ABSTRACT

Trade and Investment Policy Reform Agenda, Jordan

by

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October 1992

The report reviews Jordan's macroeconomy 1991-1992 and examines three dimensions of its trade and investment policies: the trade environment, the investment environment, and the legal framework. In the trade area, it makes recommendations regarding customs, export financing, taxation, licenses free zones, and trade relations. In the investment area, the report provides recommendations for strengthening the capital market and developing a privatization program. The report's review of the legal framework offers recommendations for immediate action in the areas of foreign investment and domestic investment and business; and long-term actions regarding the overall legal environment.

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Prepared for the U.S. Agency for International Development under subcontract to the Consulting Assistance for Economic Reform Project, contract number PDC-0095-Z-00-9053-03

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October 1992

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EXECUTIVE SUMMARY

The findings discussed below were authored by the following professional consultants: Bruce Glassburner, The Macroeconomy 1991-1992; Adrian Strain, The Trade Environment; John LaGrua, The Investment Environment; and John Westberg, The Legal Environment. The findings of each of these consultants will be presented briefly in the Executive Summary, followed by more complete discussions by each of these authors.

SUMMARY STATEMENT ON THE MACROECONOMY 1991-1992

The macroeconomic environment in Jordan is in urgent need of attention. The nation's heavy international indebtedness, high rate of unemployment, and high inflationary pressures combine to present a very complex policy environment. Because of these monumental problems, earliest possible action needs to be taken with respect to the following:

Export earnings must be expanded at the most rapid rate feasible in the present global market environment. Exporting is urgently needed for the following reasons.

Official foreign borrowing has been pressed beyond sustainable levels. If Jordan's economy is to grow at a satisfactory minimum rate, capital requirements must exceed IMF projections. Indeed, whether all international lenders will participate as projected by the Fund may be questioned.

Moreover, service on existing debt itself requires expanded export earnings. Expanded exports are also necessary to raise levels of employment of the large labor pool and to provide expanded employment for the very large cohorts entering the labor market. To contain unemployment, the minimal rate of growth of aggregate output required is 7 percent per annum (see Section One for a discussion of the growth requirement). More than that is required if the high level of unemployment (possibly 18 percent of the total labor force) is to be diminished.

This is not an easy set of objectives to attain in an economy beset with heavy foreign debt servicing obligations, because it implies expanded inflows of private foreign capital. Although expanded domestic saving must play a central role, and the expanded use of domestic labor and other resources is essential, complementary foreign inputs will have to be imported. Given the large official debt, it will be necessary to induce private capital inflows — and, in all probability, private foreign entrepreneurship.

Maintaining macroeconomic stability in the face of the problems described above will be very difficult. Inflation rates in recent years have been intolerably high, although inflation appears to be diminishing, despite a significant monetary surplus. It will require much higher taxation and a shift of the tax base away from internationally traded goods to general consumption expenditure. It will also require more stringent control of the money supply by the Central Bank, necessitating a reorganization and strengthening of the Bank's instruments of control over the activities of the commercial banks. Interest rates will need to be made responsive to supply and demand in international markets to encourage saving and economic allocation of financial capital.

The exchange regime is quite liberal by the standards of middle-income countries generally. However, given the still quite high rate of inflation, it may be necessary to allow the rate to float somewhat more freely. It is a guided float at this time, administered in accordance with a "market basket." Systems of this sort have worked well in many countries and provide more stability than a pure float would do.

The high rate of unemployment, combined with the large international debt, points to an economic strategy that is strongly outward-looking. The rapid phasing out of high-cost import substitution industries or their rapid adaptation to standards of international competition is essential.

Jordan must also become a successful competitor in international markets, so that much larger quantities of foreign exchange will be forthcoming. These expanded financial resources are required to complement domestic natural and labor resources. These adjustments are necessary to use Jordan's resources efficiently and eventually to bring the nation's balance of payments into dynamic equilibrium. These findings are discussed in greater detail in Section Three of this report.

To reinforce the outward-looking orientation of the economy, several policy, regulatory, and procedural changes are needed in the trade and investment sector and in the legal framework associated with trade and investment. Recommendations regarding needed reforms are summarized on the following pages and presented in detail in Sections Two through Four of this report.

THE TRADE ENVIRONMENT: PRINCIPAL RECOMMENDATIONS

Customs

Customs should completely replace the present system of duty drawback calculations with a simplified fixed-rate scheme applicable to exporters already registered with them. This scheme will eventually be expanded to cover all Jordanian manufacturing industry on a generic-product or whole-industry basis with provisions to encourage intermittent and indirect exporters.

The Customs Act needs to be amended to achieve the following objectives:

- To grant greater autonomy to the Amman and Aqaba customs houses in particular regarding the imposition of mandatory fines; and

- To replace the present remuneration system with an equivalent earnings salary system that is independent of any fines.

Customs procedures need to be amended to reduce the excessive number of signatures required on custom entry forms. Redesigning the forms will help, as will sharply reducing or abolishing all mandatory testing by the Ministries of Health and Agriculture and by the Directorate of Standards on export-related imports.

Customs operations should be completely computerized at an early date.

Export Financing

The proposed Export Credits Guarantee Corporation should be made operational as soon as possible.

The rediscounting facility for export financing offered by the Central Bank of Jordan should be liberalized in terms of interest rates, cash margins, and value-added ratios.

Any restrictions on the use of non-bank external accounts should be abolished.

Taxation

Anomalies in the consumption tax and in the corporation tax that discourage exporters should be corrected.

The exemption threshold for export earnings should be doubled to 80 percent.

Licenses

Import and export licenses should be abolished except for subsidized foods and fixed-price items (export licenses) and for imports of security-sensitive goods (import licenses).

Free Zones

The regulations should be altered to permit ownership of land and buildings by manufacturing exporters in all Free Zones.

The process of allowing free-zone operations in industrial estates such as those at Sahab and Aqaba should be formalized.

The Free Zones Law should be amended to allow private ownership and management of Free Zones.

Trade Relations

New protocol arrangements involving barter trade should be avoided wherever possible, and full advantage taken of the 50-plus protocols that offer Jordan market trading on virtually Most-Favored-Nation terms.

Jordan should convert its present observer status with the GATT into full membership as soon as possible.

See Section Two of this report for detailed trade policy recommendations.

THE INVESTMENT ENVIRONMENT: PRINCIPAL RECOMMENDATIONS

The current package of investment incentives is competitive with other countries in the region, but modifications are needed to enable applicants to more readily access them. Procedures are slow, lack clarity for the applicant, and involve value judgments that should be left to the applicant alone.

Inducements to foreign investment business should include such intangibles as a uniform accounting system. Such a system should be adopted using generally accepted accounting rules to ensure the accuracy and consistency of financial statements.

The tax code should be reviewed to determine whether any inequities exist that would penalize investors. Reporting and collection procedures should be simple and minimize expense for the taxpayer.

As a means to promulgate investment, a working group should be formed to foster a Jordanian government-private sector partnership. Senior representatives from government, business, finance, and law should be included.

Capital Markets

The development of a strong capital market in Jordan is essential to mobilize resources to finance industrial growth through investment. The Amman Financial Market (AFM), in concert with the other financial institutions in Jordan, will play a key role in such financing.

Several modifications of the present system could improve the financial market and encourage greater investor confidence. The AFM should concentrate on the market-making function and be relieved of regulatory and securities-processing activities. If possible, a separate regulatory agency should be created to oversee all securities activities and assist in the development of new investment vehicles.

The current system of administratively determining the price of new issues for the AFM should be replaced by a market-determined pricing system.

The Jordanian government should encourage the formation of a broker/dealer association to set industry standards and practices. The broker/dealer community and the AFM should encourage participation of investors both foreign and domestic in the Jordanian market through portfolio investments.

The government should remove legal or regulatory constraints that inhibit the establishment of mutual funds in Jordan.

Privatization

In keeping with the worldwide trend of privatization, the Government of Jordan should develop a privatization program. Formation of a commission to formulate policy — composed of senior representatives of government, business, law, and finance and chaired by the Prime Minister — should give strong evidence of government intention to end its significant position in the private sector.

An office should be created on the German model, Treuhandanstalt, that would be responsible for privatization policy implementation. A procedure for evaluation of divestiture targets and a schedule of action should be developed. Guidelines should also be crafted to allow government investment funds to acquire securities as non-intrusive investors.

The government should examine privatization programs in countries in the region, Eastern Europe, and the United Kingdom.

The Government of Jordan should commit to complete divestiture within five to seven years.

See Section Three of the report for detailed investment policy recommendations.

THE LEGAL FRAMEWORK: PRINCIPAL RECOMMENDATIONS

Foreign Investment: Immediate Action

Legislation providing for foreign investment should be reviewed for conformity with current international norms and revised accordingly. Standard legal assurances such as the clear right to repatriate profits, a guarantee against nationalization or expropriation, and the settlement of any disputes by international arbitration under international law appear to be missing from the existing legislation. The provisions regarding foreign ownership of businesses in Jordan should be liberalized.

Provision of essential information to prospective investors needs to be improved. Documentation on the relevant laws and regulations, international agreements, and the like are not readily available; establishment of a Private Investment and Business Document Center is recommended.

Criteria and procedures for approval of foreign investments should be simplified. A central, one-stop office for servicing foreign investors is recommended.

Existing intellectual and industrial property laws need to be updated to cover properties of the modern technological age such as integrated circuitry (microchips), unpatentable industrial processes (technical know-how), electronic data processing software, and video and audio cassette programs.

Domestic Investment and Business: Immediate Action

The existing legislation governing the formation and regulation of companies, both public and private, should be simplified so that government involvement is reduced to an absolute minimum. In particular, the many detailed provisions of the Companies Law and the role of the Controller of Companies need to be reconsidered.

The absence of accounting standards is impeding development at every level of the economy. The establishment of such standards and their compulsory use for the capital market and availability of tax exemptions should be set as a high priority of the government.

Long-Term Actions

All laws and regulations affecting investment, business, and trade should be reviewed and revised as necessary to remove unnecessary constraints. In addition to the laws mentioned above, the civil law, commercial law, tax laws, customs laws, banking and capital markets laws, and arbitration law should be reviewed.

Other elements of the legal system should be strengthened to give permanence to the legal framework for investment and economic growth. The courts, legal education, and governance of the legal profession (lawyers) should be included as a longer-term part of the reforms undertaken by the government.

See Section Four of the report for detailed recommendations regarding the overall legal environment.

SECTION ONE

THE MACROECONOMY 1991-1992

AGGREGATE OUTPUT AND OUTPUT GROWTH

Jordan is a small nation, heavily populated in relation to its natural resources. Total population was estimated by the National Population Commission to be 3.34 million in 1990 and growing at an annual rate of 4.1 percent. Per capita Gross Domestic Product (GDP) in 1990 (using the above population figure and the national accounts data of the Central Bank) was 769 dinars (JD).[1]

The Jordanian economy is diverse with no single dominant sector. Government services are the largest subsector, 19.4 percent of the total. The financial sector, along with real estate and business services, comprises the next largest subsector (as measured by value of contribution to GDP). Manufacturing is the third-largest subsector, producing just less than 15 percent of total output. The structure of the economy, as it was in 1990, is given in Table 1.

The striking aspect of the distribution of product given in Table 1 is the small proportion of output generated by the agricultural sector. Conversely, the financial and government sectors are quite large for a middle-income nation. Growth of real GDP, which was in excess of 6 percent per annum in the mid-1980s was negative from 1988 to 1991, while both migration and the natural rate of growth have led to very rapid population growth. This critical situation reflects the heavy impact on Jordan of the Gulf crisis, which has simultaneously eliminated Jordan's main external markets and led to massive repatriation of Jordanians working outside of Jordan, primarily in the Gulf states.

MONEY, PRICES, AND RATE OF INTEREST

There is a very large supply of broad money (M2), significantly enlarged by the repatriation of funds from the Gulf during the Gulf War (Table 2). The trend rate of inflation over the decade 1981-1991, as measured by the Cost of Living Index, has been 7.1 percent per annum. More recently, inflation has accelerated, averaging 15.5 percent over the years 1987-1991 (see Table 3). Thus, there has been a significant acceleration of inflation in more recent years, as the Gulf crisis has developed. (The average used here and elsewhere is the logarithmic slope of the trend line between endpoints.)

The structure of interest rates is peculiar, particularly for a nation suffering from high rates of inflation. Most of the published Central Bank data refer only to the administered rates of specialized credit institutions, which are implicitly subsidized. Commercial banks, by contrast, have latitude in setting rates, including making adjustment for risk. Deposit rates are below the rate of inflation, but lending rates are positive in real terms and apparently vary quite widely. However, 10-13 percent is the range of rates applicable to most loans. Although the available financial capital at such modest real rates might be partially explained by the large amount of liquidity, it remains surprising that there is not more capital flight.

[1] Equivalent to $1,153 at the 1990 exchange rate of 1.5:1.

TABLE 1

STRUCTURE OF THE JORDANIAN ECONOMY
(Percent of GDP, 1990)

I.	Industry, total	81.3
	Comprising:	
	Agriculture, hunting, and Forestry	7.5
	Mining	8.0
	Manufacturing	14.9
	Electricity	2.1
	Construction	6.1
	Wholesale and Retail Trade, Restaurants and Hotels	13.9
	Transportation, Storage, and Communications	9.5
	Finance, Insurance, Real Estate and Business Services	16.6
	Community, Social and Personal Services	2.4
II.	Government Services	19.4
III.	Other Services	1.9
	Less Imputed Bank Service Charges	-2.2
Total GDP		100.0

Source for Table 1: Central Bank of Jordan, *Monthly Statistical Bulletin*, Vol. 28, No. 2, February 1992, Tables 2 and 3.

THE RATE OF EXCHANGE

Since 1987, Jordan has been able to sustain currency convertibility and a relatively realistic rate of exchange (Table 4) despite high rates of inflation. This has been accomplished through a series of large devaluations. The exchange rate has also been unified since 1990. The overall fall in the value of the dinar vis-à-vis the dollar has been just over 50 percent since its peak rate of 2.96 (1987). Over the same period, however, the Consumer Price Index rose by 71 percent. The exchange rate is maintained against a basket of currencies the weighing of which is not public. The government is committed (to the International Monetary Fund) to maintain a competitive rate. As of May 12, 1992, the rate was JD 1.00 = $1.46.

TABLE 2

THE SUPPLY OF MONEY, 1981-1992

Year (end)	M-1	M-2	Rate of Change % per annum M-1	Rate of Change % per annum M-2
	(Thousands of JD)			
1981	701,656	1,179,880	n.a.	n.a.
1982	787,503	1,403,347	12.2	18.9
1983	869,417	1,615,157	10.4	15.1
1984	878,391	1,757,662	1.0	8.8
1985	848,222	1,874,843	-3.4	6.7
1986	897,097	2,072,423	5.8	10.5
1987	979,803	2,372,156	9.2	14.5
1988	1,181,349	2,646,713	20.6	11.5
1989	1,326,503	2,971,092	12.3	12.2
1990	1,432,755	3,122,627	8.0	9.1
1991	1,656,868	4,055,025	15.6	29.8
1992(Jan)	1,772,589	4,151,585	17.2	32.9
1992(Feb)	1,835,402	4,222,851	19.7	33.1
Log Slopes,	1981-86		4.9	11.3
	1986-91		12.3	13.9

Source: Central Bank of Jordan, *Monthly Statistical Bulletin*, January 1982, Table 9, p.22.

TABLE 3

ANNUAL RATES OF CHANGE, CONSUMER PRICE INDEX, 1987-1991

1987-88	8.0 %
1988-89	25.8 %
1989-90	16.1 %
1990-91	8.2 %

Source: Central Bank of Jordan, *Monthly Statistical Bulletin*, February 1992.

TABLE 4

AVERAGE SELLING RATES: DOLLAR EQUIVALENTS OF ONE DINAR

Year	Dollars
1984	2.62
1985	2.54
1986	2.87
1987	2.96
1988	2.91
1989	1.74
1990	1.50
1991	1.47
1992	1.47 (February)

Source: Central Bank of Jordan, *Monthly Statistical Bulletin*, February 1992.

This exchange rate strategy appears to be timid in terms of Jordan's need to expand exports at the most rapid possible rate. It is extremely important for Jordan to avoid overvaluation of the dinar, and although this appears to be understood and appreciated by officials of the Central Bank, administration of the exchange rate strategy appears to be less bold than Jordan's difficult balance of payments circumstances require. Because Jordan needs to adopt an open economy strategy with vigor, a fully competitive rate of exchange is essential, and flexibility must be maintained. The modest decline (only 18 percent) in the dinar rate against the dollar since 1989 does not appear to be sufficiently bold.

According to the Central Bank, there is no surrender requirement for foreign exchange at this time. Apparently, however, there have been such restrictions in the recent past. Despite shortcomings, it is clear that the exchange regime is liberal by world standards and certainly by the standards of nations at Jordan's level of per capita GDP.

TAXATION AND FISCAL POLICY

The Government of Jordan has had limited success in curbing aggregate demand through the broadening of the tax system and reduction of the rate of monetary growth. These measures appear to have been effective in reducing the rate of inflation. This will, in turn, encourage real investment. At the same time, success in curbing import demand and increasing exports (both badly needed for macroeconomic balance) will have broadly inflationary effects that will have to be countered.

TABLE 5

DISTRIBUTION OF TAX REVENUES, 1991 (PRELIMINARY)

Tax	Percent
Corporation taxes	24.0 percent
Individual income taxes	4.2 percent
Excises and duties	24.5 percent
Customs duties	39.0 percent
Other	8.3 percent
Source: IMF, calculated from unpublished preliminary data	

The present structure of taxes, shown in Table 5, is far from optimal from the point of view of encouraging economic efficiency and export potential. Increasingly effective taxation — including the expected move to introduce a value-added tax — will provide a fiscal instrument that can reduce the excess of aggregate demand. Some additional benefits in this direction could be obtained by revision of the income tax law and adjustment of the tax structure. Reduced taxation of international trade and broader general taxes on income — especially household expenditure — are required.

Given that expanded or even sustained levels of international borrowing are constrained by debt, curtailment of consumption, combined with private capital imports, appears to be the only effective strategy.

INTERNATIONAL TRADE AND BALANCE OF PAYMENTS

A persistently large deficit in the balance of trade has been experienced in the late 1980s and into the 1990s. It is of unsustainable magnitude, even with substantial external financial assistance. The availability of the latter, however, makes the accounting situation appear temporarily manageable (Table 6).

The balance of payments data shown below, as published by the Central Bank, show relatively modest current account deficits. In part, this is a reflection of substantial transfers of the savings of Jordanian citizens earned abroad, primarily in the Gulf. Although these funds buoy the economy significantly and are expected to continue to flow in 1992 albeit at a more modest rate, they cannot be looked to much beyond 1992, barring a political and economic turnaround in the Gulf. The main support for Jordan in its balance of payments crisis must come from working with the IMF on reducing its current account deficit and huge debt. A consortium called the Gulf Crisis Financial Coordinating Group is expected to provide more than $1 billion between 1990 and 1992.

Hope for strengthening the current account comes from an already improving export performance, worker remittances (which, it is hoped, will recover to some extent as the Gulf crisis becomes more and more distant), and economic efficiency in import substitution and import restraint. Both import strategies are being pushed — with some early success — and taxes are expected to curb domestic consumption

Still, the international imbalance is extremely large relative to the size of the economic system. The country's need for imported materials is so great that all circumstances point to a complex and chronic international payments problem.

TABLE 6

TRADE BALANCE AND CURRENT ACCOUNT, 1986-1990

Year	Trade Balance (JD Million)	Current Account
1986	-591.89	-15.95
1987	-596.87	-118.35
1988	-638.49	-105.51
1989	-589.25	214.24
1990	-1008.57	-73.69

* Preliminary
Sources: Central Bank of Jordan, *Monthly Statistical Bulletin*, Vol. 28, No. 2, February 1992

Thus far, the modest revision of trade policy has not liberalized the regime sufficiently to offer much hope for rapidly expanding export earnings, which must be achieved if the growing labor surplus is to be diminished and if foreign aid dependency is to be reduced in the foreseeable future. Without rapidly expanded, labor-absorbing production for export, Jordan will face what must eventually be politically destabilizing increases in unemployment from labor force repatriation and large cohorts of young people entering the labor market. The Jordanians have a reputation for sustaining political stability and for patience with their government, but all societies are strained by extended economic adversity.

While export-led growth is the most likely avenue of economic progress, it would be unwise to ignore the importance of the internal economy. The great influx of workers returning from the Gulf states has provided resources of entrepreneurship and professional skills that must be productively used to the fullest extent possible.

THE LABOR FORCE AND UNEMPLOYMENT

Unemployment is high. The population projections shown in Table 7 present a very sobering picture about the likelihood of attaining full employment and increasing per capita incomes. The growth rate of total population implied in the table is 4.1 percent per annum. That rate of growth is a substantial understatement of the rate of growth of the labor force because of the predominance of young people in the population distribution.

The data given in Table 8 show the impact of excessive growth of the labor force, with a rise in the unemployment rate of 22 percent in just four years. Such a huge loss of economic potential is injurious to economic welfare.

TABLE 7

POPULATION OF JORDAN, 1990-1995

Year	Total	Male	Female
1990	3,345,000	1,177,000	1,676,000
1991	3,571,000	1,837,000	1,735,000
1992	3,696,000	1,900,000	1,796,000
1993	3,825,000	1,965,000	1,800,000
1994	3,960,000	2,033,000	1,927,000
1995	4,098,000	2,193,000	1,995,000
Source: National Population Commission, Jordan, *Population Projections, 1990-2000,* May 1991			

TABLE 8

UNEMPLOYMENT RATES IN JORDAN
(Percent of Labor Force)

Year	Male	Female	Total
1987	13.3	27.0	14.8
1990	14.5	30.6	16.8
1991 (est)	(15.0)	(32.0)	(18.0)
Source: Ministry of Planning, Government of Jordan			

LIKELY EFFECTS OF THE ONGOING MACROECONOMIC ADJUSTMENT PROGRAM

With the assistance of the IMF, much is being accomplished toward diminishing the problems and pressures in the economic system discussed above. The IMF has provided substantial guidance in this effort, and much progress has already been made. However, the scope of the program is not sufficient either to reduce the level of unemployment or achieve balance of payments equilibrium without very large external support for most of the next decade. In the meantime, macroeconomic stability, if it is to be attained and maintained, will require not only continued severe austerity but also sustained balance of payments support. That statement is not intended to belittle stabilization efforts already under way, but rather to emphasize the urgency of more rapidly expanded employment. Full employment, if it is to be attained in the foreseeable future, will require an aggregate rate of growth much larger than that now anticipated.

To prevent unemployment from increasing, aggregate demand will have to expand at a rate equal to the sum of the anticipated rate of growth of the labor force plus the anticipated rate of growth of labor productivity. As stated above, population can be expected to grow at the very high rate of 4.1 percent per annum over the period 1990-1995. Moreover, the age cohorts 15-49, which are the heart of the labor force, are expected to grow at 4.2 percent per annum over that period. Thus, without consideration of migration, employment must grow at the 4.2 percent rate if unemployment is not to rise.

The high rate of growth of the labor force obviously derives from migration, the extreme youth of the community, and the high natural rate of population growth. It is also to be expected that technological change will raise productivity per person by three percentage points per year. Thus, aggregate demand must rise by more than 7 percent per year to employ the increase in the labor force. When the number of those currently unemployed is taken into consideration, making meaningful progress toward full employment requires an even higher rate of growth of aggregate demand, which will create huge pressures on macroeconomic stability.

This analysis implies a huge dilemma for a nation already beset by inflationary pressure. If Jordan were amply endowed with large quantities of complementary resources such as raw materials or agricultural land, labor-intensive economic activity might be expanded by increasing internal demand, in Keynesian fashion. However, Jordan does not have many unemployed or underemployed natural resources. Land is available in very considerable quantity, but it is desert land for the most part, and supplies of ground water which might be used to expand agricultural output are severely limited. Agricultural productivity can be improved considerably, but it would probably be ambitious to anticipate a rise in agricultural output of as much as 3 or 4 percent per year, a range of increase barely sufficient to maintain per capita output.

Absorption of the presently unemployed and the anticipated large increments to unemployment will require exports to expand at a very rapid rate. This can be achieved only if the supply of capital can be increased substantially -- by a very rapidly rising rate of domestic saving, efficiently channelled to rising production, or by very large capital inflow. The dilemma implied by the latter statement is chastening, to say the least. Total external public debt had reached $8.1 billion by mid-1991, according to IMF estimates.[2] This large debt must be serviced by a system that, in 1992, will generate a Gross National Product (GNP) of approximately JD 2.3 billion ($3.6 billion).

On the more positive side of the labor supply issue, the influx of new entrants should prevent any significant rise in real wages for the foreseeable future. This, of course, is positive only in the sense that there should be very little wage-push effect of expanded production for several years. This will not only help to contain inflation, but will also assist Jordan in its efforts to enter international markets at competitive prices.

[2] IMF Stand-By Agreement, December 1991. IMF debt data as of August 1991 appear still to include $1 billion for loans associated with the purchase of Mirage jets from France. This deal was later canceled, reducing total debt to approximately $7 billion.

Clearly, labor-intensive exports should be a primary focus of the growth strategy. The labor force now contains a very large number of older, experienced workers, many of them very recently repatriated from the Gulf states. These repatriated workers and professionals should be integrated as much as possible into the domestic labor force, lending variety and richness to the nation's labor inputs. These human resources should be utilized in raising the nation's total productivity and adding to its export capability. However, this expanded utilization of labor in any form requires at least minimal complementary capital per employed worker.[3]

COSTS AND BENEFITS (ECONOMIC AND FINANCIAL) OF THE PROPOSED TRADE AND INVESTMENT POLICY ADJUSTMENTS

The benefits — expanded employment and increased import capability — should be emphasized first. Expanded employment opportunity is extremely important, not only because it raises total productivity and total economic welfare, but because an idle labor pool causes a variety of economic and social welfare costs that Jordan can ill afford. Skilled workers become less skilled when they are idle, and their basic consumption needs remain a part of the nation's aggregate demand for final goods.

However, effective absorption of the unemployed cannot be achieved without eventual upward pressure on wages and on prices of complementary inputs. Imports of equipment and raw materials (for example, for expanded textile manufacturing) will increase. In a nation already beset with inflationary pressure, a successful effort to expand exports will exacerbate problems of macroeconomic balance. And, given Jordan's extreme international indebtedness, further efforts to export will add to the problem of excess demand. Every effort will thus have to be made to curb internal demand and to encourage private capital inflow. The former can be partially achieved by broadly based taxes on spending or on spending potential. Elimination of consumption subsidies will help, as will the proposed value-added tax.

On a related note, every effort should be made to bring import-substituting industries out from under their umbrella of protection so that foreign exchange and complementary domestic resources are used in a fashion consistent with world standards of efficiency. This is to say that an effective program of export-led growth must be complemented by domestic production that competes with imports at world market prices.

Thus, to the fullest extent possible, the entrepreneurial skills of returnees from the Gulf should be encouraged — for example with an expanded and aggressive small business loan program. Moreover, with a growing pool of young and largely unskilled labor, it seems reasonable to envisage effective and productive combinations of business leadership and increasingly available unskilled workers. Export programs based on cottage industries are one of many possibilities.

[3] Migration can help reduce labor redundancy, of course, but it would be unwise for Jordan to rely on external demand for labor to any large degree.

DETAILS OF THE FOREIGN DEBT SITUATION

The debt situation is not encouraging, as shown in Table 9. Although these figures appear to have been improved by the conclusion of the Mirage jet deal, they are still massive when compared to Jordan's total economic output. Action is now under way by the Paris and London clubs to reschedule debts coming due in the 1992-1993 period. Prior to the rescheduling, the IMF estimated debt service payments for 1991 and 1992 to be $1.24 and 1.29 billion, respectively. The IMF projects debt service will peak at $1.39 billion in 1995.

TABLE 9

JORDAN'S EXTERNAL DEBT, MID-1991
(Millions of Dollars)

Lender	Amount
Arab Countries	563
Industrial Countries	3,530
Bilateral Loans	1,988
Export Credit Guarantees	1,542
Other Countries	568
International Banks	1,248
Foreign Companies	55
Multilateral Institutions	1,328
Bonds	255
Leases	578
Total	8,125

Source: IMF Stand-By Arrangement, Table 11, December 1991.

CONCLUSION

To summarize, the major conclusions to be drawn from this analysis are the following:

1. Inflation remains a serious problem, reflecting a persistent excess of liquidity, low rates of interest, and stagnation of real output growth.

2. Jordan must internationalize its economy to a much greater extent to expand foreign exchange earnings and raise import capacity so that it can maintain service payments on its very large international debt.

3. The tax system needs to be strengthened by boosting revenue productivity and lessening the tax burden on production of internationally traded goods.

4. The rate of growth of the labor force is very high (exceeding 4 percent per annum), adding rapidly to an already very high rate of unemployment. Employment creation is, therefore, of vital importance.

Jordan's disequilibrium in external payments is of crisis proportions and can only be balanced with a strong policy shift encouraging increased earning of foreign exchange. Debt rescheduling and hopes for resumption of high earnings of Jordanians working elsewhere in the Gulf cannot be expected to support a durable recovery program. Endowed with very modest natural resources but with a large and rapidly growing labor pool, Jordan must find and cultivate markets abroad. Abundant examples of successful export-led growth now exist for Jordan to emulate. A vigorous policy reform effort in that direction must be undertaken without delay.

ADDENDUM: LESSONS FROM HONG KONG

In international economic affairs, no analogy gives a perfect fit. However, there are interesting parallels between the case of Jordan in the 1990s and the Crown Colony of Hong Kong in the 1950s. The great differences are obvious, and will only be acknowledged:

- Level of poverty (poverty was much higher in Hong Kong);
- Access to port facilities (Hong Kong is a port city and little else); and
- Levels of education (only a small elite had access to formal education in Hong Kong).

It would be a mistake, however, for Jordan to overlook the marvelous history of Hong Kong's development in the period after World War II, when that colony, in less than a decade, absorbed an idle labor pool. Hong Kong began the decade with at least 50 percent unemployment, massive poverty, and no significant resources other than the magnificent port and masses of largely undifferentiated labor.

The situation in Jordan in 1992 is analogous to that of Hong Kong in several respects — namely, the very limited natural resource base and a port outlet with good access to very large and growing markets. Indeed, its Mediterranean location affords Jordan with much larger access, as well as more distant access to the United States and Japan. Modern transportation makes market access much easier in 1992 than it was in 1950, with a ravaged world economy virtually everywhere outside the United States.

The point of calling attention to this analogy is simply that Jordan is compelled by circumstances to adjust quickly to a strategy of export-led growth. Unfortunately, Jordan has a recent history of import substitution and reliance on taxes on international trade. A successful export-led growth strategy will require some difficult choices and some disruption of lives. It will require that taxes on international trade on both the import and export side be eliminated expeditiously and alternative sources of state revenues be established. Such a strategy will expose some industries to international competition, and many will fail, creating frictional unemployment. However, this is a necessary cost of rationalizing the economy and enabling it to use its excellent labor force productively.

The resources complementary to the labor being absorbed, including entrepreneurship and industrial organizational skills, will, for the most part, have to be imported. However, this adjustment can be made, as it has been in a variety of nations that were poor very recently and that are now growing rapidly, pulled by the engine of export-led growth. Hong Kong is chosen as an example here because it too is a small, rapidly growing community with a very poor natural resource endowment. However, the cases of success with export-led growth are becoming increasingly numerous. The list now includes Japan (a poor, war-ravaged nation in 1950), Taiwan, Thailand, Malaysia, and Indonesia. It would be a serious mistake to dismiss all that economic history on grounds that it is too exotic to be relevant to Jordan's case. Indeed, Jordan's precarious financial circumstances are such that the imperative to export is, if anything, of greater immediacy than the very critical problems faced earlier by the nations mentioned above.

SECTION TWO

THE TRADE ENVIRONMENT

Jordan's general trading position and its pattern of trade-related policies and regulations have been the subject of several outside studies in recent years, most notably those by McCue at the end of 1988 and by the 1992 World Bank mission.[4] Although it is clear from our own brief investigations that the overall policy and regulatory structure remain much the same, there is little doubt in the aftermath of the Gulf War that the authorities are actively seeking ways to liberalize the trade regime and to encourage a rapid switch from import substitution to export orientation. Many measures have been liberalized over the last year, and many more are being studied or are at the draft legislation stage; several of the latter could well have a positive and substantial effect on exports. Accordingly, several policy initiatives recommended by outside studies have been overtaken by events and now have less importance than formerly. Nevertheless, many of the desirable changes in the constituents of the trade regime have been implemented only to a limited extent or not at all, and their effectiveness has often been blunted by bureaucratic obstructionism. This is particularly the case in the area of duty waivers and exemptions from taxes and other fiscal charges. Thus many of the new export incentives offered on paper have little real meaning to the would-be exporter.

The failure to make proactive changes to the policy and regulatory framework is all the more serious because the Gulf War drastically affected established trading patterns and the viability of export companies. Final statistics are not yet available for 1991, but it is clear from the evidence so far that Jordan's exports to all markets fell by around 15 percent compared with the previous year. The major markets of Iraq, Saudi Arabia, Kuwait, and Egypt have remained virtually closed since the war. Indeed sales to Arab countries generally, which constituted 42 percent of all exports in 1990, fell by around 46 percent, and their export share fell to some 28 percent. Whereas Jordan's exports to non-Arab countries rose slightly during this period, exports to the Western countries with which Jordan has the most severe trade imbalances (the United States, Europe, and Japan) declined. Sales to these markets fell by almost a third during 1991 from an already depressed level.

The export results for 1991 were also disappointing in terms of product mix. Jordan's exports consist mainly of bulk raw and semiprocessed materials (mainly phosphates, potash, cement, and fertilizers) that together accounted for more than 55 percent of total export values in 1990. Another 10 percent was accounted for by exports of raw and semiprocessed foodstuffs. Most of the remaining 35 percent (less some 15 percent for re-exports) consisted of manufactured goods, particularly pharmaceuticals, paints, detergents and soaps; wood, paper, plastic, and textile products; and some simple machinery and spare parts. Manufactured exports have been absorbed traditionally by the neighboring Arab markets, whereas the raw materials have tended to be sold outside the region, particularly in East and Southeast Asia. In 1991, as far as can be ascertained at present, exports of crude materials and fertilizers diminished only slightly, and exports of cement rose substantially, as did exports of foodstuffs (mainly vegetables), but exports of manufactures dropped sharply.

[4] *Import-Export Procedures in Jordan* by C.A. McCue for the Bureau for Private Enterprise, USAID, December 1988.. And *Export Incentives and Technological Capabilities - An Outward Looking Strategy for Jordan*; Industry and Energy Operations Division, Middle East and North Africa Regional Office, Report No. 10228-JO, February 1992.

The precarious nature of Jordan's export position and the implications for the servicing of its external debt make the effective implementation of proactive policies and regulations a matter of absolute necessity. Much of what is recommended below relates to the adjustment or implementation of existing or proposed policies and regulations; where new ones are proposed, care has been taken to place these within the framework of existing policy constraints.

THE DEPARTMENT OF CUSTOMS

The Customs Department in Jordan, as in all countries, has the duty of ensuring that trade regulations are complied with and that revenues accruing to government are not reduced by fraud. In addition, in export-oriented countries, Customs has the duty of facilitating trade through the simplification of procedures and the minimization of delays. Unfortunately, in Jordan the implicit adversarial relationship between Customs and the trading community is made explicit by the former's rigid adherence to the minutiae of the regulations, many of which are unnecessarily oppressive and complex. This rigidity is partly imposed by legislation (the Customs Law) in order to prevent corruption in the service and partly by regulations introduced by the Customs Department itself to make its administrative task easier, albeit at the cost of inconvenience and expense to traders.

Regulations and Policies Administered by Customs

The slow progress with the introduction of the duty drawback scheme is a case in point. Enabling legislation was passed in 1988, but to date none of the 15 exporters registered under the scheme have received drawback payments. Customs has delayed payments, insisting that the drawback rates be calculated on the basis of individual company transformation coefficients for each separate product, with exact accounting for wastage; the necessary investigations have been correspondingly intrusive and resented by the companies concerned. Moreover, the insistence on individual drawback rates has made Customs require a prior declaration of intent to claim drawback at the time of import, thereby lim ing the applicability of the scheme to established exporters only. Even so, the reluctance of Customs to disburse the drawbacks earned has been proverbial. Because the drawback is designed to promote exports, its impact varies directly with the speed and ease of duty reimbursement. According to these criteria, the promotional effect of the present Jordanian scheme is near zero at present.

Another disappointment has been the retention of the excessive number of signatures required for processing customs entry forms despite the McCue recommendations. Indeed, complaints have been voiced that the situation has actually worsened, with some of the extra controls imposed at the time of the Gulf War and its immediate aftermath still being enforced, so that sometimes over 50 signatures are being required to process import documents, and over 20 to process export documents. Although much of this relates to the controls imposed by the Ministries of Health and Agriculture and by the Directorate of Standards, Customs could do much more to streamline document processing.

It is recommended that before the end of 1992 the Customs Department (1) replace the present system of duty drawback for its presently registered manufacturers with a fixed-rate scheme that will eventually cover all Jordanian manufacturing industry on a generic-product or whole-industry basis, incorporating simple, transparent, and automatic rules for calculating inputs and wastage together with the duties and taxes paid; (2) introduce a system whereby duty drawback is reimbursed within three weeks of notification of encasement of export receipts, without any requirement of prior declaration of intent to export; and (3) make special arrangements to grant individual duty drawback in exceptional cases where the manufacturer can document payment of at least one-third more duties than rebated under the fixed rate.

Furthermore, by the middle of 1993 it is recommended that (4) simple procedures be worked out and implemented on the same basis for indirect exporters under both the duty drawback and temporary entry provisions to extend coverage to as many intermittent exporters as possible. To speed up the processing of customs entry forms, it is further recommended that before the end of 1993 the forms be redesigned so that (5) the number of signatures required can be reduced to eight, in line with the McCue recommendations, and that (6) the sampling requirements of the Ministries of Health and Agriculture and of the Directorate of Standards be drastically reduced or abolished for export-related imports.

Management of the Customs Department

Improved management practices within the Customs Department would benefit the trading community. Even senior customs officials lack discretionary powers over the imposition of fines under the Customs Act. Two other management features that urgently need attention are the computerization of the customs entry forms and the rationalization of the remuneration system.

Not having computerized customs entry forms, Jordan is at least 10 years behind many other developing countries. Only two personal computers are in use by Aqaba customs officials, and even these are not being used in a systematic way, partly because of the scale of the data entry task and partly because Arabic programs are not yet available. The wholesale computerization of customs records is a prerequisite for the development of an efficient service. It will allow customs to reduce the checking required on documents presented by companies with a good record of procedural conformity; to identify which products are most subject to tariff reclassification (about 96 percent of all forms are reclassified to higher duties at present) and to reduce the extent of reclassification; to speed up the processing of duty-drawback and temporary-entry documents; and to keep track of developments abroad in prices, exchange rates, creditworthiness, and the like.

The present remuneration system is unfair because customs officials at the major customs houses of Amman and Aqaba benefit significantly from the fines-reward system, whereas those at smaller houses do not. The fines-reward system relates not just to the detection of outright fraud but also to the identification of routine customs entry penalty conditions imposed by the Customs Act. The fact that customs officials of all ranks in the customs house concerned and the overall budget of the Department of Customs benefit directly from these institutionalized penalties is a powerful irritant to the trading community and one which reinforces the adversarial relationship.

It is recommended that (1) before the end of 1992 the Customs Department implement an Arabic UNCTAD ASYCUDA computer system at the Aqaba and Amman customs houses as well as at headquarters, using the Harmonized System codings, and that (2) before the end of 1993, the remuneration of customs officials of all ranks be replaced by an equivalent earnings system that is not dependent on fines and that is applicable throughout the service.

POLICIES AND REGULATIONS ADMINISTERED BY THE CENTRAL BANK OF JORDAN

The Central Bank of Jordan (CBJ) seeks to facilitate trade while limiting the speculation against the dinar, which it regards as a convertible currency. During the Gulf War, several emergency controls were imposed on the banking system that have now been relaxed but not completely done away with, particularly the level of mandatory cash margins for advances against import documents (now reduced to 10 percent for basic commodities and to 20 percent for other goods, with higher rates applicable for goods imported through the Free Zones) and the operation of external accounts (with holdings now limited to only 50 percent of foreign currency earnings). In addition, as a direct export incentive, the CBJ has waived its own requirements for bank guarantees and has introduced a rediscounting facility for both preshipment and postshipment export credits advanced by the banks against confirmed letters of credit.

Unfortunately, the regulations governing this facility have limited its attractiveness to the commercial banks, which have been in an excess liquidity position for some years and so have less need to make use of the extra liquidity afforded by the rediscounting facility (under which they have to retain full liability to the CBJ for any default on the part of the trader). Furthermore, the limitation of the interest rate spread which the banks can impose on top of the CBJ lending rate to 1 percent plus a 1/2-percent commission has not been sufficient to induce them to alter their high level of risk aversion to trade-related (particularly export) financing. The ability of the exporter to fulfill all the conditions of his letter of credit has traditionally been discounted heavily by the banks in Jordan so that additional "safe" collateral (land and buildings) is required of all but the largest and most established exporters. In addition, the CBJ requirement that the goods concerned incorporate at least 40 percent local value added is unnecessarily restrictive in view of generally accepted international ratios and the import dependency of most of Jordan's manufacturing industry.

It is recommended that by the middle of 1992 the CBJ introduce a series of measures to enhance the attractiveness of the rediscounting facility to the commercial banks, particularly (1) the removal of the present interest-rate markup ceiling to encourage the banks to equate interest rates with risk more than they presently do; (2) the increase in the rediscount rate from 60 percent for preshipment credit — which is unnecessarily restrictive given the persistence of excess liquidity — to 80 percent; (3) the reduction in the value-added requirement for the use of the rediscounting facility to 25 percent; and (4) the removal of restrictions on foreign exchange holdings in non-bank external accounts so that the exporter retains 100 percent of foreign currency receipts to spend without restrictions of any kind. The present restriction is pointless. It dates from the Gulf War emergency and casts doubt on the status of the dinar as a truly convertible currency.

POLICIES AND REGULATIONS ADMINISTERED BY THE MINISTRY OF FINANCE

The tax system in Jordan is currently undergoing a radical overhaul as part of the structural adjustment program put in place with the assistance of the IMF. The tariff spread has been drastically reduced so that the top limit (except for some luxury items) is now 50 percent, and the lowest non-zero band is 5 percent. At the same time, to make up the fiscal shortfall and to make import substitution activities less attractive, the government has introduced a fiscally neutral consumption tax on both domestic production and imports and intends to convert this tax into a universal value-added tax. The incidence of the present tax has not been perceived as equitable. Many exporting companies complain that it penalizes their domestic sales while rendering import competition more effective and that they have to find another bank guarantee for customs covering unpaid tax on exported goods pending proof of payment. A more important complaint is that in many cases the staged introduction of the tax has meant that it is being levied in full on imports of raw materials, among other things, without any offsetting reduction in the duty rate payable. Where this is the case, the profitability of the would-be exporter is seriously impaired.

At present, high rates of duty are levied on imports of spare parts (among other items) for industry and for private vehicles, although duty exemption has been granted to all pioneer companies under the new Encouragement of Investment draft law. It would be difficult to find an adequate means of remitting these duties under the duty drawback scheme, but because these imports — particularly industrial spare parts — are absolutely vital to the establishment of a solid export base, the duties should be abolished. The revenue losses are likely to be modest, around JD 20 to 30 million.

The system of collecting fines for customs entry violations needs to be revised. Customs officials complain that at present they have absolutely no discretion over the imposition of these fines, which do not constitute part of the staff reward system. Currently, a fine of 5 percent of the invoice value is imposed when the importer declares that his goods have originated in more than one country (irrespective of the value-added ratio), except in the case of transnational companies, for which the fine is reduced to 1 percent. The EC is the only regional country grouping that can be regarded as one country. Again, a fine of 4 percent is levied automatically if the foreign exporter has failed to get a certificate stamped by the Chamber of Commerce in his town of origin. Although these fines (taxes) are generally accepted, importers complain more vociferously about the lack of discretion allowed to customs officials at Aqaba, Amman, and elsewhere over clerical errors involving over- or underinvoicing on customs entry forms where there was clearly no intention to defraud the revenue. The penalties imposed in such cases can be up to twice the duty value on top of the duty properly payable and, unlike the place-of-origin fines, these penalties are all the more galling to traders because they do constitute part of the staff reward system.

Corporation tax regulations also need to be revised. Indeed, a case can be made for the abolition of all corporate taxation other than for the bulk material industries, because the revenue losses would be manageable (around JD 25 million according to one estimate), and the collection ties up management and government resources that could be better spent. While such a step may be too radical to contemplate at present, some anomalies in the current regulations should be removed. One such irregularity, which directly affects the profits of exporting companies seeking new markets, is the non-deductibility of commission fees to foreign distributors.

The general tax treatment of exporters is also ungenerous. In many countries, companies receive a rebate of 100 percent of their export earnings, on the grounds that all exports contribute to economic development. In Jordan, the maximum rebate has been raised recently to 40 percent, a level that is uninspiring given the country's need for rapid export growth in the near future. The fiscal system should be able to give much more encouragement to small- and medium-scale manufacturing exporters, particularly those who are new to exporting and who do not qualify for pioneer industry status. Judging from available evidence, the reduction in revenues is likely to be modest.

It is recommended that before the end of 1992 (1) action be taken to eliminate the anomalies in the imposition of the consumption tax that materially affect exporters, particularly taxing of imported raw materials prior to the offsetting reductions in duties; (2) duties on spare parts for industry be sharply reduced and preferably abolished; and (3) corporation tax deductions be allowable for fees to foreign distribution agents. Furthermore, it is recommended that before the end of 1993 (4) a system be found to replace the customs fines related to country of origin with equivalent duties based on value-added ratios; (5) greater autonomy be given to the Aqaba and Amman customs houses to reduce fines for customs entry discrepancies when there is clearly no intention to defraud; (6) more generous corporation tax treatment be given to manufacturing exporters — for example, raising the export earnings threshold to 80 percent.

POLICIES AND REGULATIONS ADMINISTERED BY THE MINISTRY OF TRADE AND INDUSTRY

The Ministry has been responsible for administering the system of import and export licenses since Jordan was largely a command economy run under a system of martial law. The original purpose of the license system was to ensure an orderly flow of trade in directions favored by the authorities and to raise a substantial amount of revenue. The revenue function of the export licenses has long since been abolished, but little consideration has been given to the need to maintain these controls outside the sensitive areas of subsidized foodstuffs and other price-regulated items. Although most export licenses are granted within a day or two and the signatures are collected in the same building, the fact that these licenses are required at all imposes an unwarranted burden on management in manufacturing industries where the rationale for the control is absent. At present some 75 large companies have obtained renewable annual exemptions from export license requirements, subject to monthly notification of the numbers, values, and types of the LCs they receive. This information is used in the Ministry's own database and is passed on to the CBJ. It is questionable whether the inconvenience to management is worth the cost of maintaining the system; the legitimate concerns of the CBJ over foreign currency earnings could be provided for by Customs directly.

Most import licenses are also issued on the same day or the day after in one building, and the number of signatures required has now been reduced to four. Nevertheless, as with export licenses, the requirement represents a drain on management time. However, import licenses do serve a revenue purpose as well as a control function. Jordan has abolished all quota restrictions on imports (except for four minor items), and the retention of the import license is regarded as the last vestige of direct control. However, such controls can hardly be reconciled with the maintenance of the dinar as a convertible currency, and their only justification is one of revenue.

Yet the revenue implications are questionable. A complex system of exemptions has meant that the license fees, which amount to 5 percent of the invoice value (though not the license itself), are waived for most duty-free items, particularly machinery and raw materials, and that the license itself (along with the export license) is not required for any item imported into the Free Zones, although the 5 percent fee is still exacted for any sales from the Free Zones into Jordan's domestic market. A standing committee of the Ministries of Finance, Trade and Industry, and Supply is available to consider requests for derogation, but only a small number of requests has been made (and none for the abolition of the license on imports of spare parts). At present some 25 large importers have been granted an annual license on the same reporting basis as for export license waivers. To illustrate the extent of the waivers, in 1991 the issue of 58,418 import licenses relating to invoices worth JD 1.411 billion yielded only JD 18 million in revenue. Moreover, the administration of the import license system poses a major burden on the Ministry, which issued licenses to some 10,000 traders in 1991, compared with a fifth of that number in 1989.

The draft Export Credits Guarantee Corporation (ECGC) law provides a very important instrument for improving export finance by providing insurance against both commercial and non-commercial risks. The law should be enacted soon, and its provisions should not be adulterated, particularly regarding the envisaged government backing for the ECGC commercial risk guarantee (it is not explicitly provided for in the current draft). Otherwise, the ECGC is likely to conduct its operations in a too-risk-averse fashion to be effective.

The Ministry is also responsible for the conduct of trade relations, including protocol trade. Some 60 trade protocols have now been entered into, most of which allow Jordanian exporters access on Most Favored Nation terms to markets that would otherwise have been closed because of quota restrictions or high tariffs. In most cases the protocols contain product schedules that are indicative rather than exclusive, and payment without balancing is specified to take place on an individual transaction basis in hard currency between private and public sector principals. The protocols are permissive only, and the would-be exporter has to conduct his business in a competitive market. Little advantage has been taken of these protocols to expand exports because the activities of the Jordan Commercial Centers Corporation have until recently been devoted mainly to those few protocol markets where the protocol requires explicit trade balancing on a countertrade basis or where export credits are made available through the CBJ. Most of the latter protocols are due for renegotiation soon, and the Ministry should strive as much as Jordan's weak bargaining position will allow to avoid entering into renewed agreements based on barter or central clearing arrangements.

As part of this move away from bilateralism, Jordan should apply for GATT membership. At the moment Jordan has mere observer status and thus is excluded from most of the caucuses where substantive trade issues are decided. Membership would enhance Jordan's status as a world trading partner.

It is recommended that (1) by the end of 1992 the law of the ECGC be enacted and the organization be established with the full financial resources envisaged in the present draft. Furthermore, (2) by the middle of 1993 almost all remaining import and export licenses required for manufactured goods and raw materials should be abolished, together with their fees, and that in the few cases where controls are deemed necessary, an annual licensing permit be granted to the trading company, subject only to routine reporting requirements. Also, (3) by the end of 1993 Jordan should become a full member of the GATT and should refrain from concluding additional countertrading/balanced settlement protocols.

POLICIES AND REGULATIONS ADMINISTERED BY THE FREE ZONES CORPORATION

The Free Zones Corporation was set up in 1985, and at present two zones have been established in Zarqa and Aqaba, neither of which has yet made a substantial contribution to the development of exports (as opposed to reexports). At present, the Aqaba zone is used entirely for bonding against transhipment, although one manufacturer is now in the process of establishing a bulk breaking and repackaging plant for exports (and for the domestic market). In Zarqa, only six small firms are manufacturing for export, all of which have significant sales in the local market, and the value added resulting from their operations appears to be very limited. Another 20 or so manufacturing applications have been accepted, but the takeup rate is very slow. The commercial development of both zones has suffered from their location. In Zarqa, the zone is a considerable distance outside the town, which is itself an hour away from Amman, and labor supply on a large scale will be a problem for major investors. Similarly, the population of the Aqaba area is sparse, the zone sites are at considerable distance from the town, and major industrial developments will have to invest in worker housing and other social amenities in order to import labor from outside. Assurances have been given that with the high level of unemployment in Jordan, the labor problems can be overcome with assistance from the Free Zones Corporation and government agencies. In contrast, the Sahab Industrial Estate in Greater Amman now has nearly 200 manufacturing companies in operation, and the Industrial Estates Corporation is under pressure to expand the site. Indeed, a small part of the Sahab Industrial Estate recently was declared a Free Zone, and it is hoped that this zone will now be as successful in attracting manufacturing investment as the rest of the estate.

Another problem limiting the attractiveness of the Zarqa and Aqaba zones to potential foreign (and indeed Jordanian) investors is unnecessarily restrictive zone management practices. Although the customs operations at Zarqa and Sahab have been streamlined recently, the intrusive nature of the zone management itself leaves room for improvement. The refusal to sell sites within the zones to manufacturing companies, for example, discourages investment. More importantly, however, the unremitting enforcement of the legal provisions governing the maximum rental period (30 years in the first instance), together with the requirement that all factory buildings and site improvements be handed over without recompense to the Free Zones Corporation at the end of the lease, means that the investor does not in fact own his own investments! Clearly such a provision contradicts the spirit and the intention of the profits and capital repatriation provisions of the Encouragement of Investment Law. The commercial banks rightly take the view that buildings erected by the investor at his own expense in the zone cannot be regarded as collateralizable, and impose tighter credit controls accordingly. One manufacturer in the Zarqa zone claimed that his Jordanian competitors manufacturing outside the zone could finance the import of their raw materials at half the cost of his own borrowings for this reason.

It is recommended that by the middle of 1993 (1) the Utilization of Free Zones Regulations be amended to permit the outright purchase of manufacturing sites in bona fide cases and to confirm the company's ownership of all buildings and improvements erected thereon; (2) a large proportion of the expansion of the Sahab Industrial Estate be declared a Free Zone; (3) land be set aside at Alia for the designation of another Free Zone. Furthermore, it is recommended that enabling legislation be drafted promptly so that (4) by the beginning of 1994, private ownership and operation of Free Zones are permitted.

THE CULTURAL ENVIRONMENT AND EXPORT DEVELOPMENT POLICY

It is apparent from the above that much needs to be done to improve the business environment in Jordan in ways conducive to sustainable export achievement. The adversarial relationship between the business community and the government agencies is long standing and will not be removed merely by adjustments to the policies and regulations governing trade, however desirable these may be in their own right. More is required to improve society's perception of the successful exporter as a patriotic person contributing directly to the development of the country, rather than as a swindler who "has got away with it." This distorted perception pervades government agencies and political circles in Jordan, and it has a deadening effect on business initiative, particularly in the matter of exploring new and competitive export markets, which can be hard work for little immediate reward. It has been found in many countries that the business community is responsive to official demonstrations of respect and admiration for exporters' achievements, provided these are regarded as genuine rather than perfunctory and expressed by persons who themselves command widespread respect.

In Jordan, the King is the focus of genuine respect, and much of the progress that has been made in economic affairs has been attributed to his personal intervention. The creation of a top-level Export Development Council to monitor policy reform, to encourage export promotion, and to take effective and coordinated action where necessary has been suggested by several outside studies. The impact of such a council in changing attitudes would be dramatically improved in Jordan if the King were to assume the chairmanship directly and participate in media events (such as the activities associated with the promulgation of the Jordan Export Year). This would contribute substantially to the smooth adjustment of the policy mix outlined above.

SECTION THREE

THE INVESTMENT ENVIRONMENT

The Government of Jordan, faced with economic problems, is making an effort to institute changes that could stimulate investment and encourage exports. Operating under a general policy of active engagement in the management of the economy, the government is now attempting to eliminate a number of problems that have arisen in the industrial, financial, and regulatory areas. Although reforms are needed, the fundamental issue of the extent of government involvement in the economy is not addressed. The government has not neglected the economy; rather, it has been too involved in business affairs, best left to the private sector.

Discussions in various ministries and in the business community show a pervasive presence of government, ranging from regulation and influencing corporate policy through portfolio investments to active management and operations of state-owned monopolies.

Although the proposed changes will be a move in the right direction, ultimately the fundamental relationship between the private sector and government must evolve into a partnership with the common goal of economic development. Increasingly, the inefficiencies of the state-controlled economy have been recognized, and free market concepts are on the ascendancy world wide. Where government has acted to provide the private sector with an environment favorable to investment and innovation — such as in postwar Japan, South Korea, and more recently Thailand and Singapore — strong economic growth has resulted.

Current regional political problems make any large increase of foreign investment in Jordan somewhat problematic. However, the recently announced joint venture between the Jordan Phosphate Mining Company and Indian interests to manufacture phosphoric acid illustrates that, selectively, such investments are possible. Nevertheless, mobilizing domestic resources for investment may offer a better prospect for near-term development.

A large group of returnees from the Gulf is viewed as potential investors in Jordanian industry and business. The Jordanian government is exploring ways to exploit this potential source of capital and recently announced an effort to assist this group in identifying investment opportunities. No reliable estimate of the size of the investment pool represented by the returnees is available, but the recent effort on their behalf would indicate at least that the government believes it to be significant.

Whatever the source of capital, the investment process must not be inadvertently impeded. Accordingly, the current governmental emphasis on reforms to encourage investment could, if successful, make an important contribution to economic development.

THE ENCOURAGEMENT OF INVESTMENT LAW

The Encouragement of Investment Law is the principal legislation providing incentives for investment in productive business activity in Jordan. Investment activities approved under the law are accorded exemptions from customs duties for imported fixed assets and spare parts for a period of up to five years. Profits are also exempt from income tax for a period of 7 to 15 years depending on the location of the project. Other benefits are also accorded, such as exemption from taxes on interest earned on bank deposits. The focus of the law is largely procedural, dealing with the composition and functions of the committee that reviews and approves projects under the law. There are only two criteria for project selection established in the current law. First, certain sectors of economic activity are defined as eligible: industry and mining, agriculture and livestock, tourism and hotels, sea transport, hospitals, and education. Secondly, provision is made for special incentives related to the location of the project: Projects in the more remote parts of the Kingdom are given preferential tax treatment. No criteria have been established covering issues such as profitability of the venture, value added in the course of production, relative labor or capital intensity, or the capacity to earn foreign exchange. At the procedural level, such criteria exist. However, the lack of transparency within the legislation itself regarding such criteria is liable to create uncertainty in the mind of the potential applicant. Committee decision making can appear arbitrary. The process is lengthy, often lasting nearly six months, because all factors associated with project viability are assessed.

An amendment to the law is under consideration. The draft available as of April 1992 does not change the basis for selection in the initial period, but adds several new sectors and makes it possible for the Minister of Industry and Trade to add other projects at his discretion. The regional preference is maintained as the key criterion governing the length of income tax exemption. The major innovation is to add a second phase of income tax exemptions, effectively doubling the initially approved exemptions, for those projects that meet a new set of criteria. These criteria include exclusive use of Jordanian labor in the project; use of 70 percent locally produced inputs; an increase of 25 percent over originally planned capacity; and achievement of all mandated health, safety, and environmental standards. These new criteria do not assist in clarifying standards for decision making at the initial stages. Further, they are unrealistic regarding local content and labor and do not cover two of the most fundamental needs of the Jordanian economy, the need to earn foreign exchange and the need to employ as much labor as practical per unit of capital invested. Also, the local content rule and exclusivity rule for Jordanian labor are unrealistic. Improvement in value added over time is of greater significance than the overall level of import content.

Recommendations:

Amend the Encouragement of Investment law to focus on the establishment of selection criteria that make decision making as transparent and rapid as possible. Investment analysis itself should be left to the investors, their shareholders, and bankers; they must judge the risk inherent in the proposed venture.

Establish criteria that encourage those businesses which contribute to the most fundamental economic needs of the country — employment and foreign exchange earnings — rather than the type of business or its location. Such criteria should be linked to the labor intensity of the investment and the capability of the project to earn foreign exchange per dinar of investment.

Make readily available in a variety of languages promotional material describing the program and a clear outline of all application and decision-making procedures.

FOREIGN INVESTMENT LAW

Until recently, foreign investment was regulated through Defence Regulation No. 51 of 1978, which provided that foreigners could not own more than 49 percent of any business, with the exception of industry and tourism ventures. Further, with some specific exceptions, foreigners could not invest in Jordan without obtaining the approval of the Prime Minister, which was revocable at any time. Such approval extended to the purchase of shares on the Amman Financial Market (the stock exchange). In 1986, a regulation was issued that modified this law and accorded Arab investors the same rights as Jordanian investors, in effect exempting Arabs from the provisions of the Foreign Investment Law.

In 1990, the government drafted a substantially more liberal version of the law that permitted full foreign ownership of businesses involved with industry, tourism, health, agriculture, and housing in urban areas. Foreign ownership was restricted to 49 percent for other commercial, contracting, or transport businesses. Approvals by the Prime Minister were eliminated. Arab investors were favored only with regard to transactions on the AFM, where they were allowed to use local currency rather than transferring foreign exchange to complete transactions. As in the original law, repatriation of capital, profits, and interest was permitted. No confiscation of the resulting business entity was possible without court order.

In 1992, the legislation was finally approved by Parliament with significant modification. Arab investors are given equal footing with Jordanians when starting businesses in the industry, tourism, health, agriculture, and housing sectors, whereas other foreigners are required to seek approval of the Minister of Industry and Trade and the Jordanian Council of Ministers. Although not specifically stated, it appears that any foreigner may own 100 percent of any business in the above categories. However, no foreigner may own more than 49 percent of any commercial or contracting business. The law provides that a foreign investor must have his investment capital in Jordan before "starting any business." The statute remains unchanged regarding repatriation of capital and profits. The same language is used regarding confiscation of a foreign-owned business; it cannot be done without court order.

The language of the new law as finally passed is unduly restrictive and will act as a barrier to non-Arab direct foreign investment. Given the prevailing economic situation, this is extremely unfortunate. If badly needed investment capital is to be attracted, the law must be as liberal as possible regarding foreign ownership and as simple and uniform as possible in its application, providing solid guarantees against any action that would arbitrarily deprive the foreign investor of the product of his investment.

Recommendations:

A new attempt should be made to introduce legislation that would be in the spirit of the proposal made by the government in 1990.

The new law should exempt certain service industries from the 49 percent cap on foreign ownership. The exemption should cover marketing firms, management consulting firms, and any other such firms that can aid Jordanian manufacturers and service industries to become more efficient, improve the quality of production, and penetrate foreign markets.

The new law should be drafted so that the language allowing expatriation of profits, capital, dividends, and interest is ironclad. The provision against seizure of a foreign-owned company or its assets should also be made ironclad except in cases where the owners are specifically proved guilty of fraud or criminal acts.

RATIONALIZATION OF BUSINESS REGULATION

In discussions, business executives consistently expressed concern about excess involvement of government in the operations of the private sector. Although the sample is small because solicitation of such information was not intended, the consistency of the complaint demands attention. Such complaints covered a wide range of activities including interference in individual credit decisions at commercial banks, lengthy presence of government inspectors at manufacturing plants without apparent cause, and excessive red tape and cost involved with customs procedures.

The Government of Jordan requires advance approval of investment in the Amman Financial Markets by foreign investors, although some modifications have already been introduced.

A combination of objectives seems to exist where taxation and regulation combine to cause something more than mere irritation in the business community. The earlier discussion of the Customs Department in this report provides evidence of this problem.

If the allegations of unwarranted government interference in business are sustainable, clearly such actions will discourage both foreign and domestic investment. The business community will seek only minimal contact with government, and the dialogue between them will be inhibited.

Recommendations:

Government at the ministerial level should commence a dialogue with business leaders to remove any elements of estrangement and identify plans to cooperate on resolving the current financial difficulties facing the country.

In return for the systematic elimination of excessive government regulation, the private sector must reform itself as well. Although the evidence is hearsay, sufficient comment was made in interviews with accountants and businesspeople to give credence to the existence of widespread tax evasion. Multiple bookkeeping was cited as a means whereby private business conceals earnings to avoid taxes. Toleration of such activity deprives the government of revenue and promulgates criminal activity that corrodes the standing of government.

A review of the tax code is essential to determine its equity in substance and application. Inconsistencies will discourage potential investors in new businesses and may have deleterious impact on expansion plans of operating business.

Tax collection should be simple and certain, to ensure compliance so that investors can anticipate the impact taxes will have on future business operations.

FINANCIAL INFORMATION

Inherent in any fair system of business regulation and taxation is the necessity of the creation of credible financial data. Currently, no code of generally accepted accounting principles is in force in Jordan. It is essential that the Jordanian government in cooperation with the business community seek to develop such a system. Furthermore, investors must be confident that financial data provided to them, whatever the source, are produced under an accepted method. Only then can a professional analysis be made.

Recommendation:

A commission to accomplish the adoption of the accounting code should be formed immediately and should complete its work in three years or less with enactment of any necessary legislation in that time frame.

ENCOURAGEMENT OF BUSINESS DEVELOPMENT

The leadership role of government in the government-business partnership should not be underestimated. Steps could be taken to re-cast the business community in Jordan in a new light.

A program demonstrating the necessity of a close, mutually respectful relationship between the government and the business community, enlisting leaders from both, could bridge the gap that exists in some quarters.

Jordan's is a conservative society. Financial attitudes of individuals and banking institutions are risk averse, and several interviews with major financial organizations, the Arab Bank, Jordan Investment Company (JIC), and the Social Security System confirm the conservative bias. A consequence of this attitude is high liquidity in both the banks and large fiduciary funds. High collateral requirements for loans at the banks exacerbates the problem and restricts funds available for business development. Individuals, as well, are less aggressive than in other societies in seeking loan leverage in financing new business.

The need for investment and new business formation is acknowledged as an essential ingredient in resolving current financial problems and unemployment in Jordan.

Recommendation:

Conservative financial practices are not to be discredited, but the government should use its influence to relieve the lending paralysis that inhibits business formation. Banks should be encouraged to form a "Business Development Loan Pool" to encourage borrowers by offering more liberal terms such as longer maturities and lower collateral requirements and, where possible, some interest-rate accommodation. The intention to spread risk among the participants and other institutions might be included if possible. A more detailed study of the financial institutions and investment limitations would be required before a detailed proposal could be made. The pool should be a private sector entity without government subsidy, and though encouraged by government to be more aggressive, loan policy and implementation should be in the hands of the pool directors.

Recommendation:

Venture capital pools in the private sector appear limited. The Jordanian government should investigate ways to stimulate such activity.

THE JORDAN CAPITAL MARKET

The development of a well-functioning modern industrial economy requires the coincident development of an effective capital market to mobilize capital and provide financial services in the formation and growth of business. Jordanian financial institutions offer a spectrum of services to the private and government sectors. However, the conservative lending practices of banks and the generally risk-averse attitude in the society probably limit business and certainly result in less than optimum use of available capital. Leverage is virtually unknown, with banks and other institutions requiring high-collateral coverage of borrowed funds. Funds are accumulated in bank deposits, and high liquidity is the current norm.

An institutional investor, the Social Security Fund, actively invests in high-quality ventures and maintains a position of cash and equivalents of 30 percent of total assets while it has a substantial cash flow from contributions, dividends, and interest. An actuarial schedule of future obligations makes portfolio management relatively easy. A conservative investment policy produces a yield of 7 percent.

The AFM, founded in 1978, lists over 100 companies for trading. It also has a parallel market, for trading shares of unlisted companies, and a small bond market. The AFM combines the market function, share trading, regulation, and the registration and transfer of bonds and shares. There has been a substantial increase in volume and prices. Several foreign investors have come to the market in a modest way. Such participation is a vote of confidence in the market. Currently there are 27 seats, and the last sale of a seat within the last two weeks was for the equivalent of $300,000, a measure of the potential earning power of exchange membership.

AFM is a market mechanism that can participate in the mobilization of capital by providing a vehicle for the orderly buying and selling of shares. Orderly markets and a means to arbitrate any investor complaints are essential to building and maintaining investor confidence. Current plans for expansion include a new facility for increased trading volume. Improved training of staff and higher staffing standards (including university degrees) for brokerage management are part of an effort by the new director to develop a credible and reputable financial institution.

Recommendations:

The Amman Financial Market should be restructured and the market function separated from the regulatory and transfer agency activities. The inherent conflict of interest between the market-making and regulatory functions will grow as the activity expands and, if problems arise in the future, could threaten the public perception of the integrity of the market. The ongoing surveillance of business conduct at the exchange should not diminish, but the additional oversight by a separate organization of all securities market activities, including securities affiliates of other financial institutions, will give greater protection to investors and help to avoid scandals that can be a source of acute embarrassment to the government.

The Government of Jordan should encourage the AFM to continue to upgrade personnel skills through training. Financial markets training is readily available from a variety of sources, and courses could be designed for inclusion in university and business school curricula. Upgrading personnel qualifications has led in other markets to a significant rise in the caliber of applicants for positions in an industry that offers above-average financial rewards for performance worldwide.

The registration and transfer functions along with the role of paying agency for the dispersement of dividends and interest should be moved to the banks that are generally better equipped to process such data and use staff more accustomed to such functions. Banks often have unused computer capacity that can be employed for modest fees.

The AFM would like to increase the number of companies listed. Six were added in 1991. A significant element of constraint exists in the pricing procedure for new issues of securities.

In Jordan, the pricing mechanism for new shares is less market driven than in other, more developed markets. It is set through a procedure involving the Ministry of Trade and Investment and a Committee on Issues, using par value or a formula involving book value and earnings. This method of pricing has been criticized in some quarters and is blamed for erratic after-market price action. Sellers may not get fair value for shares and buyers may be subjected to unexpected price changes.

A new method of pricing new issues should be adopted that will more accurately reflect the value of the securities offered. New issue pricing in more developed markets is normally achieved by negotiation between an investment banker or underwriter and the company selling the shares. After analysis of company financial statements prepared by a recognized accounting firm according to generally accepted accounting standards and certified by the accountants, many financial tests are applied. Results of the tests are combined with market information, supply and demand, and general market conditions to reach an offering price. In a classic underwriting, the investment banking syndicate will buy the shares from the company at the negotiated price, less an underwriting profit, and simultaneously re-offer the shares to clients. A successful underwriting will trade at a price at or near the offering price. The seller is satisfied at receiving fair market value, and the buyer is satisfied to see the open market validate the price paid. Future market action is a direct function of supply and demand influenced by company earnings performance.

Adoption of a more accurate and uniform pricing mechanism will encourage companies to finance through share offerings and encourage investors to fund corporate expansion and development via share purchase.

Successful development of the AFM could lead to alleviation of the current risk-adverse attitude of investors.

MUTUAL FUNDS

Studies have been conducted on the feasibility of creating a mutual fund industry in Jordan.[5] Legal obstacles require amendment of the Companies Act to facilitate the establishment of open- and closed-end investment companies. Starting a new financial industry may be difficult in a society preferring familiar institutions. Therefore it may be more effective to develop such an investment alternative by using the current banks to sponsor and create the funds to be managed, in a management company affiliate. Thus public confidence in the banks would be a major asset to the new vehicle. A family of funds with different investment strategies could serve the objectives of a variety of investors.

Increased demand for securities could assist corporate growth and also reduce excess liquidity in the banking system by reallocating funds to more productive purposes.

If a gener. liberalization of the investment environment in Jordan is to take place, new securities instruments must be introduced. Furthermore, if privatization of government owned industries is to occur, new investment vehicles will be necessary to provide the needed investment funds.

Recommendation:

Consultations should be held with the major banks to determine the level of interest in developing mutual fund affiliates similar to the European model found in Germany and Switzerland. If the response is positive, the legal issues involving the Companies Act and other regulatory constraints can then be addressed.

PRIVATIZATION

The tide of privatization continues to rise in many countries, both developed and developing. After decades of unsuccessful experimentation, a dominant role of government in business and commerce has been rejected. Nevertheless, the concept of a cooperative government-private sector partnership is still valid without government ownership or operation of industry. The Japanese experience since 1945 lends support to the cooperative mode. It re-enforces the view that private sector entrepreneurs, when operating in a favorable environment fostered by government policy, are able to grow, compete, and prosper, contributing a powerful engine for economic prosperity. The Government of Jordan has a significant position in the industry of the country, through direct ownership and operations of state monopolies. Among its monopoly operations are the national airline, Royal Jordanian; the electric utility, Jordan Electricity Authority; Jordan Phosphate Mining Company; the telecommunications company; and ground transit systems. In addition, the government has a large number of shareholdings in private sector companies. JIC, a government pension fund agglomeration, holds a portfolio of 73 companies, and the Social Security System also has ,nificant shareholdings. JIC is an active shareholder and, by its own admission, exerts direct influence in the companies where it has a position. Previous studies have analyzed the various major government-operated monopolies and recommended privatization, but no action on this matter is evident to date. Ample evidence is available on the inefficiencies of state-owned

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[5] *A Preliminary Assessment of the Development of Mutual Funds in the Kingdom of Jordan*, April 1987. Benjamin M. Vandergrift.

enterprises, from Eastern Europe, the former Soviet Union, Cuba, Indonesia, and Great Britain. Privatization has been a success in Great Britain with the government recouping millions of pounds sterling through judicious sale of British Airways, the electric utilities, and other municipal service companies.

Recommendations:

A privatization program should be developed.

A commission should be formed by senior representatives of the Central Bank and the Ministries of Planning, Finance, and Trade and Investment and chaired by the Prime Minister. The commission should also have an equal number of members from the private sector, including leaders from business, law, and finance. The commission should have the immediate responsibility of developing policy for privatization and proposing enabling legislation.

An office based on the German model, the Treuhandanstalt, should be established to implement policy. A schedule should be developed, and selected companies should be reviewed for sale.

Government of Jordan shareholdings should also be evaluated for timely liquidation.

The problems involved in a serious privatization program are complex, and the marshalling of strong support will be required to carry it out.

SECTION FOUR

THE LEGAL ENVIRONMENT

Part One of this part sets forth general observations on relevant laws and regulations and the legal system in general. Part Two provides a listing of the principal laws reviewed, with brief comments. Part Three suggests ways to remove impediments to investment and trade.

PART ONE: GENERAL OBSERVATIONS

Conflict Between Public and Private Sectors

We found wide agreement among the persons interviewed that the relationship between government and private business in Jordan is deeply adversarial. Although a certain amount of tension between government and business is normal, the tenor and substance of our many interviews with government officials and private businesspeople indicate that the situation in Jordan goes far beyond the norm. Each blames the other for the problems that exist, and there appears to be little meaningful communication between the two. Public sector officials at all levels seem to believe it is their mission to protect the public against what they see as dishonesty and greed on the part of private business. At the same time, these officials sincerely believe that they are not interfering unreasonably with the freedom of businesspeople to run their businesses as they see fit. Private businesspeople and their bankers, lawyers, and accountants, on the other hand, describe government officials as lacking in competence, experience, and education. These sharply antagonistic attitudes are destructive and need to be changed. The creation of a more cooperative, constructive relationship between government and business is essential, if meaningful progress toward attracting substantial new private investment is to be achieved. In particular, the mindset of government employees that it is their duty to supervise and police private business needs to be questioned and changed as a matter of first priority.

Lack of Central Office for One-Stop Handling of Investment Proposals

At present, there is no provision in the legislation for a central, "one-stop" office for handling foreign investments. Apparently, foreign investors have been left in the past to their own devices in running the gauntlet of many separate government departments to obtain permits and licenses, clear exempted goods through customs, repatriate funds through licensed banks, and the like. To facilitate new foreign investment, many developing countries have established a central, autonomous government agency with legal authority to act as foreign investors' liaison and coordinate all intragovernmental actions required in connection with foreign investment. We were informed that an attempt to establish such an agency in Jordan was made several years ago but failed. Efforts to this end should be renewed and prosecuted to fruition without further delay if a new government policy to attract private investment is to succeed.

Basic Information Not Readily Available

A corollary problem to the absence of a central office for handling investment proposals is the lack of relevant information. The basic materials needed by prospective investors are not readily available in either Arabic or English, the international language of investment and trade. The relevant laws and regulations, policy statements, and procedures are obtainable from the various government departments concerned, but only with some difficulty. It should be a near-term commitment of the government to establish a center for the collection, translation, publication, distribution, storing, and copying of the materials that are essential to both local and foreign investors. Once this has been done, an international promotional campaign could be undertaken to advertise Jordan's attractions for investment, in a manner similar to that in which other countries such as Pakistan, Singapore, Turkey, and Korea have advertised. Jordan has an attractive regional location and other assets, but it needs to be more aggressive in developing and promoting them if it wishes to encourage productive new private investment. The document and information center could be a part of, or connected in some way to the one-stop center suggested above.

Tax and Customs Reform

As described to us in many interviews, the policies, legislation, regulations, and administrative practices of the tax and customs authorities fall far short of what is required for a growing economy in need of new investment. With regard to taxation, a specialized international expert should be brought in as soon as possible to study the existing situation in detail and propose new policies, laws, and procedures. This specialist should review, in particular, the existing corporate income taxes and exemptions in relation to fiscal requirements and the need for new investment. Particular consideration should also be given to the adoption of new tax incentives for export industries and the modification of the consumption tax as it applies to exporters. If the right tax specialist is found, the work could be completed within a relatively short period of time, perhaps one to two years. With regard to customs, implementation of C.A. McCue's 1988 proposals for reform should begin without further delay.

Adoption of Generally Accepted Accounting Standards

In addition to reviewing the tax and customs regimes, the government should actively support the efforts of accountants and auditors to adopt standards that are accepted internationally. A program should be initiated immediately that would result in the adoption of such standards within one year. This goal should be possible because there already exists in Jordan a core group of internationally trained accountants. The effective administration of an equitable tax regime and operation of a dependable capital market are not possible without accounting standards to serve as the compulsory basis for financial reporting.

Improvement in Environment for Foreign Investment

The existing legislation and procedures pertaining to foreign investment are deficient in several important respects. The first deficiency concerns the legal assurances provided foreign investors to repatriate their capital and earnings in the currency of their original investment. It appears that the relevant laws do not provide investors with an unconditional right to repatriate their foreign investment and earnings; this right is made subject to at least two government approvals, those of the Minister of Industry and Trade and the Central Bank. The basis on which these authorities might approve, or disapprove, an application for transfer is nowhere indicated. Another deficiency is that these laws do not provide for an unequivocal guarantee against nationalization or expropriation of the property and legal rights of foreign investors. A third deficiency is the absence of authority for the resolution of any disputes that might arise in connection with a foreign investment by means of international arbitration under international law. These basic assurances are standard today in the foreign investment legislation of most developing countries and in investment treaties they have entered into with particular countries.

Impediments to Importing Technology and Services

Jordan may be overlooking the value of services in the development of its economy. To compete successfully in the regional and international marketplaces, ready access within the country to the latest technology, know-how, and information and to standard international services in accounting, commercial banking, merchant banking, international law, marketing, engineering, electronic data processing, and computerization will be important. In the past, however, the government's position on allowing such services to come into the country from outside has been negative, and the legal framework necessary to attract such services does not presently exist.

As examples of Jordan's backwardness in this regard, we were told that foreign ownership of service companies is limited by law to minority equity positions, and the protection of intellectual property was repeatedly mentioned as a problem, along with the fact that electronically or telephonically transmitted documents such as fax messages and telexes are not recognized in Jordan's evidentiary laws. The current laws dealing with patents, trademarks, and copyright date back to 1952 and 1953 and do not provide for new types of industrial property such as integrated circuits or microchips, electronic data processing software, and the like.

The Ministry official concerned indicated that new laws covering these matters have been drafted and are awaiting action before the Parliament, but the draft laws were not available for review. This official also mentioned that he is now studying newly proposed international conventions that provide for harmonization of national industrial property laws and for international protection of property rights in microchips. Without legal protection in Jordan for these things, it is virtually certain the economy will be denied access to the most up-to-date technology needed for new production and service industries. The government should proceed with adoption of the proposed new laws and decisions on the international conventions without undue delay.

Development of a Modern Capital Market

A reliable capital market is essential for business investment and growth in an expanding economy. Although the institutional elements of a functioning capital market exist in Jordan, the market itself remains in a rudimentary stage of development. As described in the preceding section on the investment environment, banks and institutional funds serve as efficient depositories of capital but are extremely conservative and risk averse in their lending and investment policies and practices. The AFM has made good progress in its 14 years of existence, but its development is now being constrained by a number of factors at both the policy and structural levels. We were told, for example, that efforts to develop a mutual fund industry have been stymied by the lack of statutory authority for issuance of the financial instruments. In addition, the Companies Law mandates that the pricing of new public offerings of securities be set by a government-controlled committee which, in the absence of financial reports based on accepted accounting standards, must rely on a speculative valuation process. Because this is likely to lead to undervaluation out of caution, owners of successful businesses are not encouraged to go public when they have expansion opportunities that require fresh capital. Another comment heard in our interviews concerns the conflicting responsibilities imposed on the AFM by its current law as both the operator of the stock market and the regulatory authority charged with ensuring that the market operates in a manner that is fair and honest to all concerned: issuers, buyers, sellers, and brokers alike. Regulatory responsibility must be vested in an independent government agency that does not have a financial or other interest in the operations of the exchange if the market is to fulfill its economic function as an efficient and reliable mechanism for raising capital and its social and political function of spreading ownership in major business enterprises. For these reasons and others mentioned in Mr. LaGrua's paper, consideration should be given to a comprehensive review and restructuring of the capital market to provide for its development. As a part of any such review, a study of the relevant laws and proposed revisions to them should be undertaken.

Modernization of the Legal System

There is a consensus among lawyers and businesspeople in Jordan that the legal system as a whole is basically sound but needs to be modernized. The laws relating to investment, finance, and commerce are seen as outdated and should be revised so that they support, rather than hinder, the development of modern business and financial practices that are necessary if Jordan is to compete successfully in regional and international markets. Laws mentioned as wanting include the Companies Law and intellectual property law, in addition to the tax and customs laws. If the right experts are found, the necessary revisions could be identified and drafted within one to two years. A longer-term program, one lasting three to five years, would be needed for modernization of the court system, which is described as honest but primitive when it comes to business and finance. In international organizations, much work on legal reform has been done over the past two years to provide the necessary legal framework for the change from command economies to market-oriented economies in which the private sector replaces government as the driving force for economic growth. Because Jordan has relied heavily on government for direction in the economy, the legal reform measures developed recently for many countries in Europe might be referred to for information regarding the options available for Jordan.

PART TWO: PRINCIPAL LAWS AND REGULATIONS REVIEWED

Constitution

Jordan's present constitution is 40 years old, having been adopted in 1952. It is a well-written modern constitution that is direct and clear in its provisions. It declares that Jordan's system of government is parliamentary, with an hereditary monarchy, and provides for a bicameral legislature consisting of a Senate appointed by the King and a Chamber of Deputies elected by the people. The constitution also provides for an independent judiciary and government by law. In addition to being head of state, however, the King is granted effective power over all branches of government. Executive powers are directly vested in the King, and he appoints all ministers, senators, and judges and ratifies all legislation. All court judgments are pronounced in the name of the King, and he is Supreme Commander of Land, Naval, and Air Forces. The King also has authority to declare martial law, which suspends the operation of ordinary laws; this extraordinary authority, however, may be exercised only when defense of the Kingdom is necessary and then only on the basis of a decision of the Council of Ministers.

It appears that this Constitution has served well as the legal foundation for an effectively functioning state. Notwithstanding the broad powers granted the King, lawyers and judges interviewed noted that the King has regularly stressed the importance of an independent judiciary and that the courts do in fact operate independently. On the basis of our visit to the Amman Court of First Instance, attendance at three hearings in pending cases before that court, and interviews with businesspeople and lawyers, this appears to be the case.

For our particular purposes, two provisions in the constitution should be mentioned. There is a provision in Article 11 against expropriation of the property of any Jordanian national except for purposes of public utility and in consideration of a just compensation, as may be prescribed by law. There is a question whether this express legal protection extends to foreign nationals. In addition, there appears to be an express constitutional authority in Article 103 for the civil courts to apply international legal principles and foreign law "in matters affecting the personal status of foreigners or in matters of a civil commercial nature which in accordance with international usage are governed by the law of another country." (Emphasis added.)

Civil Code of 1976

Jordan's Civil Code contains the basic legal authority for much of the commercial and financial activity that makes an economy work. In 1,449 articles, it provides, among other things, for property rights, contracts, agency, creditors' rights, tort liability, guarantees, mortgages, and employment contracts. Although it is based on the 19th century civil code of the Ottoman Empire, which has been described as a codification of the rules of Moslem Shari'a law as it was ascertained more than 11 centuries ago, it has borrowed from European code law and jurisprudence for matters not covered in the Shari'a, such as insurance and employment law. With some notable exceptions, such as the absence of a comprehensive bankruptcy law, the Civil Code provides an adequate legal basis for most modern business activity.

The Companies Law of 1989

Jordan's current Companies Law was substantially amended in 1989. It is a lengthy compilation of provisions, 321 in all, that provide in copious detail for the formation and operation of several types of companies including public shareholding companies (PSCs). It also sets forth the terms and procedures for the issuance of securities by PSCs and for the doing of business in the Kingdom by foreign companies, and it invests a government official called the Controller of Companies with the authority of a "Czar" over the formation and operation of corporate enterprises in Jordan. Finally, this law sets out penalties for violation of its provisions, which include fines and prison terms; as an example, failure to keep proper books of account for a PSC is a criminal offense that subjects the manager and auditor of the company to a mandatory prison term of one month to one year, if the company ends up in liquidation.

The Companies Law is unusual in its length, detail, and breadth of coverage. In our interviews with businesspeople, lawyers, and others, this law was the most criticized, and the Controller of Companies office was singled out most often as the worst government office when it comes to frustrating private sector initiatives. The law and its administration by the Controller of Companies may be the clearest reflection of the prevailing idea in Jordan that the government is responsible for protecting the public against greedy and dishonest businesspeople and, therefore, should closely supervise and control them. A review and overall revision of this law by an experienced international expert might be useful, particularly if they were part of a larger, longer-term effort to change the present governmental attitude toward business.

Regulation of Foreign Investment

The old defense regulation of 1978 that previously governed foreign investment has recently been replaced by a new statute approved by the Parliament in 1992 entitled "Law Governing Arab and Foreign Investments." This law is a more restrictive version of legislation proposed by the government that substantially liberalized government foreign investment contracting. The new law requires cabinet approval of all foreign investments except those made by Arabs and restricts foreign ownerships to 49 percent of commercial or contracting businesses. Guarantees against expropriation, in particular, remain weak. This law retains a bias against foreign investment that is vitally needed to strengthen the Jordanian economy. A new attempt should be made to modify this law to make it a vehicle for the encouragement of foreign investment, not the reverse.

Foreign Exchange Control Law No. 95 of 1966

Although legal provisions regarding foreign exchange appear in several different laws, including the Control of Foreign Business Activities Regulations summarized above, the basic law regarding foreign exchange is the Foreign Exchange Control Law No. 95 of 1966. It appears to be based on a model law prepared by the International Monetary Fund. As usual, it grants comprehensive authority to the Central Bank to regulate all transactions in Jordan, or by residents in Jordan, involving foreign exchange. The definition of foreign exchange includes not only foreign currencies but gold and Jordanian currency when such is to be used in a foreign transaction. There is a general requirement that all foreign exchange brought into the country be sold to dealers licensed by the Central Bank, but exceptions to this requirement are authorized. Presumably foreign nationals and Jordanian businesspeople are permitted by regulations to maintain foreign exchange accounts in Jordanian banks. As a member of the International Monetary Fund, Jordan is a party to the Articles of Agreement of the Fund, which contain provisions requiring, in effect, that restrictions on foreign exchange transactions be reasonable.

Arbitration Law No. 18 of 1953

Because of presumed bias against foreigners on the part of national courts, and for other reasons,the legal right to take disputes arising out of international business transactions to arbitration is of paramount importance to foreign investors and businesspeople. International arbitration is almost universally accepted today as the preferred means for resolving international business disputes. In Jordan, the right to arbitrate business disputes was recognized almost 40 years ago when Arbitration Law No. 18 of 1953 was adopted. Since then, Jordan has become a signatory to the United Nations Convention for the Recognition and Enforcement of Foreign Arbitral Awards (known as the "New York Convention" in practice), evidencing its acceptance in principle of international arbitration, as well as domestic arbitration within Jordan. While several businesspeople and bankers expressed their opinion that arbitration has proved an acceptable way of resolving business disputes within Jordan, the arbitration law is almost 40 years old and should be reviewed for its conformity with modern international practice. In particular, the provisions for courts to return an arbitral award to the arbitrators, to set aside awards, and otherwise to participate in the arbitral process should be reviewed.

Income Tax Law No. 57 of 1985

Jordan's current income tax law was adopted in 1985. It consists of 54 articles and 11 explanatory "Instructions," each of which contains numerous additional articles. In form and content, it appears to be a well-written, comprehensive statute. However, businesspeople and accountants interviewed were extremely critical of this law and its administration by the tax department of the Ministry of Finance. The principal criticism made was that the law is not precise and allows for the exercise of discretion by the tax collectors, a discretion that is naturally exercised against the interests of business. The law and its administration in practice should be reviewed by a specialist able to propose constructive changes.

PART THREE: SPECIFIC ACTIONS THAT MIGHT BE TAKEN

Without cooperation between government and the private business community, significant new private investment in the economy is almost certain to be limited. To foster such cooperation, an educational program addressing the antagonistic attitudes that presently exist could be undertaken. A series of seminars might be developed and presented to this end. The content, timing, and duration of such seminars might be worked out by USAID training specialists. In addition, representations might be made at the highest levels of government regarding the need to recognize the importance of investment and business as the foundation for a stable and prosperous future, free of dependence on foreign aid.

To eliminate the difficulties in obtaining relevant information, documents, and materials, a Private Investment and Business Document Center should be established. To start, the center could be a relatively simple operation serving as a depository of existing Arabic and English documents and materials including the important laws and international agreements to which Jordan is a party. The center could be gradually expanded to serve as a translation bureau, library, archive, and printing office focused exclusively on private investment and business. A project for establishment of the center — including proposed staffing, budget, and timetable — could be prepared quickly, within one to two months. With the cooperation of the government, the center could be operational within three to six months. The budget need not be large, and the costs of operation could be defrayed through charges for the services, documents, and materials. The center could be set up as a government-private sector joint venture.

To assist in modernizing the legal system and laws relating to private investment, a project for Private Enterprise Legal and Institutional Reform could be undertaken. Such a project could be prepared within two to three months and implemented over a three- to five-year period. The project would provide for a legal generalist to serve as a team leader and for international legal specialists in the several areas in which reform is needed. The areas would include the following:

- Income taxation law and administration;
- Customs law and administration;
- Accounting standards and financial reporting;
- Capital markets, banking, and privatization;
- Companies and commercial law;

- Intellectual and industrial property law;
- Foreign investment law; and
- Arbitration law.

ANNEX A

CONTACT LIST

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CONTACT LIST

PRIVATE BUSINESS

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11. Ziad F. Ifram
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12. Najah A. Jaber
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