Achievement of Market-Friendly Initiatives and Results Program
(AMIR 2.0 Program)

Funded by the U.S. Agency for International Development

A Sustainable Trade and Investment Strategy for Jordan

Accelerating Domestic Growth
While Integrating Globally

Final Report

Deliverable for Private Sector Policy Initiative (PSPI), Task Number 512
Contract No. 278-C-00-02-00201-00

May 21, 2002

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I. INTRODUCTION

This report is the product of a three week assessment of Jordan's trade and investment strategy carried out in Amman, Jordan by Nilgun Gökgür, Consultant, with Charles Krakoff, Private Sector Policy Initiative Team Leader, AMIR Program; and Tania Revault d'Allonnes, Trade and Market Access Advisor, AMIR Program, and with the substantial support of Rami Al-Qusus and Aref Al-Farra, AMIR Program advisors to the Minister of Industry and Trade. The mission was intended to review the existing trade and investment strategy for integrating Jordan globally and to help formulate a new investment and trade strategy commensurate with the efforts of establishing the Jordanian Authority of Enterprise Development (JAED). Preliminary findings during the mission were presented both to His Excellency, Dr. Salah Al-Bashir, Minister of Industry and Trade and to USAID.

This report reviews the existing trade and investment strategy for domestic growth and the implications of this strategy on existing small and medium enterprises (SMEs)[1] in manufacturing and industry, currently numbering nearly 10,000, as well as on overall growth, wealth creation and employment. It recommends adopting a new trade and investment strategy based on cluster-based analysis and cluster-based policies.

Jordan has achieved substantial success over the past several years in integrating with the global economy. This success is reflected largely in significant growth in foreign direct investment (over threefold increase between 1999 and 2001), in exports (over 20% increase in 2001) and, consequently, in overall GDP growth of 4.2% in 2001 (up from 3.9% in 2000). Recent bilateral and multilateral free-trade agreements, most notably the Qualifying Industrial Zones (QIZs) with the United States, are largely responsible for the tremendous growth in FDI flows and exports. The contributions of these investments are seen primarily in the export figures, which reflect *gross* export earnings, however. Since they heavily rely on imported raw materials and intermediate inputs, *net* export earnings remain relatively low. Moreover, these investments are concentrated in few economic sectors and within the confines of special export processing zones. Domestic Jordanian value added is fairly low, with the result that positive employment, income and wealth generation for Jordanian citizens are limited. Furthermore, the exporting enterprises, medium and large, foreign and domestic, remain de-linked from the rest of the economy where Jordan's small enterprises struggle to grow.

Jordan's trade and investment strategy has thus far relied on an industrial policy approach. It used a package of fiscal, financial and other incentives to promote targeted investments and exports. While fiscal incentives worked to reduce the tax burden on investors, financial incentives provide funds directly to firms to finance new investments and certain operations, or to defray capital or operational costs. The GOJ has not yet assessed its existing incentive schemes including explicit and implicit subsidies to determine whether they generate a net economic benefit for the country. In other words, the GOJ has never carried out a systematic analysis of the full costs of its entire investment incentives schemes and compared these with the economic benefits derived from the investments they have attracted. If investment schemes are to be effective, and if the policy makers are to have the information necessary to

[1] Jordanian enterprises over 250 employees are classified as "large," enterprises employing between 100 and 250 as "medium," and enterprises employing fewer than 100 employees " as small.

judge their effectiveness, it is critical to understand, for example, the total cost of incentives for each job created on behalf of a Jordanian, or the total cost of incentives for each additional JD 1000 in net export earnings for Jordan's balance of payments.

The Ministry of Industry and Trade (MIT) has the mandate to modify and promote its trade and investment strategy in the best of interest of Jordan, Jordanian enterprises, workers and consumers. Having endorsed the benefits of cluster-based policies, the Minister faces the challenge of articulating new trade and investment policies, and winning support for them in the Cabinet. This will require analytical support beyond that which has so far been developed in Jordan. For any resulting policy reforms to succeed, however, the Jordanian business community must be convinced that internal competition within Jordan is an essential condition for achieving international competitiveness. All enterprises need to increase productivity and compete within each cluster. Only then Jordan can compete internationally and achieve a sustainable global integration more resilient to external shocks.

II. REVIEW OF JORDAN'S TRADE AND INVESTMENT STRATEGY

2.1. Performance in External Trade

Jordan's export performance was somewhat disappointing until the late 1990s. While exports remained stagnant, imports increased rapidly. This discrepancy was, in part, a short-term and temporary consequence of Jordan's increasing openness to trade. In recent years, however, Jordan fully embraced export-oriented private-sector-led growth and created more favorable conditions for such growth by opening its economy, reducing protection by bringing down weighted average tariffs from 17.5% to 13.5%, streamlining custom administration and vastly increasing the number of zero-duty items. These measures placed Jordan as one of the most open and liberal trade regimes in the region.

The recent attempts to integrate Jordan globally through multilateral and bilateral trade agreements with the World Trade Organization (WTO), the European Union and the USA have attracted new foreign investments through several joint ventures. Consequently, foreign direct investment (FDI) flows jumped over threefold from US$ 158 million in 1998 to US$ 558.2 million in 2000.[2] These new ventures contributed successfully to increased export earnings especially in apparel and some light manufacturing products. The export earnings in 2001 exceeded that of 2000 by 26% (Table 1) Additional gains to the economy came in the form of rapid employment generation for Jordanian workers in the apparel industry with average wages higher than the minimum wage offered to their counterparts elsewhere in Jordan. (Table 3)

Table 1. Jordanian External Trade between 1997 and 2000, JD in millions

[2] Trade and Finance, FDI (Net inflows reported by Jordan), World Bank Development Indicators database, April 2002

Code	**1997**	**1998**	**1999**	**2000**	**2001**
Exports	1,067	1,046	1,070	1,125	1,484
Re-Exports	234	231	247	265	273
Imports	2,908	2,714	2,635	3,259	3,457

Source: Monthly Statistical Bulletin, Central Bank of Jordan, Vol. 38, No.2, February 2002, p. 64-65, 2001 data provided by Chamber of Industry, Amman, Jordan

2.2. The Role of Free Zones and QIZs

By any measure this has been an impressive performance. The challenge now is to continue Jordan's growth in FDI and exports while, at the same time, spreading the benefits more widely throughout the economy. Approximately 60% of Jordanian's exports are generated within the enclaves of the publicly and privately owned and operated Free Trade Zones (FTZs), the publicly and privately owned and operated industrial estates (IEs) and the Qualifying Industrial Zones (QIZs). The remaining 40% of exports come from a group of 28 large-scale Jordanian exporting enterprises in phosphate, potash fertilizers, cement and pharmaceuticals operating outside these enclaves. Some 200 large and medium sized exporting enterprises account for the bulk of these exports. Even though these enterprises constitute only 1.5 % of all Jordanian manufacturing and industrial enterprises registered by the Chamber of Industry, they employ around 27% of total manufacturing and industrial employment. The remaining 98.5% of Jordan's industrial enterprises, accounting for 73% of employment but only a tiny fraction of exports, are small companies with less than 100 employees. These small-scale enterprises operate the enclaves and few have any significant links to the globally integrated medium and large enterprises.(Table 2) They have yet to benefit in a measurable way from the recent surge in FDI-led export growth. However, if such growth is to become sustainable, these small enterprises must participate in these developments, directly or indirectly, to a much greater extent.

Table 2. Estimates of Manufacturing and Industrial Employment, Enterprises, and Exports within and outside the Enclaves, 2001

a) Employment and percentage shares by activity location:	**Public and Private FTZs**	**Public and Private IEs and QIZs**	**Phosphate, Potash Fertilizers, Cement and Pharmaceuticals**	**Rest of the economy**
160,000 (100%)	*6,000 (4%)*	*13,200 in IEs plus 61% of 19,000 in QIZs (Jordanian labor)= 25 000 (16%)*	*11,198 (7%)*	*117,802 (73%)*
b) Number of Enterprises and percentage shares:				
9,940 (100%)	*30 medium enterprises with 100 and 250 employees (o%)*	*144 medium enterprises with 100 and 250 employees (1.5%)*	*11 in mining and 17 in pharmaceuticals with over 250 employees (0%)*	*9,738 small enterprises with fewer than 100 employees (98%)*
c) Share in Manufacturing and Mining Exports(100%)	*30%*	*30%*	*40%*	*None or 0%*

Sources: Department of Statistics, Free Zones Corporation (FZC), Jordanian Industrial Estates Corporation (JIEC), Amman Chamber of Industry (COI), Jordanian Exporters' Association (JEA).

Jordan first began experimenting with free trade zones as an export and investment promotion tool in 1973. Jordanian Free Zones Corporation (FZC) started developing the public free trade zones with the intention of serving the transit trade or re-exports. The FZC exempted the investors' profits and the salaries and allowances of non-Jordanian employees from income and social service taxes for twelve years in addition to full repatriation of profits. It exempted the goods imported into Free Trade Zones (FTZs)) and subsequently re-exported from all import fees and custom duties. It also allowed industrial projects to enjoy significantly reduced rental and service charges for land and industrial premises. Besides these attractive incentive packages, FZC provided the investors with the necessary facilities, services, infrastructure such as electricity, water, telecommunication and transport networks while, at the same time, developing areas and storage facilities to cover the investors' requirements inside the free trade zones. Furthermore, the FZC provided investors with branches of banking, insurance and clearance companies to reduce their transaction costs of doing business in Jordan. The four public FTZs are now supplemented by four privately established, owned and operated ones all enjoying similar exemptions, and another seven in the process of being established.

The FTZs represent only one form of export and investment promotion tool Jordan has adopted. There are also public and private industrial estates with the intention of attracting productive investments foreign or domestic alike. The state-owned Jordanian Industrial Estate Corporation (JIEC) provides all necessary infrastructure services to suit the investor's individual needs. The investors have the option either to buy or to lease fully serviced plots of land within these industrial estates (IEs). The investors are also given different sizes of ready-made Standard Factory Buildings (SFBs) with high standards to meet the requirements of different industries.

In addition to land, buildings and infrastructure facilities, investors in industrial estates enjoy significant fiscal incentives. These privileges are similar to the ones provided to investors operating in the FTZs. They include full or partial exemptions up to ten years from income and social service taxes, exemptions from building and land tax as well as reduction on most municipal fees. Recently some industrial estates have been designated as Qualifying Industrial Zones (QIZs) enjoying duty and quota free access to all qualified products exported to the US markets as long as they comply with the product content requirements. Products eligible for duty and quota free entry to the US markets have to fulfill one of the three content requirements:

- A minimum of 11.7% of product content must be contributed by a Jordanian manufacturer in any Jordanian QIZ, 8% by an Israeli manufacturer (7% for high-tech products) and the remaining of the 35% is to be obtained by any combination of input from a Jordanian (QIZ), Israel, USA and West Bank/Gaza strip. The rest of the 65% can be obtained from the US or anywhere else in the world.
- Jordanian and Israeli manufacturers must each maintain at least 20% of the total production cost of the product eligible for duty-free treatment excluding profit. The remainder of the total production cost (60% maximum) can be sourced globally without restriction.
- The last option is the mix and match between the two options above.

Despite their rapid success, the true economic impact of the QIZs has yet to be analyzed and documented. Such an analysis would compare the overall cost of the QIZs, all the fiscal and financial incentives given to QIZ investors with the domestic value added they generate.

2.3. Linkages between Exporting Enterprises and the SMEs

As Table 2 indicates, the bulk of Jordan's enterprises remain operational outside the enclaves. The firms operating in FTZs and QIZs are medium-sized and they heavily rely on imported raw material and inputs. The same is also true for the large enterprises, especially the total of 17 pharmaceutical companies, operating outside the enclaves. Almost 90% of Jordanian pharmaceutical companies import their raw materials and intermediate inputs.[3] The other mining enterprises, potash fertilizers, phosphate and cement companies also operate with few linkages to Jordan's small enterprises.

If the economic and social benefits of the FDI are to spread more widely throughout the Jordanian economy providing a sustainable basis for long-term growth, it is important for the GOJ to develop new trade and investment policies that can help spread the benefits of FDI to the the10,000 small enterprises and nearly 120,000 people they employ. Large-scale nationwide improvements in productivity, employment generation and income growth will come only to the extent that smaller enterprises increase their participation in FDI-led export growth. A new trade and investment strategy should focus on unleashing this growth in the small and medium enterprise sector.

[3] Information gathered from the "Pharmaceuticals Cluster," prepared by the Competitiveness Unit at the Ministry of Planning.

2.4. Constraints for Domestic Manufacturing Enterprises

The relative share of the manufacturing sector in Jordanian economic activity has recently declined because the limited size of the domestic market and limited export opportunities led to much faster expansion of the service sector. Currently the manufacturing sector accounts for only 15% of GDP while the service sector accounts for as much as 70%. This could change, however, as Jordan develops its potential to expand its manufacturing and industrial sector's share not only by producing goods and services for the domestic market but also for increasing its exports within the Middle East region as well as farther a field. It can diversify both its exports and export markets by making its products desirable in price, quality and delivery. To accomplish this, Jordan needs to create a more competitive framework eliminating the constraints for domestic growth and private sector development beyond the free trade zones and qualifying industrial zone arrangements.

The concentrated export and investment activity in export processing zones (FTZs and QIZs) operates outside a national policy framework that contains many impediments to improving competitiveness and thus fails to adequately foster the development and growth potential of the other (non-enclave) Jordanian enterprises. Three factors appear to pose constraints:

First, sales into the domestic market are impeded by transaction-specific authorization requirements from the Ministry of Industry and Trade (MIT). Moreover, there are cumbersome customs procedures. Purchases by free zone companies from the domestic market can only be admitted on a duty-paid basis. Therefore, firms operating within the enclaves are discouraged to develop linkages with the rest of the Jordanian enterprises.[4]

Second, there are flaws in the package of fiscal incentives. Some of these incentives, such as tax holidays, may have limited effectiveness and may also impose significant direct costs on the country. Reducing corporate tax rates is desirable, and may constitute a powerful incentive to invest. One of the principal benefits of lower corporate taxes, however, lies in their widespread and long-term application, which creates a stable and predictable business environment and, in the longer term, tends to lead to increased overall tax revenues. Systems of temporary tax holidays, targeted by sector or region, often have a contrary effect and thus may do little to attract sustained long-term investments. Targeted exemptions tend to benefit investments with a short-term time horizon. Long-term projects generating profits beyond tax holidays do not benefit unless firms are permitted to accrue and defer asset depreciation deductions beyond tax holiday period.

One justification for special economic zones such as Aqaba or, to a lesser degree, the Free Zones, is that they can serve as a model, or controlled experiment in reform, demonstrating that lowered tax rates and other forms of incentives can lead to higher rates of economic growth and higher tax revenues. Over time, these reforms may be adopted nationwide, as the example of Mauritius demonstrates.

[4] Kishore Rao, "Free Zones in the Middle East: Development Patterns and Future Potential," in: Trade Policy Developments in the Middle East and North Africa, edited by Bernard Hoekman and Hanaa Kehir-El-Din, The World Bank, 2000, p.255

Unlike the incentive regime in Aqaba, the effects of national incentives embodied in the current Investment Promotion Law are poorly understood and may indeed have effects contrary to their purpose. These incentives, based mainly on tax holidays, have yet to be subjected to any true cost and benefit analysis. Quite possibly they may subtract more value from the economy in terms of foregone corporate tax revenues than they add in increased employment and personal income tax receipts. Additionally, a tax exemption is of little benefit if the company is not making profits which is often the case in the beginning of operations. Firms that are profitable from the outset might not have needed the incentives at all.

Third, free zone-based manufacturers operating in Jordan cannot access regional markets on a preferential basis even though there might be ample room to explore improving opportunities through Multi-Fiber Agreements (MFA). Free zone products are excluded from Arab trade agreements because free zone firms benefit from duty-free import advantages. The argument in favor of this exclusion is that by granting these firms preferential trading access, free zone firms could threaten both competing exports not located in free trade zones and domestic producers in the importing country. But, this argument overrides the fact that domestic firms can also benefit from a number of duty-free import schemes (temporary admission, duty drawback, bonded warehouses) that allow domestic exporters to import duty-free inputs and gain preferential export market access. The latter arrangement can provide the double benefit to domestic Jordanian manufacturers that is denied to free zone firms.

The MIT has the chance to improve existing export and investment promotion strategies, thus developing a more competitive policy framework and promoting ways of benefiting Jordan's domestic enterprises. However, it needs to determine the fully appraised cost and benefits—to the budget and to the country—of the fiscal and financial incentives offered to the investors operating in the free trade zones and the QIZs.

III. CURRENT POLICY INITIATIVES

Most recently the Investment Task Force, established by His Majesty King Abdullah II in 2001, commissioned a major study of Jordan's current investment development policies, strategies and institutions. This study proposed a set of quick fixes aimed at achieving near-term improvements in Jordan's export and investment performance. Even though some of its recommendations may be sound, the study falls short of proposing a sustainable trade and investment strategy for Jordan. Instead it focuses on short-term solutions with limited analysis. The danger in adopting these recommendations, apart from the specific merits or short-comings of any of them, is that a short-term, "quick-fix" approach may make it more difficult to develop and implement a more sustainable long-term approach. The limitations of the Investment Task Force study include:

- The approach taken is based exclusively on an industrial policy approach instead of cluster-based policy,
- It focuses exclusively on existing sectors but not emerging sectors,
- It ignores the composition of manufacturing and industry across enterprises by size, location and operation, number of employees, and fails to address the absence of linkages

between exporters and the rest of the Jordan's small manufacturing and industrial enterprises. (See Table 2.),

- The study extrapolates economic growth according to past performance of exporting firms operating in Jordan's free trade zones (FTZs) and qualifying industrial zones (QIZs), for example, it is risky to project annual export growth of more than 20% based on the past two years of growth immediately after the introduction of the QIZ schemes,
- It estimates increases in fiscal revenues for the GOJ without calculating the budgetary impact of fiscal incentives (tax exemptions, tax holidays and duty free imports) and financial incentives (subsidized facilities and services) to the investors,
- It makes no recommendations as to how to change investment and export promotion policies and generate domestic growth and employment.

The GOJ has relied on an industrial policy approach for a long time. The Investment Task Force has done the same. Both the GOJ and some international donors have conducted numerous studies that attempt to prioritize potential growth sectors and how to promote them. The most recent Industrial Policy Study of the University House for Consultations and Studies in July 2001 emphasized the need "to formulate a framework for a coherent industrial policy to enhance and guide the pace and direction of the future growth of Jordan's industrial sector." More specifically, the study identified and prioritized sectors, investment areas and opportunities to be targeted for further development.

As international experience illustrates, this approach has several disadvantages. Picking "winners" gives signals to the ones not picked as if they were destined to become "losers." Devoting the GOJ's resources to promote the promising sectors (by fiscal and financial incentives) works, therefore, to the disadvantage of the firms operating in sectors not picked, or implicitly identified as "losers" and therefore not eligible for incentives. It is not clear that governments in general can make better investment decisions than private investors, who risk losing their own capital if they make the wrong decision. By selecting winners, and by restricting incentives to investments in sectors it has selected as potential winners, Government may stifle investment in potentially viable sectors while also promoting over-investment in other sectors it has selected. This can distort economic decision making, causing it to be driven more by transitory incentives than by sustainable economic returns. In the extreme, it can lead to Jordan's promoting investments that subtract, instead of adding, value to the economy.

IV. TOWARDS AN IMPROVED TRADE AND INVESMENT STRATEGY

4.1. Expanding Benefits of Trade and Investment

Jordan's export activity is concentrated in the enclaves, FTZs, industrial estates or QIZs, and a small number of large and medium enterprises. Despite their significant contribution to the Jordanian economy, these exporters remain relatively unconnected to the small enterprises that make up the bulk of Jordan's industrial sector. If export-led investment in Jordan is to achieve significant multiplier effects on employment and income beyond the direct contributions of the large export enterprises themselves, it must be linked more directly to these small enterprises. Additionally, Jordan can spread these positive effects much more widely by adopting policies that encourage further diversification in the mix of products it produces for export. It can do so not by directing investment into new product areas via targeted incentives but rather by creating and improving the conditions – legal, fiscal and regulatory environment, investment and trade facilitation, basic and technical education and training, financial and physical infrastructure – that may be necessary for enterprises to develop the vision, confidence and abilities to undertake such diversification and to increase domestic value added.

4.2. Improving FDI and DDI Linkages with SMEs

Jordan has recently achieved significant success in attracting FDI in apparel and light manufacturing (mainly in the QIZs), tourism and extractive industries and largely through the promotion efforts of the Jordan Investment Board (JIB). Nevertheless, the underlying policies, including investment incentives, must be re-examined in view of the need to diversify investment both geographically and sectorally. Additionally future policies and promotion efforts must focus on stimulating domestic investment (DDI) as well as foreign direct investment (FDI).

The ongoing initiative to create the Jordanian Authority for Enterprise Development (JAED) as the principal body for trade and investment policy analysis and advice to government, and the accompanying restructuring of the corporations such as the Jordan Investment Board (JIB), the Jordan Export Development Corporation (JEDCO), and Jordan Industrial Estates Corporation (JIEC) is intended to address this need. Among the initial research activities undertaken, even prior to the formal establishment of JAED, will be to calculate the economic rate of return from the existing incentive packages given to investors. Once this has been documented, it will provide a basis for changing the existing set of investment incentives so as to be more cost effective and to promote the kinds of diversification and linkages that are critical to Jordan's future economic success.

Government and its enterprise development institutions should begin to focus on linking indigenous SMEs to foreign investors and facilitating the transfer of technology and know-how to local enterprises. Such linkages and spillovers may be classified in five categories based on international experience:

Backward Linkages with Suppliers: Foreign firms usually source some parts, components, indirect materials and services and supplies in the host country. The effect of such linkages on local SMEs depends, among other things, on the quantity and types of inputs supplied, the terms of procurement, and the willingness of the foreign firms to transfer knowledge and build a long-term relationship with local SMEs. Supplier linkages range from arms-length market transactions to very close, long-term inter-firm relations. Few of the current investors in the QIZs industrial estates and FTZs, however, have yet developed any significant links with smaller companies outside these areas

Forward Linkages with Customers: Forward linkages between a foreign company and an SME might create important opportunities for the development of local enterprises. First of all, local SMEs will always benefit if a good or a service produced by a foreign investor lowers the price or improves the quality of an input that the respective SME uses further upstream in the production process. Foreign companies mainly develop two types of linkages with the customers in the form of *marketing outlets* and *industrial buyers*. The most important and rapidly expanding mechanism for downstream relationships with local SMEs is franchising. Franchising not only offers an opportunity to establish new SMEs as independent franchisees, but may also lead local entrepreneurs to develop domestic franchises that may ultimately expand regionally or globally. In South Africa, for example, many locally-based franchise operations in a wide range of products and services compete successfully with even the largest international franchise operations, and several have expanded their operations throughout sub-Saharan Africa and even to Europe and Australia. Another important example of forward linkages is the cultivation of local agents and distributors. As all products become more technology- and knowledge-intensive, foreign companies must transfer significant technology and provide substantial training to enable local affiliates to provide levels of customer service, maintenance and repair equivalent to what they offer in their home countries.

Innovation through Competition: Competition is one of the most important determinants of growth of existing or emerging industrial clusters. When a foreign firm enters a new market it may often face competition from local firms and even from very small enterprises. Conversely, the entry of a foreign firm into a domestic industry creates additional competitive pressure. Such competition can benefit both foreign and domestic enterprises. Domestic companies will be stimulated to improve productivity to match the levels of their foreign competitors, and may also become more competitive as they begin to emulate practices, standards and innovations that their foreign rivals may introduce locally. Foreign companies, if faced with strong domestic competition, will be induced to develop linkages with domestic suppliers that they might have little incentive to do in the absence of such competition.

This suggests a need for the GOJ to review its approach to the restructuring and privatization of state-owned industries, as well as overall competition laws and policies, to ensure that they foster increased competition.

Linkages with Technology Partners: Some foreign firms choose to initiate common projects with indigenous SME partners. These projects may take the form of joint ventures, licensing arrangements and strategic alliances. Though some host countries have tried to impose local partnering arrangements through limitations on foreign ownership or local empowerment programs evidence suggests that this approach generates few, if any, long-term benefits. True benefits to the economy will result only if both parties to such arrangements see an economic benefit for themselves. Governments tend to do better by creating favorable conditions for such alliances to occur and by facilitating and supporting them with education, training and infrastructure. The GOJ can contribute significantly to this development, especially in light of its large-scale e-government initiatives, through government contracting itself, but also by encouraging the involvement of universities with both foreign and domestic companies and by strengthening universities' ability to contribute to innovation. The combination of government contracting and academic research and innovation, together with private risk-taking and management, production and marketing know-how was directly responsible for the growth of tremendously successful clusters such as Silicon Valley in California and Route 128 in Boston.

Other Spillover Effects: These include demonstration effects and human capital spillovers. Demonstration effects occur as foreign firms introduce new, often more efficient ways of doing things and indirectly provide showcases for innovation. Local entrepreneurs may emulate foreign products and management techniques or gain access to non-traditional markets by observing and copying foreign firm strategies. This might happen as a spontaneous or as a planned systematic benchmarking exercise. Human capital spillovers occur, on the other hand, whenever foreign firms train personnel beyond their own needs or if their experienced personnel moves to local firms or starts new spin-off companies.[5]

4.3 Government's Role in Linkage Development

As the foregoing discussion makes clear, economic growth in a global marketplace is a function of competitiveness. Following Michael Porter's example, we often speak of national competitiveness.[6] Yet, as Porter himself points out, this is something of a misnomer, since it is a country's enterprises, operating in clusters of primary, intermediate and support enterprises, that are themselves competitive. Not all countries are equally competitive in all sectors, and not all enterprises in a given sector and a given country are equally competitive. Those countries that are competitive in many sectors tend to be so in large part because their governments, rather than intervening directly at the enterprise level, have created conditions that support the development of successful industrial clusters.

International competitiveness, as discussed above, is a function principally of innovation and productivity, which in turn owe a great deal to the presence of competition. Innovation and productivity depend to a great degree on two elements: 1) linkages among and between companies of all sizes, both domestic and foreign; 2) effective interaction and collaboration among government, academia and private business.

These two elements are critical in developing as well as developed countries. In developing countries, however, FDI and linkages take on an even greater importance. FDI can introduce innovation, technology and business practices that domestic companies may lack. Through the various forms of linkages outlined above, FDI spreads these competitive elements to domestic companies, thus contributing to the development of globally competitive industrial clusters. While this contributes to longer-term growth in national income and personal wealth, linkages additionally provide short-term benefits through their multiplier effect on employment. Developing country governments thus have a real incentive to encourage rapid development of linkages between FDI and domestic companies, to create jobs and raise incomes in the near term. The challenge is for governments to achieve these near-term effects without creating distortions that may undermine efforts to develop international competitiveness over the longer term.

[5] TNC-SME Linkages for Development, Issues-Experiences-Best Practices, United Nations Conference on Trade and Development (UNCTAD), Proceedings of Special Round Table on TNCs, SMEs and Development, UNCTAD X, New York and Geneva, 2000, p. 7
[6] Michael E. Porter, The Competitive Advantage of Nations, The Free Press, New York, 1990

For Jordan, as for many countries, the challenge, additionally, is to create the conditions needed to accelerate the shift from low added value, labor intensive industries such as garment manufacturing into more knowledge- and technology-intensive industries. The QIZs have in recent years contributed directly to growth in Jordan's economy, and are likely to continue to do so for several years to come. Just as Singapore, Malaysia, Mauritius and many other countries have started with textiles and moved up the value chain to IT, automobiles, financial services and many other sectors, so too can Jordan use the QIZs as a springboard to developing competitiveness in many other industries. As Porter has pointed out, and as actual experience has demonstrated, governments can help this happen by focusing on the underlying factors of production and on business promotion and facilitation rather than on firm-level interventions. Porter mentions human capital – basic education and technical education and training in science, business and engineering – as well as research and infrastructure as factors that government can do a great deal to develop.[7]

It is exactly the presence and the promise of these advanced and specialized factors in Costa Rica which prompted Intel's decision in 1997 to invest US$ 500 million in a production site for the assembly and testing of Pentium-II processors. Intel had originally studied several possible sites for construction of its assembly plant, including Brazil, Chile, Mexico, the Philippines and Thailand. Costa Rica won the competition without offering major firm-specific concessions or generous tax exemptions. Instead what impressed Intel's management was the country's focus on an electronics strategy, its willingness to invest in training, and the strong commitment to the Intel project. Political support at the highest level and the facilitation work undertaken by Costa Rica's investment promotion agency (CINDE) proved to decisive.[8]

Without intervening in firm-level decision making or creating distortionary incentives or requirements for companies to develop linkages, governments can do much to facilitate development of such linkages. Mexico, city, for example, has set up a subcontracting exchange scheme (SES), which compiles information on local companies to help foreign investors identify potential suppliers. Several countries, including Singapore and Malaysia have established franchise development programs aimed at helping local SMEs and investors acquire and operate franchises. USAID has also supported franchise development initiatives in South Africa, Russia, Central Asia and other regions. Typically these programs provide information about basic franchising principles and opportunities; facilitate legal reforms that may be necessary for franchising to develop; facilitate contacts between international franchisers and potential local franchisees; encourage and support the establishment of national franchising associations; provide training to potential franchisees; help to develop indigenous "SME-to-SME" franchises of the kind that have developed in some Asian countries and also in South Africa; and, occasionally, help potential franchisees and franchisers raise capital.[9]

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[7] Michael E. Porter, The Competitive Advantage of Nations, The Free Press, New York, 1990, pp. 76-81
[8] TNCs-SME Linkages for Development: Issues-Experiences-Best Practices, op. cit., p. 48-49
[9] Ibid., p. 52, 54

4.4. A Cluster-Based Focus for National Trade and Investment Policies

Though Jordan's Ministry of Planning has conducted advanced cluster-based research for several years, this research remains largely divorced from deliberations over national investment and trade policies. The Competitiveness Unit of the Ministry of Planning has carried out cluster-based analysis in the context of its role as the Jordanian counterpart for the annual *Global Competitiveness Ranking* conducted by the World Economic Forum. This research may expand as Jordan seeks to gain inclusion in the similar *World Competitiveness Ranking* conducted by the Institute for Management Development (IMD). The utility of this research to national policy-makers remains largely unexploited. A cluster-based focus has the potential to help Jordan develop national policies to encourage emerging, high value-added industries and to develop critical linkages in ways that traditional industrial policy cannot.

What a Cluster is:

Clusters encompass an array of linked industries and other entities important to competition. They include, for example, suppliers of specialized inputs such as components, machinery and services and providers of specialized infrastructure. Clusters also often extend downstream to channels and customers and laterally to manufacturers of complementary products and to companies in industries related by skills, technologies, or common inputs**.** A cluster's boundaries are defined by the linkages and complementarities across industries and institutions that are most important to competition. Clusters promote both competition and cooperation while allowing rivals compete intensely to win and retain customers. Without rigorous competition, a cluster is likely to fail. Yet there is also cooperation, much of it vertical, involving companies in related industries and local institutions. International experience also demonstrates that competition can coexist with cooperation because they occur on different dimensions among different players.[10]

Why Clusters are Critical to Competition:

Modern competition depends on productivity, not on access to inputs or the scale of individual enterprises. Productivity rests on *how* companies compete, not on the particular fields they compete in. The way in which the companies compete in a particular location is strongly influenced by the quality of local business environment. Clusters affect competition three broad ways: first, by increasing the productivity companies based in the area; second, by driving the direction and pace of innovation; and third, by stimulating the formation of new business which in turn expands and strengthens the cluster itself. Therefore, being part of a cluster allows companies to operate more productively in sourcing inputs; accessing information, technology and needed institutions; coordinating with related companies; and measuring and motivating improvement.

A well-developed cluster provides an efficient means of obtaining important inputs. Such a cluster offers a deep and specialized supplier base. Sourcing locally instead of from distant suppliers lowers transaction costs. It minimizes the need for inventory, eliminates importing

[10] Michael E. Porter, "Clusters and the New Economics of Competition," Harvard Business Review, November-December 1998, pp. 78-79

costs and delays. Since local reputation is important, local suppliers are less likely to overprice. Furthermore, local outsourcing is a far better solution than distant sourcing, especially for advanced and specialized inputs involving embedded technology, information and service content.

A host of linkages among cluster members results in a whole greater than the sum of its parts. In a typical tourism cluster, for example, the quality of visitor's experience depends not only on the appeal of the primary attraction but also on the quality and efficiency of complementary business such as hotels, restaurants, shopping outlets, and transportation facilities. However, much depends on the extent of local rivalry or the competition among these businesses. In addition to enhancing productivity, clusters play a vital role in company's ability to innovate. As long as the companies face competitive pressure, peer pressure and constant comparison, they are likely to improve their productivity and the quality of the product or service they offer. What drives the competitiveness of firms operating in clusters is the presence of competition within the cluster.[11]

Determinants of Cluster-Based Analysis:

Cluster-based analysis was first developed by Michael E. Porter, in his *Competitive Advantage of Nations* in 1990. He identified the national competitive advantage of nations and the way in which local firms create and sustain competitive advantage in global industries. He stated that nations achieve international success in a particular industry through four broad attributes that shape the environment in which the local firms compete. These four determinants are:

1) Firm strategy, structure and rivalry (the conditions in the nation governing how companies are created, organized, and managed, and nature of domestic rivalry)
2) Factor conditions (the nation's position in factors of production, such as skilled labor or infrastructure, capital and financial resources, all necessary for firms to compete in a given industry
3) Demand conditions (the nature of domestic demand for the industry's product or service)
4) Related and Supporting Industries (the presence or absence in the nation of supplier industries that are not only domestically competitive but have the potential to be competitive internationally)

These determinants, individually and as a system, create the context in which a nation's firms are born and compete. A nation becomes competitive through the competitive advantage it helps create for its firms. It does so by improving the factor and demand conditions, helping the supporting industries and improving the competitive environment for all its firms. Government can improve or detract from accumulating competitive advantage for its clusters and it needs to examine vigilantly how its existing policies influence each of the above four determinants. For example, antitrust policy affects domestic rivalry, regulation can alter home demand conditions, investments in education can change factor conditions, government purchases can stimulate related and supporting industries.

[11] Ibid., pp. 80-83

Cluster-based analysis, therefore, includes the role of all related and supporting industries and, therefore, enterprises of all sizes. If correctly undertaken and translated into concrete policies, this approach can help solve the problem of integrating the SMEs that remain presently de-linked from the exporting or major industries in any developing or developed country, Jordan among them.

Cluster-Based Policy versus Industrial Policy:

Government policies implemented without consideration of how they influence the entire system of determinants are as likely to undermine competitive advantage as to enhance it. The basic unit of analysis for understanding and improving upon competitive advantage is the industry. However, nations succeed not in isolated industries, but in clusters of industries in horizontal and vertical relationships. Therefore, the aim of cluster policy is to reinforce the development of all clusters and *not* to select o-called "winners" or "losers" while protecting them with special tax concessions or subsidies as dictated by industrial policy.

To be fair, much of the success of Asian countries such as Japan, Korea, Taiwan, Malaysia and Singapore in moving from poverty to prosperity in a generation or less can be attributed to industrial policy. From the 1950s, well into the 1980s, these countries and others directed investment into favored industries and companies, and employed a wide array of explicit and implicit subsidies to generate faster economic growth and exports. In many cases, these countries also imposed tariffs, quotas and technical barriers to restrict foreign imports. Though it could be argued that Japan and Korea are now suffering some of the less desirable consequences of these policies (particularly the close relationships between banks and industrial companies), there is no denying that these policies in general proved highly successful.

What worked exceptionally well 30 or 40 years ago is unlikely to succeed in today's global trading environment. Faster technological innovation, increasing integration of markets, rapid globalization, and, especially, vastly greater capital mobility, make it much more difficult for industrial policy to work today. Investment nowadays cannot easily be directed by governments into the sectors or companies of their choice. Governments that attempt to impose such measures are more likely to induce capital flight than the desired investments. Moreover, these instruments are now in prohibited under the rules of the World Trade Organization (WTO), of which Jordan is a member. Subsidized and directed credit for exporters is no longer a tool available to Jordan or any other WTO member government.[12] The cluster approach, on the other hand, does not rely on or promote any direct subsidies but insists on the need for government's efforts to promote the above four determinants effectively to enable all firms to compete.

As described above, Jordan has made certain important advances towards adopting a cluster-based approach. The Competitiveness Unit at the Ministry of Planning (MOP) carries out some of the best economic research and analysis available in Jordan, using a cluster-based approach. The proposals to establish JAED as the principal body for investment policy analysis and advice have included as a core recommendation the absorption of the

[12] Emerging Asia: Changes and Challenges, Asian Development Bank, 1997, p. 104

Competitiveness Unit into JAED. This should bring increase the direct application of cluster analysis to development of national investment and trade policy.

4.5 Fostering New Business and Cluster Development

If it adopts a cluster-based approach, Jordan is more likely to enact enterprise development policies that focus on achieving productivity gains in all its clusters, rather than focusing on a few selected sectors. Recognizing that productivity growth is the principal determinant of a country's prosperity, Jordan can focus on creating the conditions for increasing productivity by improving education and infrastructure, and creating a more transparent, simple and competitive operating environment for businesses, rather than on trying to guide and target private sector investment decisions. At the highest policy level, the Ministry of Industry and Trade can work to reform anti-competitive licensing and approval policies and procedures,t to protecting intellectual property rights, and enforce anti-trust laws—so that productivity and innovation will govern success in Jordan. Many such initiatives are already underway, partly as a consequence of commitments Jordan made as part of its accession to the WTO. Continuing this progress will contribute substantially to bringing the benefits of productivity enhancement to all existing and emerging clusters in the Jordanian economy.

In keeping with this focus on competition, future policy analysis might focus on the existence of, and potential mechanisms to remove, barriers to entry in certain established and emerging clusters. The lack of barriers to entry is a critical determinant of competitiveness. Future research should examine the degree to which licensing, approval requirements or other elements constitute a significant barrier to entry in certain industries and identify ways to reduce these barriers.

Recent research into early- and mid-1990s industrial export booms in Colombia, Morocco and Mexico has revealed that ease of entry into production and export markets is a critical factor in these countries' success**.** Especially in Colombia and Morocco, more than half of the total growth in manufactured exports in the 1990s came from *new* exporters. Breaking into foreign markets involved significant start-up costs, but these costs declined as more firms became exporters and so began to establish a new image or brand for those countries' exports in general in major target markets. Critically, new entrants more often proved willing themselves to incur these start-up costs such as researching foreign markets, developing packaging systems, establishing distribution channels, and learning procedural norms, and they often tended to outperform existing exporters. This research identified low industry barriers to entry as the critical factor, suggesting that companies that had achieved some success in one industry were attracted to investing in other promising industries, provided that the barriers to entry were low. This phenomenon also suggests that companies that succeed in developing production and exports in low value-added products such as textiles, may thereby acquire both the skills and the motivation to invest and succeed in other, higher value-added industries. The study concludes that it may be best for policy makers to de-emphasize public export promotion agencies and do no more than provide modest, neutral start-up incentives. Successful export promotion is much more likely to hinge on creating a stable, predictable environment in which export profits are expected over the medium term.[13]

[13] Mark J. Roberts and James R. Tybout, What Makes Exports Boom?, The World Bank, 1997, p.17

4.6 Establishing a New Regulatory and Competition Framework

It is very likely that some clusters in Jordan might lack sufficient competition and face excessive barriers to entry. Other sectors may face barriers to more effective co-operation among companies, which could in some cases require mergers in order to achieve sufficient economies of scale to compete globally. The pharmaceuticals cluster, for example, appears poised to benefit from a new regulatory framework that would make it easier for companies to merge. Enactment of such policy reforms requires sufficient cluster-based analysis to provide convincing evidence that such reforms are necessary and will not introduce unintended distortions in other areas of the economy. Policy makers need the analytical support and justification they need to develop new policies. In the case of pharmaceuticals, such a framework and supporting legislation might, for example, allow only vertical mergers but not horizontal ones for the sake of retaining sufficient competition in the cluster.

A strong anti-trust policy ensuring vigorous domestic competition is essential to ensure productivity growth. Policies regarding domestic mergers and acquisitions need to strike a balance between preserving and increasing competition on the one hand and fostering technology transfer and greater efficiencies that may result from mergers. Critically, a uniform set of standards towards mergers and alliances should apply equally to domestic and foreign firms in order to prohibit acquisitions that significantly threaten domestic competition. Therefore, policies should favor new entrants into a cluster, whether they are domestic or foreign companies.[14]

V. CONCLUSIONS AND RECOMMENDATIONS

Jordan has been trying hard to integrate globally. Its small domestic market combined with insufficient domestic investments has forced Jordan to seek export-oriented foreign direct investments. Both the multilateral and bilateral free trade agreements with the European Union and the United States have lately attracted investors by providing unique and preferential access to markets which might otherwise remained closed to them. Foreign investors, mostly from Asia, have invested capital, set up plants and contributed to impressive export growth. Significantly, though Jordan's fiscal and financial incentives may have played some role in attracting these investors, all evidence suggests that by far the most important determinant of these investment decisions was the unique access to the U.S. market that the QIZ regime offered. To be sure, a favorable overall business environment was also critically important. Rule of law, enforceability of contracts, good infrastructure, reasonable tax rates, an absence of restriction on repatriation of profits, and many other related factors that contribute to an attractive business environment were and are present, and have contributed enormously to attracting FDI. All available evidence suggests that direct incentives played, at most, a marginal role in attracting this investment. As this report has underlined, there remains considerable scope for improvement in the business environment and for development of the critical contributing factors to productivity and innovation. The lesson appears clear that the GOJ can use its resources far more effectively to improve the overall

[14] Michel. E. Porter, The Competitive Advantage of Nations, op. cit., p. 663

business environment and enhance education, training and infrastructure than by providing targeted direct investment incentives.

To date, the foreign investors attracted by these market access agreements and by the promotional campaigns that have accompanies them have established very few linkages with domestic Jordanian companies, most of which are small enterprises employing fewer than 100 people. These investors source the bulk of their capital equipment and intermediate inputs from overseas. The small number of large Jordanian exporters tend to operate in a similar fashion. The bulk of Jordan's estimated 10,000 small and medium-sized manufacturing and industrial enterprises have participated barely, if at all, in this investment and export boom. The real benefits of FDI, however, accrue precisely from these linkages to domestic companies that so far have not developed. With the development of linkages, for every individual employed in a foreign investment company, 10 or more new jobs could potentially be created in Jordanian SMEs that supply inputs to the foreign investor. It is this multiplier effect on employment and incomes that constitutes one of the principal benefits of attracting FDI.

Linkages between large companies and SMEs are also a core element in the development of viable clusters, in which competition and co-operation jointly contribute to increases in productivity and, hence, rising wealth and greater international competitiveness for the country and its enterprises. The common denominator in successful cluster development is competition within the cluster, which in turn implies a lack of barriers to entry and a lack of explicit or hidden subsidies that distort economic decision-making.

The policy implications are clear.

- Rather than focusing on industrial policy, picking winners among sectors and companies and steering investment in specific ways through targeted incentives, Government should create conditions for development of successful clusters in any and all industries and should let private investors decide where and in which industries to invest.
- The true cost of incentives should be evaluated, and incentive regimes modified accordingly and applied more neutrally.
- Government-supported investment promotion institutions may continue to promote investment in some industries more than others, based on an accurate assessment of where Jordan's greatest competitive advantages lie. But the underlying policies and incentives should apply equally to investment in all industrial sectors.
- Successful export development depends as much on creating competition and reducing barriers to entry in industry clusters as on any targeted market access assistance provided by Government-sponsored bodies. Many companies have proven their willingness to invest in the necessary market research and promotion themselves, as long as the competitive and regulatory conditions are right.
- Government efforts to foster linkages between large companies and SMEs should focus mainly on creating the policies and conditions that enable domestic companies to meet the stringent requirements of foreign buyers and that motivate foreign investors to develop linkages on their own. These include education, research and innovation, and availability

of capital. Specific matchmaking exercises may complement, but cannot substitute for, this approach.

Annex 1
List of Persons Interviewed

Royal Court
Dr. Khalid Al-Wazani, Director, Economic Department
Ms. Jumana A. Salti, Research Officer, Economic Deparment

Ministry of Industry and Trade (MIT)
Dr. Salah Al-Bashir, the Minister of Industry and Trade
Mr. Majed Hamoudeh, Director, Department of Foreign Trade
Eng. Amer Al-Hadidi, Director, Industrial Development

Ministry of Planning
Nesreen Barakat, Director, Competitiveness Unit
Naseem M. Rahahleh, Economic Researcher, Competitiveness Unit

Ministry of Economy
Dr. Mohammad Halaiqa, Minister of Economic Affairs
Nida M. Maani, Economic Advisor

Privatization Program
Mr. Robert Wagner

Government Corporations
Ms. Reem Badran, Director General, Jordan Investment Board (JIB)
Mr. Farouk Al-Hadidi, Director General, Jordan Export Development and Commercial Centers Corporation (JEDCO)
Ms. Salam Bawab, Head of Research Division (JEDCO)
Eng. Amer Majali, Director General, Jordan Industrial Estates Corporation (JIEC)
Mr. Ali Madadha, Director General, Free Zone Corporation (FTZ)

Private Sector
Mr. Samih T. Darwazah, Chairman, Jordan Exporters Association
Mr. Halim F. Abu-Rahmeh, Managing Director, Jordan Exporters Association
Mr. Juma Abu-Hakmeh, Director General, Chamber of Industry (COI)
Mr. Karim Kawar, Chairman, INTAJ
Mr. Laith M. Qasem, CEO, Jordan Technology Group
Mr. Awni Nabulsi, Al Jidara Investment Services

US Embassy
Mr. Ian Campbell, Economic Officer

USAID
Mr. Jon D. Lindborg, Director, Economic Opportunities Office
Mr. Jim N. Barnhart, Deputy Director, Economic Opportunities Office
Mr. Jamal Al-Jabiri, Project Management Specialist, Private Sector
Dr. Roy J. Grohs, Pogram Officer and Economic Advisor
Mr. Khalid A. Al-Naif, Regional Economic & Finance Advisor

AMIR
Mr. Steve Wade, Chief of Party
Mr. Chip Krakoff, Team Leader, Private Sector Policy Initiative
Ms. Tania Revault d'Allonnnes, Senior Policy Advisor
Mr. Rami Al-Qusus, Economist
Mr. Aref Al-Farra, Economist
Mr. Ibrahim Osta, Team Leader, Business Management Initiative
Mr. Barry O'Connel, Investment Promotion Advisor
Ms. Andrea Erdmann, The Services Group
Mr. Sutherland Miller, The Services Group
Ms. Terri Kristalsky, Team Leader, Micro-enterprise Initiative
Ms. Suhair Khatib, Business Management Specialist, Micro-enterprise Initiative

Others
Mr. Montaser J. Oklah, Assistant Resident Representative, UNDP
Mr. Nicola Drago, Investment Promotion Expert, UNIDO
Dr. Dieter Katterman, Economist and Team Leader, GTZ
Dr. Yusuf Mansur, Senior Advisor, Euro-Jordanian Action for the Development of Enterprise, EJADA
Mr. Slim Tlattli, Manager Policy Support, EJADA
Mr. Santiago Botas, EJADA
Dr. Hani Hourani, Director General, Al-Urdun Al-Jadid Research Center (UJRC)
Mr. Mu'ayyad Mehyar, Program Coordinator, (UJRC)
Dr. Ercan Ozer, Ambassador, Republic of Turkey

Annex 2
Consultant Scope of Work

Consultant Scope of Work

Activity:512 Investment and Export Development Research and Policy
SOW Title:LOE/F/Comparative Advantage Analysis #1
SOW Date:March 17, 2002
SOW Status:Draft
Total LOE:14
Consultant:Nilgün Gökgür

I. Background

Accelerating foreign direct investment (FDI) is crucial to achieving higher rates of growth. Technical assistance under AMIR targeted the JIB based on the assumption that it could become a world-class, private sector-led agency for stimulating FDI. AMIR installed systems, trained JIB staff, and supported successful investment missions to the Far East and South Asia. However, the overall results of efforts to strengthen the JIB have been disappointing. A new investment promotion law drafted by AMIR advisors to elevate the JIB's private sector status and autonomy has not been enacted, and the version now advocated by the JIB maintains a strong public sector orientation. The JIB's current leadership is weak, many qualified employees have left, and government funding is inadequate. Moreover, its investment promotion activities remain diffuse and uncoordinated with the Jordan Industrial Estates Corporation (JIEC), FZC, ASEZA, and some ministries. As a result, the JIB has yet to attract significant levels of FDI.

In late 2001, HM King Abdullah created an Investment Task Force (ITF) to address this problem and to provide recommendations for restructuring Jordan's existing investment and trade promotion organizations. The ITF commissioned Booz-Allen to carry out a study to examine international best practices and recommend a model most appropriate to Jordan's needs. Having looked at investment and trade organizations in several countries, including Ireland, Singapore, Malaysia and Costa Rica, the study found that unifying investment promotion and economic policy making under one agency is more effective in accelerating foreign and domestic direct investment and in increasing exports. The ITF recommended adopting a structure similar to Ireland's Forfás. Forfás is a semi-autonomous umbrella agency that controls and co-ordinates all of Ireland's national trade and investment promotion and facilitation activities, and that functions as the principal source of advice and recommendations to the Government on trade and investment policy and strategy. The ITF recommended that existing bodies charged with investment and trade promotion functions be subsumed under this new agency, which would itself make strategy and delegate responsibilities to these bodies. These entities include Jordan Investment Board, the Jordan Export Development Corporation, the Jordan Industrial Estates Corporation, and the Free Zones Corporation.

HM King Abdullah endorsed this recommendation and created an Investment Committee charged with setting up this new agency before the end of June 2002. The Investment Committee has adopted JAED – Jordan Authority for Economic Development as the provisional name for this new agency. A key objective of the AMIR 2.0 Program is to support this effort and to provide whatever technical assistance is required for JAED to function properly. Such technical assistance will include:

- Help in establishing the appropriate internal structures and systems for JAED, such as HR, MIS, budgeting and reporting;
- Co-ordinating the policy function within JAED with other policy units in Government;
- Developing the capacities of bodies such as the Jordan Investment Board, the Jordan Export Development Corporation, the Jordan Industrial Estates Corporation and the Jordan Tourism Board to carry out the new, more ambitious mandates they will have under JAED;
- Revising the Investment Promotion Law and any other relevant laws needed to create JAED and endow it with the required authority and autonomy.

AMIR 2.0 will, initially, work with the Investment Committee to develop the necessary strategy, organizational structures and legal basis for the establishment of JAED. During this period, AMIR 2.0 will also work with several of the implementing agencies mentioned above to streamline their structures and operating practices and to upgrade their skills. This work will be carried out principally by Charles Krakoff, PSPI Team Leader under AMIR 2.0, and a senior investment promotion expert with Forfás/IDA experience.

Pending the creation of JAED, investment and trade policy remains under the joint responsibility of the Ministry of Industry and Trade as well as of the Investment Task Force.

The Investment Task Force has been instructed to present to H.M. King Abdullah II by April 30, 2002, a set of investment and trade policy and strategy recommendations, with the concurrence of the Ministry of Industry and Trade, for immediate action. The ITF, having commissioned the Booz-Allen study and in the absence of any competing vision of what the appropriate strategy should be, intends to present the recommendations of that study as its own, with whatever modifications may have been adopted in the interim by the ITF or the Investment Committee. For the establishment of JAED and related activities, the Investment Committee with AMIR Program support has developed a detailed set of recommendations that owes as much to the Committee's own research and deliberations as it does to the recommendations contained in the original study. No such research and discussion has taken place with respect to current investment and trade strategy with the result that the recommendations contained in the Booz-Allen study are likely to be presented without modification.

In addition to recommending the creation of a Forfás-like structure, the Booz-Allen report examined some 10 existing sectors and proposed immediate actions to improve the export and investment performance of these sectors. Terming them "Quick Fixes" the Booz-Allen consultants recommended sweeping reforms touching on tax codes, international agreements, regulatory and legal reforms, infrastructure development and more. These sector analyses and recommendations were based, in part, on prior sector studies carried out by Deloitte & Touche.

The danger in adopting these recommendations for "quick fixes" is that it may commit Government to a long-term course of action based on short-term considerations rather than in the context of a long-term set of policies and strategies. Such action could require the new JAED to focus to a large degree on undoing some of the harmful consequences of these "quick fixes" instead of developing a coherent basis for national investment and trade policies and strategies.

It is essential, therefore, to examine the recommendations presented in the Booz-Allen report and to propose an alternative approach based on existing strategies and on the initiatives that AMIR is supporting in respect of JAED and its affiliated implementing agencies.

II. Objectives

The Jordan Authority for Economic Development (JAED) is the process of being formed and will consolidate and combine all the investment promotion functions currently under review in Jordan. In addition it will take direction from a number of higher administrative councils and Ministries such as: The MIT, the King's Advisory Council and the ECC.

The objective for the consultant under this particular SOW is to work toward a national investment strategy that will help consolidate rigorous economic analysis with investment promotion. The intention is for those who promote both FDI and DDI in Jordan understand their task in the context of an investment strategy, with knowledge of Jordan's comparative advantages by industry and sector, and promote an incentive structure that will contribute to long-term growth rather than short-term investor gain. The ability to underpin the new JAED's mandate with rigorous analysis and solid metrics will greatly enhance the reputation of the new body and in turn promote Jordan as a destination of capital.

III.Specific Tasks of the Consultant(s)

The consultant will be expected to carry out the following activities:

A. Background Reading

Read the following documents and any other documents that may be required successfully to fulfill the objectives of this assignment

- AMIR Technical Proposal and Work Plan
- Investment Task Force Executive Summary and Accompanying Report (January 2002)
- Strategic Plan of the Ministry of Industry and Trade
- TIJARA Draft Plan
- AMIR 1.0 Report "Investor Targeting Strategy for the Investment Promotion Corporation"

- AMIR 1.0 Report "Analysis and Recommendations for Improvement of the investment Promotion Law, By-Laws and Regulations for the Investment Promotion Corporation"
- Draft JAED Law and amendments to JIB, JEDCO, JIEC and FZC laws
- AMIR 1.0 Program Document: "JAED Action Plan"

B. Persons to be Interviewed

Interview the following people and any others whose views may be important to successful fulfillment of the objectives of this assignment

- Steve Wade, Chief of Party, AMIR 2.0 Program
- Charles Krakoff PSPI Team Leader, AMIR 2.0 Program
- Barry O'Connell, IVP sub-component Leader, AMIR 2.0 Program
- HE Dr Salah Al-Bashir, Minister of Industry and Trade
- Mr Nadeem Muasher, Chairman, Investment Committee
- Dr Khaled Al-Wazani, Economic Advisor to HM King Abdullah
- Other members of the Investment committee, including the Directors of JIB, JIEC, JEDCO, FZC
- John Lindborg, Jim Barnhart and Jamal-Al-Jabri, USAID

C. Specific Tasks of the Consultant

The Consultant will perform the following specific tasks:

Evaluate the existing proposals before Government and recommend appropriate near-term and intermediate-term actions.

Draft a 12-month research agenda for JAED and the Ministry of Industry and Trade Policy Unit that will enable Jordan to identify appropriate long-term investment and trade policies and strategies.

IV. Timeframe

Name	Start	Finish	To Post	From Post	Field	3rd Country	USA
Nilgün Gökür	March 24, 2002	April 7, 2002	March 24, 2002	April 7, 2002	14		

V. LOE

Name	Travel Days	Field Days	USA Days	3rd Country	Total Days
Nilgün Gökür	2	12			14

VI. Qualifications

Education

Master's Degree or higher in the area of economics or public policy from a recognized international university.

Experience

- At least 8-10 years international experience in enterprise development, export and investment development, competitiveness and related areas
- Practical and theoretical expertise in a wide range of areas including:
    - trade and industrial policy appraisal and reform
    - enterprise development
    - economic integration,
    - cost-benefit analyses

A SUSTAINABLE TRADE AND INVESTMENT STRATEGY FOR JORDAN

Challenges for Achieving Global Integration While Accelerating Domestic Growth

Nilgün Gökgür

April 9, 2002

OUTLINE

- Reviewing Jordan’s achievements on trade and investment
  - Short- and long-term costs and benefits of trading and investing in the enclaves to the budget and to the country
- Assessing existing efforts to seek better solutions
  - Can the recommendations of the ITF ensure sustainable domestic growth?
- Crafting a new trade and investment strategy parallel to the creation of JAED
- Developing effective public-private partnerships

JORDAN'S ACHIEVEMENTS ON TRADE AND INVESTMENT

- **30% manufacturing exports are generated in the export processing zones (FTZs and QIZs) providing jobs, income and *gross* export earnings**
- **70% are generated in the public and private industrial estates by 5% of total industrial and manufacturing enterprises registered by the COI**
  - **Net export earnings *from all manufacturing and industrial exports* are low because of heavy reliance on imported raw materials and intermediate inputs and re-exports**
- **95% of manufacturing enterprises are the SMEs operating *outside* these enclaves**

FTZs and QIZs as an Export and Investment Promotion Tool

- **While presently generating jobs, income and *gross* export earnings,**
  - **How do they contribute to technology transfer, knowledge spillover, demonstration effects, human capital development, forward and backward linkages and to development of indigenous private sector?**
  - **How sustainable are they in the long-run with WTO's MFA by 2005, US and EU's FTA within ten years?**
  - **What are the fully appraised costs and benefits--to the budget and to the country--of the incentives offered in the enclaves both to investors and the trading partners?**

ASSESSING THE EXISTING EFFORTS OF THE INVESTMENT TASK FORCE (ITF)

- **The approach taken is based on industrial policy *instead of cluster-based policy***
- **Focuses exclusively on existing sectors and *not on emerging clusters***
- **Ignores sectoral composition of industry and manufacturing *across* enterprises by size, location and operation and fails to address linkages between exporters and and the rest of the economy**
- **Extrapolates growth according to past performance of exporting firms operating in FTZs and QIZs**
- **Estimates increases in fiscal revenues for the government *without* calculating the effects of implicit and explicit subsidies and special tax concessions to the investors**

FORMULATING A NEW TRADE AND INVESTMENT STRATEGY PARALLEL TO THE CREATION OF JAED

- **Need to diversify manufacturing and industrial export products as well as export markets**
- **Need to assess whether FDI promotion policies generate an economic rate of return and to assess when and where to promote a new breed of FDI that is willing:**
  - **to serve the domestic and regional export markets**
  - **to develop positive productivity spillovers for local industry through "catalyst" effect (forward and backward linkages) and through worker training**
- **Need to give not only equal treatment and facilitation to DDI, but also informing the Jordanian investors (both inside and outside Jordan) about domestic investment opportunities**
- **Need to accelerate private capital formation**

CRAFTING A NEW TRADE AND INVESMENT POLICY:
Moving Jordan away from Resource-Driven Economy to Investment-Driven and ultimately to Innovation-Driven Economy

- **Investment-driven economy:**
  - Efficiency in producing standard products and services is the dominant source of competitive advantage
  - Technology is accessed through licensing, JVs, FDI and imitation
  - Foreign technology is not only assimilated but improved upon
  - SMEs serve original equipment manufacturer(OEM) customers
  - Economy is concentrated on manufacturing and outsourcing exports
- **Innovation driven economy:**
  - Innovative products and services are the dominant sources of competitive advantage
  - Enterprises compete with unique strategies which are often global in scope
  - New entry feeds vibrant domestic rivalry in many industries, accelerating improvement and innovation
  - The economy is resilient to external shocks

BENEFITS OF CHOOSING CLUSTER-BASED POLICY OVER INDUSTRIAL POLICY

- **Industrial Policy:**
  - **Government targets selected industrial sectors and promotes or protects them**
  - **Subsidies (implicit and explicit) distort the economy**
  - **No longer valid while connecting globally within the constraints imposed by the WTO and other bilateral agreements**
  - **Centralizes decisions at the national government level**
  - ***IMPEDES COMPETITION***

- **Cluster-based Policy:**
  - **Government aims to reinforce the development of all clusters**
  - **Both FDI and DDI enhance productivity**
  - **Impediments and constraints to *productivity* are relaxed**
  - **Policies give priority to cross-industry linkages and complementarities**
  - **Initiatives at the enterprise level are encouraged**
  - ***ENHANCES COMPETITION***

FACILITATING CLUSTER DEVELOPMENT PROVIDES LINKAGES TO RELATED AND SUPPORTING INDUSTRIES AND SMEs

- **Clusters are concentrations of interconnected companies and institutions in a particular field**
- **Clusters encompass an array of linked industries, important to competition, including suppliers of specialized inputs such as components, machinery and services**
- **Clusters often extend to manufacturers of complementary products and to companies in industries related by skills, technologies, or common inputs**
- **Clusters include public and private institutions such as universities, think tanks, vocational training providers, and trade associations that provide research, training and technical support**

CLUSTERS, PRODUCTIVITY AND COMPETITIVENESS

- **Modern competition depends on productivity**
- **Productivity rests on *how companies compete not on the particular fields and sectors they compete in***
- **Clusters, therefore, affect competition as such:**
  - **By increasing productivity of companies**
  - **By driving the direction and pace of innovation**
  - **By stimulating the formation of new businesses which in turn expands and strengthens the cluster itself**
  - **By contributing directly to national productivity while affecting the productivity of *other* clusters**
  - ***By increasing productivity and enhancing competitiveness and prosperity***

EXAMPLES OF ESSENTIAL POLICY REFORMS FOR FOSTERING CLUSTER DEVELOPMENT

- **Potash and Phosphate Cluster** suffers from unfair competition from the subsidiaries of the state-owned or foreign-owned monopolies all impeding the development of competitive private sector in advanced fertilizers
- **Dead Sea Products Cluster** suffers from lack of competition by the market power of a major JV with a state-owned enterprise; remaining private producers can benefit from the establishment of a medical research center or other forms of assistance
- **Pharmaceuticals Clusters** is likely to benefit from mergers to increase capacity utilization, pull together individual R&D expenditures, increase local demand and stimulate production of imported raw materials and inputs while creating new supporting industries or supplier firms

SUMMARY

- **Need to assess the contributions of present efforts to integrate globally**
- **Need to craft a new trade and investment strategy based on *cluster development policy with emphasis on productivity growth and innovation at the enterprise level (not only exporting enterprises but all)***
- **Need to create *internal competition within the clusters* and to eliminate monopoly market power of incumbent firms and reduce barriers to entry**
- **Need to develop *effective public-private partnership* and not allowing government or quasi-government institutions to compete unfairly with private sector**