With a factor endowment in many ways similar to Jordan, Cyprus has made great strides in the creation of a specialized service economy. The core business represented by the offshore companies has indirectly created demand for professional services, and the country appears well positioned to continue to attract this type of investment. The importance of these supporting services to the success of the offshore companies, such as accounting firms, law firms, computer services, communications, air travel, etc., should not be underestimated. Although increasing the level of these services offered in Jordan is beyond the scope of the impact of investment incentives, it will be important to the success of this sector.

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# GREECE

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## Highlights of the Investment Climate in Greece

Greece represents an interesting example of investment incentives. The nation boasts a number of attractive attributes, including a stable government and economy, and access to the large European Common Market. The large government revenue base and access to European Community's Integrated Mediterranean Program funds allow the government to offer generous cash grants to investors.

While Greece offers a plethora of grants, tax deductions and other incentives that look very attractive on paper, the effectiveness of the provisions is diminished with myriad regulations and layers of bureaucracy in the implementation and approval processes. In addition, the government has prohibited foreign investment from several lucrative markets, including agribusiness, mining and pharmaceuticals. As a result, the world business community rates Greece fairly low as an investment site.

In the face of the conflicting governmental attitude toward private investment, and the generalized worldwide recession, investment in Greece has stagnated. The combined effects of the ambiguous government stance toward private enterprise and depressed regional demand caused by low oil revenues has been a stagnation in private capital flows into Greece. During the 1980s, average direct foreign investment inflows into Greece have hovered near \$450 million, only two-thirds of the level reached in the late 1970s, but still ten to twenty times the average annual foreign investment inflow into Jordan. The Greek experience can offer a number of valuable lessons to other countries interested in improving their investment climate for both domestic and foreign investment.

Greece has attracted substantial foreign investment in two sectors: As a site for regional headquarters, and as a tourist destination. Greece is in direct competition with Jordan as a location for regional headquarters. It offers the business community excellent transportation infrastructure and living conditions, and access to both European and Middle East markets, while remaining outside of the regional unrest prevalent in the Middle East. As of January 1986, 920 companies had placed their regional headquarters in Greece, of which 297 were commercial and industrial firms, and 623 were shipping companies. Greece is also well-known as a tourist destination, drawing 7.2 million tourists in 1986, up 2.3 percent from the previous year. Below, we focus on the incentives Greece offers in each of these sectors in which Greece is a serious competitor to Jordan.

In certain sectors, Greece is not a viable competitor to Jordan -- agribusiness, pharmaceuticals, and light manufacturing. In these sectors Jordan holds a clear comparative advantage, at least given the current policy environment within Greece. Foreign investment in the production of agricultural products and pharmaceuticals is prohibited in Greece, thus firms interested in supplying regional markets must look to other countries for an investment site. High wage rates relative to Jordan and other low-wage countries, and the lack of duty-free export processing zones, discourage assembly operations from locating in Greece.

#### THE INVESTMENT CLIMATE IN GREECE

Greece has taken measures to open its economy to foreign investment in order to become competitive now that it has joined the European Community, and to earn needed foreign exchange to cover its trade deficit and finance its foreign debt. The government is slowly dismantling price controls and relaxing wage increase requirements. The government has targeted a number of industries as high priorities, and is actively seeking foreign

capital to enter into joint ventures with Greek enterprises. These areas include clothing and footwear, communications and other high technology products, armaments, energy development, furniture, chemicals, nonmetallic minerals, basic metallurgy, machines and appliances, and transportation equipment. The government has taken several other steps recently to improve the business climate in Greece. One of the most important changes was the removal in July 1986 of all restrictions on repatriating profits, dividends and interest from Greece (as long as the initial capital had been in the country for three years). Also significant is the dismantling, albeit slowly, of price controls, some of which have severely constrained profitability. Automatic wage increases have been abolished.

Unfortunately, these changes have occurred at the same time as falling oil prices. The resultant lower incomes in the Middle East region has reduced the demand for many types of goods and forced the closure of many regional sales offices that had been headquartered in Greece. High domestic unemployment has caused the government to become more judicious in approving residence and work permits for foreigners.

In spite of the recent reforms listed above, the government attitude in Greece remains predominantly anti-private enterprise. The government owns and controls an estimated 70 percent of all business activity in Greece. In a recent move, the government reduced the scope of business activity open to foreign banks by prohibiting them from making certain types of loans. Several large American and European banks have reduced their Greek presence in response to the restriction.

The stagnation and high public sector deficits resulting from the extensive public sector involvement in the economy have wreaked havoc on the Greek economy. Public sector employment has steadily increased, and wages hikes have outpaced productivity

growth. Government spending as a percentage of Gross Domestic Product (GDP) rose from 35 percent during the 1970s to 50 percent in the 1980s and inflation has been high. The country has run a persistent current account deficit of approximately \$2.0 billion per year since 1979. Real GDP growth rates averaged only 1.3 percent throughout the 1980s. The poor domestic economic performance is one reason why the government is opening the economy to the dynamism, efficiency and market access of foreign investment. This is reinforced by membership in the European Community and the need for Greece to compete in the European markets.

The domestic Greek market is limited given the population of only 10 million, but as a member of the European Common Market, goods manufactured in Greece have duty-free entry into the ten EC member countries with an aggregate population of 320 million. Greece does offer investors a highly developed transport infrastructure which facilitates production and export. Fifty-four international airlines service the country's thirty-two airports. Greece boasts six main harbors, where 47 million tons of merchandise was loaded or off-loaded during 1987. Unfortunately, investors in Greece are concluding that the bureaucratic problems associated with locating in Greece outweigh these advantages. As one analyst of the investment climate stated, "There are better ways to enter the Common Market than through Greece."

## INVESTMENT INCENTIVES IN GREECE

### Incentives for Industry and Tourism

Both the government of Greece and the European Community, through the Integrated Mediterranean Program (IMP), offer incentives to businesses that invest in Greece (see Table 1). The most important incentives are contained in the 1982

Investment Law, Law 1262, which provides four types of benefits for eligible companies. All eligible firms must be "productive investments" in areas listed by the government (see Table 2). Most manufacturing firms, high-technology agricultural companies, and tourism facilities qualify for the incentives. Eligible investors may elect to receive accelerated depreciation, a reduced tax rate, and either cash grants and subsidized interest rates or an investment tax credit.

The value of the incentives depends on the size of the investment and its geographical location, with investments located in outlying areas receiving greater incentives. For the purpose of establishing the extent of incentives, Greece is divided into four zones (see map in Figure 1). In order to qualify for a grant, the investor's own participation as a percentage of total capital in a venture must be at least 35 percent in developed areas. This minimum percentage falls to 15 percent in undeveloped areas.

The size of the various incentives is shown in Table 3. Grants can range from 10 to 25 percent of the total investment in developed areas, and from 20 to 50 percent in the least-developed Area D. For investments under \$9 million, the grant is entirely in the form of cash. For investments from \$9 to \$15 million, the grant is half cash and half state participation; above \$15 million, the grant is entirely in the form of state-owned equity. An important caveat to the grant is that it must be refunded to the state if the venture fails or leaves the country within 10 years without the prior approval of the Ministry of National Economy.

An investor can opt for an investment tax allowance instead of a grant. The tax allowance of from 40 - 70 percent of the investment depending on industry and location is transferrable to subsequent years.

Table 1  
INVESTMENT INCENTIVES IN GREECE

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Treatment of Foreign and Domestic Capital

Equal treatment of foreign and domestic capital. Greeks living abroad are eligible for additional incentives.

Bank of Greece guarantees foreign exchange availability to meet repatriation and remittance requests.

Customs Relief

Reduction or exemption from import duties on machinery and spare parts for up to 10 years.

Tax Incentives

Reduced tax rate of 39 percent as opposed to 44 percent for eligible investments.

Investment tax credit worth from 40 - 70 percent of total investment depending on plant's location, transferrable indefinitely.

Reduction or exemption from every tax or levy imposed by local government, port funds or other agencies, for up to 10 years.

Export Incentives

Interest rate subsidy of up to 26 percent of interest on loans taken out by exporters, to be phased out by 1992.

Exemption from Value Added Tax.

Duty-free import of raw materials and semi-finished goods for re-export.

Other Incentives

Investment grants in cash and state equity for up to 50 percent of investment.

Integrated Mediterranean Program cash grants for up to 20 percent of Law 1262 benefits.

Increased depreciation rates from 20 - 150 percent of standard annual rates depending on number of shifts employed.

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Table 2

INVESTMENTS ELIGIBLE FOR INCENTIVES IN GREECE

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Law 1262 defines the following as productive investments:

- (a) The construction, extension, and modernization of industrial premises, building, hotel facilities and auxiliary facilities.
  - (b) The purchase or use by their owner for productive purposes of manufacturing, small industry, hotel buildings and auxiliary premises which have not been used during the two preceding years.
  - (c) The purchase of new machinery and other mechanical or technical production equipment, of computers and other data processing systems.
  - (d) The cost of investments designed to import, develop, and apply modern technology.
  - (e) Moving expenses for the relocation of existing production units to less developed areas or within the same area but in a designated industrial estate.
  - (f) The construction of new warehouse space, cold storage space, or space for drying or preserving products.
  - (g) The purchase of new refrigerator trucks or refrigerator ships made in Greece.
  - (h) The purchase of new means of transportation for materials and personnel.
  - (i) The building of new worker's homes to accommodate the firm's personnel or of premises for their recreation.
  - (j) The building, expansion, and modernization of hotel units, tourist apartments, hostels, camping sites, facilities of winter tourism, mineral spa facilities and the purchase of equipment for the above.
  - (k) The expenses for the repair, restoration, and conversion of designated traditional houses and buildings for their use as tourist accommodation (hostels/hotels) as well as the renovation of hotel units of a traditional style.
  - (l) The purchase of reproductive material in farming, livestock, or fish farming enterprises.
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Table 2 (Continued)

INVESTMENTS ELIGIBLE FOR INCENTIVES IN GREECE

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- (m) The expenses of investments involving the construction, expansion, modernization and equipment of central markets, slaughter-houses, premises for social, cultural, and other functions.
- (n) The purchase of small craft industry premises in industrial estates or centers constructed by ETBA or with ETBA funding, irrespective of their time of construction and use.
- (o) The building, expansion, and modernization of facilities and the purchase of equipment for enterprises supplying support services for tourist hotels.

The following are not regarded as productive investments and consequently are not eligible for the Law's benefits:

- The purchase of a passenger car with up to six seats.
  - The purchase of office furniture and fixtures.
  - The purchase of land, sites, and agricultural plots.
-

# INDUSTRIAL SECTOR

LAW 1262/82, 1360/83, 1479/84, 1682/87, INCENTIVE AREAS

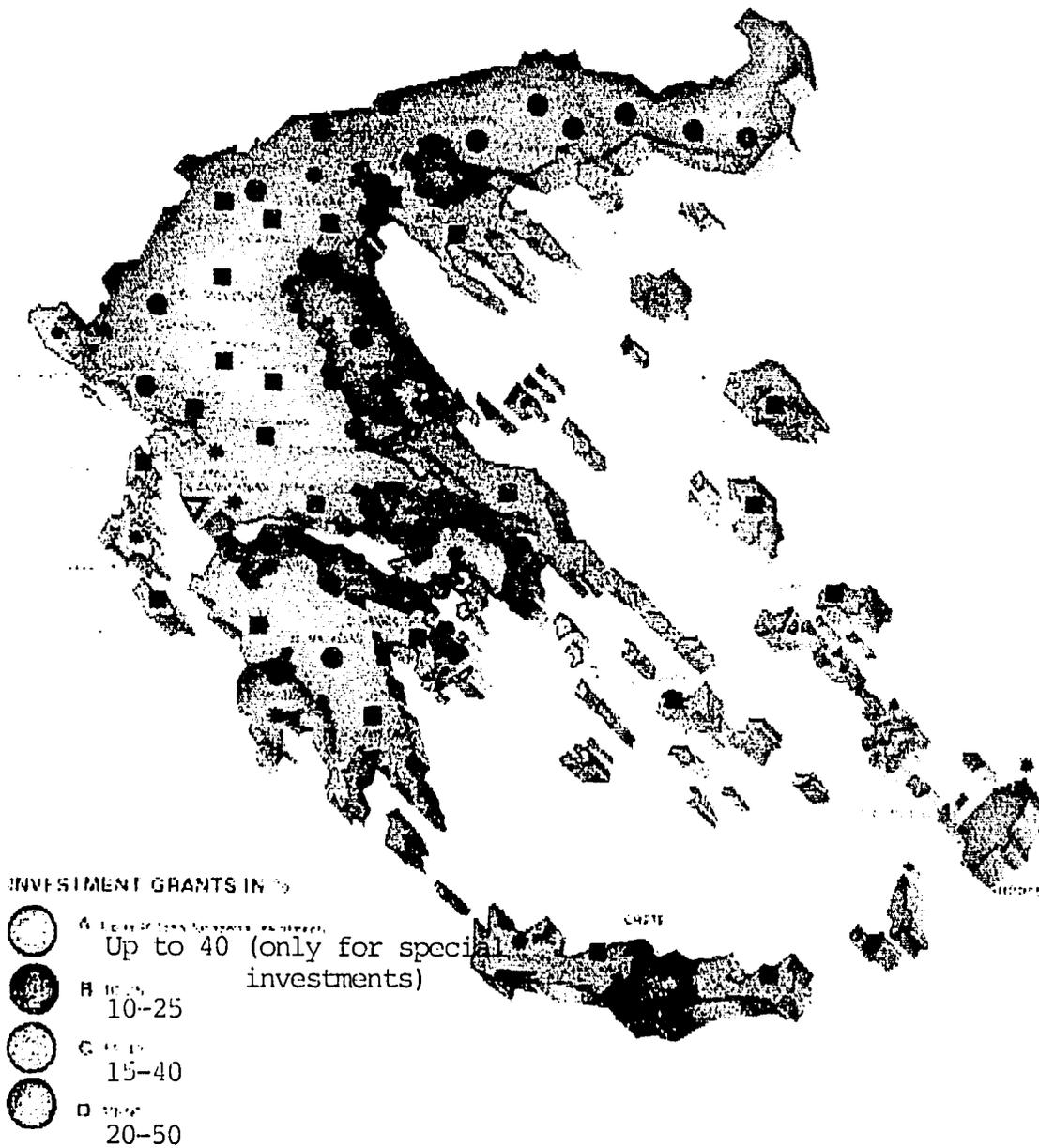


Figure 1

Table 3

## LAW 1262 INVESTMENT INCENTIVES IN GREECE

Industry	Area	Grant	Interest Subsidy	Increased Rates of Depreciation	Tax Allowances*	
					% of the Investment	% of the Profits
Manufacturing and Small Craft:						
	A		- Only for special investments -			
	B	10-25%	10-25%	20- 80%	40%	60%
	C	15-40%	15-40%	35-120%	55%	75%
	D	20-50%	20-50%	50-150%	70%	90%
Hotels and Tourist Accommodations:						
	A	-	-	-	-	-
	B	10-25%	10-25%	20%	40%	60%
	C	15-40%	15-40%	35%	55%	75%
	D	20-50%	20-50%	50%	70%	90%
Mining Operations:						
	A		- Only for special investments -			
	B	15-40%	15-40%	35-120%	55%	75%
	C	15-40%	15-40%	35-120%	55%	75%
	D	20-50%	20-50%	50-150%	70%	90%

\* Granted only as an alternative package to the grant and the subsidy.

All investments are eligible for a reduced tax rate. The tax on undistributed profits is 44 percent for Law 1262 companies, lower than the rate of 49 percent prevailing for other businesses.

The Greek government offers additional incentives to manufacturing and mining concerns which export a large percentage of their production. This benefit is set out from Legislative Decree 2687 of 1953. The Decree guarantees convertibility of the drachma to cover repatriation of capital (after one year) and profit remittances. It also offers the option of guaranteeing the corporate income tax rate against increases for ten years, as well as a reduction in or exemption from import duties on machinery, accessories, spare parts and tools for up to ten years, and reduction or exemption from local taxes for up to ten years. In addition, the venture's assets are exempted from forced expropriation except in case of war, in which case fair compensation would be awarded.

Greece has taken the exemplary action of insulating its investment incentives to a certain extent from the vagaries of domestic politics: The Decree's provisions may not be amended by subsequent legislation, only by a Constitutional amendment.

A new law now pending approval by the Greek Parliament offers additional incentives to ventures deemed to be high-technology activities by the General Secretariat of Technology within the Ministry of National Economy. Such firms can receive a grant worth up to 40 percent of the total investment if they locate in Athens or another Zone A city, and even more if they locate in an undeveloped region. In addition, they are eligible for a second grant for 30 percent of the amount of their own funds that are contributed to the venture. The second grant brings the value of the total grant to as much as 58 percent of the investment.

In addition to inducements offered by the government of Greece, the European Community has allocated 2 billion ECU in Integrated Mediterranean Program grant funds to Greece to finance public works, infrastructure projects, and selected productive investments. Firms that receive Law 1262 incentives are also eligible for IMP grants, which are worth up to 20 percent of total Law 1262 benefits. The Program is about to expire: Firms must apply for IMP benefits before May 31, 1988. However, similar aid programs will probably be available in the future.

In order to strengthen the ability of Greek businesses to compete successfully with the new foreign investments it hopes to attract, the Greek government offers incentives for mergers of locally owned businesses. Legislative Decree 1297 of 1972 aims to create strong economic units by exempting mergers from a number of taxes, including a transfer tax on assets, income tax on the surplus value of the shares resulting from the mergers, and all Treasury taxes and fees applying to the merger contract. These inducements are reportedly quite attractive and are credited with a number of mergers.

### Regional Headquarters

Greece has succeeded in capitalizing on its strategic location at the junction of three continents by offering incentives for regional headquarters. Promulgated in the late 1970s to take advantage of the exit of large numbers of companies from Beirut, Laws 89 of 1967 and 378 of 1968 provide benefits to offices established in Greece by foreign companies exclusively for conducting business outside of Greece. Such offices are exempt from all Greek income, customs and excise taxes, and from exchange control restrictions on earnings. The firms are permitted to bring in office equipment duty-free, and expatriate staff are allowed the import of a duty-free car every

two years, a valuable benefit in a country where imported cars are highly taxed. Also important, the firms are allowed to import and export samples and advertising material with no commercial value without needing licenses or paying duties or fees. Each regional headquarters is obligated to exchange \$50,000 annually in foreign exchange to cover local operating expenses such as salaries and rent, and an additional \$10,000 for every expatriate staff member. These minimums are sufficiently low that they do not constitute a problem for the sales offices.

To register as a Law 89 company, an interested firm must apply to the Ministry of National Economy, which seeks to establish that the firm is reputable. The Minister must sign all approvals, but the review and approval is usually accomplished within 10 days. The approval is then published in the government Gazette.

Some 900 regional sales offices are located in Greece, 600 of them in the shipping industry. In 1987, these Law 89 companies resulted in a net foreign exchange inflow of approximately \$200 million into Greece as they exchanged hard currencies for drachmas in order to pay salaries, rent and other operating expenses. During the 1980s, the number of headquarters in Greece dropped by approximately one-quarter, as the Middle East markets, which are the prime target of many of the firms, dwindled. However, the number of sales offices increased in 1987.

### Industrial Estates

Investors seeking industrial space for assembly operations can also receive incentives from Greek government. Firms operating on an industrial estate receive the Law 1262 incentives that correspond to the next most favorable zone. Under the auspices of the Hellenic Industrial Development Bank (ETVA), the

government operates nineteen industrial estates located in various parts of the country. The estates have attracted 325 firms that employ 16,000 people and represent an investment of \$33 million.

#### **IMPLEMENTATION AND PROCEDURES**

To receive incentives, investors submit a prefeasibility study to the Ministry of National Economy. An investor can apply for incentives before forming the legal entity that will undertake the project. However, since the incentives depend on the quantity of funds the investor will contribute, financing arrangements must be made prior to applying for incentives. Investments may receive both Law 1262 and Law 2687 benefits.

In response to investor complaints, assessment procedures were streamlined as of June 1, 1987. The Suggestive Committee on Foreign Investment was divided into two subcommittees, one composed of Ministry of National Economy officials, and a second made up of officials from a number of banks, including the Hellenic Industrial Development Bank (ETVA), the Commercial Bank of Greece and the National Bank of Greece. The two groups evaluate the incentive applications in parallel but independently. The Ministry representatives appraise the development benefits of the project, while the banking sector representatives evaluate the project's financial feasibility. If the project does not use borrowed funds, or uses funds borrowed from a bank abroad, only a single assessment by the Ministry officials is required. The two groups meet to reach a joint decision regarding the approval for and extent of incentives, which they transmit to the Minister of National Economy. While the Minister has the power to override a Committee recommendation, in practice the Committee decision is final -- it has never been overturned.

The Ministry reviews the development benefits of the proposal using a complex set of criteria, which are made known to all prospective investors. One criteria the Ministry uses to judge applications is the current capacity in the industry an investor wished to enter. The Ministry seeks to plan productive capacity to minimize the disruptive effects on businesses already in operation.

There are seven additional main criteria used to judge applications for incentives.

- 1) The investor's participation in the total investment cost;
- 2) The percentage of value added;
- 3) The percentage of domestic raw materials utilized;
- 4) The number of jobs generated;
- 5) The foreign exchange expenditure as a percentage of the total cost of the investment;
- 6) Anticipated exports as a percentage of total sales; and
- 7) The degree of import substitution to result from the investment's anticipated output.

The banking subcommittee evaluates the proposals according to traditional financial feasibility criteria, such as payback period and internal rate of return. The proposals that the banking representatives see are disguised to insure anonymity and fairness.

Under the new streamlined procedure, the Ministry responds to completed applications within three to four months. While the processing time has been reduced from the six to eight months previously required to review proposals, nonetheless, even the streamlined procedures are considered lengthy and bureaucratic by

private investors. While Greece had made important improvements in its application procedures, additional improvements are needed.

## CONCLUSIONS

Greece offers a number of advantages to potential investors, most of which are not legislated "investment incentives" per se. Access to both European and Middle East markets, a freely convertible, stable currency, and political stability all attract investors to locate in Greece. In addition to these benefits, the government has legislated a comprehensive set of tax incentives and cash grants. However, failure to administer these incentives in a timely and facile manner has in effect negated their usefulness. Investors in Greece concur that they would thrive better in a less regulated environment with both fewer restrictions and fewer benefits. The present incentive procedures are costly in terms of time and effort, and for that reason are much less valuable to investors than they appear to be on paper.

The Greek investment climate and incentives have attracted some new investment. One new investment that benefitted greatly from the Law 1262 and IMP incentives is Delmonte's wholly owned subsidiary, Hellenic Food Industries, which packs peaches, pears and apricots. The subsidiary received a grant, consisting of Law 1262 and IMP funds, for 55 percent of a \$9.8 million expansion. The funds were disbursed in three tranches, the first tranche when a certain percentage of the new plant had been constructed, the second when the plant was in operation, and the third when all capital was paid in.

In general, however, the business community that interacts with the Greek incentives and regulations on a daily basis suggests that while the incentives on paper appear liberal and

attractive, in practice they are not. As one prominent businessman stated, "The Greek government seems to believe that the only way to make things happen is to regulate. If they would only allow the business community to produce, and to grow, that would be more than enough." As Figure 2 illustrates, foreign investment inflows into Greece have stagnated during the 1980s, due to a number of factors, including depressed world markets and the government's ambiguous stance toward foreign investment.

#### IMPLICATIONS FOR JORDAN

Several interesting messages for Jordan can be derived from Greece's investment incentive regime and experience. First, Greece took a very creative, committed step in the direction of providing investors with stable, unchanging rules of the game by promulgating their incentives in a legal form that can only be altered by a Constitutional amendment. Greece has attempted to shelter its investment encouragement program, to an extent, from the vagaries of shifting political winds. In providing an extra measure of security to investors, Greece is meeting a strong need. Their action should be emulated wherever appropriate.

A second conclusion that can be drawn from Greece's attempts to attract foreign investment is that investors evaluate investment incentives and their implementing procedures as a package. Appealing incentives that are accompanied by tedious, lengthy bureaucratic procedures prove, as in the case of Greece, to be ineffective magnets for investment.

Lastly, Jordan may wish to consider an alternative way of assisting local businesses to compete with new local and foreign investment based on the Greek merger incentives. Jordan is deeply concerned about the effect of new business ventures on existing firms and has implemented the restrictive licensing mechanism to reduce any negative impacts. An alternative method

# Foreign Investment Inflows into Greece

1979 - 1986

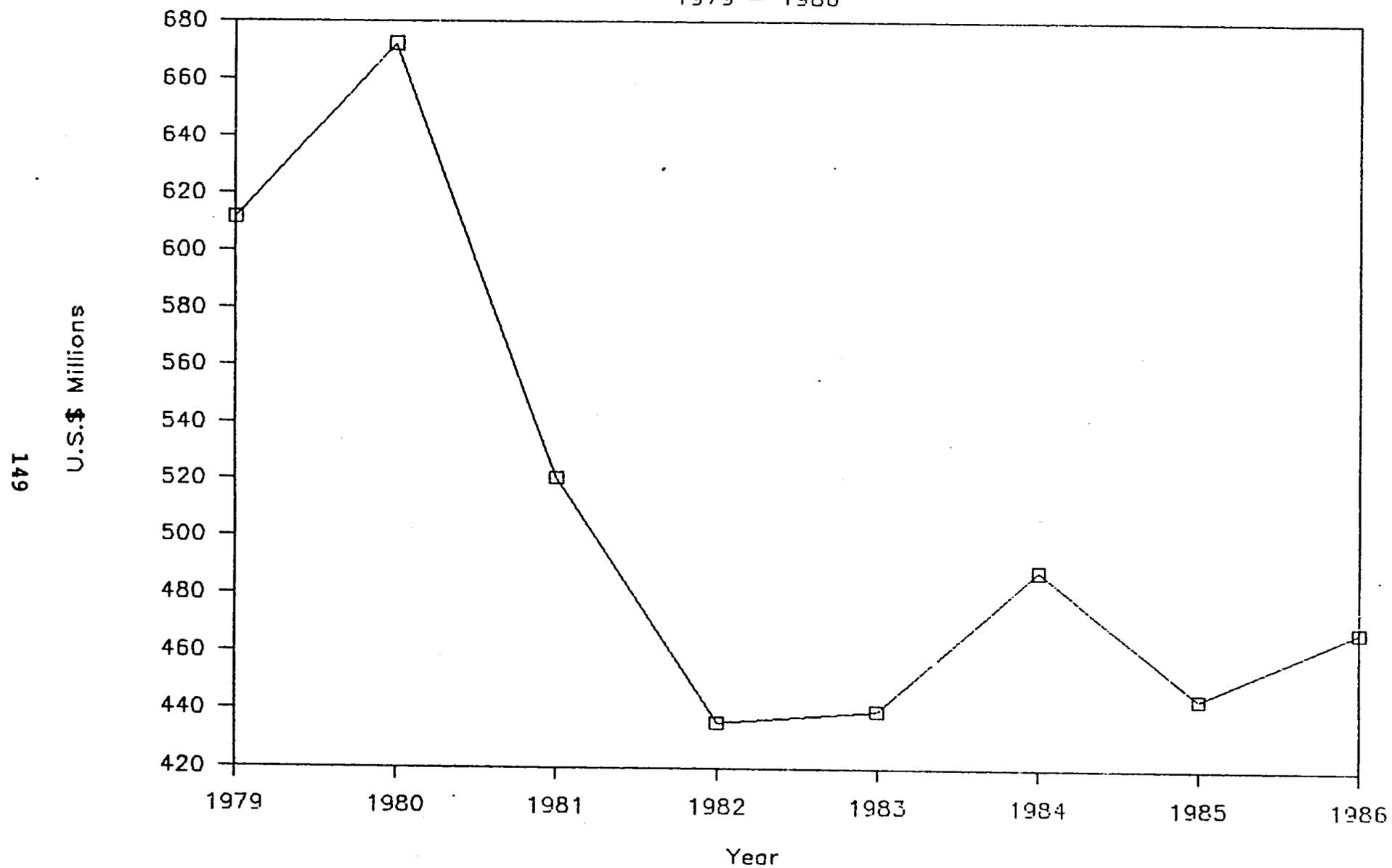


Figure 2

of boosting local competitiveness without the negative growth-limiting side-effects of the current licensing regime is a program of incentives for mergers similar to that offered by Greece. The government of Jordan could review the costs of merging under current law, and craft a series of exemptions and reductions in taxes and fees to encourage mergers. Given the high degree of concentration in the Jordanian economy that has resulted from the licensing restrictions, merger incentives should only be promulgated if licensing requirements are substantially lessened and the economy is truly opened to additional local and foreign competition.

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# EGYPT

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## Highlights of the Investment Climate in Egypt

Two successive liberalizations of the policy regime toward private investment in Egypt in the last twenty-five years provide an insightful case study for countries seeking to improve their investment incentive regimes. A first overture toward foreign investment, the Open Door Policy of 1974 which created a series of incentives, brought forth only a slight response from the foreign business community. Only some ten years later, when the incentive approval procedure was overhauled, did foreign investment into Egypt really accelerate.

As Figure 1 illustrates, foreign direct investment into Egypt has grown steadily and dramatically since 1983, to \$1.2 billion in 1986. It is important to note that there is not a one-to-one correlation between foreign investment inflows and incentive regimes. While incentives policies may help (or hinder) a country's efforts to attract foreign investment, they are nonetheless only one small factor among the many influences such as world market conditions, relative exchange rates, and political stability that affect foreign capital flows.

### THE INVESTMENT CLIMATE IN EGYPT

Until 1983, the development of a viable private business sector in Egypt was hampered by a host of economic, political and social factors. Egypt's relatively low level of economic development, particularly in regions outside the major urban areas, confronted private firms with a lack of effective demand and physical infrastructure. Perhaps more important as a deterrent to private investment was the widespread distrust of private enterprise held both within government circles and throughout the general population. The practical implications of this body of opinion in terms of government policies were felt

# Foreign Investment Inflows into Egypt

1978 - 1986

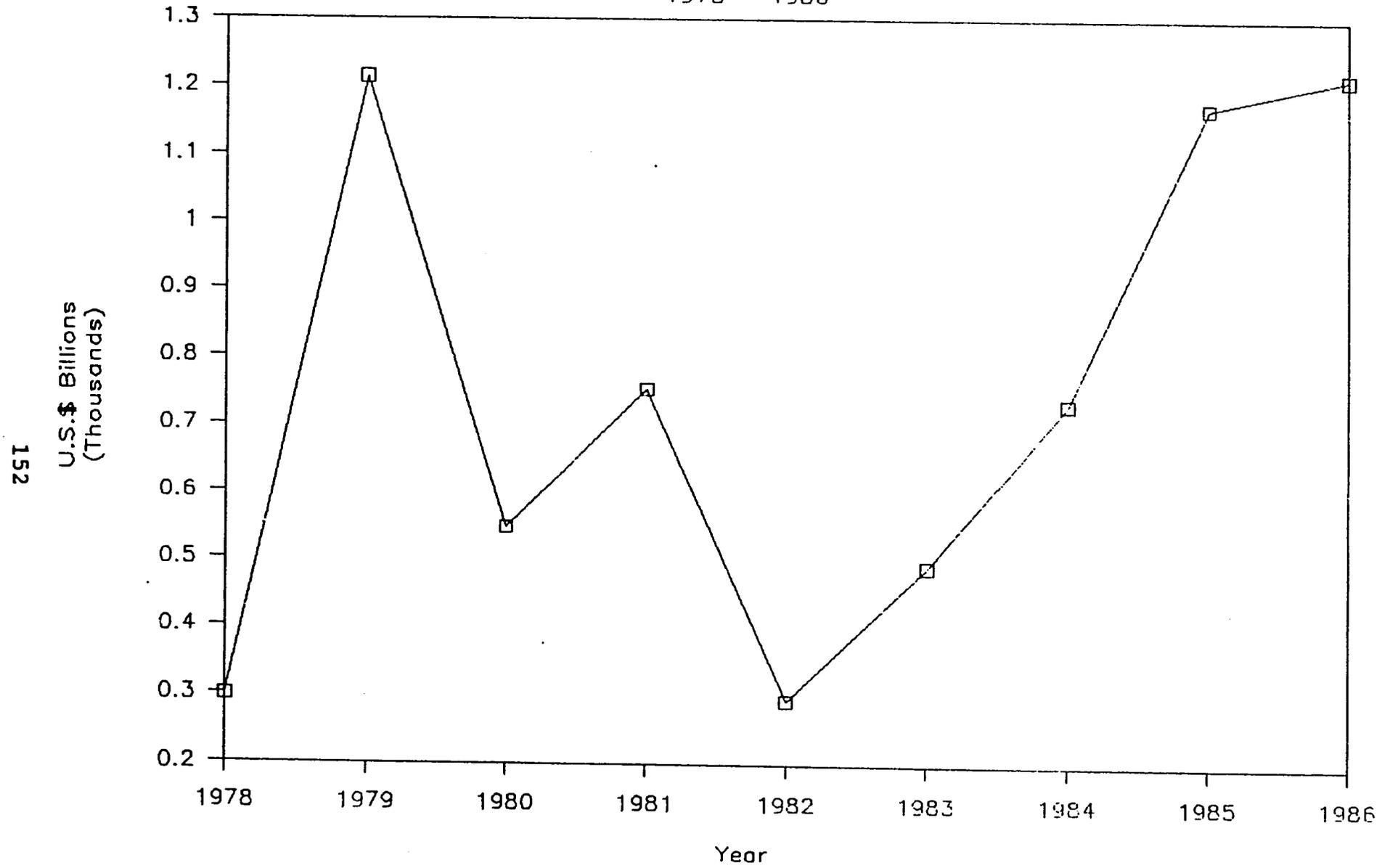


Figure 1

most strongly in the 1960s and early 1970s, when an emphasis was placed on building the size and power of public enterprises.

As much as three-fourths of Egypt's total non-agricultural output is still controlled, directly or indirectly, by government enterprises. Since many basic goods are heavily subsidized, public sector ownership and control have gained wide acceptance. The price distortions caused by these activities have in turn created strong biases against private businesses. More than a decade after the 1974 announcement of the "Open Door Policy" and the policy shift favoring private business, and five years after the streamlining of the approval procedures, some skepticism remains among both Egyptian government officials and foreign investors. It takes a long time to change attitudes. Nonetheless, Egypt has made important strides toward improving its investment climate.

Egypt benefits from a number of non-policy related attributes favorable to foreign investment: Its large domestic market, an inexpensive and relatively skilled labor pool, and a favorable location as an export base to Arab and African markets. Egypt's large population of 46 million represents an attractive potential market, although this advantage is mitigated by the low purchasing power of the vast majority of the population. Wages are low relative to other countries in the region, although much of the skilled labor force has left Egypt to work in other Arab countries. Egypt is located near European, African and Arab markets. As a member of the Arab Economic Common Market, a free-trade zone that includes Jordan, Syria, Iraq and Libya, Egyptian goods receive preferential access to these markets. However, the current recession in the Middle East occasioned by low oil prices has severely depressed the regional market.

## INVESTMENT INCENTIVES IN EGYPT

Most foreign investment incentives are embodied in Egypt's Law 43 of 1974. This law, the so-called "Open Door Policy," guarantees the right to acquire foreign exchange to repatriate capital, offers a five-year corporate tax holiday (which can be extended to 8 years, and even 10 years for projects related to the establishment of new cities and land reclamation), protects investors against expropriation or nationalization, and permits investors to pay a low 5 percent import duty on capital assets, construction materials and components required to establish an approved project. Foreign employees are exempted from the general income tax, but must pay a schedular tax, a form of income tax. Law 43 firms are waived from a requirement to distribute at least 10 percent of annual profits to employees. These incentives are summarized in Table 1.

In order to be eligible for approval under Law 43, a project must fall into one of the specified fields of investment enumerated in the Law. These fields, listed in Table 2, include industry, tourism, energy, transportation, mining, and livestock production. In general, only agricultural projects are ineligible for Law 43 benefits.

Law 43 addresses not only the substance of the incentives but how they are implemented. The Law created the General Authority for Investment and Free Zones (GAFI), a coordinating body of all the ministries with an interest in investment. While the creation of GAFI was a first step toward streamlining the investment approval process, further improvements were required.

Table 1

INVESTMENT INCENTIVES IN EGYPT

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Treatment of Foreign and Domestic Capital

Domestic investments receive some incentives not available for foreign investments.

Foreign investors have right to acquire foreign exchange for repatriation.

Investors protected against expropriation or nationalization.

Customs Relief

Low 5 percent import duty on capital assets, construction materials and components.

Duty exemption for capital assets and imported inputs for firms located in free zones.

Tax Incentives

Corporate income tax. Tax holiday for 5 years for investments in eligible fields, and up to 8 - 10 years for projects related to the establishment of new cities and land reclamation.

Personal income tax. Foreign employees exempted from general income tax, but must pay schedular tax.

Export Incentives

Egypt does not offer export incentives.

Other Incentives

Firms exempted from requirement to distribute 10 percent of annual profits to employees.

USAID funding for reconnaissance visits for investors, and feasibility studies.

Subsidized credit for up to 12 years with a 3-year grace period.

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Table 2

ACTIVITIES ELIGIBLE FOR INVESTMENT INCENTIVES IN EGYPT

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These fields are eligible for incentives:

1. Industrialization, mining, energy, tourism, transportation, and 'other fields'.
  2. Reclamation and cultivation of barren and desert land under long-term leases, livestock production, and water resource development.
  3. New housing construction and urban development including the provision of public utilities. Housing constructed as an investment, however, may be undertaken only by Egyptian and Arab capital.
  4. Investment and merchant banking and reinsurance where operations are carried out exclusively in freely convertible foreign currencies. A foreign company wishing to carry out banking operations of this kind without Egyptian equity participation may do so through a branch but not through a 100 percent subsidiary.
  5. Banking involving local currency transactions. In this case, the bank must be a joint venture with at least 51 percent Egyptian equity participation.
  6. Construction activities outside the agricultural areas and existing cities.
  7. Construction contracting activities undertaken by joint stock companies with at least 50 percent Egyptian equity participation.
  8. Technical consulting activities relating to projects within the specified fields mentioned above. These activities must be carried out by a joint stock company with at least 49 percent Egyptian equity participation.
  9. Investment companies utilizing their funds in the specified fields.
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The original intention of Law 43 was to stimulate foreign investment in Egypt. The law failed to arouse much interest among the foreign investment community, but did prove attractive to domestic capital. Therefore, the law was amended in 1977 to allow Egyptian-owned firms access to the incentives. To date, the law has continued to attract more Egyptian capital, some of which was lured back from overseas, than foreign capital. Approximately two thirds of the capital operating under Law 43 is Egyptian, with wholly-owned Egyptian companies comprising 40 percent of all projects approved. Foreign Arab investors represent some 15 percent of total equity capital, and non-Arab foreign investors 20 percent. The share of U.S. firms is 5 percent.

In order to stimulate the Egyptian private sector further, the government promulgated Law 157 in 1981, which made the five year tax holiday available for numerous activities, including agriculture, land reclamation, and all industrial companies employing over 50 people. This Law is principally aimed at Egyptian-owned companies: It applies only to companies with at least a 49 percent Egyptian participation, and does not guarantee the right to acquire foreign exchange.

U.S. Agency for International Development underwrites several additional investment incentives for Egypt, including paid reconnaissance visits for investors, up to \$6,000; feasibility studies up to \$150,000, and subsidized credit for up to 12 years with a 3-year grace period.

### Free Zones

Egypt offers the standard free zone incentives for firms to locate in the country's five government-run free zones. In addition to the five-year tax holiday granted under Law 24, firms enjoy customs duty exemption for capital assets and imported

inputs for an indefinite period of time, and unrestricted foreign equity participation. There are a number of free zones in Egypt, including one in the Suez Canal city of Port Said, in Alexandria, and in the new Nasr City. As of year-end 1985, 246 firms had located in Egyptian free zones, 68 percent for storage, 20 percent for industrial operations, and 12 percent for services. In 1983, the government stopped issuing additional storage licenses for free zone firms, explaining that storage firms did not generate as much foreign exchange as would alternative users of the free zone space.

Egypt charges a higher-than-usual fee to firms located in free zones, to be used to support future free zone development. Zone businesses must pay 1 percent of the value of goods imported into and exported out of the zones, plus 3 percent of annual value-added

Firms desiring to locate in a free zone apply to the General Authority for Investment and the Free Zones (GAFI). GAFI officials evaluate the firm using four criteria: Exports as a percentage of total production, expected foreign exchange earnings, the extent to which project introduces new technology, and management expertise to Egypt, and employment creation. The country has placed unusually strict requirements on the labor force composition within the free zones. Three quarters of each firm's total workforce must be Egyptian, and 65 percent of total salaries must be paid to Egyptians.

### Regional Headquarters

In contrast to many of its neighbors, Egypt offers no special incentives for regional headquarters. Foreign commercial activities administered in Egypt are regarded for tax purposes as taking place within the country.

## IMPLEMENTATION AND PROCEDURES

The approval process for investment applications in Egypt has long been considered one of the most onerous ordeals facing prospective investors. The creation of the General Authority for Investment and the Free Zones (GAFI) in 1974 was intended to correct the problem whereby prospective investors had to move through a veritable maze of Ministry approvals, any one of which constituted a potential veto of the project. However, the increases in efficiency achieved by the implementation of Law 43 fell short of expectations.

In 1983, the government further streamlined the investment review process. Until that year, the Board of Directors of the Authority consisted of the Ministers of Industry, Agriculture, Planning, Electricity, Housing, and Tourism. By law only a majority of votes is now required for approval (with certain exceptions, e.g., a two-thirds majority is needed for approval of 100 percent foreign-owned projects). There was evidence, however, that until the 1983 changes, deference may have been given in the past to any single ministry with particularly strong objections to any given investment. Hence individual ministers held virtual veto power over given investments.

Another problem encountered by investment applicants was the recurring question of the "completion" of the application. Continual requests for additional information made the review process lengthy. The resulting delays gave rise to a "Catch-22" situation, in which investors had to undertake new feasibility studies and change prices or strategies in response to changing conditions. The government often responded to the companies' changes by requesting additional information, extending the process even further.

Beginning in May 1, 1983, the Board of Directors was divided into three committees. A Technical Committee composed of three general directors from the Investment Authority who represent the Ministries of Industry, Agriculture and Finance meet three times each week. The Technical Committee is charged with determining the completeness of any investment application within 48 hours of its receipt. Those judged complete are then sent to the Joint Committee for substantive review.

The Joint Committee meets once a week, or more often if necessary, to recommend approval or disapproval of applications. The Joint Committee consists of representatives of the Ministries of Industry, Agriculture, Planning, Electricity, Housing, Tourism, and other ministries of standing. Only a majority vote is required for recommending approval of an application. The Joint Committee forwards its recommendations to the Board of Directors.

The Board of Directors meets on a regular basis according to the number of applications approved to render final judgement on investment applications. The Board is composed of more senior representatives from the same Ministries which form the Joint Committee. On May 1, 1983, the government announced that a reply must be given to an investor within four months of submission of a complete application. Current indications suggest that progress has been made in reaching this goal.

## CONCLUSIONS

In liberalizing its foreign investment laws and approval procedures, Egypt has made large strides toward improving its investment climate. The improvements are a contributing factor to the rising flows of direct investment into Egypt. Several problems remain for Egypt, however.

A large number of foreign investors interviewed in the course of this study were unaware of the streamlined approval procedures in Egypt. A high priority for Egypt, now that it has made important changes in its investment climate, is promotion of the "new and improved" product it now has to offer to the foreign business community. It is important to note that active promotional efforts at an earlier stage, before Egypt made important modifications in its investment climate, would have been premature and counterproductive. Those potential investors who might have been induced to look into investing in Egypt would have found the government attitude and bureaucratic requirements very antagonistic to private investment. They would have passed on their unfavorable impressions to other potential investors in what is perhaps the most valuable form of investment information and promotion among executives -- word of mouth.

#### IMPLICATIONS FOR JORDAN

A review of Egypt's investment incentive legislation and experience has suggested several ideas that are worth pursuing in Jordan. Egypt discovered that one of the richest sources of investment was Egyptian investors, both in Egypt and abroad. As Egypt liberalized its investment climate and incentive regime, it found that fully 60 percent of the capital invested under Law 43 was Egyptian. Thus, liberalization does not necessarily harm domestic firms. Both domestic and foreign investors have profited richly from the increased incentives in Egypt. Liberalization has been a "win-win" situation for both local and foreign businesses.

Jordan's restrictive licensing regime limits growth among both local and foreign ventures. In particular, remittances of wages earned in other Arab countries, returned to Jordan, are difficult to invest productively because of the lack of opportunities open to new ventures. Jordanian remittances from

abroad represent a wealth of potential investment capital that should be tapped and invested productively. Substantial benefits to the country could result from loosening the restrictive licensing procedure in order to approve an additional number of productive projects. In addition, the government may wish to publicize the existence of the investment incentives by preparing printed material outlining the investment incentives, and making that material available at a number of accessible locations such as the Chamber of Industry, the Ministry of Industry and Trade, the Industrial Development Bank, and investment and commercial banks.

A second interesting example Egypt provides is the provision of incentives for basically all investments. Between Laws 43 and 157, Egypt offers incentives to all fields and industries, thereby reducing the cost of doing business in Egypt across the board. Egypt has expanded the concept of incentives to cover nearly all new ventures and expansions, and in doing so is providing valuable assistance to firms seeking growth. Jordan might well be able to stimulate economic growth through a similar broadening of the scope of incentives.

While clearly there is no single cause of the increase in foreign investment in Egypt since 1983, it is probable that Egypt's move to streamline the investment approval process played a role. Thus, a third implication for Jordan from Egypt's experience is that reducing the amount of time required to approve investment licenses and incentive applications could be a strong stimulus to investment, both domestic and foreign.

**BAHRAIN**

162a

## Highlights of the Investment Climate in Bahrain

### THE INVESTMENT CLIMATE

Bahrain has long been a Persian Gulf trading center and entrepot, and now projects itself as the best location for gaining access to the countries in the region. It is a member of the Gulf Cooperation Council (GCC) and enjoys favorable relations with Saudi Arabia and other Arab neighbors.

Bahrain is one of the oldest oil producing states in the Gulf, but a minor one by today's standards. The country has made progress towards its economic goal of diversification away from oil. Bahrain has become the financial center of the Gulf, and one of the notable offshore financial centers of the world. It has also attracted a number of pan-Arab projects in heavy industry, in which it is a major investor. Bahrain has been notably open to foreign investment, and maintains a relatively liberal regime governing investment, with many aspects of an offshore haven, such as the complete absence of direct corporate and personal taxation. Nevertheless, new private investment in Bahrain has been largely limited to the financial sector and the equity interests of partners in the large industrial projects.

The economy, like most in the region, has been hit hard directly by the collapse of the world oil markets, as well as indirectly, since oil wealth has until recently paced the growth of other sectors. The nation's GDP contracted in 1985 and 1986, after compound growth rates in the 5-7 percent range since 1970. Bahrain still managed a net balance of payments surplus in 1986, but has been forced to cut back public spending as oil revenues have fallen. The oil market shakeout has also affected the banking center, as a number of offshore banks closed in 1986. The country has also suffered from the prolonged Iran-Iraq war

and the resulting disruption in commercial activity in the Gulf. At least two large projects, in iron and ship repair are heavily dependent on regional markets and are encountering serious difficulties, at least partially as a result of the war.

The government introduced a series of measures in September 1986 designed to provide stimulus to the private sector and improve Bahrain's competitiveness. These included decreases in interest rates and municipal fees, a 15 percent reduction in international telecommunications rates, a reduction of the social security contribution from 21 to 15 percent of gross salaries, an easing of expatriate work permits, and other measures designed to ease the cost of doing business in Bahrain. These measures were worked out in discussions with private sector representatives, and indicated a willingness by the government to consider the introduction of reforms to improve the business and investment climate.

In general, the government's attitude towards private investment is extremely encouraging. This must be placed in a context, however, of a dominant role for the state in the economy through the influence of parastatals. The Bahrain National Oil Company manages most of the interests of the government in the petroleum sector, although separate companies have been established for refining, natural gas collection and processing. As is typical in other industries, foreign corporate partners retain (usually small) equity positions in the large petroleum and industrial enterprises. For example, Caltex, the original petroleum concessionaire, still holds an interest in the refinery and the natural gas company. ALBA, an aluminum manufacturer and one of the first non-petroleum industrial investments in the Gulf, is majority owned by the Bahrain government, with minority shares held by the Saudi Public Investment Fund, Kaiser Aluminum of the U.S., and a German investment group. Other joint ventures in aluminum processing, petrochemicals (Gulf Petrochemicals

Investment Corporation) and ship repair (owned by the OAPEC members) all feature a substantial ownership role for the Bahrain government, and often a parastatal Saudi or Kuwaiti partner.

Most of these large industrial investments, with the recent exception of ALBA, are not profitable and face serious financial problems, even with substantial protection and subsidy. Those which are entirely privately owned, such as the iron pelletizing operation AISCO, generally receive substantial support from the government, including financial assistance. The financial failure of these large investments will no doubt become a burden on the economy as a whole unless they can operate profitably in the future, draining substantial resources away from other sectors of the economy. The government is reportedly now changing its development and diversification strategy away from these types of heavy industries requiring huge investments, and has indicated it will encourage import substitution and smaller scale industry.

The government, while welcoming foreign investment, limits participation in companies doing business in Bahrain to 49 percent. Branches of foreign corporations may be allowed in Bahrain provided they have a Bahraini sponsor. This is true of all sectors except the "Exempt Companies" (regional headquarters) and the Offshore Banking Units, where 100 percent foreign ownership is allowed. In addition, the government encourages "Bahrainization" of technical and managerial expatriate staff. Bahrain relies extensively on expatriate workers, particularly South Asians, in lower skilled positions. Of a total population of 415,000 in 1985, over 115,000 were expatriates. Their proportion in the labor force was even higher, at over 50 percent.

The country is relatively small, and the infrastructure of the island is well developed, with modern telephone systems,

excellent roads, ports and airports with extensive services. Bahrain recently opened the causeway connecting it to Saudi Arabia, which is expected to increase tourism traffic. The causeway has apparently eroded the operations of Bahraini traders, who were previously able to charge a premium for consumer goods over what was available in eastern Saudi Arabia. Many tourists are travelling over the causeway to Bahrain, apparently to enjoy the relatively relaxed social atmosphere which prevails in the country, especially when compared to its neighbors.

The one sector which has flourished in Bahrain has been banking and financial services, both in the domestic capital market and in offshore banking services. There are over 170 financial institutions in Bahrain, of which about 70 are offshore banks. The financial sector is estimated to account for over 15 percent of GDP. The offshore banks have suffered the brunt of the economic slowdown in the region, as some banks have pulled out and many have scaled back operations. Assets of offshore banks have declined from a high of \$62.7 billion in 1982 to \$52.5 billion in early 1987.

In addition to banking and financial services, Bahrain has also developed as a center for regional headquarters or offshore companies. Over 80 U.S. firms operate regional Middle East headquarters from Bahrain. One of the chief attractions of Bahrain as a center for offshore business is its lack of taxation. This must be counterposed, however, against a relatively high cost of living, although it is generally perceived to be more attractive than other Gulf countries for expatriates.

## INVESTMENT INCENTIVES

The incentives for investment in Bahrain are relatively simple, as can be seen in Table 1. The principal incentive is that there is no tax on corporate or personal income of any kind, except for oil production. Thus, the complex array of tax exemptions, credits, allowances and holidays found in other countries is simply not relevant. The government derives most of its income from royalties or taxation associated with oil production, and has not imposed the normal set of income, sales, and excise taxes which are the mainstay of most government budgets. There is a mandatory contribution of 7 percent of salaries to the social insurance fund, matched by 5 percent from the employee, and a 3 percent contribution to the accident insurance fund. Expatriate salaries are subject only to the latter 3 percent contribution.

There are no restrictions on the inward or outward movements of capital; there is free repatriation of capital and profits. The Bahrain Dinar is fully convertible and pegged to the SDR. As noted above, foreign investment is limited to 49 percent of the capital of any enterprise, except those operating offshore businesses.

Capital goods and raw materials used in production are exempt from import duties. Tariff rates overall are relatively low, with a maximum rate of 10 percent except for tobacco (30 percent) and alcohol (100 percent). These rates can be waived for goods re-exported to GCC countries.

The government subsidizes the cost of electricity, natural gas and water, although costs for electricity are marginally higher than in neighboring Gulf countries. Telecommunications service is generally very good, although expensive, even after the recent 15 percent reduction in rates.

Table 1

INVESTMENT INCENTIVES IN BAHRAIN

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Treatment of Foreign and Domestic Capital

Foreign investment in Bahrain companies limited to 49% percent.

Free repatriation, no currency restrictions.

Customs Relief

No duty on capital goods or raw materials used in production.

Generally low duties on other items.

Tax Incentives

No taxation on corporate and personal income.

Export Incentives

Duty exemption for re-exported goods.

Other Incentives

Regional Headquarters and Offshore Financial Institutions. One hundred percent foreign ownership allowed for Exempt (offshore) companies and Offshore Banking Units.

Subsidized utility rates.

Streamlined registration and application procedures.

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## **IMPLEMENTATION AND PROCEDURES**

The establishment of a company in Bahrain is relatively straightforward and uncomplicated. The Commercial Companies Law is the principal governing piece of legislation, and sets forth the types of business associations and their requirements. The Ministry of Commerce and Agriculture approves all applications for formation of corporations, companies and partnerships. However, the procedure is more one of the formality of registration than application for approval. Exempt Companies are also approved by the Ministry. There are certain minimum capital requirements, but they are not likely to be onerous for most operations (BD 20,000 for exempt companies).

Banking and financial companies are regulated by the Bahrain Monetary Authority. Offshore Banking Units are not required to meet any of the regulatory requirements of commercial banks operating in Bahrain. They do pay an annual fee of BD 10,000.

## **IMPLICATIONS FOR JORDAN**

The Bahrain model of an open, tax free economy is of limited direct application to Jordan. To a great extent, the absence of taxation is a function of the ability of the government to raise substantial revenues from oil production. As an investment incentive, the complete absence of income taxation is important to offshore banking and business operations. Equally important is the relative ease of conducting business in Bahrain.

In spite of Bahrain's tax free and open environment, investment has not poured into Bahrain in other activities the government has accorded priority, since there is relatively little to attract them there. Most of the heavy industry projects involve a substantial degree of public sector investment, and have not been able to become profitable, let

alone earn a return which would attract private investors. Those which do have substantial private investment rely on the patronage of government and parastatal organizations.

Jordan compares relatively well with Bahrain in attracting regional headquarters and offshore business: These companies are not taxed in Jordan. However, it is not merely the financial impact of a tax free environment that is relevant to offshore business, but the ease and cost of conducting these types of operations, which typically involve a highly skilled, senior level expatriate executive staff with substantial demands on the communications and travel infrastructure. The Cyprus example is instructive here, where offshore companies are taxed, albeit at a nominal rate, and yet still express satisfaction with doing business there. It must be kept in mind, however, that many operate so as to not show any income in Cyprus. The absolute lack of tax in Bahrain acts also as an expression of the "haven" atmosphere allowing relatively free operations and a minimum of control. The one notable area of interference, that of restrictive work permits for expatriates and pressure to employ Bahrainis, has been counterproductive and was recently relaxed in partial recognition of that fact.

In order to encourage foreign investment in regional headquarters, the example of Bahrain suggests that the removal of constraints on business operations in general is likely to be at least as important a factor as the absence of tax. Also, some companies will prefer to be located in the Gulf region, if that is where much of their business will be generated. Conversely, others preferred Cyprus because it was slightly removed from the region and more European than Middle Eastern, while still being close enough to facilitate travel and communications. Jordan's advantage will be in offering a middle ground between these two, if efforts are undertaken to reduce obstacles to normal business operations and decrease costs for conducting these types of services.

## BACKGROUND NOTES TO THE REPORT

### The PEDS Project

This study was conducted under the Private Enterprise Development Support Project. The PEDS Project is a five year (FY88 - FY92) \$20 million project managed by the Bureau for Private Enterprise. In the first year of the project, PRE provided technical assistance for nearly fifty different requests from Missions and Bureaus. The PEDS Project is designed to provide a wide range of expertise in private sector development. Areas of technical assistance include the following:

- Policy analysis related to private sector development
- Sector assessments and analyses
- USAID private sector strategy development
- Legal and regulatory analysis and reform
- Small-scale business development
- Trade promotion
- Investment promotion
- Free trade zone development
- Financial institutions and instruments
- Management and financial training
- The role of women in private enterprise
- Applications of MAPS: Manual for Action in the Private Sector

USAID Missions have the resources of thirteen contractors available to them through the PEDS Project.

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|------------------------------------|--------------------------|
| ● Arthur Young (prime)             | ● Ferris & Company       |
| ● SRI International                | ● Metametrics            |
| ● Management Systems International | ● Elliot Berg Associates |
| ● The Services Group               | ● Robert Carlson Ass.    |
| ● Trade and Development, Inc.      | ● Ronco                  |
| ● Multinational Strategies         | ● Dimpex Associates      |
| ● J.E. Austin Associates           |                          |

### The Consultancy

Before conducting field work, the team spent three weeks gathering background data on the regulations and laws which affect investment incentives in Jordan and competitor countries. Ms. Heffernan and Mr. Emery made field visits to Jordan, Cyprus, Tunisia, Greece and Turkey in February 1988 to collect additional information. Research on Egypt, Taiwan and Bahrain was conducted in Washington, based largely on material collected during recent country visits by the project team.

171-

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