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Jordan Investor Targeting Strategy 2003

An Assessment of Jordan's Competitiveness in Attracting FDI Relative to other Middle East/North African Countries

Final Report

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[1] http://www.coface-usa.com/products_services/country_risk_ratings.html
[2] *Ibid.*

Executive Summary

A. Overview

This study was undertaken on behalf of the Jordan Investment Board to assist it in developing a focused promotion strategy based on an accurate appreciation of Jordan's competitive advantages.

In 1998 under the AMIR 1 Program, The Services Group (TSG) developed the first Investor Tracking Strategy (ITS) for the Investment Promotion Corporation (IPC), now the Jordan Investment Board (JIB). The ITS recommended that Jordan focus on attracting inward direct investment in six principal sectors: downstream potash and phosphates, textiles and apparel, Dead Sea Cosmetics, information technology, tourism and pharmaceuticals. This selection was based on an evaluation of Jordan's economic structure and existing trade and industrial profile, and involved a comparison of these elements with similar measures in other countries in the Middle East and North Africa with which Jordan might compete to attract foreign direct investment.

The ITS analysis concluded by identifying target industries within the six sectors , identifying target markets for each industry, and setting promotional targets. The JIB implemented most of these recommendations and bases its marketing and promotional strategies on the original ITS guidelines.

JIB now requires a new ITS for two important reasons. First, international best practices generally call for updating investor targeting strategies every three years; thus an update of Jordan's strategy is overdue. The four and a half years since the previous study was completed have seen major changes in the global trading environment and in Jordan's position in that environment. Among the most important developments have been Jordan's accession to the World Trade Organization; launch of the U.S.-Jordan-Israel Qualifying Industrial Zones program; and signing and implementation of a U.S.-Jordan Free Trade Agreement and an EU-Jordan Association Agreement. Other important developments include:

1. The end, as of January 1, 2005, of the quota system for clothing imports under the Multifibre Arrangement and its successor, the Agreement on Trade in Clothing;
2. The outbreak of the second intifada in the Palestinian territories, affecting economic relations with Israel;
3. Intensification of the conflict between the U.S. and Iraq, with the possibility of war and uncertainty over Jordan's economic position in a postwar or post-sanctions environment;
4. Recession and uncertain prospects for recovery in major industrial countries;
5. Collapse in equity markets in most big economies, especially in information and communications technology.

The second reason for requiring a new ITS is that the original ITS offered little explanation of the rationale for selecting the six sectors of focus while failing to consider others. The approach appeared to be based in large part on selecting existing industries or, in the case of IT, a sector in which the government wanted Jordan to succeed, and crafting a promotion strategy based on those sectors or industries. The sector selection in the previous ITS has much of the flavor of industrial policy, or "picking winners": an attempt to drive investment towards sectors government may have targeted for economic, political or social reasons. This

approach has served Jordan reasonably well until now, but the major economic and political developments mentioned above require a more open and flexible approach that can identify nascent opportunities in industries that may not yet exist in Jordan, but which have the potential to contribute significantly to meeting the Kingdom's economic and social objectives.

B. Objectives

The principal objective of this new Investor Targeting Strategy for Jordan is to identify those sectors and industries most appropriate for future promotion activities undertaken by the Jordan Investment Board. The principal approaches used in developing this strategy are 1) an evaluation of Jordan's competitiveness as a regional destination for investment as compared to that of key regional competitors and, 2) an assessment of national, regional and global investment trends as they affect Jordan's potential to attract FDI in different sectors and industries.

C. Approach and Methodology

This study is based on a cluster approach to competitiveness. A cluster-based approach does not look at industries in isolation, but rather examines a much wider range of subsidiary, contributing, and supporting industries, in order to identify areas in which a country has or can develop an industrial cluster, comprising several related and complementary industries that can become globally or regionally competitive.

The cluster-based approach differs significantly from the "screening" approach, which was employed in the 1998 Investor Targeting Strategy. The screening approach seeks to identify appropriate industries for investment promotion based on a comparative ranking of a wide range of production factors and costs, investment incentives, and policy considerations. The screening approach also examines past investment trends in an industry globally, regionally, and nationally, which can be taken as a guide to future industry developments. This approach is favored by the analysts at international organizations, such as the U.N. Conference on Trade and Development, the World Bank Multilateral Investment Guarantee Agency, and the World Bank Foreign Investment Advisory Service. It is not, however, the one currently favored by potential investors.

This ITS adopts the perspective of the potential investor. Accordingly, it uses the same cluster-based approach to determining Jordan's competitiveness in attracting investment that investors use in making their location decisions. It is based on the premise that a comparative assessment of factor costs, investment incentives, and even policy environment is less central to the investment decision than the screening approach would indicate. It is rare that one country in a region possesses a clear and commanding advantage in all critical dimensions. As a result, comparative assessments, however rigorously quantified, usually come down to a subjective decision based on unquantifiable elements. If this were not the case, it would be hard to explain the great diversity of FDI location decisions in a single industry. For example, why would some garment manufacturers decide to set up a plant in Namibia, while others with a similar product range might instead choose Vietnam, Turkey, or Jordan? Why would a semiconductor manufacturer built a fabrication plant in Israel, a high cost and high tax environment, instead of in Bangladesh or Jordan? It is important for potential investors to know and evaluate the elements that are included in comparative assessments, but there are

few cases in which an investment decision has been made solely or even principally on the basis of such a screening process.

This study is also based on the premise that investment trends can be misleading. While it is important to consider any industry in which a country has experienced rapid growth in FDI as a potential candidate for investment promotion, past trends are no guarantee of future success. This study examines the industries in which Jordan has enjoyed substantial, recent growth in FDI; but, it does not automatically conclude that Jordan should consider these industries priority areas for future investment promotion.

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It is important to remember that RCA is not static. It is critical to examine the fundamentals of an industry with a high RCA to evaluate whether its advantage is sustainable and to assess whether Jordan possesses any competitive advantage relative to other countries exhibiting a high degree of RCA in the same product categories. It is equally important to evaluate other industries that do not exhibit any current RCA, but which could, given certain changes in international market conditions, achieve such comparative advantage. For example, until the introduction of the Qualifying Industrial Zone program in Jordan, textiles were for the most part not a source of RCA.

Comparative advantage is not the same as competitive advantage, and it is competitive advantage that counts in attracting FDI. The countries in the MENA region, except Israel and possibly the Gulf states, have similar physical factor endowments and input costs. What will determine Jordan's success in competing for FDI against other MENA countries, such as Egypt or Tunisia, is the degree to which it possesses unique, compelling advantages that will induce companies to invest there.

Such advantages are most likely to come from the existence of unique market conditions (e.g., Jordan's free trade agreement with the U.S., Egypt's huge domestic market), unique inputs (e.g., Dead Sea minerals), the existence of strong supporting and complementary industries (e.g., packaging in Jordan), or unique forms of regional integration (e.g., Jordan's economic ties to Israel through the QIZs and other relationships). It is less likely, that these unique and compelling advantages will come from differences in factor costs, as the screening approach assumes. Nevertheless, if it costs 50% more to ship a container from Jordan to Europe than from Tunisia, this could be sufficient for some countries to choose Tunisia over Jordan as an investment location.

This study does conduct the traditional analysis of investment environment, investment incentives, factor costs, and historical investment trends, as dictated by the screening approach and as specified in the Scope of Work. The compilation and analysis of such information can be helpful to the potential investor who may be contemplating competing investment sites. It is also of great use to Jordan and JIB as they seek to highlight and promote those areas in which Jordan does have clear advantages. However, because the value of this kind of analysis in predicting which kinds of industries may choose to invest in Jordan

is limited, this study goes further by incorporating the information from this traditional analysis into cluster-based analysis. This cluster-based approach identifies both areas that currently enjoy competitive advantage in Jordan, as well as those that could enjoy competitive advantage in the future, either in Jordan alone or together with one or more countries. This study also identifies the promotion strategies required to investment into those areas.

D. National Competitiveness

This assessment has ranked Jordan on 15 factors in comparison to the other four countries; 10 of them related to the macro-economic and political environment and five related to specific production-related aspects of the country, such as labor, utilities, transport and capital.

Jordan ranks well compared to its neighbors. On indicators of political and economic openness and freedom, political and economic risk, macroeconomic stability, taxation, investment incentives, trade policy and similar measures, Jordan is at or near the top in the region. The only significantly uncompetitive element is the exchange rate. The dinar is significantly overvalued, and the risk of a currency crisis is unacceptably high. As a competitive disadvantage, this has become even more acute since Egypt in February 2003 allowed its currency to float.

Jordan has comparative advantages in a number of sectors, industries and product categories. These include fertilizers, pharmaceuticals, inorganic chemicals, vegetable oil, essential oils, plastics and paper products. The difficulty for Jordan is that other MENA countries share most of the same comparative advantages, which may make it hard for Jordan to translate comparative advantage (specialization in certain industries or products) into competitive advantage in attracting FDI.

Jordan does, however, have certain unique attributes that can enable it to create and sustain a competitive advantage. Jordan is the only country in the region, apart from Israel, that has free trade agreements with both the U.S. and the E.U. Unlike Israel, Jordan also has free trade agreements with most of the Arab countries. Jordan and Israel also participate jointly in the Qualifying Industrial Zones program, which allows duty-free and quota-free access to the U.S. market for products containing at least 11.7% Israeli content and at least 35% joint Jordanian and Israeli content.[3] Unlike the U.S.-Jordan FTA, the QIZ has no duty phase-out for different product categories; the benefits are immediate. The QIZ program has generated immense benefits for Jordan, which include attracting more than JD200 million in FDI into the QIZs and vastly increasing Jordan's exports to the U.S. The FTA, implemented later than the QIZ program, has also begun to show results.

It follows from this that Jordan's competitiveness in attracting FDI can most readily be increased by focusing on this web of market-access agreements. Jordan's commercial and economic ties with Israel are a key element of this development. Though an FDI promotion strategy based on increasing economic links with Israel may be unpalatable in the current political environment, it is nevertheless true that existing business links and the potential to expand them through the QIZ program constitute one of the main potential sources of competitive advantage for Jordan in the near and intermediate term.

[3] The Israeli content level has been reduced to 8% as a temporary measure, but the minimum Israeli content is scheduled to return to 11.7% in June 2003.

E. Sector Focus Recommendations

The evaluation described in this report has taken into account recent trends in FDI into Jordan and other countries in the region. It has also examined some of the more important worldwide trends in different industries, particularly with respect to market growth, investment patterns, market saturation and over- or under-capacity. As mentioned above, this examination has taken place in the context of a cluster-based approach, which seeks to identify complementarities among industries and to recommend investor targeting approaches that can contribute to the development of overlapping industries and sectors in ways that potentially have a much greater economic impact than focusing on sectors *per se*.

The evaluation in this report considered 12 principal industries or sectors:

- Textiles
- Pharmaceuticals
- Tourism
- Medical Services
- IT software and services
- Fertilizers and chemicals
- Cosmetics
- Food
- Jewelry
- Alternative Energy
- Stone
- Packaging

The final recommended list for investor targeting comprised 10 of these, grouped into four principal cluster groups and four less significant (niche) industries.

The major clusters identified were:

- Pharmaceuticals
- Tourism
- Cosmetics
- Food

The niche industries are:

- IT software and services
- Stone
- Jewelry
- Alternative energy

Packaging was identified as a major element of the pharmaceuticals, cosmetics and food clusters. The approach recommended for attracting investment into the packaging industry consists largely of trying to attract investment by principal producers in each of these clusters, which in turn will help induce their main packaging suppliers to undertake investments in Jordan; in effect, following their major customers.

Medical services were considered as a subset of tourism, since one of the key factors in increasing the influx of foreign patients involves creating the tourism infrastructure needed to attract and support the families who usually accompany the primary patient. This tourism market, comprised almost entirely of Arab visitors, has substantially different requirements from more traditionally-focused tourists from Europe, East Asia and North America.

This report looked at cosmetics in a much broader context than the habitual focus on Dead Sea products, and suggested that JIB focus instead on the "natural" cosmetics market, which is as much as 100 times larger than the Dead Sea products market. This new approach would include Dead Sea products, of course, but would also comprise essential oils (in which Jordan has an existing comparative advantage), olive and grape-seed oils and even the cultivation of new, high-value crops such as jojoba, which is an important ingredient in many natural cosmetic products and for which Jordan's climate is well suited.

Jordan has placed tremendous emphasis on developing its IT industry, and IT has experienced the most rapid growth in FDI of any sector in the economy. This report concludes, however, that the potential for development of IT (focusing primarily on software development and services), though real, is limited to certain niches in areas such as software applications and integration in financial services, in which Jordanian companies have already developed some unique expertise. Jordan faces stiff competition from Israel, which has become one of the leading high-tech innovators in the world, backed by a huge pool of international venture capital; from Egypt, which has a much larger pool of skilled workers of a quality equivalent to Jordan's, as well as a very large domestic market and lower average wages; and Dubai, whose government has invested massively in creating an attractive environment for IT companies, and whose companies can pay higher salaries to attract the best Egyptian and Jordanian workers. The investment promotion prospects for Jordan may be significant, but JIB's role in attracting new FDI may be limited by the involvement of other institutions in Jordan, such as int@j and the Ministry of Information and Communications Technology.

Jordan has a very large revealed comparative advantage in fertilizers and inorganic chemicals, but the near-term prospects for attracting significant new investment appear limited. This is due largely to an investment boom that has brought over $200 million in total investment, about 60% of it FDI, into the sector in the past five years. This boom in investment in Jordan is mirrored by big investments in other countries, all aimed at supplying the main markets in East and South Asia, and which have added enough capacity to supply all of the increased demand expected over the next 10 years or so.

In textiles, the quota system that has governed international trade in textiles over the past 40 years is set to be abolished at the end of 2004. Though Jordan will continue to benefit from duty-free access to the U.S. market under the QIZ program, one of its main advantages – the exemption from quota limits on exports – will no longer apply. Jordan will find itself in increased competition from China, which has far lower production costs and far greater economies of scale, and from African countries which also enjoy duty-free access into the U.S. market under the Africa Growth and Opportunity Act and which have far lower labor costs than Jordan.

This is not to suggest that either chemicals or textiles are "dying" industries for Jordan. On the contrary, both industries will continue to contribute significantly to economic growth and development for many years to come. The implication is rather that changes in both of these

industries globally are likely to preclude significant flows of new investment into Jordan over the next five years. These industries should therefore not be principal areas of focus for FDI promotion efforts by JIB.

A cluster-based approach to attracting FDI is likely to differ from a sector- or industry-based approach. This report therefore recommends additional research into the main target clusters to identify and quantify specific investment opportunities, to identify specific target investors, and to prepare well-defined strategies and precise implementation plans.

For those industries not identified as primary areas of focus, it is recommended that JIB act as a resource and facilitator and should only take a leading role if no other institution is able to do so. In IT, for example, the leading role of int@j and MOICT is well-established. JIB should consult with these bodies and support their promotion efforts as required, but is likely to do so in the context of a sectoral development strategy developed by these other bodies. In smaller sectors, such as stone and jewelry, both of which have substantial potential to attract QIZ investment, JIB will need to co-ordinate with the Department of Economic Affairs in the Ministry of Industry and Trade, which administers the QIZ program, as a way to explore possible developments with their counterparts in Israel. JIB will also need to collaborate closely with JEDCO, which is responsible for export promotion, to identify specific importers of Jordanian product, to develop joint programs to exhibit at major international exhibitions for those products, and to target specific investors.

F. Benchmarking JIB

One of the objectives of this evaluation was to compare the performance of JIB with that of other investment promotion agencies (IPAs) in the region. Of the five IPAs examined, JIB ranks a close second behind Tunisia's Foreign Investment Promotion Agency (FIPA). FIPA's higher ranking owes a great deal to the better quality and depth of information it provides. Some of this information consists of FDI statistics that are more detailed and more accurate than those available in Jordan, though this is the responsibility of the Central Bank and Central Statistics Organization in any country far more than it is the province of the IPA itself. Where FIPA itself does excel, though, is in research that it conducts in-house or outsources to consultants, which provides the kind of depth and detail that prospective investors require.

For example, FIPA conducts regular surveys of production costs, including transport, property, utilities, and wages, and it also benchmarks Tunisia against other countries on elements such as labor productivity and return on investment. FIPA also provides profiles of the main sectors in which it seeks to attract investment; e.g., food processing, automotive, electrical and electronic, textiles, and several others.

FIPA's information is presented well, both in print and on a well-organized web site.

A further investment promotion advantage in Tunisia is the "one-stop shop," administered by a separate organization, the Agence pour la Promotion
d' Investissement (API), in which representatives of the different national and local authorities each have a counter at which they process all applications and permits from company registration through to industrial licensing and planning permission. The effectiveness of this system owes more to the ability under law and the willingness of these other authorities to participate in such a system. This has been a problem in Jordan largely

beyond the control of JIB, though business-process re-engineering underway in the company registration function in the Ministry of Industry and Trade should contribute to much greater efficiency in this area.

JIB is far ahead of IPAs in Egypt, Israel and Dubai, for a variety of reasons, including quality and presentation of information, accessibility and ease of navigation of web sites, physical location and presentation of offices and attitude and professionalism of staff. If JIB follows FIPA's example in upgrading the information available to prospective investors it can become a regional, and even a global example of best practices in investment promotion.

I. INTRODUCTION

A. Background

This study was undertaken on behalf of the Jordan Investment Board to assist it in developing a focused promotion strategy based on an accurate appreciation of Jordan's competitive advantages.

In 1998 under the AMIR 1 Program, The Services Group (TSG) developed the first Investor Targeting Strategy (ITS) for the Investment Promotion Corporation (IPC), now the Jordan Investment Board (JIB). The ITS recommended that Jordan focus on attracting inward direct investment in six principal sectors: downstream potash and phosphates, textiles, and apparel, Dead Sea Cosmetics, information technology, tourism and pharmaceuticals. This selection of sectors was based on an evaluation of Jordan's economic structure and existing trade and industrial profile, and involved a comparison of these elements with similar measures in other countries in the Middle East and North Africa with which Jordan might compete to attract foreign direct investment.

The ITS concluded by identifying target industries within the six sectors , identifying target markets for each industry, and setting promotional targets. The JIB subsequently implemented most of these recommendations and continues today to base many of its marketing and promotional strategies on the original ITS guidelines.

The JIB now requires a new ITS for two important reasons. First, international best practices generally call for updating investor targeting strategies every three years; thus, an update of Jordan's strategy is overdue. The four years since the previous study was completed have seen major changes in the global trading environment and in Jordan's position in that environment. Among the most important developments have been the flourishing of the U.S.-Jordan-Israel Qualifying Industrial Zones program; Jordan's accession to the World Trade Organization; and the signing and implementation of both the U.S.-Jordan Free Trade Agreement and the EU-Jordan Association Agreement. Other important developments include:

1. The end, as of January 1, 2005, of the quota system for clothing imports under the Multifibre Arrangement and its successor, the Agreement on Trade in Clothing;
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Why Target?

The World Investment Report for 2002 identifies three phases of investment promotion: first-generation promotion, which consists of opening an economy for FDI; second-generation promotion, which consists of marketing a location and setting up an investment promotion agency; and third generation promotion, which targets specific kinds of investment and even specific investors. Though third generation promotion can be a difficult and costly strategy, it has become increasingly prevalent as the number of investment promotion agencies (IPAs) increases: there are currently at least 160 national IPAs and over 250 sub-national ones.[4] In this competitive environment, targeting is a way for a country to differentiate itself from its competitors, especially in attracting export-oriented FDI. Some countries, such as Singapore and Ireland, have successfully practiced targeting for some time, but they have been joined more recently in this approach by countries such as Costa Rica, Bangladesh, Tanzania and Uganda.

Targeting investment also allows a country to focus on attracting investment that will contribute to the achievement of social and economic goals and development strategies such as technology transfer, employment, and cluster development.

Resource-rich countries have relatively little need to target investment. Investors will find out where the resources are and go there. Larger countries with big markets also have relatively little need to target, since investors will be attracted by the opportunities in the domestic market. But countries that seek to diversify from traditional economic activities and attract export-oriented investment often find that they require a targeted approach.

Investment promotion techniques have evolved considerably over the past twenty years, as capital mobility and increasing regional and global trade integration have given potential investors much more freedom in selecting investment locations and structuring projects to fit in with corporate global or regional production, sourcing and marketing strategies. Investment decisions now rarely involve looking at a single country in isolation, if they ever did. When a company considers a direct productive investment in a given country, it examines the ability of that investment to meet the requirements of regional and/or global markets and its ability to add value as part of regional and/or global supply chains.

[4] *The World Investment Report,* p. 220, United Nations, New York and Geneva, 2002

The competition among countries to attract foreign direct investment (FDI) continues to intensify. Within the structure of a global company, international investments must often compete amongst themselves for the mandate to make a new product or supply a new market. This means that it is not enough for a country to attract an initial investment, which often will be quite modest. A country must strive continuously to maintain and improve its competitiveness, which in turn will enable its companies to compete in global supply chains and markets. Statistics in this area are notoriously unreliable, but evidence suggests that in many developing countries the proportion of FDI that represents expansion of previous investments significantly outweighs the flows from first-time investors. If true, this marks a trend towards longer-term strategic investment and away from the footloose style of investment that has often characterized investment in clothing and other labor-intensive industries. It also suggests that cheap labor and generous investment incentives may no longer be as important in attracting investment into developing countries as they once were.

To succeed in this competitive environment, a country must market itself. This, in turn, means that a country must identify areas in which it has certain competitive advantages or has the potential to develop such advantages. Furthermore, it means that it must focus, at the highest levels of government and the private sector, on developing and reinforcing those advantages.

According to the 2002 *World Investment Report*, "The drivers and features of international production systems signal one point of particular interest to developing countries: Governments that seek export-oriented FDI need to go beyond trade and FDI policies and assess their locational advantages in the international production system context. More specifically: 'the issue is no longer whether trade leads to FDI or FDI to trade…rather it is: how do firms access resources – wherever they are located – in the interest of organizing production as profitably as possible for the national, regional or global markets they wish to serve? In other words, the issue becomes: where do firms locate their value-added activities?...It follows that, increasingly, what matters are the factors that make particular locations advantageous for particular activities for both domestic *and* foreign investors.'"[5]

For Jordan, attracting FDI takes place in several overlapping contexts: the Arab countries, the Eastern Mediterranean, the Middle East, and the set of countries possessing free trade agreements with the U.S. or the European Union. These contexts tend to be defined as markets, but they could just as easily be defined as production area. NAFTA, for example, effectively defines the U.S., Canada and Mexico as a single market. Within that context, however, the border area between the U.S. and Mexico has come to be defined as a single production area.

Jordan's challenge, then, is to position itself not only as an important part of one or several regional markets, but also as an important part of one or more productive areas defined by market access and productive capability. This requires that Jordan identify a specific set of productive activities in which it has or has the potential to develop a competitive advantage and that, at the promotional level, it focus its efforts on attracting investment into those activities.

This approach may seem to have some of the flavor of industrial policy that was very much in favor in the 1960s and 1970s and which persists to this day in some countries. It is, however, radically different.

[5] "International Production Systems, " *World Investment Report,* p. 125, United Nations, New York and Geneva, July 2002

Industrial policy as applied to investment promotion often means that a country will attempt to devise projects, complete with pre-feasibility studies and calculated rates of return, for which it then tries to get a strategic and financial investor. This approach may have merit in infrastructure projects, where it is the responsibility of a national or regional government to identify and try to respond to the demands for infrastructure. In these cases, the government is, to a large degree, the market. Egypt continues to follow this approach for both infrastructure and industrial development projects, as well as for tourism and agriculture. But in the area of industrial investment, and especially in export-focused investment, governments cannot possibly have the necessary understanding of markets, production processes, and supply and distribution links, all of which may vary substantially among companies in the same industry, to be able to structure such projects.

A competitiveness-based investment promotion approach seeks, instead, to identify existing or potential areas of national competitive advantage and to target investors based, in large part, on their ability to help increase the country's competitiveness in a particular sector or industry. Government needs to play a substantial role in determining the overall strategies, improving the policy and regulatory environment needed for the desired kinds of investment to occur, and determining the type and level of incentives, if any, that may be offered to investors in the desired areas of activity. Government should also focus on creating the conditions necessary for the development of industrial "clusters," comprising not only the primary focus industries themselves but also a wide array of ancillary and supporting industries and services. For example, as discussed later, developing better packaging technology, possibly with the participation of foreign investors, may be a critical element in the successful development of Jordan's cosmetics and pharmaceutical industries.

Yet, to be effective, Government should rarely, if ever, intervene at the firm level to dictate levels of production, specific product mixes and other decisions best left to managers of enterprise. Government, heeding the advice of its investment experts, may legitimately provide incentives targeted by sector, by industry, or even, for large projects, on a case-by-case basis. It is important, however, for incentives to be left as open as possible, consistent with national health, safety, environmental and social priorities. This will help create an environment in which private investors, both foreign and domestic, can identify and develop new opportunities that Government may not have considered but which contribute to national development goals.

Therefore, the objective of this study is to:

1. identify FDI trends in Jordan and neighboring countries;
2. compare the overall economic, policy, and regulatory environment in Jordan with that of other potential regional competitors;
3. compare the cost and quality of Jordan's factor endowments with those of its neighbors;
4. identify the sub-sectors and industries in which Jordan has the greatest chances to compete globally and on which it should focus its investment promotion efforts; and,
5. recommend further research that may be required to develop and implement effective targeted promotion strategies.

It is important to note that investor targeting is a dynamic process. The industries identified in Jordan's last investor targeting survey, conducted four years ago, are not necessarily those that it should promote today. In another four years, the target industries may have shifted yet

again. The hope is to create a basis for organic growth of Jordanian industry, enabling it to move into industries that add greater value and thus generate greater benefits for the Jordanian people.

It is also important to note that countries must address them in the context of comparative and competitive advantage. In comparing itself to neighboring countries, however, Jordan should not regard them solely as competitors. With overlapping membership in different regional and global trade areas, and as regional integration increases, Jordan has the potential to participate in production chains that involve neighboring countries and that also enhance Jordan's competitiveness. Examples of this can be found in moves towards financial market integration between Jordan, Bahrain and Dubai; the Jordan-Israel QIZ program; and cooperation in regional IT developments such as the tejari.com B2B and B2G e-commerce initiative launched in Dubai, in which a Jordanian company has become one of the first regional partners.

Finally, a country's factor endowment consists of a combination of elements, some of which are beyond the capacity of any human agency to change. Natural resources, location, climate, history, and regional or global politics are all entirely or almost entirely beyond the control of any national government or regional grouping. For Jordan, its arid climate, lack of water, lack of oil and location in a region of intense political and religious conflict, all constitute disadvantages that the Jordanian government can do little to overcome. It is possible, however, to focus too much on natural disadvantages to the exclusion of other, more important factors. Nigeria and Angola, each with enormous oil and other mineral resources, are destitute. Japan and South Korea, almost entirely lacking in natural resources, are rich. Jordan's fixed endowments, which include the Dead Sea, a stunning variety and richness of sites of antiquity, and a unique position between Egypt, Israel and Saudi Arabia, can become sources of competitive advantage. However, as the Korean and Japanese examples show, it is the non-fixed endowments, over which governments have substantial control, that are most significant as determinants of a country's competitiveness and, ultimately, its prosperity. In Jordan's case, these include political stability and moderation, leading to privileged access to key European and North American markets. One of the objectives of this report is to identify those factors which may be most significant in determining Jordan's competitive position vis-à-vis its neighbors, and to propose ways in which it can derive maximum economic benefit from those factors.

C. Methodology

1. Overall Approach

This study is based on a cluster approach to competitiveness. A cluster-based approach does not look at industries in isolation, but rather examines a much wider range of subsidiary, contributing, and supporting industries, in order to identify areas in which a country has or can develop an industrial cluster, comprising several related and complementary industries that can become globally or regionally competitive.

The cluster-based approach of this study differs significantly from the "screening" approach, which was employed in the 1998 Investor Targeting Strategy. The screening approach seeks to identify appropriate industries for investment promotion based on a comparative ranking of a wide range of production factors and costs, investment incentives, and policy considerations. The screening approach also examines past investment trends in an industry

globally, regionally, and nationally, which can be taken as a guide to future industry developments. This approach is favored by the analysts at international organizations, such as the U.N. Conference on Trade and Development, the World Bank Multilateral Investment Guarantee Agency, and the World Bank Foreign Investment Advisory Service.

While it is clear that an approach to FDI competitiveness should include consideration of macroeconomic and policy factors, the question of how much weight to assign to different factors is very much open to debate. The U.N. Conference on Trade and Development (UNCTAD) has suggested the critical determinants of FDI decisions, as shown in Table 1. UNCTAD does not, however, identify which of these criteria are the most important; it goes only so far as to state that different criteria will have different degrees of importance for different industries or companies.

In their 1999 article, Padma Mallampally and Karl P. Sauvant offer a number of important insights into the changing ways that investors are choosing investment locations. They emphasize the importance of the policy framework, but also assert that an investor-friendly policy climate is not, by itself, a sufficient condition for attracting investment. In their words, "changes in policies have an asymmetric effect on the location of FDI: changes in the direction of greater openness allow firms to establish themselves in a particular location, but do not guarantee that they will do so." This can be a source of great frustration for countries that have faithfully adopted the policy reform prescriptions of the World Bank and other donor agencies, yet still have relatively little in the way of FDI or overall economic growth to show for it.

Mallampally and Sauvant also suggest that the pace of reform in developing countries is such that it will become increasingly difficult for them to differentiate themselves on the basis of policy frameworks alone. Although this may be true over the long term, this study reveals substantial disparities in policy environments among the countries surveyed, as well as in a worldwide context. Although it is undoubtedly true that a policy framework alone cannot attract investors, Jordan still has an opportunity to differentiate itself from other countries on this basis and attract investors that would, for example, avoid Egypt precisely because its policy framework is so much less conducive to FDI than Jordan's.

Furthermore, Mallampally and Sauvant give substantial emphasis to business facilitation, which they take to include investment promotion, investment incentives, facilitation, after-investment (or after-care) services, efforts to simplify investment procedures, and improvements in the quality of life. As they point out, "While by no means new, these measures have proliferated and are becoming more sophisticated, targeting individual investors and investments in particular industries. After-investment services are noteworthy because they can encourage reinvestment by existing investors, who, if satisfied, provide publicity for the host country, sparking further investment." They downplay the importance of financial and fiscal incentives, noting that they are "also used to attract investors, even though they typically figure into investors' location decisions only when the economic determinants are in place."

Business facilitation is, however, similar to a policy framework in that its absence can deter investors, but its presence is by itself insufficient to attract them. This is especially true of investment incentives, in which substantial convergence has been observed, not only in the MENA region, but also worldwide. Certain locations, such as Dubai, Mauritius, and, to a significant degree, Jordan, have come to rely more on general incentives such as a low

corporate tax rate rather than on specifically targeted tax holidays or cash grants. Other countries prefer to offer more targeted incentives as a way of exerting greater control over the industries or even the specific companies they attract. In reality, a large and prominent company can probably negotiate a special deal in almost any jurisdiction given the combination of cash, employment, and prestige it can provide. The more standard incentive regimes are of greater importance to smaller enterprises. As this study reveals, there appears to be little relationship between the generosity of incentives and a country's FDI performance, suggesting that incentives play a role mainly at the margin or to provide some measure of equality between a country with low taxes and one with high basic taxes.

It stands to reason, therefore, that economic fundamentals, as outlined in Table 1, are the most important criteria in investment decisions. Mallampally and Sauvant write, "The most important determinants for the location of FDI are economic considerations, which come into full play once an enabling FDI policy framework is in place. They may be divided into three groups: those related to the availability of location-bound resources or assets; those related to the size of markets for goods and services; and those related to cost advantages in production. Although many of the factors that attract investment to particular locations—such as abundant natural resources; large host country markets; or low-cost, flexible labor—remain important, their relative importance is changing as transnational corporations, within the context of a globalizing and liberalizing world economy, increasingly pursue new strategies to enhance their competitiveness."

The authors also note the shift in motivation for FDI from the traditional, stand-alone strategies of market-seeking, resource-seeking, or efficiency-seeking, in which each investment location may be viewed largely in isolation, to strategies based far more on regional and global integration. "[Strategies] have evolved from the traditional stand-alone strategies based on largely autonomous production by foreign affiliates, to simple integration strategies based on a limited number of strong links at the production level, to complex integration strategies that involve, where profitable, splitting the production process into specific activities or functions and performing each of them in the most cost-effective location from the viewpoint of the corporate system as a whole."

As this analysis reveals, the approach now taken by potential investors in choosing a location for their investments is far more advanced than the traditional comparison of certain policy elements or factor costs. The replacement of a stand-alone approach, which considers each investment location in isolation, with one that focuses on regional and global integration is very strongly suggestive of a cluster approach, which may extend beyond the borders of a single country. With this approach, the policy environment or factor costs and endowments of a single country may be far less important than other factors related to integration of one or more countries in a region that may make two or more countries together far more competitive than any individual country on its own.

In addition to this emphasis on regional and global integration, another critical aspect of the approach now taken by potential investors in choosing a location for their investments is a search for "created assets" and clustering. Certain economic determinants are fixed. Governments have very limited scope to alter a country's geography, population, and natural resource endowments. However, it is within the power of governments and private enterprises to change many of the other determinants, creating assets that will alter a country's comparative and competitive advantages. "Transnational corporations looking to invest not only take for granted the presence of state-of-the-art FDI policy frameworks and a

range of business facilitation measures but also seek a combination of cost reduction, larger markets, and 'created' assets that can help them maintain a competitive edge. Created assets include communications infrastructure, marketing networks, technology, and innovative capacity and are critical for enabling firms to maintain their competitiveness in a rapidly changing world. The rising importance of such assets is probably the single most important shift that has occurred among the economic determinants of FDI in a liberalizing and globalizing world economy. The new configuration also pays more attention to 'agglomeration' economies arising from the clustering of economic activity, availability of infrastructure facilities, access to regional markets, and competitive pricing of relevant resources and facilities."

As discussed at greater length below, Dubai is a prime example of the way a country can create assets and substantially alter its competitive profile. Thirty years ago, oil accounted for about 80% of Dubai's economy; today, it accounts for less than 10%. At the same time, Dubai has become far richer in per capita GDP than it was when its economy was almost entirely based on oil. This phenomenon is largely due to the creation of assets that altered the entire economic makeup of the emirate. Recognizing that its oil resources would not last, Dubai's rulers in the 1970s began to plan a transformation of the economy, using their own funds as a catalyst to bring in private funds and operators. They began by building a huge container terminal and industrial free zone. From there they progressed to creating a tourism industry from scratch, building hotels on reclaimed land, creating a new airline to deliver the visitors. Along the way, they built first-class road and communications infrastructure. Dubai also undertook its own policy reforms, aimed at reducing the tax and administrative burdens for businesses and also at increasing regional integration. Dubai may have had more money from its oil revenues to fund its infrastructure development, but this funding takes a back seat to the importance of the vision that a country's comparative advantage can be changed deliberately, whether by building container ports or by improving basic and technical education.

The following quotatation from Mallampally and Sauvant underscores the importance of this concept. "Recognizing that FDI can contribute to economic development, all governments want to attract it. Indeed, the world market for such investment is highly competitive, and developing countries, in particular, seek such investment to accelerate their development efforts. With liberal policy frameworks becoming commonplace and losing some of their traditional power to attract FDI, governments are paying more attention to measures that actively facilitate it. Still, the economic determinants remain key. What is likely to be more critical in the future is the distinctive combination of locational advantages and, especially, created assets that a country or region can offer potential investors."

So, while the screening approach may be favored by analysts at international organizations, it is not the one currently favored by potential investors. This study adopts the perspective of the potential investor. Accordingly, it uses the same cluster-based approach to determining Jordan's competitiveness in attracting investment that investors use in making their location decisions. This study is based on the premise that a comparative assessment of factor costs, investment incentives, and even policy environment is less central to the investment decision than the screening approach would indicate. It is rare that one country in a region possesses a clear and commanding advantage in all critical dimensions. As a result, comparative assessments, however rigorously quantified, usually come down to a subjective decision based on unquantifiable elements. If this were not the case, it would be hard to explain the great diversity of FDI location decisions in a single industry. For example, why would some

garment manufacturers decide to set up a plant in Namibia, while others with a similar product range might instead choose Vietnam, Turkey, or Jordan? Why would a semiconductor manufacturer built a fabrication plant in Israel, a high cost and high tax environment, instead of in Bangladesh or Jordan? It is important for potential investors to know and evaluate the elements that are included in comparative assessments, but there are few cases in which an investment decision has been made solely or even principally on the basis of such a screening process.

This study is also based on the premise that investment trends can be misleading. While it is important to consider any industry in which a country has experienced rapid growth in FDI as a potential candidate for investment promotion, past trends are no guarantee of future success. This study examines the industries in which Jordan has enjoyed substantial, recent growth in FDI; but, it does not automatically conclude that Jordan should consider these industries priority areas for future investment promotion.

The cluster-based approach begins with an assessment of the products and industries in which Jordan has a revealed comparative advantage. Revealed comparative advantage (RCA) is a simple concept, which consists of comparing a country's share of world exports of a given commodity with its share of total world exports. An RCA greater than one for a certain commodity indicates that a country exports more of that commodity than a neutral weighting would suggest, indicating a higher degree of specialization in the industry that produces that commodity. Jordan, for example, has very high RCA scores in several product categories, including fresh and processed food, textiles and garments, pharmaceuticals, and fertilizers and chemicals. The challenge then is to examine these industries to determine whether the RCA reflects a genuine comparative advantage or is instead the result of market distortions or other exogenous factors. Food exports, for example, may benefit from Government subsidies on water or fertilizers, absent which Jordan's exports might decline substantially.

It is important to remember that RCA is not static. It is critical to examine the fundamentals of an industry with a high RCA to evaluate whether its advantage is sustainable and to assess whether Jordan possesses any competitive advantage relative to other countries exhibiting a high degree of RCA in the same product categories. It is equally important to evaluate other industries that do not exhibit any current RCA, but which could, given certain changes in international market conditions, achieve such comparative advantage. For example, until the introduction of the Qualifying Industrial Zone program in Jordan, textiles were for the most part not a source of RCA.

Comparative advantage is not the same as competitive advantage, and it is competitive advantage that counts in attracting FDI. The countries in the MENA region, except Israel and possibly the Gulf states, have similar physical factor endowments and input costs. What will determine Jordan's success in competing for FDI against other MENA countries, such as Egypt or Tunisia, is the degree to which it possesses unique, compelling advantages that will induce companies to invest there.

Such advantages are most likely to come from the existence of unique market conditions (e.g., Jordan's free trade agreement with the U.S., Egypt's huge domestic market), unique inputs (e.g., Dead Sea minerals), the existence of strong supporting and complementary industries (e.g., packaging in Jordan), or unique forms of regional integration (e.g., Jordan's economic ties to Israel through the QIZs and other relationships). It is less likely, that these unique and compelling advantages will come from differences in factor costs, as the

screening approach assumes. Nevertheless, if it costs 50% more to ship a container from Jordan to Europe than from Tunisia, this could be sufficient for some countries to choose Tunisia over Jordan as an investment location.

This study does conduct the traditional analysis of investment environment, investment incentives, factor costs, and historical investment trends, as dictated by the screening approach and as specified in the Scope of Work. The compilation and analysis of such information can be helpful to the potential investor who may be contemplating competing investment sites. It is also of great use to Jordan and JIB as they seek to highlight and promote those areas in which Jordan does have clear advantages. However, because the value of this kind of analysis in predicting which kinds of industries may choose to invest in Jordan is limited, this study goes further by incorporating the information from this traditional analysis into cluster-based analysis. This cluster-based approach identifies both areas that currently enjoy competitive advantage in Jordan, as well as those that could enjoy competitive advantage in the future, either in Jordan alone or together with one or more countries. This study also identifies the promotion strategies required to investment into those areas.

This study addresses all elements of the investment decision, with special attention to those areas in which Jordan can differentiate itself now and in the future. The principal aim for this study is to guide Jordan's investment promotion strategies over the next three years, a period during which Jordan can still exploit certain policy framework advantages over its neighbors. The next three years will, however, be a critical time during which Jordan will need to begin to create certain advantages that can alter its competitive position. The country has already begun to do so, most notably in creating the Aqaba Special Economic Zone, which is distinctive not only for its special tax and Customs regimes, but even more importantly for the infrastructure development that promises to improve Jordan's competitive position in a variety of sectors, including tourism, transport, trade, and manufacturing. An additional aim of this study, therefore, will be to identify areas in which Jordan has the potential to create additional assets to shift its comparative advantages and to develop a unique competitive position with respect to its neighbors.

Table 1: Host Country Determinants of FDI
Policy framework for FDI
▪ Economic, political, and social stability ▪ Rules regarding entry and operations ▪ Standards of treatment of foreign affiliates ▪ Policies on functioning and structure of markets (especially competition and policies governing mergers and acquisitions) ▪ International agreements on FDI ▪ Privatization policy ▪ Trade policy (tariffs and nontariff barriers) and coherence of FDI and trade policies ▪ Tax policy
Business facilitation
▪ Investment promotion (including image-building and investment-generating activities and investment- ▪ facilitation services) ▪ Investment incentives

▪ Hassle costs (related to corruption and administrative efficiency) ▪ Social amenities (for example, bilingual schools, quality of life) ▪ After-investment services
Economic determinants (see table on the below)

Type of FDI classified by firm motives of firms	**Principal economic determinants in host countries**
Market-seeking	Market size and per capita income ▪ Market growth ▪ Access to regional and global markets ▪ Country-specific consumer preferences ▪ Structure of markets
Resource/asset-seeking	Raw materials ▪ Low-cost unskilled labor ▪ Skilled labor ▪ Technological, innovative, and other created assets (for example, brand names), including as embodied in individuals, firms, and clusters ▪ Physical infrastructure (ports, roads, power, telecommunications)
Efficiency-seeking	▪ Cost of resources and assets listed above, adjusted for labor productivity ▪ Other input costs, such as transport and communication costs to/from and within host economy and other intermediate products ▪ Membership of a regional integration agreement conducive to the establishment of regional corporate networks

Source: UNCTAD, World Investment Report 1998: Trends and Determinants, Table IV.1, p. 91.

2. Choice of Countries

This ITS has focused on Egypt, Israel, Tunisia and UAE as the principal points of comparison and potential competition for Jordan. The UAE as a whole was not considered, except to the extent that most statistics treat the UAE as a whole. Instead, the principal point of comparison was Dubai. Time and budget constraints did not permit the ITS team to visit Lebanon and Morocco, though both countries can be considered potential competitors to Jordan in attracting FDI. We have nevertheless included those two countries in many of the numerical rankings and have included them in other measures to the extent that adequate data are available.

This selection is based on a number of factors. First, except for Dubai, all of the countries in the comparison, including Jordan, have preferential market access agreements with the U.S. and/or the European Union. These agreements constitute an important source of competitive advantage.

Second, each of the countries seeks to compete for FDI in many of the same sectors. For each of the countries, tourism is an important source of foreign exchange revenues, while each of the countries explicitly targets export-oriented manufacturing as a source of future growth. Dubai, unlike some of its neighboring emirates and other states in the region, relies very little

on oil relative to other sectors, while Egypt, in spite of its growing oil and gas sector, will never meet the requirements of its population by concentrating on oil to the detriment of other sectors. Most of the other Gulf countries, as well as Algeria and Libya, whose economies depend almost exclusively on oil and gas, operate in a very different environment and with substantially different priorities.

Israel, in many ways an outlier – a "developed" country by most measures, non-Arab and at political odds with the rest of the region – is included largely because of the actual and potential future importance of economic ties with Jordan. Jordan's mini-boom in inward FDI and export growth owes a great deal to the Qualifying Industrial Zone program involving shared Jordanian-Israeli content and free U.S. market access. In spite of the current political upheaval, this kind of cooperation must be considered one critical source of competitive advantage for Jordan.

Third, each country has undertaken substantial economic reforms. In each case, though progress is often uneven, trade barriers are being lowered or eliminated, state enterprises are being restructured and privatized, and governments recognize the need to achieve greater economic openness and create a more business-friendly environment.

3. Data Sources and Interpretation

The present study relies on a wide range of international and domestic published and unpublished sources of quantitative data, as well on a more qualitative assessment of other important factors in investment decisions. These sources provide information on FDI statistics and trends, as well as on the quality and cost of factors of production. In addition to quantitative data, we have relied on subjective data and analysis, some of it from published sources such as the Economist Intelligence Unit and the Heritage Foundation, and much of it from a series of private interviews with government officials, diplomatic representatives and private business people in the countries examined.

By tracking the trends in FDI in both Jordan and neighboring countries, it is possible to identify investment trends in the Middle East as whole, as well as identifying areas in which FDI into Jordan may differ from or complement investment in other countries in the region. The trends focus not only on gross investment figures, but also on the breakdown of FDI by industry. Changes in the industry or sector mix of FDI can reveal important trends in the way investors perceive the competitiveness of one country or another in given areas of activity. It is critical to note, however, that the utility of these data may be limited in significant ways.

First, of course, data in many countries are out of date, incomplete, unreliable, contradictory or simply unavailable. The available data may, at best, allow one to identify general trends without providing sufficient detail to permit more detailed conclusions.

Second, major global economic and political developments have caused FDI flows, especially to developing countries, to decline precipitously in 2001 and 2002. This global tendency has been aggravated even further in the Middle East, due to the *intifada* and growing tension over Iraq.

Third, FDI flows, especially in smaller economies, can be skewed by one or two huge transactions in a given year, which may dwarf all other transactions combined. This is especially true in countries undertaking large privatization programs. In Egypt, for example,

inward FDI nearly tripled from 1998 to 1999, going from $1.1 billion to $2.9 billion, before falling to $1.2 billion in 2000 and $510 million in 2001. But in 1999, over $1 billion was raised from foreign strategic investors through the privatization process,[6] including $800 million from the sale to foreign investors of three cement plants.[7]

Additionally, 2002 FDI figures are likely to be skewed by the sale of over 98% of the country's largest brewery, privatized in 1997 through sale to Heineken in a deal worth about $287 million.[8]

Finally, FDI figures include many transactions often thought of as portfolio investments. Under the definition established by the UN Conference on Trade and Development (UNCTAD), FDI includes any investment in which the investor acquires a significant degree of control over an enterprise in a foreign country, including via purchase of listed shares. According to UNCTAD, "An equity capital stake of 10 per cent or more of the ordinary shares or voting power…is normally considered the threshold for control of assets."[9] For a country with a large and active stock market, especially Israel, transactions of this kind can dwarf the more traditional kind of FDI. For Israel, whose high-tech companies have raised substantial amounts of capital by listing on the U.S. NASDAQ, the picture is further complicated. Also, in liquid capital markets foreign investors can sell or reduce their stake easily. Thus, though Israel recorded FDI inflows of $3 billion in 2001, its stock of inward FDI increased by only $1.7 billion. If FDI stocks were marked to market, which they are not, the fall in equity values of both Israeli and foreign companies would almost certainly have been reflected in a substantial decline in the value of the country's stock of inward FDI.

Data on factor cost, quality and availability have been compiled from a wide range of official, private, published and unpublished sources, which are cited throughout the report. It is important to remember that factor costs can change rapidly (e.g., the price of fuel), though the relative costs from one country to another are likely to remain more stable. Assessments of the quality of workers, technicians and managers cannot rely solely on statistics on enrollment or number of students or teachers. Invariably, the subjective assessments by people who actually employ the workers count most.

In general, the approach to data gathering and interpretation has been to identify trends and relationships rather than to invest any set of statistics with too much meaning. If a given source indicates a certain dollar amount of FDI in a given industry in a given country, we should not base too many conclusions on the accuracy of that number. But, if a source indicates a shift over the past 10 years from FDI focused on mining and agriculture to a pattern more focused on tourism and manufacturing, that is a useful indicator, which will form part of our assessment.

[6] "Privatization: Background and Achievements," The International Investment Advisor Ltd., Cairo, 2002, http://www.tiiaegypt.com
[7] "1998-1999 Privatization Transaction Data," 2000 The World Bank, http://www.ipanet.net/documents/WorldBank/databases/plink/soceco/3egypt.htm
[8] "ABC Goes Dutch," *Al-Ahram Weekly On-Line*, October 3-9, 2002, Cairo.
[9] *World Investment Report 2002*, p. 291

II. SOURCES OF COMPETITIVE ADVANTAGE

This section deals with the business environment, policies and factor endowments that constitute the principle elements of a country's competitiveness.

It is important to note that these endowments are not fixed for all time and that a country's comparative advantages and competitive advantages can change, sometimes very rapidly. Countries can change their policies, build infrastructure and educate their populations in ways that alter comparative advantage. In 1840, John Bowring, a British economist, advised several German states that their comparative advantage dictated that they should grow wheat and sell it to buy British manufactures.[10] The Germans, needless to say, ignored the advice.

It is important to highlight one shortcoming of this methodology. For reasons outlined above, this ITS has focused only on countries in the Middle East North Africa (MENA) region. Yet Jordan and its neighbors must compete for FDI not only with one another, but with countries throughout the world. As the remainder of this section will show, Jordan compares favorably on many of the most important dimensions of competitiveness with most of the other countries in the MENA region, but the MENA region itself fares poorly in comparison to most other regions of the world. Obviously, there exist great variations within regions; however, on most important dimensions of development, the MENA region and sub-Saharan Africa stand out as the laggards.

A. Macro Environment

1. Country Risk

Country risk is defined by a University of British Columbia study as "the likelihood that changes in the business environment will occur that reduce a company's wealth. These changes can adversely affect operating profits as well as the value of assets."[11]

Country risk is also defined in a report published by the National Association for Business Economics as "risks arising from a variety of national differences in economic structures, policies, socio-political institutions, geography, and currencies."[12] The NABE report goes on to describe the art of country risk analysis as the "attempt to identify the potential for these risks to decrease the expected return of a cross-border investment,"[13] and identifies six major dimensions on which country risk is usually evaluated. These are:

1. **Economic Risk:** a significant change in the economic structure or growth rate that produces a major change in the expected return of an investment. Risk arises from the potential for detrimental changes in fundamental economic policy goals (e.g., fiscal, monetary, international, or wealth distribution or creation) or a significant change in a country's comparative advantage. Assessments of economic risk tend to focus on fiscal and monetary policies.
2. **Transfer Risk:** the risk arising from a decision by a foreign government to restrict capital movements. Restrictions could make it difficult to repatriate profits, dividends,

[10] Landes, David, *The Wealth and Poverty of Nations*, New York, 1998, p. 521
[11] "Political Analysis and Strategy," unattributed, University of British Columbia, Centre for International Business Studies, 2002, http://pacific.commerce.ubc.ca/john/crisk.htm
[12] Meldrum, Duncan, "Country Risk and Foreign Direct Investment," National Association for Business Economics, 1999, www.nabe.com/am99/meldrum.pdf
[13] *Ibid.*

or capital. It usually is analyzed as a function of a country's ability to earn foreign currency, with the implication that difficulty earning foreign currency increases the probability that some form of capital controls can emerge.

3. **Exchange Risk:** an unexpected adverse movement in the exchange rate. Exchange risk includes an unexpected change in currency regime such as a change from a fixed to a floating exchange rate.
4. **Location or Neighborhood Risk:** spillover effects caused by problems in a region, in a country's trading partner, or in countries with similar perceived characteristics. Location risk can be defined by simple geographic position, though trading partners, international trading alliances (e.g., Mercosur, NAFTA, EU), size, borders, and distance from economically or politically important countries or regions are also considered.
5. **Sovereign Risk:** a government becomes unwilling or unable to meet its loan obligations, or reneges on loans it guarantees. This may also be related to transfer risk (i.e., the risk that a government may run out of foreign exchange with which to pay its debts). Sovereign risk is measured in a similar way to transfer risk and also takes into account a country's past performance in repaying debts.
6. **Political Risk:** risk of a change in political institutions stemming from a change in government control, social fabric, or other non-economic factors. This category covers the potential for internal and external conflicts, expropriation risk and traditional political analysis. Political risk analysis takes into account a multitude of historical, cultural and political factors and tends to be the most subjective of the six gauges of country risk.

Several services compile annual country risk ratings. These include The Economist Intelligence Unit (EIU), *Euromoney*, *Institutional Investor*, and Dun and Bradstreet, as well as the credit rating agencies Standard & Poor's and Moody's.

Several of these services, such as *Euromoney* and *Institutional Investor*, pay particular attention to the risk of portfolio investment in equity or debt markets, while S&P and Moody's, in their country credit ratings, focus on sovereign risk, or the ability of governments to repay their debts (e.g., the quality of bonds issued by a country). The EIU rankings focus entirely on emerging markets and include a wide range of measures that can be used to evaluate risks for direct or portfolio investments and even for trade transactions. The EIU rankings are also the most comprehensive, comprising 66 separate measures of which 29 are quantitative and 37 subjective.

The EIU rankings include both alphabetical (A to E) and numerical (0-100) rankings, with A and 0, respectively, being the highest scores. The overall scores include political risk, economic policy, economic structure and liquidity risk. In the overall rankings, the UAE is by far the highest-ranked (least risky) country and Lebanon the lowest (riskiest) of the countries surveyed. Egypt, Jordan, Israel, Morocco and Tunisia each received a similar aggregate score, in the middle of the continuum of risk and close to the regional average, though Egypt, with a score of 50, is considerably riskier than Jordan, Israel, Morocco and Tunisia, each with a score of 43 or 44.

Table 2:
Economist Intelligence Unit Middle East/North Africa Country Risk Ratings, May 2002[14]

	Total (A-E)	Total (0-100)	Political risk	Economic policy	Economic structure	Liquidity risk
Algeria	C	48	E	C	C	A
Bahrain	B	36	C	B	B	B
Egypt	C	50	C	D	C	B
Iran	C	51	D	D	C	B
Iraq	E	97	E	E	E	E
Israel	C	43	C	B	C	B
Jordan	C	44	C	C	C	B
Kuwait	B	35	C	B	B	A
Lebanon	D	65	D	D	D	D
Libya	C	52	D	D	C	A
Morocco	C	44	C	C	C	B
Oman	B	32	B	B	B	B
Qatar	B	34	B	B	B	C
S.Arabia	C	41	C	B	B	C
Sudan	D	78	E	D	D	E
Syria	D	61	D	C	D	D
Tunisia	C	43	C	B	C	C
UAE	B	28	C	A	B	A
Yemen	C	49	E	B	C	B
Average	C	49	D	C	C	B

Political risk, in the EIU rankings, accounts for 22% of the overall score and includes two major dimensions: **political stability** and **political effectiveness**, classified as follows.

Table 3: EIU Political Risk Criteria			
Political stability		**Political effectiveness**	
1.	War	6.	Change in government/pro-business orientation
2.	Social unrest	7.	Institutional effectiveness
3.	Orderly political transfers	8.	Bureaucracy
4.	Politically motivated violence	9.	Transparency/fairness
5.	International disputes	10.	Corruption
		11.	Crime

The EIU gives a 28% weighting to **economic policy risks**, which it groups into five major categories as follows.

Table 4: EIU Economic Policy Risk Criteria	
Monetary policy	
1.	Inflation rate
2.	Inflation rate, direction

[14] "Risk Ratings Review," Country Risk Service, The Economist Intelligence Unit, 24 June 2002

3.	Policies favorable to savers
4.	Ability to boost interest rates
5.	Monetary stability
6.	Use of indirect instruments of monetary policy
7.	Real lending rates
8.	Boom/bust scenario
9.	Financial liberalization
Fiscal policy	
10.	Public-sector budget balance/GDP
11.	Cumulative years of a public-sector budget balance
12.	Government's ability to generate capital
13.	Public debt/GDP
14.	Public debt/GDP, direction

Exchange-rate policy	
15.	Real appreciation
16.	Real appreciation, evaluation
17.	Exchange-rate regime
18.	Change in prospects
19.	Expectations of a regime change
20.	Interest differentials
21.	Black market/dual exchange rate
Trade policy	
22.	Trade liberalisation
23.	Exports/GDP
Regulatory policy	
24.	Official data (quality/timeliness)
25.	Policy towards foreign capital
26.	Popular attitudes towards foreign tax revenue
27.	Restrictions on transfers

Economic structure risk focuses on risks to a country's overall solvency, particularly with respect to growth, investment and reliance on foreign savings (hence the U.S., which relies heavily on foreign savings to cover its trade deficit, would be considered relatively risky on this dimension). This category is grouped into five sub-categories and accounts for 28% of the total country risk rating.

Table 5: EIU Economic Structure Risk Criteria	
Global environment	
1.	Global short-term interest rates
2.	Global real GDP growth
3.	International financial support
4.	"Contagion" effect
Growth	
5.	National savings/GDP
6.	Fixed investment/GDP
7.	Pension system
8.	Investment efficiency
9.	Real GDP growth, average

10.	Real GDP growth, latest
11.	Real GDP growth, volatility
Current account	
12.	Cumulative years of a current- account deficit
13.	Current account, direction
14.	Current account, magnitude
15.	Current-account deficit, investment/consumption driven
16.	Reliance on a single raw material export
17.	Reliance on a single export category
18.	Export receipts, annual rate of growth
Debt	
19.	Default history
20.	Total external debt/exports debt
21.	Debt-service ratio
22.	Interest due/exports
Financial structure	
23.	Asset price
24.	Performance of bank stocks
25.	Incidence of bank failures
26.	Banking sector ratings
27.	Reliance on external debt
28.	Corruption in the banking sector
29.	Government involvement in the banking sector

Liquidity risk is a measure of a country's ability to meet its international financial obligations. Liquidity risk declines as a country's foreign reserves increase and also as a function of the proportion of foreign direct investment to overall foreign investment. (Portfolio investment is potentially much more volatile than direct investment, and a rapid flight of foreign capital can cause a rapid increase in a country's liquidity risk.) Liquidity risk accounts for 23% of the overall country risk score and includes the following measures.

Table 6: EIU Liquidity Risk Criteria	
1.	External short-term debt/exports
2.	Percentage decline in official reserves, actual
3.	Percentage decline in official reserves, forecast
4.	Net direct investment/financing requirement
5.	Import cover
6.	"Means"/"spending" ratio
7.	Net portfolio inflows/financing requirement
8.	US$M2/reserves
9.	Access to the capital markets
10.	Domestic debt maturity structure

Though the overall score for the Middle East-North Africa region improved very slightly, from 50 to 49, the EIU analysis highlighted several elements that could contribute to increased political risk for the region as a whole and for several countries in particular. The countries most at risk politically were identified as Jordan, Egypt, Israel and Lebanon, with increased risk associated with the Israel-Palestine conflict and with the possibility of a U.S. war with Iraq.

The EIU also identified significant economic risk for Jordan and several of its neighbors. For Jordan it stated, "high levels of poverty and unemployment are putting pressures on the government to increase spending. However, fiscal deficits of more than 7% in 2001 and 2002 cannot be sustained. Although concessionary loans have been forthcoming, FDI inflows are low and tourism earnings will take a long time to recover from the current situation. An attack on Iraq would be likely to drag economic performance into negative territory. Jordan will therefore face a testing time over the next six months." [15]

Political and economic events caused the EIU to predict a worsening in Israel's risk rating. The continuing Palestinian crisis and the possible effects of a war involving Iraq contributed to a rise in Israel's political risk, but have also contributed to heightened economic risk. Increased military and security spending and losses to businesses from an increase in military use of reserve forces, together with a near-complete rupture of economic ties between Israel and the Palestinian territories, have led to a severe economic contraction. This is compounded by moves by the Bank of Israel to raise interest rates to strengthen the currency and avoid inflation. Higher interest rates have dampened economic growth, resulting in an expectation of a 1.5% contraction in the economy for 2002. Perceived political and economic risk has increased the cost of Israel's foreign borrowing; in February 2002 the Israeli Government issued a €375 million Eurobond issue, which it was forced to price at 120 basis points above the benchmark German Bund rate – about double the spread before the outbreak of the second *intifada*.[16] Israel needs to increase its foreign borrowing, but may not be able to rely on international financial markets to do so, depending instead on State of Israel bonds and U.S. financial support.

The macroeconomic situation is aggravated by the crash in U.S. equities markets, which have been an important source of capital for Israeli firms, especially in high-tech industries. The official Israeli government position is that the current downturn in the economy is almost entirely attributable to the worldwide decline in IT and telecommunications spending and share values; however, this view is disputed by non-official sources.[17]

Egypt too suffers from a combination of heightened political risk and economic factors. Popular support by most Egyptians for the Palestinian cause has led to deep anger towards the U.S., as Israel's most important backer, and towards the Egyptian Government because of its close ties with the U.S. Egypt's structural economic problems include an overvalued exchange rate (until the recent devaluation), high fiscal deficits, and lack of progress on privatization. The persistent violence between Israel and the Palestinians and the buildup to war involving Iraq have caused tourism revenues, one of Egypt's biggest sources of foreign exchange, to decline, with no immediate prospect of recovery. Talks with the IMF on releasing funds to relieve balance-of-payments difficulties apparently reached an impasse over Egypt's initial refusal to devalue the pound. Until the recent devaluation, overvaluation of the pound negatively affected domestic companies and foreign companies operating in Egypt. Not only did it render Egypt's exports less competitive, thus increasing to current account deficits, but it also made it hard for companies to obtain essential foreign exchange to buy imported inputs. This largely explains why Egypt ranks so poorly in measures of currency risk, as detailed below.

In addition to its overall country risk rankings, the EIU also compiles a **currency risk** ranking, which assesses the likelihood of a country's currency devaluing by more than 20% against the U.S. dollar over the forecast period. These rankings are based on the same

[15] *Ibid.*
[16] *Ibid.*
[17] Personal interviews with Israeli government and private sector sources, December 1-6, 2002.

indicators as the country risk assessments, but assign different weightings to certain factors. Thus, exchange rate policy accounts for 45%, and overall economic policy risk (including exchange rate policy) accounts for 65% of the ranking. Political risk accounts for only 15%.
The currency risk rating is especially important in assessing the risk for foreign direct investment. A depreciation of a country's currency can, of course, make that country's exports more competitive and would thus lead one to conclude that the environment has improved for export-oriented FDI. But a high risk of depreciation also increases the risk that the value of an investor's assets will decline, thus decreasing the country's FDI competitiveness. All evidence suggests that investors prefer exchange rate stability and realistic exchange rates. The currency risk rating serves as a measure of appropriateness of the current value of a currency and thus, by proxy, of the reasonableness of a country's exchange rate policies.

The EIU currency risk ratings, like the overall country risk ratings, show UAE as by far the least risky and Lebanon as the most risky. In contrast to the country risk ratings, Jordan, Israel, and Tunisia receive a much less risky rating, while Egypt is rated considerably riskier. This is borne out by in-country research, in which the real value of the Egyptian pound was reported by economists and business people at around US$1 = LE5.3, or about 14% lower than its official value of US$1 = LE4.65. Similarly, the Central Bank of Tunisia manages the Tunisian Dinar so that its real value declines slightly (less than 2%) each year, relative to basket of currencies that serves as the "anchor".

Table 7: Economist Intelligence Unit Currency Risk Ratings, May 2002

	Total risk	Political policy	Economic structure	Economic risk	Liquidity
Algeria	B [28]	E	B	A	A
Bahrain	B [25]	C	B	B	B
Egypt	C [60]	C	D	C	C
Iran	C [47]	D	C	B	B
Iraq	E [98]	E	E	E	E
Israel	B [36]	E	B	B	B
Jordan	B [33]	C	B	B	B
Kuwait	A [18]	C	A	A	A
Lebanon	D [64]	D	D	C	C
Libya	C [56]	C	D	C	A
Morocco	C [42]	C	B	C	C
Oman	B [25]	B	B	B	B
Qatar	B [25]	B	A	C	C
Saudi Arabia	B [22]	C	A	A	B
Sudan	C [60]	E	D	C	D
Syria	C [46]	C	C	C	D
Tunisia	B [26]	C	A	C	C
UAE	A [15]	C	A	A	B
Yemen	B [23]	E	A	B	A
Average	B [39]	C	B	B	B

It is important to note that the EIU uses a forecasting period of six months. Though a country's overall risk rating is unlikely to change substantially in six months, barring some major political or economic change, currency risk may be far more sensitive to smaller changes. Consequently, developments during the past seven months may have materially affected the currency risk rankings, especially for Jordan, as discussed in Section III A 8, below. Also, the dollar has experienced a significant decline against major currencies since May 2002, when the EIU rankings were established. This has had no effect on the value of the Jordanian Dinar, the UAE Dirham, the Tunisian Dinar and the Egyptian Pound, all of which are pegged partially or exclusively to the US Dollar, nor has it had a significant effect on the Israeli Shekel, for which the Bank of Israel pursues an exchange rate policy mainly with reference to the U.S. dollar.

Another widely used ranking of country risk is that compiled by COFACE, a credit insurance and trade risk management services company, which ranks countries from A1 (the highest level of investment grade) to D (highly speculative), in an effort to assess the level of risk of default on corporate payments. The indicators used by COFACE include many of the macroeconomic and political risk criteria used by the EIU, such as political stability, currency risk and banking system stability, but they also include the experience of COFACE and its partners with respect to previous claims against credit insurance underwriters.

Table 8: COFACE Country Risk Ratings, 2002[18]

Egypt	B
Israel	A4
Jordan	B
Lebanon	C
Morocco	A4
Tunisia	A4
UAE	A2

Table 9: COFACE Credit risk categories[19]

A1	The steady political and economic environment has positive effects on an already good payment record of companies. Very weak default probability.
A2	Default probability is still weak even in the case when one country's political and economic environment or the payment record of companies is not as good as in A1-rated countries.
A3	Adverse political or economic circumstances may lead to a worsening payment record that is already lower than the previous categories, although the probability of a payment default is still low.
A4	An already patchy payment record could be further worsened by a deteriorating political and economic environment. Nevertheless, the probability of a default is still acceptable.
B	An unsteady political and economic environment is likely to affect further an already poor payment record.
C	A very unsteady political and economic environment could deteriorate an

[18] http://www.coface-usa.com/products_services/country_risk_ratings.html
[19] *Ibid.*

	already bad payment record.
D	The high risk profile of a country's economic and political environment will further worsen a generally very bad payment record.

The COFACE ratings show the UAE ranked A2, the second-highest investment grade (the U.S. is also ranked A2). Israel, Tunisia and Morocco each rank A4, the lowest level of investment grade, while Jordan and Egypt are considered speculative and Lebanon "highly speculative" Tunisia, however, is given a "negative watch-list" rating, meaning that it risks falling a notch to Grade B, owing to a significant drop in foreign investment and tourism during 2002.

2. Economic Openness

This section examines a wide array of economic and political factors related to the issue of economic openness that can affect the attractiveness of a country to foreign investors. These factors include:

- Political stability
- Economic growth
- Monetary stability
- Government interference in economy
- Corruption
- Taxation
- Regulatory burden on enterprises
- Labor market flexibility
- Openness of banking sector and capital markets
- Restrictions on economic activity by foreigners

Political and economic openness is difficult to measure, even more difficult to define, and hard to distinguish from country risk. The elements of economic openness listed above overlap considerably with the indicators used by the EIU to measure country risk. In general, though, country risk measures give considerable importance to elements beyond the control of national governments, such as regional political or economic stability. Jordan, affected by the political and security situation in Israel and Iraq, might be considered fairly risky even if it scores relatively highly on most internal policy dimensions. Similarly, Brazil has suffered from Argentina's economic meltdown and would probably count as riskier now than it did before the Argentine crisis. It is important to note, however, that the general public may lump many countries together, but investors can examine the macroeconomic fundamentals to distinguish between Brazil and Argentina, just as investors can distinguish in political, security and macroeconomic terms between Jordan and its neighbors.

In contrast to generalized country risk, openness indicators tend to measure the effects of a country's internal policies (i.e., elements over which it has substantial control). Two of the more prominent rankings of economic openness are those compiled by the Heritage Foundation, in collaboration with *The Wall Street Journal*, and the annual rankings published by the Fraser Institute, a Canadian think tank.

Indices of economic freedom or openness are by nature flawed, since they tend to rely to a great degree on official reports and documents. At an EU-sponsored Southern African investment conference that took place in Harare, Zimbabwe in1988, a member of the official Angolan delegation expressed surprise at Angola's almost total lack of non-oil FDI. "We

have the most liberal investment code in Southern Africa," he said.[20] And he was right; on paper, the Angolan investment law was as liberal as anything in the world. Similarly, the Soviet Constitution written by Josef Stalin enshrined human rights and freedom at the heart of the Soviet system. The difficulty in both instances came when individuals or companies tried to exercise those guaranteed rights.

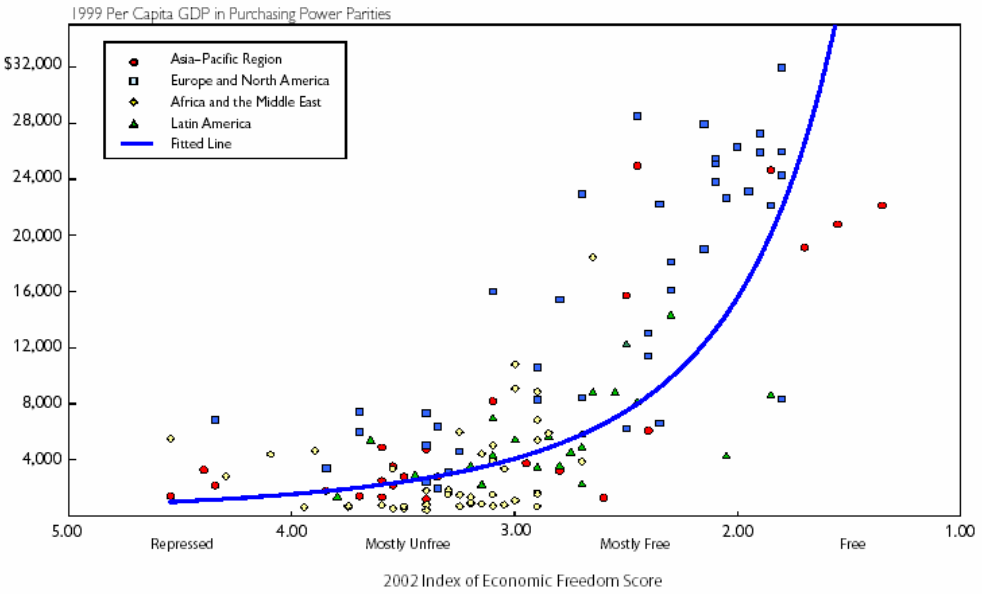
More recently, and closer to home, Syria in 1991 promulgated a new law to attract investment by Syrians and foreigners. Under this law, which covered investments of over 10 million LS ($240,000), investors could propose projects in any economic sector. Approved projects are eligible for a seven years' tax holiday, largely exempt from customs duties and import restrictions, and granted generous profit and foreign exchange repatriation. The government hoped that such a law would attract significant and badly needed investment. It has not happened. As of 1997, exactly one foreign firm (Nestle) had invested in the manufacturing sector, while private Syrians, meanwhile, are estimated to hold more than $25 billion overseas.[21] Among the explanations for this gap between intention and results is that, although it undertook certain limited reforms in trade and macroeconomic policies, the Syrian government maintained completed control over the economy, which was generally perceived as being managed for the exclusive benefit of established government and military elites.

As flawed as they may be, measurements of economic openness and freedom tell us something important about a government's real attitude towards private enterprise that may not adequately be captured in a reading of investment codes, tax laws and tariff classifications. They therefore tell us something important about a country's attractiveness as a destination for FDI.

The Heritage Foundation, in its annual *Index of Economic Freedom*, links economic prosperity to two critical factors: strong property rights and a lack of government intrusiveness. In their Introduction, Editors William W. Beach and Gerald P. O'Driscoll, Jr. "focus on two important and related issues: the role of constitutions and the pivotal role played by a strong system of property rights. The connection is that properly constructed constitutions incorporate the concept of negative liberty, constraining governments to the protection of person and property. A system of private property fosters economic growth and wealth creation."[22] The 2002 Index identifies property rights as one of the single most important determinants of economic freedom and draws a very strong correlation between economic freedom and income levels, as shown in Figure 1, and also between protection of property rights and income, as shown in Figure 2.[23]

[20] Plenary session, EU Centre for Development of Industry Conference on Foreign Investment in Southern Africa, Harare, 1988.
[21] Richards, Allen, "The Political Economy of Economic Reform in the Middle East:
The Challenge to Governance," RAND Corporation/University of California at Santa Cruz, October 2001
[22] Beach, William W. and O'Driscoll, Gerald P., Jr., "The Role of Property Rights in Economic Growth: An Introduction to the *2002 Index*," p. 27, Heritage Foundation,/Wall Street Journal, Washington, D.C., 2002
[23] Hoskins, Lee and Eiras, Ana I., "Property Rights: The Key to Economic Growth," *The 2002 Index of Economic Freedom*, Chapter 3, pp 37-40, Heritage Foundation/Wall Street Journal, Washington D.C., 2002

Figure 1: Economic Freedom and Income

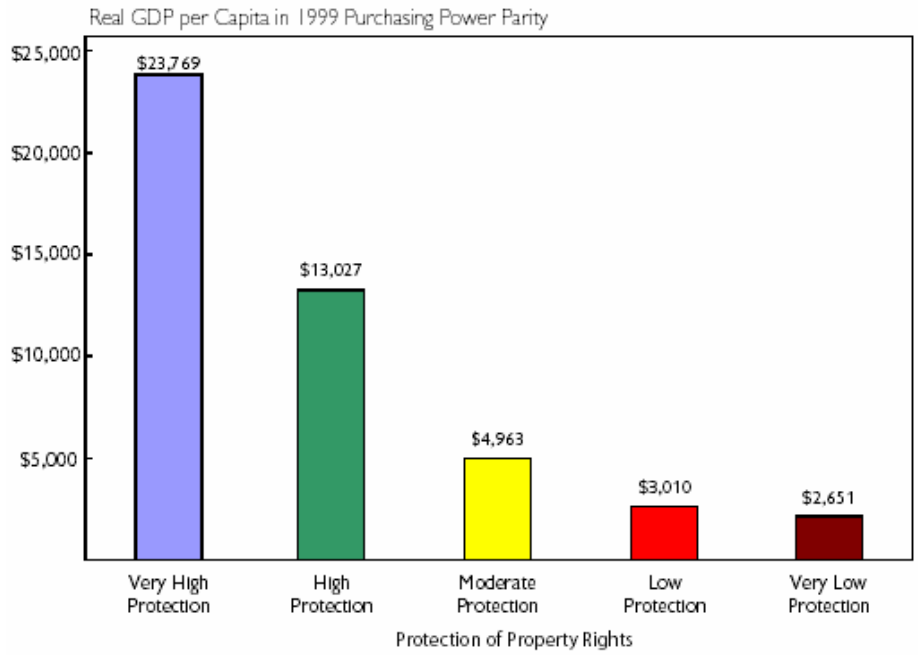


Note: Per capita GDP figures were not available for the following countries: Armenia, The Bahamas, Bahrain, Bosnia, Democratic Republic of Congo, Cuba, Djibouti, Iraq, North Korea, Kuwait, Lebanon, Libya, Malta, Oman, Qatar, Suriname, Taiwan, Tajikistan, United Arab Emirates, Yugoslavia. Per capita GDP figures are in current international dollars and are from 1999.
Source: The World Bank, *2001 World Development Indicators on CD-ROM.*

The Heritage Foundation defines economic freedom as "the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself."[24] This definition may be taken as advocating a laisser-faire approach to government control of the economy, but may be taken, equally, as a non-prescriptive gauge of the weight of government intervention in the economy. As the authors point out, "All government action involves coercion. Some minimal coercion is necessary in order for the citizens of a community or nation to defend themselves, promote the evolution of civil society and enjoy the fruits of their labor… Throughout history, governments have exercised their authority to place a wide array of constraints on economic activity. Many such constraints can be measured by assessing their impact on economic choices. Constraining economic choice interferes with the production, distribution or consumption of goods and services…economic growth suffers to the extent that governments practice coercion in the market place." [25]

[24] Beach, W.W. and O'Driscoll, G.P., Jr., "Explaining the Factors of the Index of Economic Freedom," *op.cit,* Chapter 5, pp. 59-77.
[25] Ibid., p. 60

Figure 2: Protection of Property Rights and Per Capita Income



Source: The World Bank, *2001 World Development Indicators on CD-ROM*. Property rights score extracted from the *2001 Index of Economic Freedom*, The Heritage Foundation and The Wall Street Journal.

As a guide to government policy-making, the Heritage Foundation index is at best imperfect, though it does serve to make explicit some of the policy choices that governments make. As a guide to the decision-making process engaged in by multinational corporations as they consider investment locations, the index has considerable predictive value, and is thus a useful tool in this ITS evaluation. The Heritage Foundation examines fifty variables in its index of economic freedom, grouped into ten categories, including the following.

1. **Corruption** in the judiciary, customs service, and government bureaucracy
2. **Property rights**
3. **Monetary policy**
4. **Trade policy,** including tariff protection and non-tariff barriers to trade**,** such as import bans and quotas as well as strict labeling and licensing requirements
5. **The fiscal burden of government,** which encompasses income tax rates, corporate tax rates, and government expenditures as a percent of output
6. **The rule of law,** including efficiency within the judiciary and the ability to enforce contracts
7. **Regulatory burdens** on business, including health, safety, and environmental regulation
8. **Restrictions on banks** regarding financial services, such as selling securities and insurance
9. **Labor market regulations,** such as established work weeks and mandatory separation pay
10. **Black market activities,** including smuggling, piracy of intellectual property rights, and the underground provision of labor and other services

Each of the ten categories is given equal weight in the rankings, one representing the highest and five representing the lowest possible score.

Several caveats need to be considered in evaluation of the Heritage Foundation rankings.

- **Monetary policy** for each country was evaluated solely on the basis of inflation as measured by the IMF weighted average inflation rate for each country from 1992 to 2001. The ranking criteria did not take into account the possible overvaluation, undervaluation or volatility of exchange rates, which are an important indicator in determining a country's export competitiveness and thus its competitiveness in attracting FDI. Empirical evidence, discussed elsewhere in this report, suggests that overvaluation of the currency is a significant concern in Jordan, Israel and Egypt.
- **Tax burdens** are based on official tax rates and tend to ignore hidden taxes such as company licensing fees. Incorporating these could, for example, lower the ranking of UAE and Egypt on this dimension.
- **Government intervention in the economy** is assessed on the basis of official figures on government consumption as a percentage of GDP. These rankings are suspect due to doubts about the reliability of official figures, the difficulty in defining certain companies as government or private (example.g., partially privatized state enterprises), and questions as to the techniques used by Heritage Foundation analysts to adjust for these inconsistencies. The use of GDP instead of GNP would tend to skew percentages for countries like Egypt, Israel and Jordan that are big recipients of both foreign aid and foreign workers' remittances.
- **Capital flows and foreign investment** rankings are based mainly on official laws and regulations rather than on actual practice. Egyptian law guarantees investors freedom to repatriate capital and also to obtain foreign exchange to purchase imported inputs, but in practice foreign exchange is almost unobtainable at the official exchange rate.Overall, it is possible to argue with the equal weighting of the different evaluation factors.

Perhaps the most important caveat of all is that the figures used in compiling the rankings are invariably out of date. Most of the figures used for Jordan in the 2003 rankings, for example, date from 2000. In a country such as Jordan, which has since 2000 launched several important policy reforms, the current rankings on such dimensions as trade protection, customs efficiency and foreign investment may not accurately reflect these improvements.

Table 10: Index of Economic Freedom Rankings, 2003

Overall Rank	Country	Year	Overall Score	Trade	Fiscal Burden	Government Intervention	Monetary Policy	Foreign Investment	Banking/ Finance	Wages/ Prices	Property Rights	Regulation	Black Market
24	UAE	2003	2.20	2.0	2.0	3.0	1.0	3.0	3.0	2.0	2.0	3.0	1.0
33	Israel	2003	2.45	2.0	5.0	3.0	1.0	2.0	3.0	2.0	2.0	3.0	1.5
62	Jordan	2003	2.85	5.0	3.5	4.0	1.0	2.0	2.0	2.0	3.0	3.0	3.0
68	Morocco	2003	2.95	5.0	4.0	2.5	1.0	2.0	3.0	2.0	4.0	3.0	3.0
68	Tunisia	2003	2.95	5.0	4.0	3.0	1.0	3.0	3.0	2.0	3.0	3.0	2.5
94	Lebanon	2003	3.25	5.0	3.5	3.0	1.0	3.0	2.0	2.0	4.0	4.0	5.0
104	Egypt	2003	3.35	4.0	5.0	3.0	1.0	3.0	4.0	3.0	3.0	4.0	3.5

Table 11: Index of Economic Freedom Rankings, 1998

Overall Rank	Country	Year	Overall Score	Trade	Fiscal Burden	Government Intervention	Monetary Policy	Foreign Investment	Banking/ Finance	Wages/ Prices	Property Rights	Regulation	Black Market
21	UAE	1998	2.25	2.0	1.5	3.0	2.0	4.0	3.0	3.0	1.0	2.0	1.0
51	Israel	1998	2.75	2.0	5.0	3.5	3.0	1.0	3.0	2.0	2.0	2.0	4.0
53	Tunisia	1998	2.80	5.0	4.0	3.0	2.0	2.0	2.0	2.0	3.0	2.0	3.0
61	Jordan	1998	2.90	4.0	4.0	3.0	2.0	2.0	2.0	3.0	2.0	3.0	4.0

76	Morocco	1998	3.05	5.0	4.0	2.5	2.0	2.0	3.0	3.0	3.0	3.0	3.0
90	Lebanon	1998	3.25	5.0	3.5	3.0	3.0	3.0	2.0	2.0	3.0	3.0	5.0
95	Egypt	1998	3.35	5.0	4.5	3.0	3.0	3.0	2.0	3.0	3.0	4.0	3.0

The two tables above show the relative and absolute rankings for seven countries in the 1998 and 2003 rankings, based to a large degree on statistical information for 1995 and 2000, respectively. The only significant change in the relative rankings is that Jordan has become more competitive than Tunisia. In absolute overall scores, Jordan has improved slightly from 2.90 to 2.85, while Tunisia has declined from 2.80 to 2.95. Morocco has improved slightly, from 3.05 to 2.95. Egypt and Lebanon's scores remain unchanged. Israel and UAE have both improved: UAE by 0.05 from 2.25 to 2.20, and Israel from 2.75 to 2.45.

The Fraser Institute, a Canadian think tank, also prepares an annual report on economic freedom, entitled *Economic Freedom of the World*, which ranks countries along similar dimensions, focusing on twenty-one variables falling into five categories as follows.

- **Size of Government: Expenditures, Taxes and Enterprises**, including government consumption as a share of total consumption; percentage of output produced by private as opposed to government-owned enterprises; transfers and subsidies as a share of GDP; and top marginal tax rates and the threshold level at which it applies;
- **Legal Structure and Property Rights**, as measured by indices of judicial independence, impartiality of the courts, the ability of private businesses to challenge government actions or regulations; protection of intellectual property rights; military interference in rule of law and political processes; and, integrity of the legal system (i.e., bribery or political interference);
- **Access to Sound Money**, as measured by monetary policy (i.e., growth of the money supply relative to inflation rates); inflation rate volatility; current inflation rates; and, freedom to hold foreign exchange;
- **Freedom to Trade with Foreigners**, as measured by tariff rates, non-tariff barriers, differential between official and black market exchange rates; access of foreigners to domestic capital markets and of citizens to foreign capital markets; and,
- **Regulation of Credit, Labor and Business**, as indicated by
    - credit market regulations (i.e., percentage of deposits held in privately owned banks, openness of banking sector to foreign competition, avoidance of interest rate controls and negative real interest rates);
    - labor market regulation (i.e., lack of measurable employment effect of minimum wage, few restrictions on hiring and firing practices, relative absence of centralized collective bargaining, unemployment benefits that preserve the incentive to work, military conscription)
    - business regulation (i.e., price controls, administrative obstacles to starting a new business; amount of time spent complying with government bureaucracy, prevalence of corruption and bribery in connection with licensing, customs, taxation, police protection).

The Fraser Institute's 2002 rankings as shown in Figures 5 and 6 differ significantly from those presented by the Heritage Foundation. Note that for the Fraser Institute rankings, the higher the score the more free the index.

Table 12:
Fraser Institute Economic Freedom Ratings and Rankings Overall Scores, 2000

	Rating	Ranking
Hong Kong	8.8	1

UAE	7.4	19
Sweden	7.4	19
Jordan	7.3	24
Japan	7.3	24
Israel	6.8	47
South Africa	6.8	47
Egypt	6.7	51
Malaysia	6.7	51
Morocco	6.1	73
Tunisia	6.1	73
India	6.1	73

Table 13: Fraser Institute Economic Freedom Ratings and Rankings, 2000

	Areas					Components of Area 5		
	1 Size of Government: Expenditures Taxes, Enterprises	2 Legal Structure and Security of Property Rights	3 Access to Sound Money	4 Freedom to Exchange with Foreigners	5 Regulation of Credit, Labor and Business	5a Credit Market Regulations	5b Labor Market Regulations	5c Business Regulations
UAE	7.6 (13)	6.5 (45)	8.9 (46)		6.5 (40)	6.9 (67)		
Jordan	5.6 (73)	7.2 (29)	9.6 (13)	7.7 (32)	6.4 (44)	7.3 (53)	6.5 (10)	5.4 (59)
Israel	3.1 (122)	8.0 (22)	9.2 (38)	7.8 (28)	5.9 (61)	6.1 (82)	4.3 (56)	7.4 (18)
Morocco	5.9 (64)	7.1 (34)	6.7 (81)	5.5 (101)	5.1 (99)	7.0 (61)		
Tunisia	5.3 (85)	6.5 (45)	6.9 (72)	6.1 (87)	5.6 (72)	7.4 (51)		
Egypt	6.5 (45)	5.9 (63)	9.4 (28)	6.3 (80)	5.4 (88)	6.9 (65)	4.0 (62)	5.2 (65)
Hong Kong	9.2 (1)	7.2 (28)	9.4 (27)	9.8 (1)	8.4 (1)	9.1 (8)	7.7 (1)	8.5 (2)

Hong Kong, the highest ranking country or territory of the 123 surveyed, is shown for comparative purposes. (Singapore and the United States ranked 2 and 3, respectively) Also for comparison, other countries with similar rankings to those in the ITS evaluation are shown. In contrast to the Heritage Foundation ranking, the Fraser Institute rates Jordan much higher (on a par with Japan), while Israel ranks much lower and Egypt considerably higher.

Though both surveys assign roughly equal weights to the different factors, the Fraser survey examines a smaller number of factors, which can result in a greater relative weight for any individual element (i.e., each factor in the Heritage survey counts for 1/50 or 2% of the total, while each factor in the Fraser survey counts for 1/23, or 4.3%). Moreover, the Fraser rankings combine a number of elements into a single ranking, taking the average score for the four or five or ten elements in a single grouping, and then taking the average of the five averages to arrive at an overall ranking. Israel tends to do very badly here. Its high levels of government expenditure related to defense and absorption of immigrants, as well as its high levels of taxation, give it a score of 3.1 and a ranking of 122 of 123 in the size of government criterion.

At the same time, overweighting of this dimension and the lack of data for certain other categories may have caused Dubai, which has no income taxes, to rank higher than it otherwise would. Egypt's lack of official exchange controls (as opposed to effective ones) probably gave it a higher-than-expected ranking, as do misleading figures on the size of government consumption as a proportion of total consumption.

In comparison to its neighbors, Jordan ranks very high on several key determinants of economic freedom, including property rights, legal structure, freedom to exchange with

foreigners and monetary policy, while it ranks above all other countries in the survey, apart from UAE, in its regulatory environment (the Fraser composite rankings on regulation of labor, credit and business correspond to the heritage rankings on foreign investment, banking and finance, and wages and prices).

The only major discrepancy between the two sets of rankings is in foreign trade. The Fraser Institute ranks Jordan highly on this dimension, while the Heritage Foundation ranks Jordan very poorly. The difference is due, in large part, to the narrow focus of the Heritage Foundation on average tariff rates (Jordan scores poorly, though it is improving fast), whereas the Fraser index also includes openness of capital markets.

Also, strangely, the Heritage Foundation index indicates a trade-weighted average tariff of 18.9% for Jordan based on 2000 data, while it shows an average tariff of 13.7% for Egypt in 1998 (the most recent year for which data were available), an improvement of three percentage points from 1995. By contrast, the U.S. Commerce Department considers Egypt a very high tariff country and notes that, as tariff rates have declined on certain categories of imports, non-tariff barriers have increased.[26]

Weighted average tariffs are not the only, nor necessarily the best, indicator of relative tariff levels among countries. They apply to existing patterns of trade. If one motivation for attracting FDI is to change a country's pattern of exports, then a simple average tariff might be a better measure. Neither is perfect. As Hanaa Kheir-El-Din and Sherine El-Shawarby of the University of Cairo point out, "a simple average tariff may give too much weight to high tariffs on goods which are not actually imported, or which have become redundant because trade was already precluded at much lower tariffs, as with alcoholic beverages in Egypt. On the other hand, an import-weighted average may significantly understate the tariff level, as high tariff themselves choke off imports and, hence, receive less weight in the calculation of the average."[27]

On this dimension Jordan, with a simple average tariff of 21.6% (still very high) as of 1998 scores better than Egypt, which has a simple average tariff of 28.1%. [28] More recent data, however, show a marked improvement for Jordan, which has reduced its simple average tariff rate to 14.9%, while its weighted average tariff rate fell to 13.4%.[29] Egypt also applies a range of Customs service charges that are not reflected in the nominal tariff rates; these add from 2% to 5% to the final assessment.

Tunisia and Morocco are worse still. On the measure of escalation, or the ratio of tariffs on final goods to those on intermediate goods, Egypt shows a far higher rate of tariff protection on final goods (2.8) than Jordan (1.1). Jordan too shows a nearly complete absence of non-tariff barriers (NTBs) as compared to Egypt, which has NTBs on nearly 30% of its imports, and Tunisia, which imposes NTBs on 33% of imports. Various aggregate measures of protection, which seek to incorporate trade-weighted aspects, dispersal of tariff rates, MFN versus non-MFN rates, escalation and NTBs, all show Egypt, Tunisia and Morocco with far higher protection rates than Jordan. [30]

[26] *Foreign Trade Barriers*, pp. 94-100, U.S. Department of Commerce, 2002
[27] Kheir El-Din, Hanaa and El-Shawarby, Sherine, *Trade and Foreign Exchange Regime in Egypt*, Working Paper 2034, Cairo University, 2001
[28] Srinivasan, T.G., *Globalization in MENA – A Long Term Perspective*, Fourth Mediterranean Development Forum, Amman, October 6-9, 2002, http://www.worldbank.org/wbi/mdf/mdf4/papers/global.pdf
[29] Marto, Michel, *Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding*, International Monetary Fund/Government of Jordan, June 18, 2002
[30] Srinavasan, *op.cit.*

Despite their many flaws, the Heritage and Fraser rankings, as well as many other similar measures of competitiveness or openness or risk are important, in large part because potential investors look at them and consider them in their decisions. For this reason they are included in the current ITS as an indication of how the world may perceive Jordan in comparison to its neighbors. As such, these rankings show certain areas in which Jordan or other countries should examine possible reforms to existing policies and practices. But they also highlight areas in which Jordan or other countries may need to devise marketing programs aimed at correcting certain misperceptions.

Based on a close interpretation of the Heritage and Fraser rankings together with supplementary information from other sources and many direct interviews with government officials and private sector business people in each country, this survey proposes an economic freedom/openness ranking as follows.

1. UAE
2. Israel
3. Jordan
4. Tunisia
5. Morocco
6. Lebanon
7. Egypt

According to this ranking, UAE and Israel rank as the most open in our survey. Jordan and Tunisia are roughly equivalent, Jordan significantly better in measures of trade openness and Tunisia significantly better in availability of information and government interference. Egypt is at the bottom of the rankings.

This ranking is, admittedly, at least partly subjective, but it reflects the perceptions of a wide cross-section of economic and policy actors. Perhaps most important, this ranking seeks to weight the different elements of openness and economic freedom according to their perceived importance to foreign investors. Thus, government regulation is one of the essential elements that companies consider (i.e., How much red tape must I encounter and how much do I have to pay to get my project up and running? And, how much government interference will I face in my ongoing operations?) Investors place a great premium on a lack of surprises.

Every country, including the most liberal, will require various kinds of approvals or other administrative measures before a project can begin operating. In the U.S., for example, lawsuits over environmental or zoning matters often scupper projects even at a fairly advanced stage. As long as potential investors can predict with some assurance the time and cost of obtaining the necessary approvals, they can entrust the mechanical aspects of the process to their lawyers or other representatives. (More complicated approval processes do tend to favor larger companies that can afford to hire armies of lawyers and also to tie up capital for a longer period. Countries that wish to encourage innovation-based investment would do well to consider the complexity, cost and timing of their approval processes, as well as minimum capital investment requirements. Smaller companies – the next Microsoft? – may decide to pass on certain investments for such reasons.) Far more disturbing to businesses than initial investment hurdles are the surprises that might occur in the operating phase, once capital has been committed, orders have been placed and received, and time and cost-effectiveness are at a premium. New wrinkles in the tax or customs codes or changes in

foreign exchange regimes can, at this point, spell disaster. This is closely related to security of property rights and rule of law, two other critical considerations for investors.

Both the Heritage and Fraser rankings place a great deal of emphasis on the size of government, as measured by government's share of total consumption and the overall tax burden imposed by government. Government size, *per se*, need not be an indicator of economic freedom or lack thereof. Much depends on what government does with the money it collects and spends. Government borrowing may indeed crowd out private sector borrowing, but government expenditure, especially on infrastructure development, can stimulate private investment and expenditure.

The field research portion of this assessment has focused specifically on identifying the gaps between official policies and the way things work in practice. These gaps may cause a country's subjective ranking to rise or to fall. For example, all of the economies included in this survey are more open to some kinds of investments than others, and they can be much more welcoming to investments in industries they especially want to attract and can make life difficult for investors who want to develop opportunities in other areas. It could be argued that these restrictions are more onerous for purely domestic investors, whose capacity for innovation may be stifled. For foreign investors, especially those in export-focused industries, these restrictions on the nature and scope of potential investments need not be felt to any great degree. Similarly, fairly stringent basic investment laws may be riddled with exceptions pertaining to certain kinds of investments and investors. The critical challenge in these cases is to ascertain to what degree these exceptions are permanent and codified in law, as opposed to being ad hoc measures that could be rescinded at any time by reversion to the strict text of the law.

For example, in Dubai, as in the rest of the UAE, there remain stringent restrictions on foreign ownership. A foreign company must have a local (i.e., UAE citizen) partner that holds at least 51% of the shares in the joint venture. It is also very difficult for foreign citizens to own land. (This is changing, and the first residential development open to foreign buyers went on sale in December). Foreigners, who make up more than 80% of the one million people in Dubai, remain unable to obtain permanent residence and so live with the possibility that if they lose their jobs or reach retirement age they will be required to leave. All of this sounds unduly restrictive and unattractive to the foreign investor.

Dubai flourishes nonetheless, in large part because there exist myriad ways to escape the worst of these restrictions, ways that are well-defined in law and practice and which enjoy legal protections at least as strong as any of the basic laws to which they provide exceptions. One of the most important developments has been that of the various free zones, including the Jebel Ali Industrial Zone and port, as well as new Internet and media zones and a health care zone in early stages of development. Jebel Ali, focused on export-oriented manufacturing, and the other zones have been created by the Dubai Government, with much of the infrastructure funded by the government, to promote investment in areas which Dubai's ruling family sees as critical to the territory's continued economic development. The authorities that operate each of these zones have full autonomy, protected by royal decree, to set their own policies for economic activity in the zones. Consequently, 100% foreign ownership of companies is allowed in all the zones, along with some potential to own property. The zones themselves grant visas and work permits to foreigners on conditions much less restrictive than those applied outside the zones. Even for companies that for a variety of reasons may wish to operate in "Dubai proper" as opposed to one of the zones, the

laws and regulations are less onerous than they appear. An investor may need a local partner who owns 51% of the shares of the new company, but the local partner is not necessarily entitled to 51% of the company's earnings. All companies conclude agreements with their local partners that provide for a much more modest payment (i.e., a flat annual fee or a small percentage of revenues or profits), and these agreements are legally enforceable. Foreign employees who also own equity in the company for which they work are able to obtain long-term visas and work permits much more easily. On paper, therefore, Dubai appears a very closed and restrictive environment for foreign investors. In practice, it is one of the freest, most open and most accommodating and flexible places to do business, not just in the Arab world, but in the world at large.

At the other end of the scale, Egypt's foreign investment regime and overall business climate appear moderate, reasonable and straightforward. On paper, that is. In practice, it is another story. Heritage Foundation appears to recognize this implicitly, and gives Egypt a ranking at or near the bottom of the countries in the survey. The Fraser Institute, by contrast, appears to go much more by what is on paper, ignoring some of the realities of life as it is experienced by business people.

The denseness of Egypt's bureaucracy, combined with nearly complete autonomy of Customs and tax inspectors and others who apply laws and regulations at the sharp end, make for an *ad hoc* application of most relevant laws in ways invariably to the detriment of business. For example, Egypt's weighted average tariff rate (the measure reflected in the openness rankings) may indeed be lower than Jordan's. But the Customs Department has a list of 191 product categories that must be subjected to 100% inspection on import to ensure conformity with Egyptian safety and quality standards. The list includes all food and drug items, but also ballpoint pens, clothing, footballs, machinery, and much more. Needless to say, foreign standards and approvals are not recognized. Customs also can and does inspect any shipment of products not on the list of 191. Jordan, by contrast, has undertaken substantial Customs reform, moved to a risk-based inspection systems and adopted a more facilitative approach. The major difference, which the openness rankings and simple tariff rates do not capture, is that in Jordan Customs is explicitly tasked with facilitating import and export transactions, while continuing to maintain safety and security. In Egypt, the Customs Service is a principal source of revenue for the government. Any reforms that moved Customs away from a revenue-maximizing stance would meet fierce resistance not only from the Ministry of Finance, but also from the Customs inspectors who depend on the current system for their livelihoods. The Customs Service is described by Egyptians and foreigners alike, as a disaster area, which will take decades to reform, if reform can be achieved at all.

Strangely, in Egypt it is the diplomats who speak bluntly while the business operators speak much more circumspectly. This may be a function of the lack of immunity that business people face. The message, nevertheless, is that government is always and everywhere in Egypt an obstacle to doing business rather than a facilitator. Customs and tax authorities are singled out for special scorn, both for their ignorance of the law and its proper application and for their inventiveness in imposing taxes and duties that are nowhere sanctioned by existing laws. Most economic and investment information is closely guarded by the government as a state secret. As a country with high tariff and non-tariff barriers to imports and a very large domestic market, Egypt has proven itself a profitable place to do business if one's primary target is the domestic market. As a platform for exports, Egypt is far more doubtful.

One multinational consumer products company opened its first production facility in Egypt sixteen years ago with an investment of about $5 million. Now its cumulative investment (funded mostly out of retained earnings) amounts to about $200 million and its turnover exceeds $160 million. The company has reinvested all of its profits domestically and has never yet paid a dividend to its overseas parent. The company attributes this mainly to the profitability and growth of the domestic market, though also partly to difficulties in obtaining foreign exchange. For the first ten years of operation, the company sold only in the domestic market. Starting about five or six years ago, it began to export to other, mainly regional markets. Now it exports about 20% of its output to countries in the Arab Free Trade Zone and in the East African COMESA trading bloc, of which Egypt is a member. Because of tremendous difficulties with Customs, the company has invested significant amounts in upgrading local suppliers to meet international quality standards. Yet Customs remains an obstacle, not only to imports of raw materials, but also in its habit of imposing export duties or inspection requirements even where none are mandated by law.

One major international computer software company reports that although the nominal tariff on imported software is 5%, they typically pay from 15% to 20%. Sales tax is nominally 10%, but tax inspectors will assess a variety of additional taxes whose basis in law is unclear. Export licenses are required for every shipment. This company stays in Egypt, as do so many others, because the domestic market is huge. In the software industry, government accounts for at least 70% of the total market. In spite of a significant lack of transparency in government tendering and the other severe difficulties mentioned above, this company and many others stay. It is even easier to do so in software, which requires minimal capital investment. And, given enough time, export sales are likely to result as a spillover from the expertise acquired in addressing the domestic market.

The lesson here is that companies will put up with tremendous difficulties to address a sufficiently large (and, even better, protected) domestic market. They may even be able to develop a profitable export sideline over time. But the message uniformly is that Egypt is an inhospitable environment for business and that foreign companies, especially those looking for a base from which to export, would do much better elsewhere. One diplomat, speaking off the record, stated, “I would not recommend any [foreign] company, except in the oil and gas sector, to invest in Egypt”. The reason cited by everyone is the same: in practice, government is generally hostile or, at best, indifferent, to foreign investment. As a corollary to this, it seems clear that the Egyptian Government knows very little about the needs or requirements of foreign investors or, knowing, does not much care to take the necessary steps to meet those needs. It is hard for numerical rankings based on common criteria to reach such a conclusion, but the conclusion is nevertheless quite plain. Egypt is, if anything, less open economically than its position in the wider rankings might suggest. This discrepancy cuts both ways, however. Standard measures of economic openness fail to capture much of the progress Jordan has made in Customs reform and in overall trade and investment policy.

3. Political Freedom

Political freedom may appear to have relatively little to do with a country’s competitiveness in attracting FDI. It is possible to cite scores of examples of countries with limited political freedom that have proven highly successful in attracting substantial FDI. The success in attracting FDI of South Korea, Indonesia, Singapore and Taiwan from the 1960s to the 1990s and, more recently, the successes of China, Vietnam and Equatorial Guinea show that lack of political freedom is not necessarily an impediment to attracting FDI. North American,

Japanese and European investors have often, if not publicly, expressed a preference for tightly controlled environments in which political activists or militant labor unions are unlikely to disrupt production. Though increased economic openness can often bring with it increased political freedom, this is not invariably the case, at least in the near or intermediate term. Examples abound of relatively open economies in which political freedom remains severely curtailed. From the point of view of most investors political freedom, if it is considered at all, would be rated far less important than considerations of country risk and economic openness. There is nevertheless ample reason for considering political freedom as an important element of competitiveness and one that is growing in importance. The Heritage Foundation index, discussed above, makes an explicit connection between economic and political freedom, both of them based, in their view, on security of property rights.

There is a high correlation between economic and political freedom, especially if one begins to dissect those regimes that nominally accord a high degree of economic freedom. In many cases, economic freedom is limited to those sectors in which the government explicitly seeks to attract investment. Companies trying to pursue opportunities in other sectors may find themselves blocked at every turn. As long as industrial development remains focused on manufacturing, most often of the labor-intensive kind, or FDI focuses mainly on primary resource industries, these restrictions need not pose a significant problem. But maintaining these restrictions comes at the price of limiting innovation by companies that want to do something new.

Even more fundamentally, lack of political freedom and openness impedes the exchange of information and ideas that lies at the heart of a knowledge-based economy. It is hard to imagine a country like Tunisia, which has very little political freedom and which blocks access to an extraordinary number of Internet sites thought to contain politically or culturally sensitive material, ever developing a competitive IT industry. The same goes for China. These countries may be able to excel at assembling the physical components of IT systems, but they are unlikely to develop the more knowledge-intensive activities such as software that may hold the key to future competitiveness. Freedom House, a U.S. NGO, compiles an annual ranking of political freedom, which examines a variety of political rights and civil liberties.[31]

Political rights include the following:
- The frequency and fairness of elections
- The amount of real power vested in elected bodies
- The ability of people to organize into political parties
- The presence of an effective political opposition
- Lack of cultural, ethnic and religious discrimination
- Lack of domination by foreign powers, the military or economic oligarchies

Civil liberties include the following:
- Freedom of expression and belief
- Freedom of political, religious association and labor, professional or social organization
- Independence of the judiciary
- Adherence to rule of law in civil and criminal cases
- Protection from terror, unjust imprisonment, torture and exile
- Freedom of open political discussion
- Freedom of internal and external movement

[31] *Freedom in the World : The Annual Report of Political Rights and Civil Liberties 1999-2000*, Freedom House, New York

- Security of property rights
- Social freedom and gender equality
- Equality of economic opportunity

Importantly, Freedom House distinguishes between constitutional guarantees of political and civil liberties and the degree to which they are protected in practice.

Table 14: Freedom House Ranking of Political Rights and Civil Liberties, 2000

	Political Rights	Civil Liberties	Free/Not Free
Australia	1	1	Free
Egypt	6	5	Not Free
Israel	1	2	Free
Jordan	4	4	Partly Free
Lebanon	6	5	Not Free
Morocco	5	4	Partly Free
Tunisia	6	5	Not Free
UAE	6	5	Not Free
Saudi Arabia	7	7	Not Free

The Freedom House rankings rate countries on a scale of one to seven, one being the most free and seven the least free. This table includes those countries targeted in this ITS competitive assessment, together with certain other countries for comparative purposes.

Jordan scores relatively high in comparison to its neighbors. Only Israel ranks significantly higher and qualifies as "free." Jordan is considered "partly free," together with Morocco, but scores higher than Morocco on political rights. The other countries in the survey are classified as "not free." It is possible to take exception to certain aspects of this survey. In Israel, freedom, and especially civil liberties, does not apply equally to Jewish and Arab citizens or to Palestinians living under Israeli control. Civil liberties for non-Jewish Israelis and those living in the occupied territories have worsened significantly since the start of the second *intifada*, the reoccupation of much of the territory formerly under the control of the Palestinian Authority, and the replacement of the Barak government by one led by Ariel Sharon.

In the UAE, although political rights are very limited, and foreigners have no political rights, civil liberties vary widely from one emirate to another, as well as between Emirati citizens and different expatriate groups. Additionally, the Freedom House Survey cites a 1999 U.N. Development Report that ranks the quality of life in the UAE as among the highest in the world. If Dubai is a cage, it is a very pleasant one.

The Freedom House report, based on findings in 1999 and 2000, praises Jordan for the political opening undertaken by H.M. King Abdullah II, especially his readmission of the Islamist IAF into the political process. Clearly, regional political events have not lent themselves to increasing political openness within Jordan. The *intifada* and associated militancy of the Palestinian population of Jordan, the events of September 11, 2001, the outbreak of war between the U.S. and Iraq have all put pressure on political and civil liberties in Jordan, most notably in the postponement of elections and the governing of the country without a parliament for the past eighteen months. To counterbalance some of these political developments, Jordan has continued its rapid pace of economic reform.

By contrast, Freedom House summarizes its report on Egypt by highlighting continuing suppression of independent political activity and by stating that "arbitrary arrest, detention, torture, and summary justice against political opponents continue."

Tunisia's 2000 presidential election, in which Zine el-Abidine Ben Ali won a third five-year term, was described by the government as a bold experiment in democracy because it allowed for the first time opposition parties to contest the election. Most outside observers described the election as a farce. Freedom House describes President Ben Ali's rule as "…autocratic and repressive. Intolerant of public criticism, [President Ben Ali] has allowed almost no credible opposition to exist; opposition parties have been banned or crippled by arrests and harassment. The government has consistently targeted trade unionists, human rights activists, student leaders, and the media, but it treats Islamists most harshly, claiming the need to avoid the kind of unrest seen in neighboring Algeria." Freedom House does, however, cite an IMF report that describes Tunisia's social indicators as "'outstanding by regional standards,' notably in education, gender gaps, housing, and health care."

Lebanon ranks very low in the Freedom House survey, largely because of the Syrian occupation. It is likely that a new ranking would reflect the partial withdrawal of Syrian troops and the lessening of Syrian political control.

Morocco's partly free ranking reflects many of the humanitarian and social reforms undertaken by King Mohammad since he ascended the throne in June 1999. These included releasing large numbers of political prisoners and sacking the brutal Minister of the Interior who had served King Hassan for many years. King Mohammad has also reportedly undertaken several measures to lessen discrimination against Morocco's sizable Berber minority.

4. Press Freedom

Freedom House also publishes an annual ranking of press freedom, which looks at the existence and enforcement of criminal libel and sedition laws; other laws, such as licensing of publications and journalists; and overt and official harassment of publications and journalists to rank countries as free, partly free or not free. Press freedom is also a close approximation of freedom on the Internet and may thus be used as a gauge of competitiveness in developing industries based on free exchange of ideas and information. In the 2002 Freedom House *Annual Survey of Press Freedom*, reviewing events during 2001, Middle East and North African countries did poorly. Jordan did, however, rank behind Israel (Free), but ahead of most its Arab neighbors as one of only three countries in the region ranked as partly free. Within these categories, however, are certain subdivisions. Each country is assigned a numerical score on a scale of 1 to 100, 1 being the most free. Thus, each category contains gradations of freedom.

Table 15: Freedom House Annual Survey of Press Freedom

	Free 1-16	Free 17-30	Partly Free 31-45	Partly Free 46-60	Not Free 61-75	Not Free 76-100
Australia	10					
United States		16				
Israel		30				
United Kingdom		18				
Argentina			37			
Brazil			32			
Jordan				60		
Kuwait				49		
Turkey				58		
Morocco				58		
Lebanon					74	
Tunisia					73	
UAE					74	
Egypt						77
Saudi Arabia						80
Palestinian Authority						84

The Freedom House report shows Jordan well ahead of most of its regional neighbors. (The table above has included other countries for comparison.) The report noted, however, several disturbing developments, including passage of a new law following the September 11 attacks that increases press censorship in Jordan. According to the report, "A plethora of laws directly or indirectly restricting press freedom generates uncertainty among journalists of what and who may be covered with impunity. This leads to considerable self-censorship. By law, journalists must be members of the Jordan Press Association, and expulsion is tantamount to ending a career in journalism. Broadcasting and the Jordanian news agency (Petra) are state owned and operated. The government owns large shares of two major newspapers and influences other private publications. In 2001, the trial of publishers and journalists in State Security Courts was provided by an amendment to the penal code. This was attributed to the defense against terrorism, but the courts' function was only vaguely defined. Other amendments would imprison journalists for harming national unity, inciting hatred, insulting the dignity of individuals, or promoting "deviation from what is right." The measures also provide for the "temporary or permanent" closure of newspapers and restore prison sentences for defamation. The information ministry was dissolved and would be replaced by the state-appointed Higher Media Council whose purposes were also ambiguously described. In March, six Israeli journalists were barred from an Arab summit in Amman because officials claimed to be unable to ensure their safety. In December, two journalists of the independent Qatar-based Al-Jazeera network were held for questioning."[32]

This assessment is still far better than that of Egypt, which is classified in the least free category, registered a decline in press freedom, and fined and imprisoned several journalists during the course of 2001. Paradoxically, the United Arab Emirates ranks in the Not Free category, but is the most highly Internet-connected country in the Middle East. Freedom House attributes the lack of freedom to ownership and/or control of domestic print and broadcast media by the government and/or ruling families, as well as to direct and self-censorship of domestic media and direct censorship of foreign publications. The UAE is, however, a loose federation of seven emirates, each of which has a great deal of autonomy in

[32] Sussman, Leonard R. and Karlekar, Karin D., *Annual Survey of Press Freedom* , p. 34, Freedom House, 2002, New York

everything but defense, foreign affairs and monetary policy, which are the domain of the federal government in Abu Dhabi.

Dubai is thus able to be far more open and liberal in both economic and social matters than many of the other emirates. Foreign publications are widely available in Dubai, as are uncensored foreign satellite TV broadcasts. Etisalat, the fixed and mobile telephone monopoly owned by the federal government, has the only publicly available international Internet gateway in the UAE and does block access to some sites (more for culturally-sensitive than for political content). Dubai, however, has created an Internet and Media City, a sort of free trade zone for ICT and media companies. The Internet and Media City authority operates its own ISP with its own international gateway, which does not block Internet content. As a result, scores of major international media groups, including CNN, NBC and Reuters, have set up their regional headquarters in Dubai.[33]

5. Macroeconomic and Socio-economic Indicators

The indices described in the preceding sections, especially those dealing with country risk and economic freedom and openness, include many important macroeconomic indicators in constructing their overall rankings. These include GDP growth, savings, and domestic fixed capital formation, as well as trade and current account balances. Other macroeconomic indicators, such as the amount and composition of FDI, will be examined in detail in Section III of this report. It is useful here to highlight certain macroeconomic and socio-economic indicators that provide a basic sense of the size and attractiveness of a market, which may in turn influence investment decisions.

Table 16: Economic Indicators, 2001

	Population (millions)*	Population growth % per year	GDP ($billions)	GDP Growth			GDP Per Capita ($)	Gross Fixed Capital Formation (% of GDP)
				2001	2002	2003		
Jordan	5.0	2.91	8.8	4.2	5.1	6.0	1760	21.9
Egypt	65.2	1.85	97.5	3.3	2.0	3.7	1495	22.7
Israel	6.4	2.06	110.4*	-0.9	-1.5	1.8	17,250*	19.3*
Lebanon	4.4	1.30	16.7	2.0	1.5	1.0	3800	18.7
Morocco	29.2	1.62	33.7	6.5	4.4	4.1	1180	25.0
Tunisia	9.7	1.16	20.0	5.0	3.8	6.4	2070	28.1
UAE	3.0	2.42	66.3*	5.1	0.3	3.1	21,300*	n/a
Dubai	0.9	2.42	16.5*	n/a	n/a	n/a	19,100*	29.4*
MENA	300.7	1.98	652.3*	n/a	n/a	n/a	2000	20.2*

*estimate/forecast

**2000 Sources: IMF *World Economic Outlook*; World Bank *World Development Indicators*; Dubai Department of Economic Development, International Monetary Fund

Table 17: Development Indicators, 2000

	Electricity consumption KwH per capita (1999)	Secondary school enrollment (% of eligible population 1999*)	Primary school enrollment (% of eligible population 1999*)	Exports (% of GDP)	Human Development Index Rank
Jordan	1207	75.87	93.57	41.8	92
Egypt	900	79.03	92.32	16.1	119
Israel	5689	88.08	100	40.0	22

[33] Private interviews with Internet and Media City officials, December 14-19, 2002

Lebanon	1778	n/a	70.95	13.0	82
Morocco	430	29.94	74.48	31.2	124
Tunisia	911	67.86	98.17	44.0	101
UAE	10,643	67.46	78.24	n/a	45
Dubai	11,764	n/a	n/a	8.5**	n/a
MENA	1276	n/a	83.14	37.4	n/a

*UAE education statistics refer only to government schools, which cater exclusively for the 15% of the population who are UAE citizens.

**Non-oil exports only. Also excludes re-exports, roughly three times the value of Dubai origin exports.

Sources: World Development Indicators, World Bank; Dubai Department of Economic Development, UNDP Human Development Indicators

Electricity consumption is often a useful indicator of a country's level of industrialization and urbanization. Israel has a level of per capita electricity consumption comparable to other developed (OECD) countries. Dubai has the highest level, but this is partly a function of abundant oil and cheap energy prices, which in turn has led to establishment of highly energy-intensive industry. One of Dubai's largest industrial enterprises is Dubai Aluminium (DUBAL), a 536,000 ton per year aluminum smelter, which consumes approximately 1000 MW on a constant basis; this amounts to well over 8000 KwH per person per year in Dubai; exclusive of DUBAL, Dubai's per capita electricity consumption is closer to 3000KwH.

Jordan ranks considerably higher than Egypt, Morocco or Tunisia, suggesting that its population is more concentrated in urban areas and that its level of industrialization is higher than in these countries.

The Human Development Index is an annual ranking compiled by the United Nations Development Program, which combines a number of economic and social indicators, including per capita GDP at purchasing power parity; life expectancy, educational levels, access to health services and clean water, and much more. As with all such rankings, there are limitations. The UNDP gives Libya a higher HDI than either Tunisia or Jordan, which few people having visited all three countries would agree with. (The fault may be with over-reliance on official statistics). Jordan nevertheless ranks considerably higher than Egypt, Morocco and Tunisia on the HDI Index and not far behind Lebanon, a country whose per capita GDP is more than twice that of Jordan.

6. Trade Policy, Tariffs and Customs

Trade policy and tariffs constitute an important element of the EIU country risk rankings and the Heritage and Fraser economic openness and economic freedom rankings. As the following table shows, Jordan can fairly be said to rank third, behind UAE and Israel, in the openness of its trade regime. Even though tariff rates remain high, Jordan has simplified its tariff structure, eliminated most non-tariff barriers, and drastically simplified and improved Customs procedures.

Table 18: MENA Tariff Rates

	Simple Average Tariff All Goods	Trade-weighted Tariff†	Simple Average Tariff Manufactures	Surcharges	VAT or Sales Tax (%)	NTB Coverage*
Jordan	21.6	18.9	n/a	0	13.0	0.0
Egypt	20.5	13.7	22.7	2-3%	10.0	28.8
Israel	7.5	4.0***	19.9	0	18.0	0

Lebanon	9.8	19.1	n/a	Various	10.0	30 (est.)
Morocco	22.1	25.8	28.9	n/a	20.0	5.5
Tunisia	29.9	28.8	n/a	n/a	18.0	32.8
UAE**	4.0	4.0	n/a	0	0	0

* Percentage of imports subject to Non-Tariff barriers

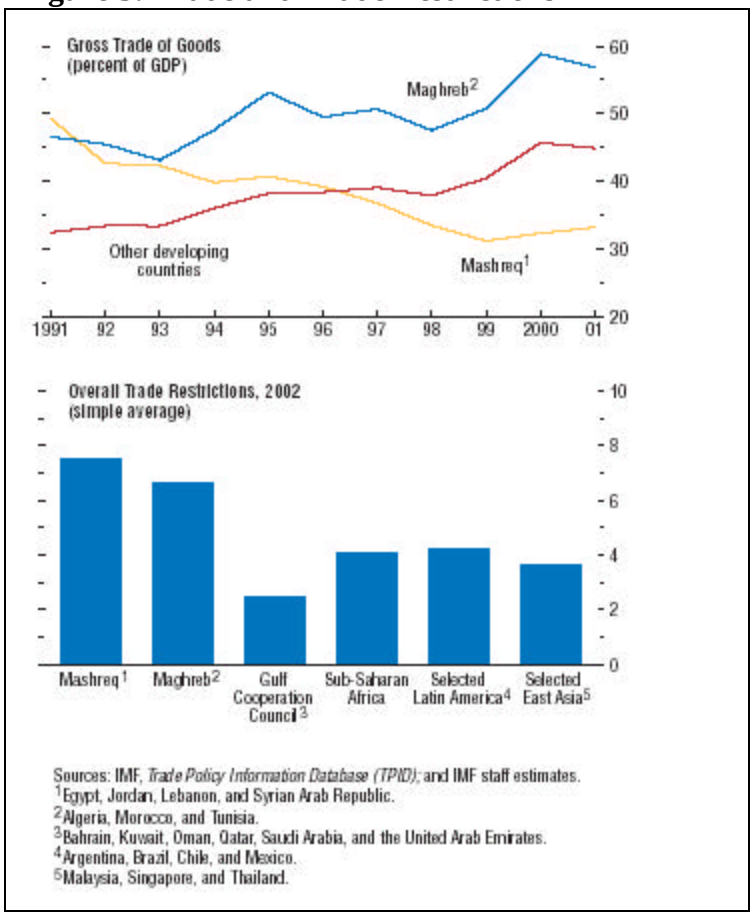
** The basic tariff will rise to 6% as part of the transformation of the Gulf Cooperation Council into a common customs area

***1993, World Bank

†Heritage Foundation, mainly 2000-2002

Sources: Srinavasan, *op.cit.*, Jordan Customs Department, Lebanese Customs, World Bank, Egyptian Tax Department, Israel Ministry of Finance, Morocco Ministry of Commerce

Figure 3: Trade and Trade Restrictions



As indicated in Figure 19, from the IMF *2002 World Economic Outlook*, the MENA countries in aggregate, but especially the Mashreq countries, have the highest level of trade restrictions of any major developing country region. The main exception to this is the Gulf Co-operation Council (GCC), which has very low external tariffs. Trade as a proportion of GDP is only 35% for the Mashreq countries, as compared to 45% for developing countries in general. As the *IMF 2002 World Economic Outlook* points out, "gross trade in the Mashreq is particularly low, reflecting the impact of trade restrictions, real exchange rate appreciations during the 1990s, and political uncertainties. This suggests there is substantial scope for increased regional and international trade integration to help support stronger growth."[34]

This is further supported by IMF statistics showing that the MENA trade far less, both amongst themselves and extra-regionally, than would be expected using the "gravity model,"

[34] International Monetary Fund, *World Economic Outlook*, p. 56, September 2002

which attempts to identify the "natural" level of trade and thus correct for artificial impediments to trade. The gravity model draws a positive correlation between the joint sizes of any two economies and the volume of trade and a negative correlation between distance and trade volume. Consequently, under-trading indicates that a country suffers from artificial impediments related principally to its trade and overall economic policy environment, while over-trading could be the result of especially favorable policies (or market access agreements).

Figure 4: Trade Policy Restrictiveness in Developing Countries

Region	Trade Policy Restrictiveness[2] All trade	Intraregional trade
Africa, sub-Saharan	0.21	1.52
Asia		
East Asia	−0.32	0.37
South Asia	2.95	5.07
Middle East and North Africa	3.19	6.76
Western Hemisphere		
Caribbean and Central America	−0.46	−0.09
South America	−0.93	−1.48
Memorandum:		
North-North trade	—	−1.78
North-South trade	−0.53	—
South-South trade	—	0.87

Source: IMF staff calculations.

Trade Policy Restrictiveness is an index from 2 to 20, based on a combination of tariff and non-tariff barriers.

Figure 20 highlights the lack of intraregional trade openness in most developing country regions. This reflects a lack of effective regional economic groupings that promote policy harmonization and trade integration. It is important to note that there are substantial variations within regions. As discussed in the next section, the GCC and COMESA regional groupings are exceptions to the overall rule for their regions. Figure 20 also highlights the importance for most developing regions of trade with the rich countries as compared to trade with neighboring countries. Some of this may reflect greater purchasing power and demand in rich countries for developing country exports and also the diversity of goods available from rich countries. Equally important may be the fairly recent advent of free trade and market access agreements between rich countries and developing countries. The spike in exports from Maghreb countries in the mid 1990s, as shown in Figure 19, very likely reflects the opening of European Union markets to goods, especially textile products, from those countries.

Figure 5: Under-Trading in Developing Countries, 1995-1999

Region	Average Difference Between Actual and Predicted Trade[1]				
			Extraregional trade[3]		
	All trade[2]	Intraregional trade	Total	Developing countries[4]	Industrial countries[4]
Africa, sub-Saharan	0.05	0.50	−0.01	−0.04	0.01
Asia					
East Asia	0.45	0.96	0.42	0.40	0.45
South Asia	−0.44	−0.76	−0.43	−0.46	−0.35
Middle East and North Africa	−0.49	−0.74	−0.48	−0.60	−0.24
Western Hemisphere					
Caribbean and Central America	−0.12	0.82	−0.24	−0.41	−0.09
South America	−0.11	0.44	−0.15	−0.34	0.18

Source: IMF staff estimates.
[1]Based on a gravity equation estimated with data averaged over 1995–99.
[2]All bilateral trade flows involving at least one country from this region.
[3]Bilateral trade with other developing and industrial countries.
[4]Extraregional trade flows involving other developing countries or industrial countries.

Figure 21 shows the MENA region as trading far below its potential, more so than any other developing country region. Strikingly, as illustrated in Figure 19, trade for the Mashreq countries has fallen from 50% of GDP to about 35% over the past 10 years.

As the next section on market access indicates, regional integration is a key element of overall trade and investment growth and of international competitiveness. With the exception of the GCC countries, there exists little in the way of meaningful trade or other economic integration among the MENA countries.

7. Market Access and Integration

"Market-seeking" has always been one of the main motivations for FDI. In an earlier era when most countries had high tariff or non-tariff barriers, locating production in a country was often the only way for a foreign company to sell its goods competitively in the domestic market. This condition persists for some countries. For example, Procter & Gamble would probably sell very little detergent in Egypt if it did not manufacture there; the high import duties would make its products too expensive in comparison to locally manufactured goods.

In large markets the complexity of doing business often dictates a significant presence by foreign companies. Japanese car manufacturers set up plants in the U.S. in part to overcome trade barriers, but these investments were also driven by a need to be closer to their customers. Market-seeking remains a critical motivation for FDI, but the context has largely changed. The world trading environment is increasingly dominated by regional trading blocs and bilateral or multilateral market access agreements. The groupings of countries into different and sometimes overlapping trading blocs increasingly determine the form and direction of FDI. Market access is usually multidirectional. A company may invest in Jordan to gain access to the U.S. via the Jordan-US Free Trade Agreement. It may also invest in Jordan to access other member countries of the Greater Arab Free Trade Agreement, while benefiting from the U.S. free trade agreement to import inputs duty-free into Jordan.

Market-seeking behavior has thus become a much more complicated phenomenon, involving trade in both finished and intermediate goods, as well as seeking integration of supply chains that can use a country's access to different markets in combination with its economic and technical endowments to maximize productivity on a global basis. Market access therefore

constitutes a "created asset" as described in Section II: a genuine competitive advantage that a country can create in partnership with one or more other countries.

Market integration via such market access agreements has become, and will remain, one of the prime determinants of FDI decisions. Such integration is of particular benefit to smaller countries, which can become part of a market consisting of hundreds of millions of people and hundreds of billions of dollars in purchasing power. And, to the extent that such countries can act as a bridge between two or more integrated market groups, their market power grows even larger.

Table 19: Participation in Major Trade Groups

	U.S.	E.U.	GCC	GAFTA**	COMESA***	WTO
Jordan	x	x		x		X
Egypt		x		x	x	X
Israel	x	x				X
Lebanon				x		
Morocco	x*	x		x		X
Tunisia		x		x		X
UAE			x	x		x

*Signed but not yet implemented

**Greater Arab Free Trade Area

***Common Market of Eastern and Southern Africa, comprising twenty countries from Egypt in the North to Madagascar in the South.

In addition to the agreements listed in Figure 19, Jordan and Israel also have an "Agreement on Trade and Economic Cooperation," signed in 1995, which grants preferential access to certain product categories and lowers Jordan's basic tariff on Israeli goods to 15%. Despite recent efforts in Jordan to abrogate this and other agreements with Israel, this agreement remains in effect. As Figure 19 shows, each of the countries surveyed participates in at least two multinational trade areas. Some of these are more effective and meaningful than others.

COMESA, for example, comprises twenty countries and an aggregate population of about 380 million (i.e., nearly the size of the post-enlargement European Union, though with considerably less purchasing power). Trade among countries within COMESA is small at just over $5 billion, but growing at about 20% per year. COMESA's external trade amounts to over $70 billion and is growing at about 7% per year.[35] In sharp contrast to many other regional bodies in Africa and elsewhere, COMESA has achieved a great deal in respect of Customs cooperation and harmonization and elimination of internal tariffs. The organization expects to achieve full Customs Union with a common external tariff in 2004, as well as becoming a common investment area and, ultimately, achieving full monetary union. Egypt's membership in COMESA has generated measurable benefits in exports by Egyptian and foreign companies operating in Egypt to other COMESA member states. Procter & Gamble Egypt mentions COMESA as one of its most important and fastest-growing export markets.[36]

The Greater Arab Free Trade Area (GAFTA) is considerably less effective than COMESA. In fairness, GAFTA is a relatively new group, established in January 1998 with a projected ten-year transition period to full integration. The integration plan calls for reduction by 10% per year to achieve full elimination of internal tariffs by the end of 2007; "tarification" of non-tariff charges; adoption of common rules of origin; elimination of all internal non-tariff

[35] Common Market for Eastern and Southern Africa, http://www.comesa.org

[36] Personal interview with Ramy Zaki, External Relations Manager, Procter & Gamble Egypt, December 12, 2002

barriers.[37] So far the program has been adopted by fifteen of the twenty-two Arab League member states, excluding the least-developed countries that require further assistance. There is little evidence of progress to date. Arab trade officials meeting in Amman in July 2002 pledged to develop a framework for implementation of GAFTA. This followed an earlier meeting in May 2001 when foreign ministers from Jordan, Egypt, Morocco and Tunisia agreed to abolish tariffs among themselves.[38] The July meeting highlighted the lack of any firm agreement on rules of origin, nearly four years after the initiation of the GAFTA agreement. In any event, inter-Arab trade integration remains low; in 1998, only 2.95% of all goods entering or leaving MENA countries came from another MENA country.[39] This figure may also include trade with Iran and Turkey. Elsewhere, the Economic Research Forum for the Arab Countries, Iran and Turkey (ERF) cites IMF statistics as indicating $12 billion in total intra-Arab trade in 1998, accounting for 8.2% of total Arab exports. Of this $12 billion, some $5.3 billion, or 44%, was intra-GCC trade. (The GCC, or Gulf Co-operation Council, is a smaller and richer group with its own free trade agreement, comprising Saudi Arabia, UAE, Kuwait, Bahrain, Qatar and Oman.) Trade among the Mashreq countries (including Egypt, Jordan, Lebanon, Syria and Sudan, and excluding Iraq), amounted to only $1 billion, or 8.6% of their total exports, while trade among the Maghreb countries (Algeria, Libya, Morocco, Mauritania and Tunisia) also amounted to $1 billion and only 3.1% of total exports.[40]

The ERF asks "Why Arabs don't trade more with one another," and answers the question thus: "The policies of Arab governments discourage trade within the region. With the notable exception of GCC countries, which maintain relatively open trade regimes, most Arab countries impose major trade barriers. The average import tariff for the region is higher than that of any other region except Africa. Non-tariff barriers include restrictive licensing, outright import bans, state trade monopolies, restrictive foreign exchange allocations and multiple exchange rates."[41] The ERF goes on to cite other factors such as the lack of a diverse industrial base, which limits opportunities for trade-based on product differentiation, as well as high transport, communications and other costs of trade. Huge income differentials may also play a part. Finally, a large part of the difficulty may be the simple construct of a grouping based on ethnicity rather than geography. The Maghreb countries are far closer to Europe than to the Gulf or even the Mashreq countries. Trade ties based on geography, former colonial ties or attempts by rich countries to encourage trade with poorer countries for both political and economic reasons (e.g., E.U. and U.S. trade agreements) seem to trump trade groupings based solely on a common Arab language or cultural identity.

This may help explain why the GCC is more successful and more integrated than the GAFTA. The GCC member states share a common language and culture, but they are geographically contiguous and are at roughly similar levels of income. They also have similar approaches to foreign investment and trade, with tariff levels far below those applied by most other Arab countries. Consequently, the GCC has found it relatively easy to agree on a common external tariff of 6%, which will go into effect in 2003. This required the UAE to raise its basic tariff from 4% to 6%, and other member states to lower their basic tariffs. In announcing the common external tariff, the GCC also announced its intention to adopt a common currency by 2010 and to seek to negotiate a free trade agreement with the EU, its biggest trading partner.

[37] "Arab Commercial and Economic Co-operation: The Greater Arab Free Trade Area," *Cooperacion Internaciona No7,* Euro-Arab Management School, Granada, May 2001
[38] Ayoub, Tareq, "Arab Officials Hold Talks on GAFTA," *Jordan Times,* July 23, 2002.
[39] *Economic Trends in the MENA Region 2002,* Economic Research Forum for the Arab Countries, Iran and Turkey, pp57-59, The American University Press, Cairo
[40] *Ibid.*
[41] *Ibid.,* p. 59

For Jordan, regional integration refers as much to Israel as it does to other Arab countries. The QIZ program gave a tremendous boost to Jordan's overall exports, especially to the United States, the intended market for QIZ manufacturers. From 2000 to 2001, Jordan's total exports increased by nearly $400 million, from $1.9 billion to $2.3 billion.[42] Most of this increase is attributable to QIZ exports to the U.S., which amounted to $330 million in 2001. In the first eight months of 2002, Jordanian exports to the U.S., also mainly from the QIZs, had risen 77.5% over the first eight months of 2002.[43] Also during the first eight months of 2002, in spite of calls by opposition parties for Jordan to boycott trade with Israel, overall Jordanian trade with Israel increased by 27%. Jordanian exports to Israel rose from $94 million to $115 million, while Jordan's imports from Israel grew from $98 million to $115 million.[44]

In addition to the QIZ Program, the Jordan-U.S. Free Trade Agreement could be substantially expanded through greater trade integration with Israel. The Jordan-U.S. agreement states that within six months of entry into force of the Agreement, "the Parties shall enter into discussions with a view to deciding the extent to which the cost or value of materials which are products of a territory contiguous to Jordan may be counted in the appraised value of the Article for purposes of determining the 35 percent content requirement under this Agreement."[45] This is an explicit reference to Israel, which also has an FTA with the U.S., and offers the possibility of "cumulation" of origin, so that Israeli inputs could be counted towards the 35% domestic content rule. The wording of the EU Association Agreement with Jordan also allows such cumulation between Jordan and other Mediterranean countries party to the Euro-Med Association Agreement with which it has a Free Trade Agreement. This includes Israel, which signed a trade agreement with Jordan in 1995.

8. Availability and Cost of Capital

It is debatable to what degree domestic capital availability and cost are factors in attracting FDI. One principal motive for countries to seek FDI is to augment the domestic supply of investment capital. Multinational corporations that can raise financing globally are unlikely to look to domestic financial institutions or capital markets to fund their initial investment in a developing country, though they may possibly do so in subsequent phases of investment.

Trade financing, however, is a different matter. Though multinationals can also arrange trade financing globally, the ability of local banks to engage in competitive trade financing can increase the competitiveness of a country's exports. All countries in the survey are members of the Multilateral Investment Guarantee Agency (MIGA), the World Bank's investment and export insurance agency, and are eligible for OPIC and Exim Bank guarantees, as well as for export credit insurance programs in other countries. According to the 1998 ITS report, Jordan's Export and Finance Bank, founded in 1996 with 20% state ownership, was then the only source of trade finance. With only $25 million in capital, since increased to $31 million, this is insufficient to meet the demands of growing export markets. A number of other banks now offer trade finance. These include the Jordan National Bank, the Jordan Kuwait Bank, the Cairo Amman Bank, the Jordan Investment and Finance Bank and others. Their trade financing activities are for the most part limited to letters of credit while more innovative kinds of trade finance products are mostly unavailable.

[42] *Handbook of Statistics* ,U.N. Conference on Trade and Development, 2002
[43] "Exports to U.S. Shoot Up 77.5%," *Jordan Times,* November 3, 2002
[44] "Jordan-Israeli Trade up 26.90%" *Arab Finance,* January 9 2003.
[45] *U.S.-Jordan Free Trade Agreement,* Annex 2.2 "Rules of Origin," article 13

The Jordan Loan Guarantee Corporation, established in 1994, is the only financial institution offering export credit guarantees, which can allow exporters to raise pre-shipment and post-shipment financing. (Exim bank also offers some financing to Jordanian exporters selling into the U.S.). JLGC serves mainly the SME market, so its normal policy is to guarantee up to 75% of loans up to JD100,000, although it can guarantee loans up to JD250,000. Its guarantees apply to most kinds of commercial risks as well as political risk. JLGC's products also include domestic loan guarantees, which can help Jordanian SMEs trying to become suppliers to foreign investment companies. Though the domestic availability of investment capital may not matter much to foreign investors themselves, it does matter indirectly, in that the ability of smaller domestic companies to raise venture capital and early-stage investment has a direct impact on the growth of smaller enterprises to serve as suppliers and partners to foreign investors. Access to capital markets (i.e., stock exchanges) is of great importance in establishing an environment in which private equity and venture capital can flourish, since investment funds, in evaluating an investment, place great emphasis on their eventual exit strategy: the ability to cash out their investment after a certain period and realize the return on their investment.

Israel has one of the largest venture capital/private equity industries in the world in absolute terms. Relative to the size of its economy, it is by far the largest. Israel's ratio of investment to GDP is the highest in the world. This availability of capital has played an important role in the rapid development of Israel's high-tech industry, which in turn has attracted more capital. One of the essential conditions permitting this explosive growth is the size and liquidity of domestic capital markets, which allow companies to list on the stock exchange, thus affording an exit mechanism for private investors. Equally important is the lack of controls on capital movements, which has allowed Israeli companies to list overseas, mainly on NASDAQ. More Israeli companies are listed on NASDAQ than from any other foreign country. Between 1995 and 2000, sixty-seven Israeli companies raised $2.5 billion in IPOs on foreign exchanges. Of these, fifty-one companies raised just under $2 billion through NASDAQ listings, while the remainder came from listing on European exchanges, including the London Stock Exchange and the Neuer Markt. In addition to IPO activities, a further twenty-six companies raised $2.3 billion in follow-on offerings, all but three of them on NASDAQ. The total market capitalization of Israeli companies listed on foreign exchanges was estimated at around $20 billion in 2000, though it has certainly fallen significantly since then. Also, between 1996 and 2001, thirty-nine Israeli companies were wholly or partially acquired by foreign companies in transactions worth about $17.5 billion (This is skewed by two huge M&A transactions in 2000, together worth $7.5 billion. Otherwise, the annual volume of M&A transactions is typically in the range of $0.5 to$1.5 billion).

Though the other countries surveyed have stock exchanges, their market capitalizations, trading volumes and liquidity are low and thus do not provide the boost to entrepreneurial activity found in Israel. In the UAE, for example, the Dubai Islamic Bank recently launched a $10 million IPO for a new insurance company – the first IPO in the UAE in two years – which was oversubscribed on the first day. This is in contrast to the previous IPO, also for an insurance company (National General Insurance), for which the promoters had to buy back some of the shares to ensure that the offer was fully subscribed.

The Israeli Venture Capital Association (IVCA) reports that in 2001 there were seventy fund management companies managing104 Israeli funds, with over $9 billion under management, roughly 90% of which is foreign-sourced.

In 2001 526 Israeli companies, almost entirely in technology industries, raised approximately $2 billion in capital, a 36% decline from 2000. Of this amount, Israeli venture funds invested $812 million in 438 companies. This was a big decline from the peak in 2000, when Israeli VC investments amounted to nearly $1.3 billion. The biggest decline occurred in the seed capital or start-up phase of investments as investors became more risk averse. The rest of the $2 billion included $254 million from three U.S. public offerings on NASDAQ, and $118 million from one European public offering. (By contrast, in 2000, twenty-eight Israeli companies issued public offerings in the U.S. and seven in Europe.) A further $631 million came from mergers and acquisitions of Israeli companies by foreign companies.[46] The plethora of investment opportunities in Israel continues to mobilize additional capital. General Electric, Intel, Siemens, Philips, Johnson & Johnson, Nokia, AOL Time Warner, Agilent and Motorola have all set up their own investment funds in Israel, each one with anywhere from $20 million to $1 billion of capital under management.

Other countries in the MENA region have far less venture capital activity and almost no participation in overseas capital markets. Seven of Egypt's largest companies have obtained secondary listings on overseas stock exchanges by issuance of General Depositary Receipts (GDRs). In July 2000, Orascom, a mobile telephone operator with operations throughout the Middle East and Africa, offered 18% of its capital in a joint Cairo and London IPO, which raised $320 million and was 1.7 times oversubscribed. This IPO gained tremendous publicity for its size – the largest IPO in Egyptian history – and its rarity. In the MENA region, apart from Israel, venture capital/private equity has developed slowly and has, for the most part, depended on government backing. The U.S. Overseas Private Investment Corporation provides backing for investment funds focusing on developing regions. Two OPIC funds focus on the Middle East, especially Jordan, while several other funds are able to consider investments in Jordan or other MENA countries.

Egypt has two prominent fund management companies, EFG-Hermes and HFM, which dominate the private equity fund market in Egypt. HFM manages an estimated $100 million in private equity. EFG-Hermes, the largest fund manager and investment banking firm in Egypt, manages two Egyptian private equity funds with approximately $200 million, as well as two international private equity funds: the $15 million Jordan Hi-Tech Venture Fund and the $25 million Middle East Technology Fund. These two firms account for the bulk of private equity available in Egypt. In late 2001, a $12 million high-technology business incubator and fund was launched by Idea Developers with Egyptian Government backing.

In Jordan, the Government in October 2002 contributed $20 million to launch a new $50 million private equity fund to be managed by Deutsche Bank and the Jordanian Atlas Investment Company, with the remaining $30 million to be raised from local and international investors. The OPIC-backed $60 million West Bank, Gaza and Jordan Fund was canceled due to the *intifada*. There remains the $46 million Jordan-based and OPIC-backed Inter-Arab Investment Fund, launched in 1998, which focuses mainly on Jordan and Oman, but data on its investment performance to date are unobtainable.

The relative lack of early-stage financing for companies in most MENA countries has certainly inhibited entrepreneurial growth and has resulted in relatively fewer investment opportunities for foreign capital. It has also led to the development of large family-owned conglomerates, which tend to start new businesses within the family corporate structure

[46] *IVA 2002 Yearbook,* IVC Research Center, Tel Aviv

rather than investing through arm's-length transactions. This phenomenon owes something both to the lack of alternative investment opportunities and to the relative underdevelopment of domestic capital markets.

The foregoing discussion of the Israeli VC industry is important because its development has occurred almost entirely since 1991 and because Government played an important role in sparking its growth. Until 1991, venture capital in Israel consisted of a very small number of funds with at most $50 million under management. In that year, the Government launched the Yozma Program, which put $100 million as seed money into privately-managed venture capital funds run by international managers. The funds, each of which received $8 million from Yozma, had to raise $12 million from private sources. The attraction for private capital was the leverage involved, since the program guaranteed the private investors the full returns from the funds (this is similar to OPIC backing for developing country funds). In 1997, the program was wound up with the funds buying out the Government share, which by that time had become a small percentage of the funds' value. Government during the same period also funded a number of high-tech business incubators, which subsequently were privatized. These played an important role in supporting the development of companies that could benefit from VC funding.

The critical elements identified in the success of the Israeli VC industry, which fueled the development of its high tech industries, include the following.

- **Market Access:** Israeli companies moved very quickly to establish a foothold in the U.S., which later made it much easier to access U.S. funds and to seek listings on NASDAQ.
- **Size and Scalability:** The ability of companies to achieve a critical size rapidly. Small enterprises that remain small cannot generate the returns on investment that VCs and other investors require. Funds need to have the skills to evaluate companies' international growth potential, while the companies themselves must have a clear vision for growth. Companies that can't grow to at least $50 million in sales within the first three to five years are unlikely to generate sufficient returns for investors. Socially-motivated funds that may be content with lower returns are likely to fund more marginal investments that have smaller chances of success.
- **Human Resources:** High-caliber professionals are needed in both the VCs and their portfolio companies. Israel has these in abundance. Other countries, including Jordan and Egypt, also have significant numbers of professionals, domestically and abroad, that could contribute to this growth.
- **Local Investment Capital:** Some 90% of the funds managed by Israeli VCs is foreign-sourced. Nevertheless, local funding played a much more prominent role in the early days. It was only after the funds had achieved some success that they began to attract foreign capital. It will be important for Jordan to seek ways to identify and attract domestic capital into VC funds.
- **Exit Strategies:** The availability of domestic capital markets and access to foreign capital markets as a mechanism for funds to exit from their investments after the normal five to seven years.
- **Government Involvement:** Government funds provided the seed capital for venture funds and incubators, but this by itself would not have been enough. Government had to create the right incentive structure to encourage the sharing of risk by private investors. The Yozma program can possibly serve as a model for Jordan and other countries to develop domestic VC activity.

There is no shortage of capital available in the region; the challenge is channeling it into productive investments in the region. According to a 1997 study by Merrill Lynch, some 200,000 very high net worth individuals control about $1.6 trillion in private wealth in the Arab world.[47] Much of this, naturally, is concentrated in the GCC region, but even a significant portion of this could be mobilized for investment in Jordan and other less wealthy countries by adopting portions of the Israeli program.

All countries in the region have undertaken initiatives to develop their capital markets, and the markets have grown rapidly in response.

Table 20: MENA Stock Market Indicators

	Average Daily Volume (shares)	Average Daily Volume (US$)	Market Capitalization (billion US$)	Market Capitalization (% of GDP)
Amman ASE	2,500,000	5,000,000	7.7	88.0%
Cairo/Alexandria CASE	420,000	1,000,000	9.4	10.0%
Tel Aviv TASE	n/a	40,000,000*	44.0*	65.2%
Tunis BVM	30,000	700,000	2.2	11.0%
Dubai Financial Market (DFM)**	350,000	1,800,000	10.0	60.6%

* This has fallen from about $72 billion in 2000.

** Abu Dhabi also has a stock market, with about one-third the market cap and trading volume of the DFM.

Sources: ArabFinance.com; Zawya.com; Amman Stock Exchange; Tel Aviv Stock Exchange; Cairo and Alexandria Stock Exchange; Tunis Bourse des Valeurs Mobilières; Dubai Financial Market

Jordan has the highest ratio in the region of market capitalization to GDP, an important measure of the development of capital markets and an indicator of the degree to which domestic capital markets can mobilize savings. Trading volume remains low on all the Arab exchanges, though the average volume on the ASE is far higher relative to its market capitalization than that of other MENA exchanges, excepting Israel.

One challenge for Jordan is to try to attract some of the savings of other Arab countries, particularly the wealthier Gulf states. There are reports that banks, especially in Saudi Arabia, Kuwait and the UAE have begun to develop vehicles to invest in private equity in the MENA region, some of them based on Islamic finance principles. Little information exists on them, largely because the parent financial institutions tend to disclose relatively little information. Most of these funds appear to be in early stages of development, and so far they do not appear to have made many significant investments, at least outside of the Gulf region.

Other financial instruments for investment, trade or working capital finance are underdeveloped in the region. Commercial paper is virtually unknown, as are corporate bonds and asset-backed securities. The expansion of equity and government debt trading on exchanges may encourage such developments, although, outside of Europe and North America, even highly-developed markets, such as the Johannesburg Securities Exchange, have barely begun to develop such instruments.

Commercial lending in the region is constrained by conservative banking practices, including excessive collateral requirements and restrictions on foreign land ownership. Local family conglomerates tend to have very close banking relationships, often owning a significant share

[47] Cordesman, Anthony H., *Stability and Instability in the Middle East,* Center for Strategic and International Studies, Washington, D.C., 1997

of the banks' equity, which thus provides access to debt financing. Smaller companies find it much more difficult to obtain loans.

The 2002-2003 *Arab World Competitiveness Report*, recently published by the World Economic Forum, conducted extensive surveys of business people in Jordan and other MENA countries. Jordan ranked at the bottom in respect of ease of access to loans.[48]

Table 21: How easy is it to obtain a loan with only a good business plan and no collateral?

(scale: 7 = easy, 1 = impossible)	
Jordan	1.97
Egypt	2.46
Lebanon	2.41
Tunisia	3.67
UAE	3.71

Jordan also ranked low in availability of venture capital, ahead of Lebanon and Egypt, but behind Israel, Tunisia and the UAE.

9. Exchange Rates and Access to Foreign Exchange

Maintaining a competitive exchange rate is one of the most critical elements in trade competitiveness and, therefore, attracting foreign direct investment. As the data in Figure 20 indicate, most of the MENA countries have overvalued currencies, which numerous studies have shown to reduce trade competitiveness and actual export volumes. The countries covered in this ITS operate a variety of exchange rate regimes, including free float, managed float, soft peg and hard peg. The specific mechanism used by each country is less important than the real and perceived stability of the currency, as well as the extent to which the currency may be overvalued or undervalued. Overvaluation clearly increases the cost of a country's exports, while making its imports cheaper. For export-oriented industries, and in terms of competitiveness in attracting FDI, overvaluation is undesirable. Yet neither is undervaluation a clear benefit, at least in the long term. While a depreciating currency renders a country's exports more cost-competitive, it also raises the cost of imported inputs. For most developing countries, which need to import a relatively high percentage of their industrial inputs, currency depreciation may hurt as much as it helps. In addition, foreign investors are wary of currency depreciation, since depreciation or devaluation can significantly reduce the home-currency value of their fixed investments.

Exchange rates matter in other fundamental ways. Overvaluation of an exchange rate, particularly under a fixed-peg regime, is particularly dangerous. Very few countries have ever managed to withstand a speculative attack on their currencies, especially since such attacks almost always come as a result of a perceived overvaluation of the currency. As Howard Schatz and David Tarr point out, "one classic pattern is to attempt to defend an overvalued exchange rate by protectionist trade policies. Experience shows that protection to defend an overvalued exchange rate will significantly retard the medium to long run growth prospects of the country. In fact, an overvalued exchange rate is often the root cause of protection, and the country will be unable to return to the more liberal trade policies that allow growth without exchange rate adjustment."[49] Many countries nevertheless persist in maintaining

[48] *Arab World Competitiveness Report 2002-2003*, World Economic Forum, p. 361
[49] Schatz, Howard J. and Tarr, David G., Exchange Rate Overvaluation and Trade Protection: Lessons From Experience," *Working Paper#2289,* The World Bank, pp.1-2

overvalued exchange rates in pursuit of exchange rate stability. These governments may be correct in their perception that exchange rate volatility is undesirable, but their techniques for avoiding volatility may be suspect.

A fixed exchange rate is no guarantee of exchange rate stability. Argentina, which for several years had a currency board and a fixed exchange rate, underwent a severe currency crisis and was forced abruptly to abandon the U.S. dollar peg, with severe economic and political consequences. Though the ERF report (*Economic Trends in the MENA Region 2002)* suggests that fixed exchange rates minimize the risk of currency crises, it also points out that Egypt, Lebanon and the UAE have overvalued exchange rates and that Egypt and Lebanon are indeed vulnerable to currency crises. In Egypt, the unavailability of foreign exchange at the official exchange rate was for many months a clear sign of overvaluation, while the growing spread between the official and black market rates indicated that the situation was worsening. By sticking to an overvalued exchange rate rather than allowing gradual depreciation, Egypt setting itself up for a much sharper and more painful devaluation in February 2003. At that time, Egypt allowed its currency to float, at which point the exchange rate moved immediately to $1 = LE 5.50.

Jeffrey Sachs, in an evaluation of ten currency crises in middle-income developing countries during the 1990s, writes that "crises typically reflect a three-stage process that hits a developing country engaged in large-scale international borrowing. In the first stage, the exchange rate becomes overvalued as a result of internal or external macroeconomic events. In the second stage, the exchange rate is defended, but at the cost of a substantial drain of foreign exchange reserves held by the Central Bank. In the third stage, the depletion of reserves, usually in combination with a devaluation, triggers a panicked outflow by foreign creditors holding short-term claims. The trigger of panic, in most cases, is the devaluation itself, resulting from the exhaustion of reserves. The panicked outflow of short-term creditors leads to macroeconomic overshooting, characterized by sharp economic downturn, typically followed by a nearly equally sharp recovery. Various dimensions of the macroeconomy are involved in this overshooting: real GDP, the real exchange rate, real interest rates, net capital flows, and stock market valuations."[50]

Sachs goes on to criticize the view that devaluations themselves cause the panic, as well as the countries that engage in robust, but ultimately futile, attempts to maintain the exchange rate. In his words, "it is not the devaluation but rather the *defense* of the exchange rate preceding the crisis that has often opened the door to financial panic." According to this view, it is the depletion of a country's reserves in order to defend the exchange rate that causes the real crisis. Few countries have sufficient reserves to withstand a concerted speculative attack against an overvalued currency. Sweden in 1992 briefly raised overnight interest rates to over 500%, but was still forced to devalue. Hong Kong is one of the very few examples of countries that have managed to maintain an overvalued exchange rate in spite of speculative attack. The UAE could be another. Yet both the UAE and Hong Kong have high ratios of reserves to debt. More highly-indebted countries such as Egypt, which are struggling to maintain an overvalued exchange rate, could be positioning themselves for a much worse crisis. Panizza states that during 2000 the Central Bank of Lebanon spent $2.1 billion, or one-third of its reserves, to maintain the peg to the U.S. dollar,[51] yet the Lebanese pound remains highly vulnerable. Regardless of the real risk of a currency crisis, overvaluation reduces a

[50] Sachs, Jeffrey D., "Creditor Panics: Causes and Remedies," *Cato Journal*, Vol. 18, No. 3, Winter 1999, pp. 377-390.
[51] Panizza, Ugo, "Exchange Rate Policies in the MENA Region," American University of Beirut, April 2001. http://webfaculty.aub.edu.lb/~ugo/papers/exchangerate.pdf

country's competitiveness, especially in an environment in which competing countries may be pursuing deliberate policies to keep their exchange rates undervalued. Morocco, for example, experienced a 22% increase in its REER from 1990 to 2000, one of the main reasons for its declining competitiveness. Over the same period, however, Morocco's real exchange rate appreciated by 42% against the Chinese renminbi, about 40% against the Thai baht, and 64% against the Indian rupee.[52]

Though overvaluation has not been proven to have a direct effect on FDI flows, it has the potential to do so. In Egypt, where the pound is overvalued by more than 15%, companies are unable to obtain foreign exchange at the official exchange rate, even to purchase essential imported inputs. They are thus forced to engage in illegal (though tacitly permitted) activity or do without. For potential investors, this constitutes a serious impediment, as does the possibility that they will be unable to obtain foreign exchange to remit dividends overseas.

Calculating real exchange rates is often difficult, particularly when the Real Effective Exchange Rate (REER) is used: the REER takes account of trade and consumption patterns and is capable of revealing misalignments that occur when a currency is pegged to one foreign currency (e.g., the U.S. dollar), when a country's trade is denominated mainly in another currency (e.g., the Euro). Egypt, for example, trades far more with the EU than with the United States, but the anchor for its exchange rate management policy is the U.S. dollar. The same is true of Lebanon and the UAE. In the case of the UAE, however, the dollar peg is justifiable, given the importance of dollar-denominated oil exports. The time lag in calculating real exchange rates means that the available data, mostly from 2000, are out of date. Nevertheless, since none of the countries surveyed has substantially altered its exchange rate policies in the past two to three years, these data remain a useful indicator of the direction and magnitude of exchange rate misalignment.

The difficulty in estimating real exchange rates is illustrated by disputes over the level of overvaluation of MENA currencies. Dasgupta, Keller and Srinavasan suggest that, overall, the MENA region's currencies are not significantly overvalued and that, after a period of substantial overvaluation in the 1980s and early 90s, the nominal values (i.e., official exchange rates) of MENA currencies, taken in aggregate, were by 1998 only about two per cent higher than the real exchange rate as measured by purchasing power parity (PPP). Latin American currencies were overvalued somewhat more, at about 5%, while East Asian and South Asian currencies remained very substantially undervalued.[53] In sharp contrast to this assessment, Nabli and Véganzonès contend that from 1985 to 1999 the MENA currencies have, in aggregate, been overvalued by an average of 22%,[54] though they too agree that the level of overvaluation has declined in the late 1990s.

As the Heritage Foundation Index shows, all of the MENA countries surveyed have achieved very low inflation rates. Given that devaluation risks increasing inflation, central banks, especially in countries with a history of inflation, cannot be blamed excessively for keeping their currencies somewhat overvalued. This is particularly true of Israel, which suffered from hyperinflation in the 1980s. The Bank of Israel targets inflation rather than currency value,

[52] "Moroccan Manufacturing Sector at the Turn of the Century," The World Bank, February 2002, pp. 8-9,17 http://rru.worldbank.org/countryassessments/documents/Morocco/morocco-final.pdf

[53] Dasgupta, Dipak, Keller, Jennifer, and Srinavasan, T.G., "Reform and Elusive Growth in the Middle East: What Has Happened in the 1990s?"MEEA Conference on Global Change and Regional Integration, London, July 2001,

[54] Nabli, Mustafa K. and Véganzonès, Marie-Ange, Exchange Rate Regime and Competitiveness of Manufactured Exports: The Case of MENA Countries, World Bank, May 2002, http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Nabli-Veganzones/$File/Nabli-Veganzones.pdf

but also seeks to maintain the strength of the shekel, in part because Israel's huge borrowing requirements would become more expensive if the currency were to depreciate.

Table 22: Exchange Rate Regimes and Over/Under Valuation

	Exchange Regime	Official or Market**	Over/under valuation (2000)	Anchor Currency
Jordan	Fixed peg	Official	+9.8%	USD
Egypt[55]	Managed peg	Official	+15.5%	USD
Israel	Crawling band*	Market	+14.4%	USD
Lebanon	Fixed peg	Market	+22%†	USD
Morocco	Fixed peg	Official	+8.2%	Basket
Tunisia	Monetary targeting/ crawling peg***	Market	+0.8%	n/a
UAE	Fixed peg	Official	neutral	USD

Note: The exchange rate misalignments are calculated against the U.S. dollar, which has declined substantially against many major currencies since these calculations were made.
* Allowed to float within a band that is periodically readjusted
** Official rates are set by the central bank, which is the ultimate source of foreign exchange; market rates may be fixed or managed through intervention by the central bank in the interbank market † 1999
*** Tunisia in 2002 adopted a Constant Real Exchange Rate policy under which it allows the nominal value of the dinar to adjust to maintain a constant (or slightly depreciating) real exchange rate

Sources: IMF, International Financial Statistics; World Bank Development Indicators 2001, Global Development Finance 2000; U.S.-Arab Tradeline – The Year in Review 2002; The Economist

It is important to note that all of these measures of overvaluation are based on the real *effective* exchange rate, which is trade weighted and significantly biased towards trade in manufactures. Measured solely by purchasing power parity (PPP) against the dollar or the euro, all of the currencies except the Israeli shekel and the UAE dirham are significantly *undervalued*. This means that a given basket of goods will tend to cost less in Egypt or Tunisia or Jordan than it would in the United States. This has important implications for tourism and a country's ability to be perceived as a good value. Of course, even in countries with undervalued currencies in PPP terms, tourism often operates outside the normal local economy so that a sandwich costing perhaps 10 Egyptian pounds (a little less than $2) in a local Cairo café might cost $10 at one of the major hotels.

The Jordanian Dinar (JD) is not highly overvalued according to REER measures. Yet it, together with the Egyptian Pound and the Lebanese Pound, are probably the most vulnerable of the region's currencies to a currency crisis or, at the very least, increased pressure to devalue. For Jordan, the increasing possibility of a war between the U.S. and Iraq together with the resumption of weapons inspections indicate that, one way or another, the economic sanctions against Iraq will disappear and, with them, the arrangement under which Jordan receives its oil free of charge or at heavily subsidized prices from Iraq. This will increase pressure on Jordan's foreign exchange reserves and thus pressure to devalue the dinar, pressure that will increase the higher the price of oil. Conversely, Iraq's return to full participation in world oil markets could lead to a sharp decline in the oil price, which could lead to significant reductions in job opportunities for Jordanians in oil producing countries. This would cause a drop in remittances from Jordanians working abroad, which would also reduce foreign exchange reserves and increase pressure to devalue. These risks, which have intensified considerably in the past several months, may not be fully reflected in the EIU currency risk rankings, cited above. By contrast, the recent improvement in Jordan's trade

[55] Based on the current (end 2002) differential between the official exchange rate USD1 = LE 4.59 and the prevailing parallel market rate of USD = LE 5.3

balance is fully reflected and may have contributed to an underestimation of exchange risk in the medium term.

10. Taxation

Taxation is indisputably one of the major concerns for potential investors. Corporate income tax is probably the most significant, but personal income taxes, property taxes and sales or value-added taxes are also important considerations. Typically, the higher the tax rate, the greater the incentive for companies and individuals to seek ways to avoid taxes, though this does not seem to be a significant factor in Israel, which has the highest taxes of any of the five countries surveyed. This can distort economic decision-making, lead to unnecessary complexity and in tax regulations, and contribute to a deterioration in government transparency.

Table 23: Selected Tax Rates

	Jordan	Tunisia	Israel	Egypt	Dubai
Corporate tax*	0.15 – 0.35	0.35	0.36	.032 – 0.40	0.0††
Property taxes/rates†	0.02	0.05	$16.50/m2/yr	10-40%	0.05
VAT/sales tax	0.13	0.18	0.17	0.1	0.0
Personal income tax					
Top rate	0.3	0.35	0.5	0.65	0.0
Average rate**	0.24	0.28	0.4	0.385	0.0

* Exclusive of investment incentives and tax holidays. In Jordan, industrial, mining, hotel and transport industries are taxed at 15%. Financial enterprises are taxed at 25%, service enterprises at 35%. In Egypt, the basic corporate tax is 40%, while industrial and export activities are taxed at 32%. Egypt grants many bonuses and exemptions, which lower the effective tax on industry to around 25%.

** Based on $50,000 annual income. Salaries of non-Jordanian citizens working for non-Jordanian companies registered in Jordan are tax-exempt. Egypt's top personal income tax rate is 48%; however, Egypt also assesses a general tax on income that reaches 65% for income over LE200,000.

† Tax rates vary substantially by location and activity (agricultural land is taxed at lower rates than commercial/industrial land). Except where otherwise indicated, tax rates are based on actual or imputed annual rental income. Other property taxes in most countries include one-time fees on sale and purchase of property.

Sources: KPMG; Bank of Israel;, Central Bank of Jordan; Tunisia Foreign Investment Promotion Agency; Abdoun Real Estate; Info-Prod Research, Middle East; The World Bank

B. Investment-Specific Factors

1. Investment Incentives and Free Zones[56]

Notwithstanding the variation in tax rates indicated above, each country offers substantial incentives to encourage FDI. These incentives are, typically, targeted towards specific industries or even individual companies the country wishes to attract, as well as towards certain geographic areas in which a government wants to encourage development. Incentives generally consist of a combination of tax holidays, duty exemptions on imported inputs, cash grants and subsidized land or industrial buildings.

Though incentives have undoubtedly helped some countries to attract FDI, very little hard evidence exists as to how much incentives have helped and whether the cost of incentives to governments has been repaid through increased tax revenues from new investment. The costs and benefits of geographically targeted incentives are even more difficult to measure.

There is considerable debate over the virtues of incentives. The main problem occurs in the structure of incentives: how to offer incentives sufficient to attract desired FDI without overpaying. Uniform incentive packages are far and away easier to administer; but, if effective, they undoubtedly give away more than they need to. Case-by-case incentives, on the other hand, can be less transparent than uniform ones and can result in overpaying to attract prestigious and highly visible investments. In either case, there exists an unfortunate tendency for countries (and regions or states, in Europe and the United States) to compete on the generosity of incentives, often to the point where it is almost certain that whoever succeeds finally in attracting the investment has paid too much. An examination of the competition among U.S. states to attract huge investments in car manufacturing will support this conclusion.

Evidence suggests that incentives, especially tax incentives, can attract additional FDI, increase employment and, effectively, pay for themselves. A study of Puerto Rico's incentive regime, in which tax exemptions of different magnitude and duration were given for three different zones based on existing levels of industrialization and unemployment, suggested that the incentives, along with low wages, were an important factor in attracting investment, especially by companies from the U.S. mainland. The same study, however, showed that the regional differences in incentives were far less effective. The underdeveloped regions with more generous incentives did not attract more investment than the more developed regions with less generous incentives. In other words, "after firms decided to locate in Puerto Rico, the local incentive program seems to have [had] no impact over the within-island location decisions."[57] As to the more fundamental question of how much difference the incentives make, or whether an overall lowering of the basic corporate tax rate would help more, it is impossible to say. Certainly, Dubai's uniform zero tax rate is more attractive than applying for a tax holiday of limited duration. Jordan's uniform 15% tax rate on industry, especially if combined with certain other incentives, provides a much higher degree of confidence to the

[56] Information on incentives and free zones comes principally from the following sources: Jordan Investment Board (www.jordaninvestment.com), Jordan Industrial Estates Corporation (www.jiec.com), Aqaba Special Economic Zone Authority (www.aqabazone.com), Egypt Ministry of Foreign Trade, Egypt General Authority for Investment and Free Zones (www.gafinet.net – website is inoperable), Israel Investment Center (http://www.moit.gov.il/root/hshkaot_beisrael/ADVANTAGES-BENEFITS.HTML) and Israel Investment Promotion Center (http://www.moit.gov.il/root/Hidden/ipc/home.html) - Ministry of Industry and Trade (http://www.moit.gov.il/tamas_en.htm), Tunisia Foreign Investment Promotion Agency (www.investintunisia.com), Dubai Development and Investment Authority (www.ddia.ae), Jebel Ali Free Zone Authority (www.jafza.co.ae), Dubai Media City (www.dubaimediacity.com), and Dubai Internet City (www.dubaiinternetcity.com).

[57] Guimares, P., Rolfe, R. J., Woodward, D. P., "Regional Incentives and Industrial Location in Puerto Rico," University of South Carolina, 1996.

investor who knows that, after the tax holiday ends, the basic tax will revert to 15%, rather than a much higher figure, as is the case in Israel, Tunisia and Egypt.

Free zones are a form of incentive, in that they often involve a more open and less regulated business environment than that which prevails in the general economy. They also make life easier for exporters by virtue of their special Customs status. In almost all cases, imported goods enter a free zone free of duty. Companies importing capital goods, raw materials or intermediate products and then exporting the finished product need to tie up far less working capital than companies operating under a duty drawback or similar system for rebate of import duties. Free Zones often form a part of a government's strategy to increase export competitiveness So, free zone development often involves substantial improvement to infrastructure, including ports, railways, roads, electricity and communications. Free zones often serve as a sort of laboratory in which reforms are tested before being introduced into the general economy. Mauritius, which started by setting up free zones in the early 1980s, had effectively transformed the entire country into a free zone by the mid-1990s.

The question of incentives is also closely tied to the issue of investment targeting. Though the international consensus is that investment promotion efforts need to be targeted by sector or industry, the benefits of that targeting are less clear. Of the countries evaluated, Israel has the most highly skewed approach, which strongly favors high-tech industry, which accounts for 70% of the country's exports. This has left it highly vulnerable to external shocks. Of the countries surveyed, all continue to display fairly robust economic growth, except for Israel, whose economy has shrunk in both 2001 and 2002. At least some of this can be attributed to Israel's over-dependence on the information and communications technology (ICT) sector, which has undergone a worldwide slump over the past two and a half years.

a. Jordan Investment Incentives

Most of Jordan's investment incentives are evaluated and granted through the Jordan Investment Board, the statutory body responsible for promotion and facilitation of FDI. Incentives are available to domestic, as well as foreign, investors. Incentives are generally granted for industrial projects, traded services (also classified as industry), tourism and mining projects. The Government of Jordan recognizes three different geographic classifications, each of which qualifies for a different level of incentives. Zone A consists of the major urban centers; Zone B of some of the peri-urban and more developed rural areas, and Zone C of remoter rural areas and disadvantaged towns.

i. Income and Social Service Taxes Exemptions

Projects approved by the Investment Committee enjoy a ten year exemption from income and social services taxes at the following rates depending on the sector and the area in which the project is located.

- Projects in zone A 25%
- Projects in zone B 50%
- Projects in zone C 75%

Where a project is expanded, improved or modernized so as to increase its production capacity, it shall receive an additional year of exemption for every increase of production, which is not less than 25%, for a maximum of four years.

ii. Customs Tax Exemptions

- Imported fixed assets required for the project are exempted from customs taxes and fees for a period of three years starting from the date approval is granted.
- Imported fixed assets needed for expanding, modernizing, or developing a project are exempted from customs taxes and fees, if this results in an increase of a minimum of 25% of the production capacity.
- Spare parts imported for the project are exempted from taxes and fees provided that their value does not exceed 15% of the total value of the fixed assets utilizing these spares.
- Hotel and hospital projects are granted extra exemptions from customs taxes and fees on their imports of furniture and supplies for the purpose of renewal, once every seven years.
- Any increase in the value of imported fixed assets is exempted from customs taxes and fees if the increase results from a rise in prices, freight charges or changes in exchange rates.

Taxes are defined in the Investment Law to be "taxes that are levied by virtue of the laws in force on fixed assets except for municipality fees," whereas fees are defined to include "import, customs and other fees provided for in other legislation in force that are levied on different fixed assets except for municipality fees."

iii. Industrial Estates

In addition to these incentives, the Jordan Industrial Estates Corporation (JIEC) offers other incentives to companies locating in one of their estates, of which there are currently four, with several others in development. These incentives include, for newly established or relocated companies:

- Two additional years of income and social services tax exemptions, commencing on the date of production.
- Permanent exemptions from building and land taxes.
- Full or partial exemptions from most municipality planning and services fees.

JIEC also operates two of the five Qualifying Industrial Zones (QIZs), which operate under the joint U.S.-Jordan-Israel QIZ agreement discussed above in Section 7, Market Access. JIEC estates offer competitive rental rates and purchase prices for industrial land and buildings.

JIEC's purpose is, largely, to encourage industrial development in less developed areas, but it is moving in the direction of providing incentives, supervision and assistance to private developers to build new industrial estates.

iv. Free Zones

Jordan has a number of public and privately-owned free zones, operating under the authority of the Free Zones Corporation, whose purpose it is to facilitate trade between Jordan and neighboring countries such as Iraq, Egypt, Syria and the Gulf states. Companies in the Free Zones enjoy the following benefits.

- Exemptions of profits from income and social service taxes for a period of twelve years from the commencement of operations.
- Salaries of non-Jordanian employees working in the free zone are exempted from income and social services taxes.
- Goods imported into the free zone are exempted from customs duties, import fees and sales taxes. Goods exported from the zone are exempted from all taxes and fees as well.
- Exemption of products produced in the free zone for domestic consumption from customs fees and taxes limited to the value of materials, costs, local expenditures involved in the products manufacturing, provided this value is approved by the Free Zone Committee.
- Buildings constructed therein are exempted from licensing and real estate taxes.
- Freedom to repatriate capital invested and profits earned.
- 10% exemption on the annual rent of land and structure for industrial projects.

The zones operated by the Free Zones Corporation offer competitive rental rates and purchase prices for land and industrial buildings.

v. Aqaba Special Economic Zone

The Aqaba Special Economic Zone (ASEZ) was created in August 2000 to become a globally-competitive center for trade, tourism, high-tech and other high value-added industry, multi-modal transport, logistics and professional services. As such, the Aqaba Special Economic Zone Authority (ASEZA) has developed a comprehensive master plan for infrastructure, tourism, residential and industrial development in the Zone, and has also instituted a new and streamlined business environment that includes a one-stop shop for investment approvals, simplified registration and licensing procedures, and a duty-free and tax-advantaged environment in which businesses can operate. ASEZ is a duty-free port, and Customs duties are assessed on goods only when they leave the Zone and enter the rest of Jordanian territory. ASEZ operates outside Jordanian customs boundaries and as such constitutes a separate Customs territory from Jordan itself.

ASEZ also applies its own investment incentives regime, which includes:

Tax incentives

- No Social Services Tax
- No sales tax on most goods and services consumed within the zone
- No annual land and building taxes on utilized property

- A low 5% tax rate is applied on all net business income (inside the zone and outside Jordan), except banking, insurance and land transport, which are subject to prevailing Jordanian income tax rates
- 10% land transfer tax (4% paid by seller; 6% paid by purchaser)
- 7% sales tax limited to the final consumption of selected personal goods and hotel/restaurant services

Relaxed land and labor laws
- Fewer restrictions on foreign land ownership and long-term leaseholds
- Companies can bring in foreign workers up to 70% of total work force
- Greater ease of obtaining work permits for foreigners

Other
- Full repatriation of profits
- 100% foreign ownership
- No foreign exchange controls

b. Egypt Incentives and Free Zones

i. Direct Incentives

Egypt's Investment Law of 1997, as amended by Presidential and Prime Ministerial decrees in 2000, 2001 and 2002, opens up most of Egypt's industrial, agricultural, infrastructure and service sectors to foreign participation and makes such investments eligible for investment guarantees and incentives provided for in the law.

Guarantees and incentives include the following.

- 100% foreign ownership
- Guarantees against nationalization and expropriation and seizure of assets
- Absence of price controls
- Full repatriation of capital and profits
- Exemption of short-term (less than one year) expatriate salaries from local income tax
- Five-year exemption from corporate income tax, from first year of operation
- Twenty-year exemption from corporate tax in certain disadvantaged areas
- Ten-year tax holiday on investments in new urban communities, industrial parks and remote areas
- Five-year tax holiday on expansion of existing projects
- No registration requirements to import and export equipment
- Flat 5% Customs duty on imported equipment
- Three-year exemption from stamp duties, as well as registration and notarial fees on new project contracts

ii. Free Zones

Egypt currently has seven public free zones, hosting 674 companies, with three other zones under development. Their incentive and guarantee structure is similar to that provided under the investment law, with a few important additional advantages. These include:

- Greater flexibility in obtaining foreigner work and residence permits

- Full exemption from corporate income taxes for the life of the project; instead 1% of value added is payable annually
- Full exemption from all import and export duties, import and export licensing, and sales taxes, except for a 1% duty on all imports
- Reduced tariff on free zone products sold in the domestic Egyptian market
- Protection against lawsuits
- Low-cost industrial and commercial land and buildings

Egypt also has private free zones, usually set up by an individual company, to undertake commercial and industrial activities. There are 177 companies located in private zones, and they benefit from the same incentives as in public zones. In addition to the free zones, Egypt also has established some thirty-nine industrial parks, most of them located in underdeveloped areas in Upper Egypt, the Delta and the Suez Canal Zone. Most of these parks offer free industrial land to investors and as such are suited to large-scale investments such as chemicals, cement and pharmaceuticals for which companies must build their own facilities and for which the land requirements are large.

c. Israel Incentives and Free Zones

The Israeli Government offers incentives to investments, foreign or domestic, in "Approved Enterprises" in industry and tourism. Officially, all industrial and tourism enterprise are equally eligible for incentives, but investment in high-tech industries (mainly IT-related, though biotechnology is also significant) accounts for most incentive approvals and unofficial reports suggest that obtaining incentive approval for non-high-tech investments is far more difficult. For that reason, according to the Israel Investment Center, which issues incentive approvals, roughly one-third of industrial investment applies for approved status. Israel Government statistics show that in 2001, 125 out of 163 approved investments were in the electric and electronics sector, in which IT predominates, and that these enterprises counted for about 54% of the total capital invested in approved enterprises, and 52% of the foreign share of capital invested in approved enterprises.

i. Direct Incentives

The Government offers a range of incentives that include tax exemptions, accelerated depreciation, and capital grants. Approved enterprises are free, within certain limits, to choose from a menu of benefits. For example, a company receiving capital grants may pay a higher rate of tax than companies waiving the grant. For certain kinds of high-tech companies, especially in software where capital expenditures are usually small, this can be a more attractive option.

The government has designated three investment zones: Central Israel, Priority Zone B, and Priority Zone A. The Government also recently enacted a more generous incentive regime for companies locating in the northern border region. Given Israel's small size, priority incentive zones are not necessarily in remote locations. For example, one of the country's largest high-tech zones, in a Priority Zone A, is in suburban Jerusalem, no more than 10 minutes drive from the city center.

Tax Exemptions

The tax benefits for an Approved Enterprise are granted over a period of seven consecutive years, starting with the first year that the company earns taxable income. If at least 25% of an

enterprise's owners are foreign investors, the enterprise is eligible for a ten year period of tax benefits. These benefits are granted to expansions of existing investments, as well as to new investments. It is important to note the outstanding feature of this regime, which is that it grants the tax benefits for a period starting from when the company first generates taxable income.

Table 24: Israel Tax Incentives

	Company owned by local investor	Company owned by foreign investors, foreign investors´ percentage ownership			Company that is not an approved enterprise
		90-100%	74-90%	49-74%	
Taxable income	100%	100%	100%	100%	100%
Company tax	25%	10%	15%	20%	36%
Balance	75%	90%	85%	80%	64%
Income tax	0%	0%	0%	0%	0%
Total tax on undistributed income	25%	10%	15%	20%	36%
Dividend tax: 15% of balance (for Approved Enterprises)	11.25%	13.5%	12.75%	12%	25%*
Total tax on distributed income	36.25%	23.5%	27.75%	32%	52%

* When distributed to a person or a company abroad; when distributed to an Israeli company: 0%

Most of the major international investors, including Intel, Motorola, Cisco, Sun and IBM, have located some or all of their investments in Priority Zone A, with the status of 100% foreign-owned subsidiaries, where they benefit from an effective 10% tax rate for the first ten years.

Capital Grants

Israel offers a range of capital grants to approved enterprises, which vary according to size of project, location, activity, and percentage of foreign ownership. For companies investing along the northern border, the grant is increased by 6%.

Table 25: Capital Grants

	Priority Zone A 2001	Priority Zone B 2001
Industrial projects (Up to 140 Million Shekel)	24%	10%
Industrial projects (Above 140 Million Shekel)	20%	10%
Investments in hotels; other accommodation	24%	10%
Other tourist enterprises	15%	

Research and Development Grants

The Office of the Chief Scientist of the Ministry of Industry and Trade administers an incentive scheme to encourage investment in industrial R&D activities. An approved R&D project is defined as "one lasting one or more years, resulting in the manufacture of a new product, or a significant improvement to an existing product. The development also may lead to a new industrial process, or a significant improvement in an existing industrial process."

The program provides a grant of 50% of the total approved R&D expenditures. R&D projects for improvement of an existing product are eligible for grants at a rate of 30%.

A unique feature of this program is that the grant recipient must repay the grant by paying royalties on the revenues from the product developed with grant funding. The royalties are repaid according to the following schedule.

- 3% of revenues during the first three years
- 4%over the next three years
- 5% in the seventh, year and any year thereafter, until full repayment

Recipients can, and often do, repay the grant over a shorter period.

In effect, these grants constitute an interest-free, risk-free and unsecured loan, repayable only in the event that the product succeeds in the market. The program is self-funding, since royalty receipts go to fund new grants.

Other

The Government provides a range of education and training grants and subsidies to companies on a case-by-case basis by the Committee on the Development of Human Capital.The focus of the program is mainly on high-tech industry.

d. Tunisia Incentives and Free Zones

i. General Incentives

All industrial and tourism investors, as well as most agricultural investors, in Tunisia qualify for certain basic incentives as follows. It is important to note, however, that the Government targets certain priority industries and that approval for projects falling outside the preferred categories may find it more difficult to obtain investment approval and appropriate incentives. The priority industries are:

- Food processing
- Textiles and garments
- Automotive
- Leather
- Electric
- Electronic
- Packaging
- Computer
- Pharmacy

The main incentives are:

- Foreign ownership of land
- Full repatriation of capital and profits for foreign enterprises and for foreign workers' salaries
- Current account convertibility of the Tunisian dinar
- Free access to foreign exchange for production inputs

- Tax exemption on 35% of net income (reducing effective tax rate from 35% to 22.75%)
- Exemption from Customs duties on capital equipment for which there is no locally made equivalent
- Maximum 10% value-added tax on imported capital equipment (versus normal 18% VAT)

ii. Export Incentives

Exporting companies in approved sectors receive significantly more generous incentives, which include:

- Ten-year tax exemption on profits from exports; 50% exemption from profits on exports from year eleven onwards
- Complete tax exemption on reinvested profits
- Duty-free import of capital equipment and raw materials
- Ability to sell 20% of production in the local market
- Accelerated depreciation

iii. Priority Investment Areas

The Tunisian Government has designated thirteen "Incentive Zones" in certain areas in which it wants to encourage investment. Investment in these areas, whether or not they are export-oriented, receive an incentive package similar to that offered to exporting companies. In addition, investors can receive other benefits that include:

- State payment of the employer's contribution to the Social Security scheme for the first five years of operation
- A State grant of 15.5% of payroll expenses during the first five years of operation
- Possibility of State assumption of a portion of infrastructure/site development costs
- A grant equivalent to 15% of invested capital

The Government has designated well over fifty other areas as "Priority Zones," in which investors receive the same incentives as for the Incentive Zones, except that the capital grant is increased from 15% to 25%. Investments in agriculture, aquaculture, and fisheries receive a package of incentives similar to those for exporting companies, though the tax exemption runs only for ten years. Depending on the area of investment and the specific activity, investors may receive capital grants ranging from 7% to 25%.

iv. Free Zones

Tunisia also has two free zones, located in Bizerte in the north about 60 km from Tunis and Zarzis in the south. The government is also seeking to develop Sfax, Tunisia's second-largest city, on the central coast, as a high-tech cluster and may undertake a free zone development in this area. The Free Zones operate their own one-stop shops for investment approvals, without any requirement for investors to interact with other national or local authorities. The free zone advantages include:

Tax regime

Companies established in free zones are subject only to the following taxes, duties, rights, and fees.

- Duties and taxes related to passenger cars
- Single countervailing duty on land transport
- Contributions and shares for the social security legal scheme
- Corporate tax from the eleventh year of operation, to date from the first effective export sale after a 50% deduction for export-derived profits (i.e., full tax exemption for first ten years)
- Additionally,
- Free Zone companies enjoy a complete exemption from import duties;
- Foreign employees of free zone companies pay a flat 20% tax on gross income; and,
- Foreign employees can import personal belongings free of taxes and duties.

v. Promoting Research and Development

The Tunisian Government, in order to encourage domestic development of R&D capacity, will assume the Social Security contributions for the first five years of employment for Tunisian university graduates hired by investors. The Government will also assume 50% of Social Security charges for companies adding a second or third production shift.

e. Dubai Incentives and Free Zones

Dubai does not grant investment incentives *per se*. With no corporate or personal income taxes, full convertibility of the dirham, and very low import duties (with full duty exemptions for re-exports and most capital goods and industrial inputs), there are few areas in which direct incentives could be applied.

Dubai does, however, provide more indirect incentives. Among the most important of these is infrastructure development. The Government and ruling family of Dubai (and the UAE) have invested huge sums to develop physical infrastructure, which includes land reclamation, office space, hotels, roads, telecommunications, ports, airports, and airlines. In the early days of Dubai's industrial development, most of these developments were financed directly by the Government and ruling family. Today, increasingly, the Government acts as a catalyst for private development of infrastructure. In the 1970s and 1980s, the ruling family itself put up much of the money to develop Port Rashid and the Jebel Ali Free Zone. Today, with the planned development of Dubai Health Care City, an integrated medical complex, the Government, as an equity partner in the first phase of development, is providing land as its sole direct contribution, as well as creating the necessary legal and regulatory framework; the cash investments will come from private interests. In subsequent phases, the Government is unlikely to participate in ownership or financing in any way.

The second major way in which the Dubai Government provides incentives is through the establishment of free zones, which offer a less regulated business environment. These zones have been created by Government to promote investment and development in areas it identified as priorities for development. The Jebel Ali Free Zone was the first, providing a regime and infrastructure for companies involved in trade and re-export (the traditional mainstay of Dubai's economy) and manufacturing. Jebel Ali has been followed by numerous others: the Dubai Airport Free Zone, Dubai Media City, Dubai Internet City and Dubai Knowledge Village (the latter three administered under one authority), and the planned Dubai Health Care City, the first phase of which is estimated to cost about $2 billion.

The main benefit that the free zones offer to foreign investors is the right of 100% foreign ownership. This right does not extend to land, the purchase of which by foreigners has historically been prohibited. (The first residential housing development open to purchase by non-GCC citizens opened for sale in December 2002.) Under normal Dubai law, foreigners (some exemptions are available to citizens of other GCC countries) can own only up to 49% of a company; the other 51% is reserved for UAE citizens. As discussed earlier, the actual profit sharing may differ substantially from this proportion. Nevertheless, this requirement is a significant obstacle for many companies and, in effect, constitutes a hidden tax on foreign enterprises.

Some foreign service companies, especially in the engineering and construction field, cannot find many ways around this requirement, but most other companies can by locating in a Free Zone. It is also true that, for companies focusing mainly on manufacturing for the domestic market, the 4% duty (soon to rise to 6%) payable on goods "exported" from one of the zones into UAE Customs territory could inhibit their ability to compete. For most foreign enterprises, however, the free zones are an attractive option. Free zone companies benefit from the 100% corporate and personal tax exemptions. Obtaining work and residence permits is substantially easier in the zones. Each zone functions as its own "one-stop-shop" and does its own approvals without recourse to Dubai or UAE authorities. The zone authorities themselves act as sponsors for foreign workers applying for work and residence permits, historically one of the functions of the local Emirati partner under normal Dubai company law. Free zone companies can import duty-free and pay duties only when goods leave the zone to enter UAE Customs territory.

Many business regulations are relaxed or dispensed with in the zones. In Dubai Media City and Dubai Internet City, for example, free-lance journalists, producers, consultants, designers, and other experts can obtain work and residence permits through the sponsorship of zone authorities, without having to establish their own companies. This could never be done under normal UAE law. By facilitating the development of a pool of talent that can be outsourced, Dubai is making its knowledge- and technology-intensive industries more competitive on cost and quality. Dubai Internet and Media Cities, by establishing their own ISP and international gateway, are able to escape the internet content monitoring and blocking practiced by the UAE authorities.

2. Telecommunications and Internet

Table 26: Technology Indicators, 2000/2001

	Personal Computers Per 100 Population*	Internet Users (Thousands 2001)*	Internet Hosts (2001)	Internet Hosts Per 10,000 Population (2001)	Telephone Mainlines Per 100 Population	Annual Growth Rate 1995-2001	Cellular Mobile Subscribers Per 100 Population	Annual Growth Rate 1995-2001
Jordan	3.28	212	2185	4.22	12.74	9.5%	16.71	102.9%
Egypt	1.55	600	1802	0.28	10.3	14.1%	4.33	169%
Israel	24.59	1800	143,678	220.77	47.63	2.2%	80.82	50.9%
Lebanon	5.62	300	7101	19.97	19.49	12.2%	21.25	44.0%
Morocco	1.31	400	2454	0.81	3.92	-1.3%	15.68	133.4%
Tunisia	2.37	400	218	0.22	10.89	11.0%	4.01	122.8%
UAE	13.55	976	76.546	246.92	39.69	5.5%	61.59	56.7%

* These figures are increasing rapidly. According to the San Jose Mercury News (December 1, 2002) the number of Internet users in Egypt is now 1 million a year-on-year annual growth rate. Other estimates suggest that Internet usage is increasing at a similar rate in Jordan.

Sources: UNDP Human Development Indicators, International Telecommunications Union

Table 27: Internet and Telephone Costs*

	Jordan	Tunisia	Israel	Egypt	Dubai
Internet					
Dial-up***					
Connection	$14.00	$178.00		Free	$27.40
Monthly usage	$14.00	$37.00	$20.00	Free	$5.50+0.49/hr
No. of ISPs	11	3	40+	35+	3
ASDL					
Connection	$113	$444	$70-120		$130-240
Monthly usage†	$36.00	$244	$39-60.00	$70.00†††	$68.50-300
Telephone					
Local/National (per min.)	$.016-0.21	$0.008-0.115	$0.0055-0.057	0.00	Free
International (per min.)**	$.836- 1.198	$0.37-0.83	$0.08-0.50	$0.92-1.44	$0.38-0.58
No. of providers	1	1	1	1	1
Mobile					
Connection	$0-30	$115.00		$0-32	$20.00-35.00
Monthly fixed††	$0-20	$15.38	$0 – 20	$0-24	$2.30-2.78
Per minute	$0.05-0.21	$0.135-0.19	$0.11-0.25	$0.05-0.19	$0.058-0.083
No. of providers	2	2	4	2	1

* Composite estimates based on different service providers and different tariff and usage options. Costs are based on individual usage; corporate packages may involve lower tariffs and are often negotiable. Some telcos have a minimum call charge, usually equivalent to three minutes of usage.
** To the United States. International mobile charges generally consist of local mobile tariff plus normal fixed line international charge.
*** Dial-up usage charges do not include cost of telephone call, which is billed per minute.
† Guaranteed 256 Kbps download; higher speeds/bandwidth can cost three to five times more.
†† Many prepaid services have no fixed monthly charge.
††† Monthly charge includes installation.

As expected from the different levels of per capita GDP, Israel has the highest rate of teledensity in fixed and mobile lines, as well as computer and Internet penetration, followed by the UAE. Jordan, however, scores well above Tunisia and Egypt in both fixed and mobile teledensity, as well as computer and Internet penetration. On the measure of Internet hosts per 10,000 population, which can indicate the quality and speed of dial-up connections, Jordan scores far higher than Egypt, Morocco, or Tunisia.

On cost, too, Jordan scores well. Internet connections and usage are relatively inexpensive for both dial-up and broadband connections. International telephone charges are relatively high, while local fixed line and mobile tariffs are relatively low.

Egypt, however, has introduced a new service in which Egypt Telecom offers dial-up Internet access for the price of the telephone call alone. Egypt Telecom then splits the call revenues with the ISP. This has given the country one of the cheapest Internet connection costs in the world, especially when the low cost of domestic telephone calls is taken into account. This has undoubtedly contributed to the very rapid growth in the number of Internet users in Egypt.

The number of ISPs is also an indicator of the vibrancy of the domestic IT industry. Jordan, with at least eleven ISPs, has more, relative to size, than any country except Israel.

Number of ISPs is also, to a degree, a measure of the degree of freedom of information exchange in a country. Dubai, for example, has only three ISPs, two of which are owned by Government. Nevertheless, one of the two, operated by the Dubai Media City/Internet City Authority, is largely autonomous and also has its own international gateway, which prevents blocking by the government telco monopoly. Tunisia also has three ISPs, two of which are private; but the state-owned telco has the only international gateway and blocks Internet content fairly aggressively. Jordan Telecom is the monopoly international gateway in Jordan, but it appears to exercise a hands-off policy with respect to Internet content monitoring and blocking. There is no evidence that Government has pressured it to introduce more stringent controls.

In short, there are few bandwidth, connectivity, or cost problems that would prevent Jordan from becoming a competitive center for IT development in the region.

3. Transport

Transport costs can be a significant portion of the final cost of an exported product, not only for the shipment of final goods to market, but also for the transport costs of imported inputs. This is especially true for lower-value products, for which shipping can represent a significant portion of the final product cost. Shipping costs vary tremendously according to the kind and value of product being shipped. Thus, figures presented below are indicative only.

Table 28: Ocean and Air Freight Charges

	Jordan Irbid via Haifa	Jordan Irbid via Aqaba	Tunisia Tunis	Israel Haifa	Egypt Alexandria	Dubai Jebel Ali
OceanFreight (20-foot container to New York*)						
Cost	$2,200	$2,270	$1,887	$1,662	$1,762	$2,087
Transit time	24 days	31 days	20 days	23 days	21 days	31 days
Air Freight (Per kg.)						
New York***	$4.25**		$4.85	$3.90	$3.90	$3.30
London**	$2.55		$2.55	$1.50	$1.45	$0.98

Exclusive of insurance, duties, and Customs clearance charges at destination
* via Antwerp
** from Amman, Cairo, Tel Aviv
*** based on 100 kg shipment
2Air freight to Amman, Tunis, Cairo, Tel Aviv, Dubai (reliable information on air freight from these locations is unobtainable, but these figures serve as an indicator of relative costs)
Sources: Atlantic Container Line, Maersk Sealand, Al Watanieh Company, Rum & Gulf Company, FIPA Tunisia, World Bank, APX Air Cargo, American Baggage, Inc.; ASEZA

It is not always clear to what extent these prices include port handling charges, which range from about $100 to $350 for a 20-foot container. Shipping costs are lower for European, especially Mediterranean, destinations. According to the Aqaba Special Economic Zone Authority, it costs about $600 to ship a 20-ft. container from Aqaba to Rotterdam. Shipping costs from Haifa or Ashdod in Israel, Alexandria in Egypt, or Tunis to French or Italian Mediterranean ports average between $400 and $600 for a 20-ft. container, exclusive of port charges.

4. Physical Infrastructure and Inputs

Quality, availability, and cost of land and buildings, electricity, and water are important considerations for investors. The cost of electricity and water is especially important for industry and agriculture. Garment manufacturing can use enormous quantities of water, as do many kinds of electronics manufacturing, such as chip fabrication. Fuel costs have a direct effect on transport costs. Most countries throughout the world provide a variety of subsidies for such inputs, which are even more important to the general public than to potential foreign investors. Indeed, in many countries utilities and fuel charges are higher for industrial users than for household and agricultural users, reflecting the importance to governments of keeping their constituencies happy. One important follow-on study from this report might consist of an assessment of the actual versus the real costs of electricity, fuel, and water in Jordan, and to examine the distortionary effects current pricing policies may have on trade and investment.

a. Land

In all countries surveyed, the investment promotion agencies try to steer investors towards industrial zones where Government and/or the private sector have established much of the infrastructure that companies require. Some of these industrial developments may be in remote areas, where the government wishes to encourage development and may provide special incentives to companies locating there. A large number of such developments, however, are in good locations, close to markets and transport hubs. They have been set up by governments as a way to segregate industrial activity from residential and commercial zones.

Two attractions of industrial parks and estates are that they are already zoned for the kinds of industrial activities most investors want to undertake and that the zone authorities can grant the necessary approvals without obliging investors to apply separately to planning committees, zoning boards, and other authorities. Most industrial estates offer a combination of pre-built office, factory, and warehouse buildings that companies can rent, together with serviced land available for long-term lease or purchase. Land sites are more attractive to companies that need to build specialized plants that cannot be installed in a standard factory or warehouse shell.

Table 29: Rental Cost of Land and Buildings (US$ per m^2 per year)

	Jordan	Egypt	Israel	Tunisia	Dubai
	n/a	200-250	200-250	65-80	250-410
Warehouse/industrial buildings*	16.7-21.7	30-60	48-240	30-35	67-75
Industrial land	2.11-3.52	3.50-7.00	n/a	2.50-5.00	2.52-5.45

*Office space often includes electricity and water charges as part of basic rent. In some areas, especially in the Dubai Free Zones, offices are often furnished, contributing to higher rental costs

b. Utilities and Fuel

Table 30: Utility and Fuel Costs

	Jordan	Egypt	Israel	Tunisia	Dubai
Electricity ($ per KwH)	0.046-0.066	.015-.034	0.025-.1675	.025-.085	0.055
Water ($ per m^3)	1.40	0.35	.435-1.09	.12-.67	1.81-2.19

Sewerage ($ per m^3)	0.70			.30-.58	
Fuel ($ per litre)					
Gasoline*	0.39	0.26	1.00	0.546	0.30
Diesel	0.17	0.10	0.67	0.284	0.20

* The most commonly used grade. In Jordan and Egypt, it is regular; in Israel, Dubai, and Tunisia, it is unleaded or super.

Sources: JIEC, JIB, ASEZA, GAFI, Israel Investment Promotion Center, FIPA-Tunisia, DDIA, JAFZA, Dubai Media City

As might be expected from a country with fairly abundant oil reserves, Dubai's fuel prices are low. Egypt, whose oil industry is growing rapidly and which consumes domestically most of its petroleum output, has lower fuel prices than even Dubai. Tunisia and Israel both have prices reflecting their status as oil-importing countries: Israeli prices are comparable to Western European prices, while Tunisia's prices are fairly high by world standards. Jordan, which depends on imports of refined products, has very low prices, especially for diesel. The low prices are largely a function of Jordan's relationship with Iraq, its largest trading partner, which provides Jordan with petroleum products at very low prices, mainly for barter.

This arrangement is largely unsustainable, and fuel prices are almost certain to rise, at least in nominal terms, in the near term. The same is likely to be true of Egypt. High external debt and large budget deficits bring pressure from lenders and donors to reduce public subsidies. Changes in Jordan's trade relations with Iraq may increase its cost of oil. The risk in both countries of currency devaluation will result either in an increase in oil prices (especially in Jordan, which imports all its oil) or pressure to increase subsidies on retail prices.

Sudden increases in fuel prices increase political volatility. Whether in France, Germany, Israel, Nigeria, or Zimbabwe, threatened fuel price increases have led to road blockades by truckers, strikes, and riots. The advantage Jordan may currently enjoy from low fuel prices could easily turn into a liability if such events were to occur.

5. Human Capital

Of all the inputs required by foreign investors, none is as important as human capital. Though the term "human capital" may sound dehumanizing, it in fact reflects the reality that for all companies their employees are one of their most precious resources. Underlying the term is the notion that companies must invest in human capital, just as they do in physical capital, and that they must seek to maximize their return on human capital, just as they do on financial capital.

Improving productivity, seen as the key to developing global competitiveness, is no longer – if it ever was – a question of replacing people with machines. Instead, it consists of enabling employees to work with more sophisticated processes and machinery, thus vastly increasing their output per hour of work or dollar of salary. Indeed, the size of the gap between a worker's wages and the value of his or her production is not, as Marx thought, the measure of worker exploitation, at least not in the negative sense that Marx gave it. Rather, the gap is the measure of increasing worker productivity. This invariably translates into rising wages, which temporarily narrow the gap until new innovation widens it again. Absent this process, productivity remains static and competitiveness cannot develop.

a. Cost of Labor

Cost of labor remains an important aspect of competitiveness and an important factor in investment decisions. Yet, if cost were the only or the most important factor, Israel and Dubai would be by far the least competitive of the countries analyzed, while no country in MENA would have any chance of competing with China, Vietnam, or Bangladesh on labor costs alone.

Labor cost does, to a large degree, influence the investor targeting strategies a country can or should pursue. One reason that garment manufacturing has been a traditional entry for many countries into industrial development is that labor content is high and required skill levels are low. Countries with low wage levels and a large supply of unskilled workers have repeatedly succeeded in garments, generating employment and income for millions of people. By itself, however, garment manufacturing does little to raise a country out of poverty, while its very success in garments can lead to higher wages and a loss of competitiveness. Special market access agreements, tariffs, and quotas have created opportunities where none might otherwise exist. However, as quotas disappear from the international garment trade and as tariffs fall, the advantages will shift back to countries with absolute advantages in labor cost. For middle income countries like Jordan, the challenge is to invest in and maximize returns on its human capital, focusing on areas in which it can compete on productivity and quality, rather than on cheap labor costs.

Table 31: Average Manufacturing Wages and Salaries (US$)

	Jordan	Egypt	Israel	Tunisia	Dubai*
Min. wage (hourly)	0.60	0.25	3.90	0.72	none
Avg. manufacturing wage (hourly)	1.95	0.85	11.51	n/a	n/a
Avg. wage (monthly)					
Textile industry			1,390		
Semi-skilled	141-197	60-110	710	132-193	
Highly skilled	183-281		1,527	206-271	
Supervisors	197-422		3,000	260-360	
High tech			3,706		
Semi-skilled	155-211	280	1,527	155-300	
Highly skilled	211-422		3,540	302-480	1,600 – 3,100
Supervisors	352-704		5,000**	395-730	2,300-4,100**
Mechanical			2,343		
Semi-skilled	141-211	140	1,000	154-227	
Highly skilled	211-352		2,300	256-330	2,000 – 3,000
Supervisors	281-563		4,000	330-590	
Avg. salary (annual)					
Technical	15,000-20,000	28,000	50,000-60,000***	6,500-15,000	35,000-50,000
Managerial			50,000-250,000***		70,000-150,000
Social Charges (% of salary)					
Employer	10%	26%	33%-50%	19%	0
Employee	5%	14%	10%	7.75%	0
Technical Salaries (annual)	15,000-20,000	28,000	50,000-60,000***	6500 – 15,000	35,000-50,000
Manager Salaries (annual)			50,000-250,000***		70,000-150,000

* Dubai imposes no compulsory social charges, though many companies pay health insurance and education expenses for employees. Since most employees in Dubai are expatriates, most employers pay or provide housing, transport, repatriation, and end of service gratuities, which can add up to 100% to the basic salary.

** Engineers

*** Israeli managers and senior technical staff are more likely to be eligible for stock options, bonuses, and other non-salary compensation, though the value of such compensation, especially stock options, has fallen dramatically in the past two years
Sources: Adva Center for Equality and Social Justice in Israel; Bank of Israel; Israel Central Bureau of Statistics; www.globes.co.il; National Insurance Institute of Israel; Dubai Tourism Board; www.datadubai.com; www.godubai.com; Al Tamimi Company, Dubai; General Authority for Free Zones and Investment, Egypt; Jebel Ali Free Zone Authority; UNIDO; The Gallup Organization; UNDP

Figures are approximate and from a variety of dates and sources. Nevertheless, it is possible to observe that wages and salaries are highest in Israel and Dubai, lowest in Egypt and in the middle for Jordan and Tunisia. Jordan, Tunisia, and Egypt are all high-unemployment countries with a shortage of highly-qualified technicians and managers.

b. Labor Productivity

Apart from Egypt, none of the MENA countries can possibly compete against East Asian countries, such as China, Vietnam, and Indonesia, on the basis of low labor costs alone. Even in Egypt, evidence suggests that its growth in labor productivity, estimated at 1.6% annually during the 1990s,[58] has been much slower than that of low-wage Asian countries, indicating that Egypt's competitive advantage as a low-cost manufacturing location may be eroding.

Labor productivity in the MENA region (excluding Israel) is low. According to Keller and Nabli, "During the 1990s, the growth of GDP per worker was lower in the MENA region than in any other region of the world, averaging only 0.8 percent per year." They go on to state that "In MENA, output per laborer has grown at an average annual rate of only 0.6 percent, with actual deterioration in output per laborer in Algeria, Jordan, Morocco, Yemen, Saudi Arabia, and the United Arab Emirates… implying virtual stagnation in productivity per potential laborer for the region as a whole." In Jordan, output per worker *decreased* by an average 0.6% per year from 1992 to 1999. Egypt and Tunisia were the region's best performers, averaging 1.5% and 1.8% average annual growth, respectively, in worker output.

Keller and Nabli compare this performance with that of East Asia during the 1970s, its period of most concentrated economic expansion. They demonstrate that although the East Asian countries had rates of labor force growth similar to those in the Middle East, their real output far exceeded the growth in the labor force. From 1970 to 1980, output per worker increased by an average 4.4% per year for the East Asian region (Hong Kong, Philippines, Thailand, Indonesia, Malaysia, Singapore, and South Korea).

More recently, the 2002-2003 *Arab World Competitiveness Report* measured changes in total factor productivity in the MENA countries from 1975 to 2000. Total factor productivity (TFP) measures the growth in the economy that cannot be accounted for by measured increases in physical capital or labor, and which must therefore be attributed to increased efficiency in the employment of capital and labor. In the Arab world, only Tunisia and Egypt, as well as Syria and Oman, showed increases in TFP during this period. Jordan's TFP declined at an annual average of 2%.[59]

Some of this productivity gap could be attributable to the high proportion of MENA workers employed in the public sector. According to Mustafa Nabli, the percentage of the work force employed by the Civil Service in the MENA region is double that of other developing

[58] Keller, Jennifer, and Nabli, Mustafa K., "The Macroeconomics of Labor Market Outcomes in MENA Over the 1990s: How Growth Has Failed to Keep Pace with a Burgeoning Labor Market," Egyptian Center for Economic Studies, Working Paper No. 71, August 2002
[59] *op. cit.,* p. 29

regions.[60] This can be explained, in turn, not only by government's role in most MENA countries, as the employer of last resort, but also by the ratio of public sector to private sector salaries: 1.3, as compared to 0.9 for the OECD and between 0.7 and 1.0 for developing and transition economies in Asia, Europe, Africa, and the Americas.[61]

These figures also highlight the relative lack of growth in real *per capita* GDP in the region. GDP growth in most countries in the region lags behind or barely keeps pace with population and labor force growth (labor force growth tends to exceed population growth because of the demographic bulge in rapidly-growing populations of people at or near the age of entry into the work force, plus growing participation of women). In East Asia during the 1970s, the labor force grew at an average 3.1 per cent annually, but GDP grew at 7.6 per cent, leading to a doubling of per capita incomes in sixteen years. At present rates, it would take the MENA region about 120 years for per capital incomes to double.

The conclusion is clear: unless significant growth in labor productivity can be achieved, the MENA countries have no chance of replicating the economic success of the East Asian economies.

c. Quality of Work Force

The discussion of worker productivity certainly encompasses questions of worker quality, though productivity measures such as output per worker are more closely related to rates of capital investment than to innate or acquired qualities of employees. As countries seek to move into more knowledge-intensive industries that depend on innovation and technical know-how, more imprecise measures of work force quality come into play. This occurs far more at the management and senior technical levels than at the "labor" level. Shifting into knowledge-intensive industries typically involves a change in corporate structures from the traditional steep pyramid to a "flatter" organization, as the proportion of highly-skilled technicians and senior technical staff increases as a proportion of total employment.

In Israel, for example, even the production-line workers in high-tech companies must have at least a high school diploma, while most have more advanced training. Well over half of the employees in high-tech companies in Israel have a university degree, which is increasingly seen as a basic minimum qualification.

The ability of a country to provide people capable of meeting the employment needs of technology-based companies is one of the critical dimensions in its ability to attract technology-based FDI. Several companies have reported that one of the major elements in their decision to invest in Israel was the availability of highly-skilled people. Israel was helped in this by the influx of about a million people from the former Soviet Union, many of them with advanced scientific educations. But the quality of basic and higher education is the foundation on which the competitiveness of a country's technical work force is based.

It should be stressed that companies almost uniformly report a desire to recruit highly-educated people who can be trained in the company's own processes, rather than people with more specialized training who may need to be retrained.

[60] Nabli, Mustafa K., "The role of secondary education and training in the Middle East and North Africa: Regional economic developments and labor markets," http://www.etf.eu.int/etfweb.nsf/pages/eventsdown/$file/01Nablislides.ppt

[61] Pissarides, Christopher, "Labor Markets and Economic Growth in the MENA Region," London School of Economics, March 2000

It is difficult to assess the quality and availability of technical workers in a general sense. Jordan, Egypt, Israel, and Tunisia all have rates of primary school enrollment well in excess of 90%. Furthermore, Jordan, Egypt, and Israel all have more than 75% of the eligible population enrolled in secondary school, according to the World Bank and UNDP (see Figure 16, Development Indicators, above). Yet, this is at odds with a 1997 UNDP estimate of Egypt's illiteracy rate at 50% and the 1998 World Development Report estimate of Egypt's average educational attainment at three years. In a similar vein, the World Bank reports that, "In 1999, a girl in [MENA] was only slightly more likely to be literate than a girl in Sub-Saharan Africa where illiteracy rates were 27%. And this is despite public spending on education in [MENA] that is higher than in any other developing region."[62]

Individual companies in Egypt report an abundant supply of engineers with appropriate technical backgrounds and further report positively on their performance as employees. Cairo University and the American University in Cairo both turn out very good computer science and business graduates. Companies do, however, report a shortage of mid-level supervisory and management staff, even as unemployment among university graduates is estimated at nearly 20%. One part of the problem may be an imbalance in university disciplines. In 1997, for example, out of a total of 137,000 university graduates in Egypt, only 4,895 had majored in engineering and 23,000 in all scientific disciplines as compared to more than 20,000 graduates in the arts and social sciences and nearly 15,000 law graduates. Only in commerce (30,000 graduates) did there appear to be some balance between disciplines of study and the needs of the economy.[63] In spite of these trends, however, the Egyptian Government and donors have devoted considerable resources to improving technical and vocational education, and companies do not appear to regard lack of quality employees as a constraint. Salaries are very competitive as well. For example, a software engineer employed by a foreign company (and most foreign companies tend to fix their salary scales in the top 5% to 10%) will earn between $1,000 and $1,500 per month. This compares to the $4,000 to $6,000 that an engineer with comparable experience will earn in Israel or Dubai.

Educational attainments in Jordan are higher than the average for the region. Israel has an average educational attainment of 10.2 years, but Jordan, at an average of 6.0 years, is well ahead of Egypt (4.3 years) and Tunisia (3.9 years).[64] Jordan turns out some 22,000 university graduates per year (20,000 with first degrees and 2,000 with postgraduate degrees), though their technical skills may be insufficient. Though according to some estimates, about 2% of Jordan's entire population are engineers; almost all of these are civil or industrial engineers, with very few specializations in high-technology fields. According to a 2001 report by UNDP, there has been minimal penetration of IT, communications, and networking in Jordan's system of higher education.[65] Another report undertaken by the Competitiveness Unit in the Ministry of Planning stated that 75% of Jordanian university graduates were unfit for the job market.[66] The report went on to note that "fresh graduates seemed to lack practical and analytical skills, in addition to low levels of computer skills and weak language skills." The report suggested that Jordanian universities improve their infrastructure and curricula in areas related to information technology, and that they increase linkages with private sector companies to develop in ways that meet the evolving skills needs of Jordanian companies. There are signs that this is happening.

[62] *Middle East and North Africa Strategy Paper,* The World Bank, 2002
[63] Louis Berger International and Checchi and Company, *Trade and Investment Trends and Prospects in Egypt,* USAID, January 2000.
[64] Pissarides, *op.cit.*
[65] Al Farawati, Oula, "Report Cites Minimal Penetration of IT in Higher Education System," *Jordan Times,* December 24, 2001
[66] "The Competitiveness of Jordan's Higher Education System," Ministry of Planning, www.mop.gov.jo/partners/issue42_nov/page2.html

A number of initiatives have been launched to improve the quality of Jordan's higher education, including a $65 million, five-year project launched in 2000 to expand and improve IT and networking in Jordanian universities. Jordan's universities, with USAID support, have begun to place university graduates in internships with local companies, many of which lead to full-time employment. So far, this program is conducted on a small scale, but it shows potential for developing the technical and management skills that employers in Jordan need. MobileCom, one of two GSM operators in Jordan, works closely with one of Jordan's technical training universities to improve education in technical areas in which it is interested. Though MobileCom itself recruits some of the graduates, the larger result is a more broadly-based upgrade of technical education. The Japan International Cooperation Agency has funded an IT upgrading program at the Royal Scientific Society, providing postgraduate education to students who already have a B.Sc. in computer science.

Several universities, including Hashemite University, Yarmouk University, and Jordan University of Science and Technology, have announced initiatives to conduct technology research with the support of private companies, while the University of Jordan has established an IT faculty. Numerous private training institutions have opened, providing accredited training and certificate programs in Microsoft, Oracle, and IBM systems.

One indication that the quality of Jordanian technical staff is higher than some reports might indicate is the large number of Jordanians working in technical and management positions in the Gulf countries. Jordan is one of the biggest suppliers of IT and banking staff for Gulf countries, suggesting that the paucity of talent available locally could be due, in part, to the best talent having left the country. Barring a major downturn in expatriate employment in the Gulf, which could send many of these workers home, Jordanian salaries would have to increase significantly to induce these people to return. Anecdotal evidence does suggest, however, that many Jordanians, after working in the Gulf for a number of years, return to Jordan where some of them establish their own companies.

In spite of this "brain drain" and questions about the quality of Jordanian technical education, businesses report that the quality and availability of engineers and technicians are more than adequate. In its survey of business executives in the MENA region, the World Economic Forum reported that Jordan ranked highest in the region in availability of scientists and engineers and close to the top (slightly behind Tunisia and Lebanon) in quality of math and science education. Unsurprisingly, Jordan also ranked as one of the highest countries in brain drain (i.e., likelihood of skilled people to leave the country), though this seems not to have affected the domestic availability of skilled personnel.[67]

Salaries for managers and technical staff in Jordan are similar to those in Egypt. According to the Jordan Investment Board, salaries for managers and senior technical staff start at about $800 per month. An annual salary of $35,000 is considered very good for a very senior management or technical position.

[67] *Arab World Competitiveness Report, op.cit.,* pp. 356-357

III. TRENDS IN FOREIGN DIRECT INVESTMENT

A. Regional Investment Trends

The economic slowdown in the OECD countries in 2001 caused a 14% decline in FDI in developing countries, from $238 billion to $205 billion. This was far smaller than the 59% decline in developed countries, but it also has to be considered that 2000 was a peak year for FDI in both developed and developing countries. Though data are not yet available for 2002, most reports suggest that it will be even worse than 2001.

More disturbing than a year-on-year decline, largely attributable to external events, is evidence of a longer-term decline in FDI in the MENA region. After strong growth from 1995 to 1997 in most MENA countries, FDI fell in 1998, from $6.3 billion to $5.9 billion, while Arab countries share of world FDI fell from 1.4% to under 1%,[68] at a time when world FDI was experiencing a substantial surge. Subsequent increases in 2000 could be viewed as anomalous increases in an overall decline. However, the character of FDI data and reporting, especially in developing countries, makes it harder to confirm this interpretation.

The character of FDI flows to developed countries is very different from those to developing countries, in that mergers and acquisitions account for the vast bulk of FDI flows to developed countries (including Israel), while flows to developing countries conform more to the stereotypical model of foreign companies setting up factories.

Among developing countries, FDI trends can be hard to isolate and quantify, mainly because the relatively low amounts of FDI can be substantially skewed by a single, large transaction. This is especially true when governments privatize large SOEs. For example, FDI flows into Morocco jumped more than tenfold, from $201 million in 2000 to $2.7 billion in 2001, almost entirely as a function of the sale to Vivendi of a 35% stake in Maroc Telecom for $2.1 billion.

This one transaction, plus a $700 million increase in FDI in Algeria's oil and gas sector, caused FDI into North Africa nearly to double between 2000 and 2001, from $2.9 billion to $5.3 billion. But, during that same period, Egypt's FDI inflows fell by more than 50%, from $1.2 billion to $0.5 billion, and Tunisia's by 38%, from $779 million to $468 million. In Egypt, this decline is largely attributable to a drop in privatization and M&A activity from the previous year, when several cement companies were privatized. FDI flows into Israel fell from $4.4 billion to $3 billion, while the UAE experienced *negative* FDI inflows (representing disinvestment) of $156 million, as contrasted with positive inflows of $260 million the previous year. Only Jordan experienced an increase in FDI from 2000 to 2001, from $39 million to $169 million.

What does appear clear is that the MENA region as a whole, and most of the countries in it, attract far less FDI than most models would predict and less than they need if they are to achieve the growth rates in per capita GDP needed to lift their populations out of poverty. FDI as a percentage of gross fixed capital formation and GDP is lower in the MENA region than in most other developed or developing regions.

[68] Azzam, Henry T., "Foreign Direct Investment Inflow to Arab Countries on the Decline," *The Jordan Times*, December 9, 1999.

Table 32: FDI Relative to GDP and Gross Fixed Capital Formation

	Jordan	Egypt	Israel	Tunisia	UAE
FDI Stock as percentage of GDP					
1990	15.30%	25.60%	5.60%	62.00%	2.20%
1995	9.20%	23.40%	7.10%	61.00%	4.10%
2000	18.10%	21.10%	19.40%	58.80%	3.80%
2001	19.10%	21.90%	20.90%	58.40%	2.50%
FDI Inflows as percentage of Gross Fixed Capital Formation					
1997	19.30%	6.10%	6.70%	7.80%	1.80%
1998	18.50%	6.10%	7.80%	13.60%	1.90%
1999	10.30%	15.40%	12.90%	6.90%	-7.80%
2000	2.30%	5.80%	19.30%	15.20%	2.00%
2001	8.80%	2.30%	14.30%	8.60%	-0.80%

Source: UNCTAD World Investment Report 2002

FDI inflows into the North African region (the Maghreb countries plus Sudan, Egypt, and Libya) in 2000 were 5.5% of gross fixed capital formation; for West Asia (comprising the Mashreq and Gulf countries, plus Iran, Turkey, and Yemen), FDI inflows amounted to only 0.3% of gross fixed capital formation. Inward FDI stocks for North Africa amounted to 15.1% of GDP and for West Asia, 8.5% of GDP.

FDI inflows for Europe in 2000 were heavily skewed by the massive investments made to acquire third-generation mobile telephone licenses, as well as by a spate of large mergers and acquisitions. Consequently, inward FDI flows for the European Union amounted to 50.1% of gross fixed capital formation. In 1999, a more "normal" year, it was still 28.5%. Inward FDI stocks for the EU in 2000 amounted to 30.3% of GDP. For the United States, the largest recipient of FDI in absolute terms, the corresponding figures for 2000 were: FDI stocks/GDP = 12.4% and FDI inflows/gross fixed capital formation = 17.5%.

It is possible to interpret these figures in many contradictory ways. Countries with very active and liquid capital markets are, on the one hand, more open to foreign investment; but, on the other hand, they have a greater ability to raise capital domestically and thus less apparent need for FDI. Yet the U.K., with the most open capital markets in the world and the largest relative to GDP, received FDI inflows equivalent to 46.4% of GDP in 2000.

The size of FDI inflows relative to gross fixed capital formation and the importance of FDI stocks as a percentage of GDP may be a sign of a relative lack of domestic fixed capital formation as well as a sign of a country's attractiveness to foreign investors.

UNCTAD has devised a set of measures of FDI performance and potential that aim to quantify a country's success in attracting FDI.

B. Investment Potential and Performance

UNCTAD's *World Investment Report 2001* introduced an Inward FDI Index, now renamed the Inward FDI Performance Index, as a way to benchmark a country's success in attracting FDI. This index is a simple ratio of a country's share in global FDI flows to its share of global GDP. It has the advantage of accounting for global changes in FDI activity, so that if a country's inward FDI flows fall or rise by the same percentage as global FDI inflows, its performance index will not change. The FDI Performance Index also can gauge how well

countries respond to changes in the composition of global FDI (towards high-tech industry, for example). The index is not perfect. FDI flows, as indicated in the previous section, can be lumpy and can be affected by big privatization transactions, the introduction of new technologies, natural resource discoveries, or large mergers and acquisitions. For any given year, therefore, a country's performance ranking or changes in its ranking may not be terribly meaningful. The trends in performance over a longer period can, however, tell us something about a country's ability to compete successfully in attracting FDI.

UNCTAD in its *World Investment Report 2002* also introduced another benchmarking index, which aims to assess a country's potential to attract FDI. This index consists of an unweighted average of a country's score on eight dimensions judged to be among the most critical, in addition to absolute size of GDP, in determining a country's innate ability to attract FDI. These are:

- GDP growth rate
- Per capita GDP
- Share of exports in GDP
- Telephone lines per 1,000 inhabitants
- Commercial energy use per capita
- Share of R&D expenditures in gross national income
- Share of tertiary students in the population
- Country risk

What is immediately apparent is that this index consists entirely of elements that are subject to change over time and that are within the power of governments and the private sector to alter. Countries such as Angola and Azerbaijan rank very high (third and eighth, respectively) in FDI performance because of the growth of their oil industries and the relatively tiny sizes of their GDP, while countries such as the U.S., which attracts huge amounts of FDI, rank low (74^{th} out of 140 countries ranked) on performance because their economies are so large relative to FDI flows. As UNCTAD points out, increased prosperity and higher GDP can lead to a drop in a country's FDI performance index ranking.

FDI potential does not take into account oil discoveries or other transient events, since over time these events should lead to significant GDP growth and an increase in real potential, while also contributing to a drop in performance rankings as FDI becomes less important relative to the entire economy. Angola, ranked third in FDI performance in 2000, ranks 126^{th} in FDI potential. In 1990, it ranked 126^{th} in FDI performance. This jump is attributable to a surge in oil-related FDI in response to more stable political conditions. Apart from oil, it has few of the factors that make a country attractive to foreign investors. Future changes in Angola's FDI Potential Index will reflect the extent to which oil-driven economic growth translates into real development, as measured by infrastructure and education improvements, as well as the overall size of GDP. To the extent that Angola does reinvest its oil earnings, its FDI potential index will rise as will its GDP, and the gap between performance and potential will narrow.

The above table highlights some of the differences in performance and potential among countries, as well a ssome of the heterogeneity of countries with similar performance or potential rankings. Both Belgium and Angola have shown tremendous increases in FDI performance in both absolute and relative terms. Angola's absolute potential score has increased slightly, while its relative ranking has dropped. Belgium's score has improved

slightly and its relative ranking has remained fairly stable as well. For Angola, the reasons, discussed above, are clear. Belgium, a rich country in the heart of Europe, would be expected to have a high ranking in both performance and potential. Its dramatic increase in FDI performance is most probably due to its emergence as the "Capital of Europe," and the property development and decisions by foreign companies to locate there that have followed.

Table 33: FDI Performance and Potential Rankings, 1990 and 2000

	FDI Performance Index				FDI Potential Index			
		Value		Rank		Score 0-1		Rank
	1988-1990	1998-2000	88-90	98-00	88-90	98-00	88-90	98-00
Jordan	0.4	0.6	97	86	0.179	0.301	87	60
Egypt	2.8	0.5	21	91	0.172	0.287	90	66
Israel	0.4	0.8	100	70	0.388	0.531	24	21
Tunisia	0.7	0.8	68	67	0.179	0.268	86	74
UAE	0.1	-0.1	115	137	0.324	0.488	32	26
Morocco	0.6	0.4	76	101	0.178	0.278	77	70
Lebanon	0.1	0.1	117	126	0.141	0.297	109	62
Turkey	0.5	0.1	83	123	0.192	0.275	79	72
Ireland	0.7	5.1	71	4	0.377	0.599	25	11
Belgium/ Lux.	3.9	13.8	13	1	0.516	0.604	11	10
Angola	0.0	5.1	129	3	0.151	0.166	105	126
Malaysia	4.4	1.2	8	44	0.252	0.368	52	40

Source: UNCTAD World Investment Report 2002

Ireland has improved in both FDI performance and potential, in absolute and relative terms. Its investor-friendly policies and promotion, and greater European integration have both played a significant part. Malaysia, often considered one of the second generation of Asian "tiger" economies, has seen its FDI performance decline dramatically, while its potential has increased modestly. Much of this can be attributed to the Asian financial crisis of the late 1990s, since other countries in the region, including Thailand and the Philippines, experienced similar declines in FDI performance and improvements in their FDI potential.

In the MENA region, the UAE stands out as an anomaly, since it ranks very high (and improving) in FDI potential, while its FDI performance remains very low. This is typical of other mature oil-producing countries, such as Saudi Arabia and Kuwait, both of which have experienced declines in already-low levels of FDI performance, even as their FDI potential scores and rankings have improved. (These countries stand in marked contrast to newer oil producers which attract a flood of investment for initial exploration and development and whose oil potential is not yet reflected in GDP growth).

Israel has something of the profile of a mature, developed economy. Although it receives nearly as much FDI as the entire MENA region combined, its GDP is so much larger than that of any other country surveyed (only Egypt, with 10 times the population of Israel comes close) that its FDI performance index is lower than might be expected. In this respect, it is similar to France or Germany, which rank 69th and 43rd, respectively on FDI performance and 19th and 20th, respectively, on FDI potential.

Jordan stands out from Tunisia and Egypt, as well as other Arab countries, in that it is the only one to have improved both its FDI performance ranking and its FDI potential ranking between 1990 and 2000. For the rest of the MENA region, the picture has been one of general decline in investment performance or investment potential, or both. Total FDI in West Asia accounted for less than 0.6 per cent of world FDI flows in 2001, one-tenth of the region's

share of world GDP. UNCTAD includes Turkey as part of the West Asian region, and its FDI inflows dwarf those of the rest of the region ($3 billion out of a total $4.1 billion in 2001). Excluding Turkey, the picture is even worse. However, as UNCTAD notes, "even in Turkey, inflows are not commensurate with the country's potential." It goes on to point out that "Overall,…judging from the ratios of FDI to GDP and domestic investment, the role of FDI has declined in West Asian economies over the past 15 years."[69]

In North Africa, FDI performance was better than in West Asia, although much of this had to do with telcom privatization in Morocco, and oil and gas investments in Sudan and Algeria. FDI flows to North Africa declined relative to those to Sub-Saharan Africa and relative to global flows as well. Tunisia, Egypt, Libya, and Morocco all saw their FDI performance index values and rankings fall; Algeria, Libya, and Morocco also saw their FDI potential index scores and rankings fall.

UNCTAD has developed a convenient way of classifying countries according to the two dimensions of FDI performance and potential.

Table 34: Country Classification by FDI Performance and Potential, 1998-2000

	High FDI Performance	**Low FDI Performance**
High FDI Potential	"Frontrunners" Israel, Malaysia, Ireland	"Below Potential" Egypt, Jordan, UAE, Lebanon
Low FDI Potential	"Above Potential" Tunisia, Angola, Mozambique, China	"Under Performers" Algeria, Morocco, Turkey, South Africa

Source: UNCTAD World Investment Report 2002

As the above matrix indicates, Jordan, together with Egypt, Lebanon and UAE, attract less FDI than their potential would indicate. Jordan, in particular, has improved its FDI potential ranking significantly over the past tne years and has the ability to move into the upper left-hand quadrant of frontrunners. UAE, with a higher FDI potential than Jordan's, could also do this, although the relative abundance of capital available domestically means that it is less likely to have the same motivation to do so. Lebanon's potential has also increased dramatically since 1990, largely as a function of the return of peace after more than fifteen years of civil war; it too could improve its performance, although the persistence of macroeconomic and political imbalances make this less likely than for Jordan. Egypt also has the potential to move closer to the front-runner category.

Morocco and Tunisia are in less enviable positions. Morocco has lost ground in FDI performance and potential, while Tunisia has gained very slightly on both measures. Tunisia's FDI performance is, however, significantly higher than its potential. This is understandable, as the recent downturn in inward FDI flows cause it to revert to a performance closer to its potential (i.e., in the under-performing category).

It is important to bear in mind, however, that all of these indicators of performance and potential can serve only as rough diagnostic guides. They tell us very little about the actual patterns of investment in a country and very little about what actually goes on in a given

[69] *World Investment Report 2002*, UNCTAD, p. 59

economy. The next section focuses on patterns of foreign and domestic investment in each of the countries surveyed. This will help to indicate where investors see the most potential for growth, as well as areas in which governments have tried to stimulate investment, possibly of a different magnitude or character than the fundamentals of the economy might otherwise dictate.

C. Investment by Sector and Industry

1. Jordan

The data supplied by the Jordan Investment Board show much higher levels of FDI than the figures supplied by UNCTAD. One principal reason may be that JIB data refer to investment approvals and not to actual investment. Few investment agencies track the implementation of projects once approved, so it is difficult to determine the actual investment flows from approved projects. In addition to some approved projects never being implemented, many projects have investment plans that extend over two or more years, so that a $30 million project might involve an investment of $10 million in the first year, followed by further investment tranches of $10 million in years two and three. The true FDI figures would show an investment of $10 million in each of the three years, possibly starting a year or more after the approval has been granted, while JIB figures would show the total amount in the year the approval itself is granted, irrespective of the actual investment schedule. Information on approvals is nevertheless important, because it can reflect trends in investor interest and can also reflect the division, by sector and industry, of that interest.

As the following tables indicate, investment approvals declined precipitously from 2000 to 2001, from $576 million to $185 million. Industry and tourism (mainly hotels) have accounted for the vast bulk of investment, both foreign and domestic. 2000 was a peak year for hotel investments, with over $790 million in total investment approvals as compared to $275 million in approved industrial projects. In 2001, however, JIB approved over $1 billion in industrial projects and only $85 million in hotel projects. The foreign portion of these approvals has ranged from 23% to 50% in industry (averaging around 30% to 40%) and 21% to 61% in hotels.

Correcting for industries in which one large project may skew overall trends, the top industries for investment between 1997 and 2002 are shown in the following table.

Table 35: Approved Investments, 1997-2002 (US$ millions)

	Total	Foreign
Tourism	1,536	738
Food and beverages	962	537
Garments	392	253
Chemicals	298	121
Hospitals	204	24
Mining products/beneficiation	169	49
Paper and printing	160	36
Pharmaceuticals and medical consumables	159	15
Plastics	106	33

This, of course, tells us very little about future investment prospects. Some of the most important investment sectors have experienced significant declines in recent years, while

other, smaller investment sectors have shown robust rates of growth. The fastest-growing industries for both domestic and foreign investment over the past five years have been:

- **Software and IT:** 300% annual growth in investment approvals 1997 to 2002
- **Garments:** Average 92% annual growth in investment approvals 1997 to 2002 followed by decline of 63% from 2001 to 2002
- **Printing and Paper:** 32% annual growth in investment approvals 1997 to 2001, followed by decline of 64% from 2001 to 2002

Other industries have either experienced declines in investment approvals over the past five years or have experienced such volatility in approvals from year to year that it is impossible to identify any meaningful trends. Investment approvals in tourism climbed from $184 million in 1997 to $794 million in 2000, but then fell to $84 million in 2001 and just over $8 million in 2002. Tourism investment is highly cyclical and tends to fluctuate between periods of over-investment alternating with periods of under-investment. Arguably, the tourism sector, represented mainly by hotel projects, was over-invested even before the *intifada* and other political events caused tourist visits to decline. (Interestingly, much of the decline in European and North American tourists was compensated by corresponding increases in visits from other Arab countries. However, Arab visitors have different lodging and spending preferences, many of them staying for longer periods and preferring to rent houses to accommodate large families instead of staying in hotels. Hotel occupancy rates have remained very low as a result).

These figures, too, are of limited utility in identifying investment prospects, since extrapolation of current trends can lead to erroneous conclusions.

e 36: JIB Approved Projects (US$)

	1996				1997				1998				1999			
	No.	Total (USD)	Foreign ($)	% FDI	No.	Total (USD)	Foreign ($)	% FDI	No.	Total (USD)	Foreign ($)	% FDI	No.	Total (USD)	Foreign ($)	%
try	196	317,107,600	72,628,200	23%	142	312,813,900	89,584,800	29%	146	259,590,000	64,052,400	25%	253	520,230,400	233,332,700	
s	39	119,167,600	25,591,500	21%	30	167,050,700	72,732,400	44%	26	293,123,200	122,004,600	42%	32	139,657,200	23,619,700	
ulture	9	25,091,500	7,956,500	32%	8	24,028,200	6,852,100	29%	16	36,010,300	5,008,500	14%	19	39,338,000	2,464,800	
tals	7	28,295,800	563,400	2%	1	7,746,500	-	0%	8	65,028,200	10,688,700	16%	3	44,480,300	-	
port		-	-		1	5,915,500	-	0%	2	20,436,600	14,149,400	69%	1	70,400	-	
ntions & Exibitions		-	-			-	-			-	-		1	70,400	-	
ation Compounds		-	-		2	16,591,500	5,033,200	30%	1	4,225,400	2,201,400	52%	3	29,225,400	-	
	251	**489,662,500**	**106,739,600**	**22%**	**184**	**534,146,300**	**174,202,500**	**33%**	**199**	**678,413,700**	**218,105,000**	**32%**	**312**	**773,072,100**	**259,417,200**	

JIB APPROVED PROJECTS (USD)

	2000				2001				2002			
	No.	Total (USD)	Foreign ($)	% FDI	No.	Total (USD)	Foreign ($)	% FDI	No.	Total (USD)	Foreign ($)	% FDI
Industry	226	274,604,100	135,111,100	49%	296	1,078,693,200	534,452,400	50%	289	390,838,900	176,217,500	45%
Hotels	22	791,774,600	479,577,500	61%	10	85,211,300	26,901,400	32%	4	4,202,700	-	0%
Agriculture	8	3,105,600	352,100	11%	24	32,014,100	4,616,900	14%	13	7,236,600	3,162,000	44%
Hospitals	3	45,339,400	-	0%	7	41,129,000	7,253,500	18%	2	8,611,300	5,681,800	66%
Transport		-	-			-	-		0	-	-	
Conventions & Exibitions		-	-			-	-		1	8,873,200	-	
Recreation Compounds	1	2,464,800	2,394,400	97%	2	4,295,800	2,974,600	69%	1	4,225,400	-	0%
Total	**260**	**1,117,288,500**	**617,435,100**	**55%**	**339**	**1,241,343,400**	**576,198,800**	**46%**	**310**	**423,988,100**	**185,061,300**	**44%**

Table 37: Total JIB Approvals Including Expansions (US$)

	1997		1998		1999		2000		2001		2002	
	No.	Investment	No.	Investment	No.	Investment	No.	Investment	No.	Investment	No.	Investment
Transportation Sector	1	5,915,500	1	1,422,500	1	70,400	0	-	0	-	0	-
Hotels, Resorts and Entertainment Cities	32	183,642,300	27	297,348,600	35	168,882,500	23	794,225,400	11	83,873,200	5	8,428,200
Health (Hospitals)	0	-	8	65,028,200	3	44,480,300	3	45,339,400	7	41,129,000	2	8,611,300
Agrigulture	9	24,591,500	15	29,133,800	17	39,049,300	8	3,105,600	24	32,014,100	25	12,573,200
Convention and Centers	0	-	0	-	1	70,400	0	-	0	-	1	8,873,200
Industry		-		-		-		-		-		-
Food and Beverages	37	69,180,700	45	62,502,000	56	147,418,300	39	26,773,500	51	618,718,600	58	37,384,500
Tobacco and Alcoholic Beverages	1	14,084,500	3	11,690,100	4	6,711,800	2	12,761,000	2	14,295,800	1	352,100
Textiles	5	15,000,000	3	1,302,800	12	28,110,700	4	7,323,900	3	2,138,000	6	5,683,100
Garments	6	7,387,300	4	1,690,100	17	100,563,400	35	89,311,300	32	94,559,000	28	34,988,500
Leather	2	183,100	2	9,929,600	1	70,400	4	3,056,300	2	181,700	3	323,900
Wood and Wooden Products (except Furniture)	1	211,300	0	-	3	1,309,900	4	10,245,100	2	662,000	12	4,352,100
Paper and Paper Products	6	4,793,700	5	19,769,400	9	35,218,000	3	542,300	9	23,528,600	6	3,995,100
Printing and Advertising	10	8,495,200	9	12,197,200	20	15,494,900	25	16,200,400	39	14,715,500	30	9,831,000
Petroleum Products	2	1,366,200	0	-	0	-	0	-	3	4,802,800	1	3,521,100
Chemicals and Chemical Products	15	29,804,200	10	14,188,500	20	43,571,100	14	10,520,600	16	23,659,900	14	174,803,000
Rubber and Plastic Products	15	25,740,000	1	69,345,100	2	720,093,500	20	19,943,400	3	219,746,500	23	11,388,700

Engineering	10 10,408,500	11 10,252,100	30 21,670,300	21 31,183,100	20 38,142,300	17 15,592,000
Cosmetics and Detergents	6 91,725,400	5 30,126,800	8 5,570,400	5 697,200	7 3,274,600	7 1,683,100
Medical Products and Consumables	6 13,471,800	5 44,239,400	12 36,687,300	4 24,225,400	4 33,067,600	5 8,169,000
Electrical Equipment	4 10,949,700	7 6,922,500	4 8,780,300	4 2,323,900	8 11,868,900	5 3,870,400
Satellite receivers and transmitters	0 -	0 -	2 422,500	0 -	0 -	1 70,400
Software and IT	0 -	1 70,400	2 281,700	17 5,070,400	27 11,471,300	17 17,288,700
Vehicles and Transportation Equipment	4 5,666,200	0 -	2 1,831,000	0 -	3 99,014,100	2 154,900
Furniture	0 -	1 404,200	6 2,789,600	10 6,678,200	14 11,450,700	3 1,549,300
Mining	1 373,200	3 6,302,800	0 -	1 42,300	1 70,400	8 20,056,300
Mining Products	11 11,156,100	18 44,547,200	14 30,128,200	12 7,142,500	19 47,409,200	26 28,931,000
Other Industries	0 -	0 -	3 464,800	0 -	0 -	2 774,600
	184 534,146,400	**199 678,413,300**	**312 773,072,000**	**260 1,117,274,600**	**336 1,229,793,800**	**308 423,248,700**

Table 38: Foreign Investments in JIB Approved Projects Including Expansions (US$)												
	1997		1998		1999		2000		2001		2002	
	No.	Investment	No.	Investment	No.	Investment	No.	Investment	No.	Investment	No.	Investment
Transportation Sector	0	-	1	995,800	0	-	0	-	0	-	0	-
Hotels, Resorts and Entertainment Cities	5	77,765,600	7	124,206,100	8	23,619,700	7	481,971,800	3	29,876,100	0	-
Health (Hospitals)	0	-	3	10,688,700	0	-	0	-	2	7,253,500	1	5,681,800
Agriculture	2	6,852,100	4	3,247,900	8	2,323,900	3	352,100	12	4,616,900	6	3,162,000
Convention and Centers	0	-	0	-	0	-	0	-	0	-	0	-
Industry		-		-		-		-		-		-
Food and Beverages	10	11,130,700	14	25,026,600	12	79,144,800	15	8,094,600	6	401,211,300	16	12,999,300
Tobacco and Alcoholic Beverages	1	1,408,500	3	2,447,200	0	-	1	3,169,000	1	4,929,600	1	140,800
Textiles	4	9,028,200	2	246,500	8	17,020,100	3	7,183,100	1	70,400	2	1,507,000
Garments	3	3,217,600	2	633,800	13	63,766,200	32	77,707,700	19	86,206,800	16	20,662,000
Leather	0	-	1	9,816,900	1	70,400	3	2,956,800	0	-	1	105,600
Wood and Wooden Products (except Furniture)	1	211,300	0	-	0	-	3	6,005,800	1	169,000	6	1,323,900
Paper and Paper Products	1	498,600	2	797,200	2	31,126,800	0	-	2	281,400	0	-
Printing and Advertising	0	-	2	97,200	4	894,400	2	1,229,600	1	915,500	2	845,100
Petroleum Products	1	403,100	0	-	0	-	0	-	0	-	1	3,521,100
Chemicals and Chemical Products	5	2,566,900	6	11,503,700	7	11,415,500	5	1,760,600	2	282,300	6	93,183,100
Rubber and Plastic Products	5	3,535,800	4	993,000	5	2,583,900	8	13,745,900	13	8,450,700	2	2,816,900

Engineering	42,356,300	44,155,500	114,557,700	108,654,800	73,218,300	510,373,200
Cosmetics and Detergents	140,963,400	21,852,800	62,181,700	2211,300	2542,300	1140,800
Medical Products and Consumables	24,647,900	11,657,000	37,302,400	0	- 1352,100	21,253,500
Electrical Equipment	0	- 22,816,900	22,436,600	42,281,700	34,277,300	0 -
Satellite receivers and transmitters	0	- 0	- 1281,700	0	- 0	- 0 -
Software and IT	0	- 0	- 2211,300	4448,300	153,763,700	916,154,900
Vehicles and Transportation Equipment	34,704,200	0	- 11,408,500	0	- 2422,500	2154,900
Furniture	0	- 1105,600	11,008,500	5746,500	75,457,700	2140,800
Mining	0	- 0	- 0	- 0	- 170,400	25,076,600
Mining Products	45,411,000	616,816,800	67,654,600	4352,100	413,831,000	74,768,300
Other Industries	0	- 0	- 2183,100	0	- 0	- 2732,400
	52174,701,200	**67218,105,200**	**104259,417,200**	**113617,435,100**	**105576,198,800**	**92184,744,000**

Table 39: JIB Approved Projects in QIZ, 1996-2002

Garments & Textiles Sectors

Estate	Number of Projects			Investment Volume			Labor						Nationality
				Million USD	Million USD	Million USD	Existing			Expected			
	Existing	Under Construction	Total	Existing	Under Construction	Total	Jordnian	Non Jordanian	Total	Jordanian	Non Jordanian	Total	
Al Hassan Industrial Estate	15	7	22	139		139	4,890	4,795	9,685			-	Jordanian+Pakistani+Indian+Chi American+Taiwan+Israel
Hussain (karak) Industrial Estate	3		3	56		56	1,701	1,442	3,143			-	Taiwan + Hong Kong
Dhulail Industrial Zone	11	3	14	70	28	99	2,900	2,000	4,900	4,000	2,500	6,500	Jordanian+Pakistani+Indian+ Lanka + United Arab Emirates+ Kong
Tajamouat Industrial Estate	25	10	35	211	70	282	11,000	4,000	15,000	4,000	2,000	6,000	Pakistani+American+Indian+Tai + Hong Kong+Korean
Cyber City	5	3	8	28	21	49	700	1,000	1,700	1,000	700	1,700	Taiwani+Indian+Chinese+Sau Arabian
Qastal Zone	2		2	23		23	600	200	800			-	Jordanian+Indian+Sri Lanka
Al Zay Industry	1		1	11		11	570		570			-	Jordanian
TOTAL	**62**	**23**	**85**	**538**	**120**	**658**	**22,361**	**13,437**	**35,798**	**9,000**	**5,200**	**14,200**	

2. Egypt

Table 40: Direct Investment in Egypt by Sector (US$ millions)

	1997	1998	1999	2000	2001	2002 (Jan-Jun)
Total Direct Investment	8,349	9,369	7,370	3,312	1,975	1,024
Foreign share	985	1,640	1,312	576	273	126
	11.8%	*17.5%*	*17.8%*	*17.4%*	*13.8%*	*12.3%*

Sources: GAFI, American-Egyptian Chamber of Commerce, UNCTAD World Investment Report

A breakdown of investment by sector is not publicly available for all years. As a result, it is not possible to observe any trends in investment. However, the following data for 2001 are indicative of the approximate share of investment that particular sectors have attracted in recent years.

Table 41: Direct Investment in Egypt by Sector, 2001

Sector	2001
Industry	33%
Tourism	17%
Financial	18%
Free Zones	19%
Agriculture	3%
Construction	7%

Sources: GAFI, American-Egyptian Chamber of Commerce, UNCTAD World Investment Report

Furthermore, a breakdown of investment within the Industrial sector in 2000 is indicative of activities within that sector in recent years.

Table 42: Industry Investment in Egypt by Sub-sector, 2000

Industry*	**2000***
Textiles/Garments	8%
Chemicals	27%
Engineering	15%
Metal	13%
Pharmaceuticals	5%
Food	14%
Wood/Furniture	1%
Construction materials	16%
Mining	1%

Sources: GAFI, American-Egyptian Chamber of Commerce, UNCTAD World Investment Report
***** Industry breakdown is of FDI stock as of mid 2000

Egypt's decline in FDI, in contrast to other countries surveyed, began earlier. According to the Egyptian Government, overall direct investment fell from $9.4 billion in 1998 to just under $2 billion in 2001. During the same period, FDI fell from $1.6 billion to $273 million. These figures appear to exclude privatization receipts. Figures from UNCTAD, which do include privatization receipts, show a peak of $2.9 billion in FDI in1999, falling to $510 million in 2001. FDI numbers for 2002 will almost certainly increase, due at least partly to the $287 million acquisition of Al-Ahram Beverages Company (ABC), Egypt's largest brewery, by Heineken. Similarly, Hero, a Swiss food company, in October acquired 65% of Vitrac, the leading Egyptian jam maker. Danone, a leading French food group, is reported to be in negotiations to acquire one of Egypt's biggest dairy groups. These acquisitions appear to be motivated by the emerging potential of Egypt as an exporter to other MENA countries and the COMESA region, by the potential for Egyptian food exports to Europe once the

Euro-Mediterranean Free Trade Agreement comes into effect in 2010, and by the non-cyclical nature of the food and beverage sector.

Another bright spot in Egypt's FDI picture is pharmaceuticals. Total investment in the industry increased by 60% from 1997 to 2000, reaching a total stock of about $870 million, of which U.S. investment accounted for some 5%. Foreign corporations operating in the market include Novartis, Glaxo Wellcome, Aventis, Pfizer, and Eli Lilly and account for more than a third of domestic sales. One possible damper to future growth in FDI is the restricted privatization in the industry, which allows only 40% of any state-owned pharmaceutical company to be sold. As a result, foreign companies have not participated in the privatization of Egypt's big state-owned pharmaceutical manufacturers, which have instead opened their capital through listing on the CASE.

In contrast, investment in Egypt's textile and garment industries has fallen as a direct consequence of Jordan's success in exporting to the U.S. through the QIZ program. Jordan, which exported an estimated $350 million in textile products to the U.S. in 2001, is closing in on Egypt's industry, which exported some $778 million to the U.S. over the same period.[70] This is a major concern for the government, since textiles account for 11% of all industrial production and 30% of total employment. Though Egypt has a far larger domestic market for textile products than Jordan, imports have made significant inroads in the Egyptian market, contributing to a negative trade balance in textiles.

Also in 2002, Sony has disinvested from Egypt as part of a wider closure of many of the company's Middle East operations.

Future FDI inflows will probably comprise relatively little in privatization receipts, which have bolstered Egypt's FDI numbers for much of the past decade. 2002 saw only one significant privatization transaction, the $39 million sale of a fertilizer company to a domestic Egyptian investor. The existing privatization law makes it very difficult to sell a state enterprise at a price lower than the value established by the company's own management and ratified by the Central Auditing Agency. In practice, this has meant that many enterprises have failed to sell because the government has insisted on too high a price, especially for loss-making enterprises whose net asset values may be high. The decline in share prices on the CASE and the poor current state of the economy have further dampened the enthusiasm of potential buyers.

The United States accounts for about 13.5% of Egypt's non-Arab[71] FDI stock outside of the petroleum sector. The value of the U.S. FDI stock in Egypt at the end of 2001 amounted to about $1.4 billion, of which 65%, or over $900 million was in the petroleum sector. The $489 million in non-petroleum FDI stock comprised $194 million in industry, $51 million in banking and venture capital, $17 million in tourism, and $18 million in construction. In the industrial sector, U.S. investment is concentrated mainly in textiles (29%), engineering (16%), food and beverages (15%), chemicals (15%), and pharmaceuticals (12%). The value of the non-petroleum U.S. FDI stock in Egypt remained flat from 2000 to 2001, declining significantly in the food and beverage industries and increasing substantially in engineering.[72] Europe accounts for a far larger share of FDI – close to 50% – while Arab countries account for nearly as great a share as the U.S.

[70] Wahby, Eman, "Textile Exports Suffer from US-Jordan FTA," *Business Monthly*, American-Egyptian Chamber of Commerce, December 2002, p. 17

[71] The Egyptian Government classifies FDI from other Arab countries separately. Detailed data on Arab FDI in Egypt are unobtainable, though macro-level data suggest that about 13% of FDI in Egypt comes from other MENA countries

[72] American Chamber of Commerce in Egypt, http://www.amcham.org.eg/BSAC/ustrade/US_FDI.asp

More than 65% of FDI projects in Egypt are majority foreign-owned, and, of these, most involve more than 95% foreign ownership. FDI in Egypt is far more focused on the domestic market than on export markets. Only 16% of FDI companies in Egypt export 60% or more of their output, while for Vietnam and India the corresponding figures are 46% and 33%, respectively. In Egypt, more than half of all foreign investors start out by serving only the domestic market, while in most other MENA countries, there is a far greater export orientation. This observation is confirmed by direct interviews with foreign companies, most of which report that they tend to spend several years serving the domestic market before beginning to look at export markets.

Part of this phenomenon is due to high import barriers, which raise profit margins in the domestic market and reduce incentives for companies to become more competitive against foreign competition. Foreign investors in Egypt earn an average 21% return on investment, which is far higher than most earn in their home markets.[73]

Most of Egypt's investment promotion efforts in the industrial area focus on production for the domestic market. Projects identified by the Ministry of Industry seek to attract investment in food processing, leather and footwear, automotive, metal, wood, and electronics. The Ministry of Tourism has identified over $100 million in new tourism projects for which it seeks investors and developers, while the Ministry of Communications has identified several voice and data communications, as well as e-commerce and e-government projects, requiring over $2 billion in investment, for which it seeks investors and technical partners.

3. Israel

The investment approvals shown in Figure 49 represent only a small portion of total direct investment and total FDI in Israel. The total value of projects approved by the Israel Investment Center (IIC) in 2001 amounted to $425 million, of which foreign investment amounted to 22% or $93 million. This represents a decline of 32% from the previous year, in both overall and foreign investment approvals.

These amounts are dwarfed by the FDI flows from foreign venture capital and overseas public offerings by Israeli companies, as well as from acquisitions of Israeli companies by foreign companies. In 2001, a year of dramatic decline in Israeli venture capital and listings, Israeli companies nevertheless raised $372 million in offshore public offerings. Mergers and acquisitions of Israeli companies by foreign companies amounted to $631 million, and foreign venture capital raised by Israeli companies came to about $812 million. These methods of fundraising accounted for nearly $2 billion in 2001, representing 65% of Israel's total FDI of $3.044 billion[74]

Why the discrepancy? Approvals by the Israel Investment Center are confined to projects applying for and receiving approval for investment incentives – mainly tax holidays and capital grants – for which only certain kinds of investments in certain areas are eligible. Capital raising in the form of acquisitions, venture capital, and public offerings does not immediately translate into project-specific physical investment of the kind that qualifies for incentives, though some of it eventually does.

[73] These observations on the characteristics of FDI in Egypt and comparisons with other countries are from an unpublished and preliminary analysis conducted for the European Association for Comparative Economic Studies.
[74] *Israeli Venture Capital Yearbook, 2002,* pp 32-39 and UNCTAD 2002 *World Investment Report,* p. 303

There exist, nevertheless, many parallels between incentive-eligible investment and the larger investment picture. Both are dominated almost exclusively by high-tech companies in the ICT and biotechnology industries. Of the $425 million in IIC approvals in 2001, over 60% were in the ICT, pharmaceuticals, and biotech areas. This was in a year when the ICT sector experienced a calamitous decline. In 2000, probably a more representative year, these areas accounted for about 79% of total IIC approvals. The dominance of high tech investment in venture capital, IPOs, and mergers and acquisitions was even more pronounced. High tech accounted for virtually all of the $2 billion in FDI raised through these methods. This investment was divided among the following activities.

Table 43: FDI in Israel by Sector, 2000

Communications	42%
Software	20%
Life Sciences/Biotechnology	16%
Internet	9%
Other	13%

Other sectors mentioned by the Israel Investment Promotion Center as promising include plastics, cosmetics, and stone.

The plastics industry produces about $2.6 billion and exports about $1.2 billion per year, mainly in packaging products. Other significant and growing areas of plastic manufacture include plastic medical equipment, such as IVs, syringes, plastic skin for burn victims, and other technology-intensive products, which currently account for about 5% of the total production and exports. Lower-technology products, such as irrigation equipment, lawn furniture, and plastic tool boxes, have proven very successful in export markets. One of the largest foreign investors in this sector is Stanley Tool Works, which manufactures plastic tool boxes. Stone is a very small industry, though its production has grown in recent years to about $150 million, with exports that have increased from $2-3 million to about $40 million. The industry is largely dominated by Israeli Arab and Palestinian owners and small companies with fewer than 100 employees. The availability of what is called Jerusalem stone guarantees a strong demand, while the demand for hand-finished stone products offers potential for QIZ production using lower-cost Jordanian labor.

Cosmetics production amounts to about $350 million annually, mostly for the domestic market and consisting mainly of production under license from European and U.S. companies. A small number of companies produce cosmetics using Dead Sea minerals and other natural ingredients. The Israeli Manufacturers Association has begun to promote this area and to identify profitable niches in partnership with foreign investors.

The pharmaceutical industry is another promising one, in both biotechnology-related production and generic human and veterinary pharmaceuticals. The industry produces about $300 million for the domestic market and exports about $1 billion.

Table 44: Israel Investment Center Incentive Approvals, 1997-2001

	1997			1998			1999			2000			2001		
	Projects approved Number	Total inv. $000	Foreign share $000	Projects approved Number	Total inv. $000	Foreign share $000	Projects approved Number	Total inv. $000	Foreign share $000	Projects approved Number	Total inv. $000	Foreign share $000	Projects approved Number	Total inv. $000	Foreign share $000
ndustrial															
Food	1	525	142	5	11,205	1,377	1	4,254	179	1	2,155	614	2	5,452	1,172
Textiles	1	38,339	11,502	1	900	135				3	42,265	6,593	3	55,893	8,531
Garments & footwear	2	6,027	1,715	2	3,238	278	8	84,993	13,201	2	33,669	3,110			
Paper & printing				2	7,600	1,019							1	18,589	2,797
Wood & building materials	2	1,096	249							1	6,000	1,800			
Glass & ceramic				1	3,262	979	1	7,911	2,373		5,017	1,505			
Plastic & rubber	6	50,646	8,567	8	48,050	9,405	4	28,556	7,392	7	11,760	2,310	4	24,626	6,026
Chemicals & pharmaceuticals	7	40,431	6,914	7	27,801	5,338	5	32,250	9,632	10	6,490	141	11	44,903	11,495
Metal	4	24,256	6,590	9	46,122	13,582	6	6,037	1,008	7	84,514	17,497	8	25,440	5,908
Cars & transport equipment	1	210	5	2	3,813	1,013	1	1,140	56				6	2,662	606
Electrics & electronics	76	260,955	61,253	103	205,688	46,039	80	194,775	44,635	168	345,041	75,172	125	212,593	40,271
Other	4	2,438	682	1	240	65	2	786	192	5	8,272	1,790	3	628	148
Total Industrial	104	424,923	97,619	141	357,919	79,230	108	360,709	78,709	203	545,198	110,532	163	390,786	76,954
Real Estate	10	14,818	6,285	2	24,361	24,337	3	13,858	11,797	3	13,858	11,797	4	14,165	10,475
Tourism	4	74,494	20,068	5	74,155	21,415	2	64,992	15,809	2	64,992	15,809	2	20,009	6,026

Source: Israel Investment Center

4. Tunisia

Foreign direct investment (FDI) in Tunisia grew at a faster rate than total investment during the period 1996 to 2002. Total investment in the economy grew at an average annual rate of 11%, while FDI grew at an average rate of 21%. This average rate of growth encompasses the surge in FDI, especially in manufacturing, that occurred in 2000. FDI was concentrated in manufacturing, energy, and tourism, growing at an annual rate of 38% in manufacturing, 16% in tourism, and 14% in energy.

Within manufacturing, the largest recipients of overall investment and FDI are described in the following table.

Table 45: Manufacturing Investment in Tunisia by Sub-sector, 2002

	2002 Total Investment (US$ millions)	Avg. Annual Growth
Textiles, clothing, and footwear	223	11.0%
Food processing	185	9.4%
Glass and building materials	169	12.0%
Mechanical and metal	146	14.4%

Tunisia explicitly promotes investment in these and several other key industries. Though the official policy of Government is that investment is welcome in all industries, in reality companies trying to invest in non-priority industries will find it far more difficult to obtain investment incentives. FIPA has also prepared detailed project profiles to try to guide investment into desired projects in specific areas. These include new projects in various industries, but also planned privatizations in which investors will be required to invest new capital for renovation (these include some ten tourism facilities, mainly resort hotels). The main areas of focus for FIPA's promotional efforts are the following.

- **Computer Services:** applications development, systems integration, multimedia, Arabization. Export focus is on other francophone African countries, as well as on other Arab countries.
- **Food Processing:** Tunisia is the fourth largest exporter of olive oil and the largest exporter of dates in the world. Frozen seafood is also an important export. France accounts for nearly half of all FDI in the industry and the second largest export market after Italy. Tunisia is trying to encourage investment to modernize its date processing and packaging, to develop new lines of tinned fruits and vegetables, to improve fish processing and packaging, and to develop fish-farming. It also seeks additional FDI to improve olive oil production and to increase capacity, aimed mainly at penetrating new markets such as the U.S., Canada, Japan, and the Gulf States. Government currently has ten projects in horticulture, dairy, ostrich-raising, and fish-farming for which it seeks foreign investors.
- **Electronics:** audio-video components and assembly, mobile telephone transmission equipment, printed circuits, other electronic components. Tunisia promotes its relatively low production costs as compared to Western and Eastern Europe.
- **Packaging:** including glass, paper, and plastic products, largely to serve demand of local textile and food exporters.
- **Automotive:** especially automotive electric systems, but also engine parts, wheels and tires, transmissions, suspensions, and brakes. Government is trying to encourage both OEM and aftermarket production of seats and seat covers, plastic components for doors and dashboards, exhaust pipes, windshield wipers, and shock absorbers. Exports have increased

from about $100 million in 1990 to around $400 million in 2001. France, Germany, and Italy account for about 86% of total investment and 90% of exports.

- **Electrics:** especially cables and wire harnesses for automobiles, which represent the largest export item and the fastest-growing segment of this sub-sector.
- **Pharmaceuticals:** The industry remains small with only $100 million in annual production, of which most is for the domestic market. Major investors are from France, Sweden, the U.S., and Arab countries. Government wants to encourage production of generics and vaccines, as well as upgrading of R&D.
- **Textiles:** focused mainly on ready-to-wear garment manufacturing, which represents about 75% of total sub-sector production and 93% of exports. The biggest recipient of FDI, at least until 1999, with signs now that exports (almost entirely to EU) are declining in favor of Turkey and Eastern Europe. Government seeks to increase competitiveness by promoting vertical integration and greater development of spinning, weaving, and finishing. Government currently has twenty-five projects for which it seeks foreign investors.
- **Leather:** mainly shoes and shoe uppers, of which nearly half are exported to Italy. Also handbags and other fine leather products, also mainly for the Italian market. Foreign investment is small (about $50 million in 1999), but the U.S. is the biggest investor, accounting for over 40% of the total.

Table 46: Investment in Tunisia by Sector, 1996-2002 (TND million / US$1 = TND1.3)

	1996	1997	1998	1999*	2000**	2001***	2002***	Avg. Growth Rate
Agriculture & Fisheries	717.8	736.1	824.3	860.8	890.0	930.0	1,000.0	5.68%
Manufacturing	642.3	719.0	832.0	876.3	953.1	1,030.0	1,195.0	10.90%
Food Processing	140.0	173.0	221.8	231.0	241.6	220.0	240.0	9.40%
Glass & Construction Materials	112.0	98.0	100.0	120.1	129.7	160.0	220.0	11.91%
Mechanical & Electrical	84.6	100.0	120.0	135.0	150.0	170.0	190.0	14.44%
Chemical	70.0	83.0	85.0	75.0	84.9	90.0	105.0	6.99%
Textile, Clothing & Leather	155.1	170.0	208.2	215.1	233.1	260.0	290.0	10.99%
Other	80.5	95.0	97.0	100.0	113.9	130.0	150.0	10.93%
Non-Manufacturing	469.2	716.9	775.5	678.3	1008.8	1127.0	890.0	11.26%
Mining	20.6	39.8	41.5	43.2	42.3	40.0	50.0	15.93%
Oil & Gas	182.3	247.0	272.0	222.0	354.7	370.0	255.0	5.75%
Electricity	154.2	308.1	303.0	238.0	416.8	487.0	325.0	13.23%
Water	42.1	40.0	60.0	70.0	80.0	90.0	100.0	15.51%
Construction	70.0	82.0	99.0	105.0	115.0	140.0	160.0	14.77%
Service Sector	2,130.0	2,417.5	2,595.1	3,238.4	3,499.8	3,708.0	4,225.0	12.09%
Retail/Wholesale	82.0	91.6	101.4	113.2	124.2	128.6	146.7	10.18%
Transport & Communication	734.8	917.8	943.8	1,397.6	1,490.0	1,520.0	1,770.0	15.78%
Hôtels, Cafés, Restaurants	336.0	324.9	329.0	331.0	324.0	360.0	380.0	2.07%
Financial Services	55.5	58.0	83.9	118.5	88.5	102.3	116.7	13.19%
Miscellaneous	921.6	1,025.1	1,137.1	1,278.2	1,473.1	1,574.8	1,811.6	n/a
Housing	698.6	783.3	843.1	946.1	1,055.1	1,175.0	1,330.0	n/a
Government	462.9	563.3	583.2	623.8	668.5	830.0	950.0	12.73%
Education and Training	179.3	173.0	195.2	202.6	217.1	n/a	n/a	n/a
Health	63.8	55.5	60.4	65.9	70.6	n/a	n/a	n/a
Sanitation	18.5	16.5	17.4	20.3	21.7	n/a	n/a	n/a
Urban Development	16.7	39.5	39.9	40.7	43.6	n/a	n/a	n/a
Social and Cultural	70.5	54.0	67.6	69.7	74.7	n/a	n/a	n/a
Other Public Services	114.1	224.8	202.4	224.6	240.7	n/a	n/a	n/a
Total	4,422.2	5,152.8	5,610.2	6,277.6	7,020.3	7,625.0	8,260.0	10.97%

Source: Institut National de la Statistique

Table 47: Foreign Direct Investment in Tunisia by Sector, 1996-2001 (TND million)

	1996	1997	1998	1999	2000	2001	Annual Growth
Energy	166.90	271.30	201.80	194.80	323.40	327.30	14.42%
Tourism	48.40	23.00	24.60	37.20	41.50	101.10	15.87%
Manufacturing	49.50	85.70	523.30	197.90	688.30	251.00	38.36%
Agriculture	2.00	3.30	1.40	3.20	4.00	8.90	34.79%
Privatization	n/a	n/a	409.00	n/a	158.10	64.00	n/a
Total	272.50	402.90	759.90	437.20	1068.20	700.00	20.77%

Table 48: Tunisian Enterprises with Foreign Participation, 2002†

	Number of Companies	2002 Investment Flow ($000)	Employment	Foreign Ownership
Manufacturing				
Food Processing	106	196,752	7891	
Building Materials	63	786,336	6051	
Metal, Mechanical	161	247,815	7316	
Electric, Electronic	171	277,302	28,904	
Chemical, Rubber	70	335,010	6278	
Textiles, Clothing	1,156	514,341	118,426	
Leather, Footwear	148	73,242	14,797	
Other Industrial	165	103,186	6303	
Total Manufacturing	2,040	2,526,301	195,966	24%
Tourism				
Hotels, Lodging	95	866,134	16,096	
Tourism Operations	38	86,653	1160	
Other	27	7268	153	
Total Tourism	160	960,055	17,409	27%
Agriculture/Fisheries	61	125,131	1482	5.5%
Services				
IT	37	5785	463	
Telecommunications	4	260,015	166	
Call Centers	6	2307	708	
Consulting	51	4272	379	
Other	41	7522	292	
Total Services	139	285,018	2008	5.7%
Total	2,400	3,896,504	216,865	9.8%

† Companies wholly or partially engaged in export

5. Dubai

Many of the investment statistics available from official sources such as the United Nations and the World Bank do not disaggregate Dubai from the other Emirates. Nevertheless, statistics published by the Dubai Government allow one to understand in substantial detail the patterns of investment in Dubai itself.

Foreign investment is relatively insignificant for the UAE in general and Dubai in particular, though this may change. Dubai's approach to industrial, infrastructure, and tourism development has been to create a vision and then to use a combination of public and private funds to develop

mega-projects that in turn will attract further private investment and development. The approach of the ruling family has been largely to provide land, build infrastructure, and create a framework that can encourage private investment in areas deemed to be important to the future development of the Emirate. Dubai was fortunate in having enough money from oil to fund initial development of infrastructure and equally fortunate to realize that its oil reserves were insufficient to provide long-term sustained growth. As a result, almost from the discovery of oil in Dubai in the 1960s, the Ruler of Dubai began to plan for a future without oil. The creation of the Jebel Ali Free Zone and container port in the late 1970s was the first such development, establishing infrastructure at government expense and creating an investment-friendly regulatory framework. Jebel Ali and other, similar developments have also reduced the need for foreign companies to invest in land and buildings (with few exceptions foreigners have not been able to buy land). This has reduced the amount of foreign investment required for foreign-owned industrial projects.

It is therefore more meaningful to look at gross fixed capital formation instead of FDI. *Note: The following table contains numbers provided by the Ministry of Planning for indicators of gross fixed capital formation and numbers on industrial investment provided by the Dubai Chamber of Commerce and Industry and the Dubai Department of Economic Development. There exist large discrepancies between the two, apparently because the Ministry of Planning figures do not include investments in the Jebel Ali Free Zone, the location for most industrial investment in Dubai. Nevertheless, the relative importance of different investment sectors and industries, as well as the trends over time serve as useful indicators.*

Table 49: Dubai Gross Fixed Capital Formation, 1990-2000 (million US$)

	1990	1995	1997	1998	1999	2000
Agriculture	2	11	7.2	12	6	10
Mining & Quarrying	5	10	7	7	6	7
Manufacturing**	292	333	445	458	583	611
Food, Beverage, Tobacco	184	304	392	504	n/a	n/a
Textiles, Garments, Leather	80	207	222	223	n/a	n/a
Paper, Printing, Publishing	72	193	193	269	n/a	n/a
Chemical, Rubber, Plastic, Petroleum	492	623	847	874	n/a	n/a
Glass, Ceramic, Stone	129	543	687	603	n/a	n/a
Basic Metals*	1,389	1,414	1,767	1,972	n/a	n/a
Metal Products and machinery	240	471	1031	659	n/a	n/a
Electricity and Water	174	292	299	283	250	292
Construction	53	135	160	169	194	206
Trade	55	195	272	290	326	349
Tourism	101	269	337	363	394	423
Transport, Storage, Communication	279	670	968	1,013	1,259	1,051
Finance	5	20	28	30	38	38
Real Estate	56	621	691	916	1,213	1,274
Government Services	215	197	204	208	211	215
Other Services	11	22	30	33	56	63

*Almost exclusively Dubai Aluminium

** Excluding Jebel Ali Free Zone investments

Sources: Dubai Chamber of Commerce and Industry and Dubai Department of Economic Development for manufacturing investment breakdown by industry; Dubai Ministry of Planning for overall gross fixed capital formation figures.

This shows that, after infrastructure, manufacturing and tourism are the main focuses of investment. Significantly, in 1995 the Government of Dubai prepared a Development Strategic Plan for the period 1996 to 2000, in which it identified the following priorities and goals.

- Improve the policy framework for investment promotion and improvement in business environment.
- Improve productivity and diversification of economic base (specifically reduction of oil's share of the economy from 20% to 11%).
- Increase per capita GDP from $14,562 in 1995 to $16,114 by 2000 and $19,450 by 2010, even as the oil sector, which generates 25% higher per capita incomes, declines in relative importance.

The Strategic Plan identified the development of tourism, trade, and manufacturing as the pillars of this strategy, to be supported by the following.

- Increases in investment in key sectors and in essential physical (i.e., transport and communications) and educational infrastructure
- Articulating and carrying out a tourism master plan
- Undertaking selective and targeted investment promotion and improving support services, focusing on manufacturing in food and beverages, textiles and garments, chemicals and petroleum products, basic metals and metal products, packaging, electrics and electronics, office equipment, air conditioning, and other products with potential in domestic and export markets
- Strengthening business links and promotion campaigns with Asia, Africa, and the Middle East to stimulate trade and tourism
- Improvement of productivity, as well as improvement of business registration procedures and of investment promotion initiatives

To achieve these goals, the Strategic Plan estimated a capital investment requirement of about $12 billion.

It is remarkable to review this document now, for Dubai has met or surpassed virtually all of the goals set forth in its 1996 plan. Investment during the five years from 1996 to 2000 amounted to $21.5 billion. Per capita GDP stood at $19,438. Oil's share of GDP had dropped to 10.4%. Government had streamlined investment and company registration procedures, creating a new one-stop shop in the Dubai Department of Economic Development and granting greater autonomy and flexibility to the Free Zones; creating new Free Zones focused on Internet, media, trade, education, health care; and expanding the existing Jebel Ali and Airport Free Zones. In 2001, Dubai created a new agency, the Dubai Development and Investment Authority, charged with promoting FDI and improving the business environment.

In tourism, thirty-four new deluxe and first-class hotels were built, and the number of beds increased from under 13,000 to over 20,000. An entire new tourist area at Jumeirah Beach was developed, the site for most of the new hotel construction. Tourist arrivals went from about 1.6 million to 2.8 million. Hotel revenues increased from $397 million to $739 million.

In industry, the number of industrial enterprises increased from 800 to 1,200; annual industrial investment jumped from about $2.6 billion to over $5 billion; and total manufacturing output increased by nearly 100%, from $3.4 billion to $6.1 billion.

This performance indicates that Dubai has both the vision and the implementation ability to achieve even the most ambitious development goals. The government's Strategic Plan calls for oil to fall to about 2.5% of GDP by 2010 and to catch up with the most developed economies from that point onwards. The three pillars on which this future strategy rests are the following.

- Economic dynamism, based on economic growth, local investment and entrepreneurship, and market expansion
- Quality of life. as defined by physical and social environment and prosperity
- Regional cooperation and integration, especially in trade and industry

Industrial clustering, growth of manufacturing and service industries, and networking and other high tech developments, including health care and biotechnology, will be the main sectoral areas of focus for the next ten years.
Though in theory investors are free to invest in any area of the economy they choose, in practice Government guides investment decisions very carefully. In tourism this is clear from the master plan and the way the government and the ruling family use their own funds as a catalyst to mobilize private investment from other sources. Examples of this approach abound.

For example, as the ruling family decided in the mid-1980s to turn Dubai into a tourist destination, they established Emirates Airlines, still largely owned by the ruling family, to bring the tourists. At the same time, they undertook major tourism developments, providing land and infrastructure, as well as encouraging leading development and tourism management companies to undertake the development of the hotels and other facilities themselves. Though the details of the funding of these projects are not publicly available, they invariably involve a partnership between the government and private interests, and operate on a purely commercial basis.

The most ambitious tourism project to date (in the world, not just Dubai) involves the creation of two man made islands, 120 sq. km. in total area with each island hosting at least forty luxury hotels, villas, golf courses, marinas, and shopping centers. The price tag for the first phase of the project is estimated at about $3 billion, mainly for the land reclamation and infrastructure development. Most of this is likely to be funded by the government/ruling family, but the development will then offer land for sale to developers of housing, hotels, and other tourism facilities. The project was initially conceived and announced by the Crown Prince of Dubai and the development company is chaired by the Executive Chairman of the Ports, Customs and Free Zones Corporation.

Other developments, including Dubai Internet and Media Cities and the planned Dubai Health Care City, are carried out in a similar manner. For the Dubai Health Care City, the Government will give a prime site to the project, as its equity contribution to the master development, expected to cost about $2 billion. Other partners in the development will contribute the rest. The Government will own no equity in subsequent phases of the project, but will generate returns on the sale or rental of land and buildings to the many health care companies – hospitals, clinics, pharmaceutical companies – the project is expected to attract.

The authorities responsible for Jebel Ali, the Airport Free Zone and other prime industrial and commercial areas take pride in their selectivity and do not disguise that they reject as many project applications as they select. More recently, the government has become even more proactive and directive in its approach to manufacturing investment. Explicitly seeking to emulate the Singapore model, Dubai engaged the Business Planning Department of the Jurong

Town Corporation, which built and managed Singapore's first major planned industrial estate. JTC has prepared eighteen profiles of projects for Dubai to promote, with capital requirements ranging from under $1 million to over $200 million, all of them seeking American, European, or Japanese technology and all of them to be located in Jebel Ali or one of the other industrial Free Zones. Projects include video monitors, printed circuit boards, hard disk drives, audio and video assembly, assembly of chips and computer components, electronic point of sale systems, precision metal components, hydraulic equipment, machine tools, heat exchangers, titanium dioxide pigment, chemicals for concrete hardening and enhancement, flux and paste for soldering and welding, chemicals for etching and cleaning of electronic components, high quality furniture and fittings, precast concrete, waste management services, and broadcasting, publishing, and multimedia and television production.
The major manufacturing areas in Dubai are the Jebel Ali Free Zone and the Airport Free Zone. Of the more than 2,300 companies located in Jebel Ali, 17% are now engaged in manufacturing and 4% in services. Most of the international companies that have established themselves in the Free Zones have done so to have a regional distribution and service base.

Dubai's first pharmaceutical manufacturer, which began production in 2002, is a $20-million joint venture between Dubai Investments Company and an Indian pharmaceutical company. The joint venture plans to manufacture generic products under license from companies in U.K., Netherlands, Germany, and South Africa for sale in the UAE and GCC markets.

Given Dubai's success in attaining the goals spelled out in its previous strategic development plan, there is every reason to think that the Emirate will experience similar success in achieving its next round of development goals. This success is almost certain to involve an increase in FDI from its currently low levels, increasing growth in manufacturing (especially in high tech, chemical electronic, pharmaceutical, food); growth in media, internet, health care, and other traded services; and tourism development on a massive scale (in addition to the Palm Island development, at least fifty other hotel, shopping center, recreation complex and other tourist developments are currently in development).

More than twenty massive infrastructure developments are planned, including major expansions to Jebel Ali port and Dubai airport, creation of new industrial "cities," including Silicon Oasis, a new area devoted to semiconductor manufacturing that will be a joint venture between the Dubai Government, Intel, and the Government of Brandenburg State in Germany. A railway is planned, as well as a new textile city. Increasingly, these projects are involving foreign private capital in partnership with the Dubai government. Parks, sports stadiums, golf courses, water parks, beaches, and an artificial ski center are among the many tourist-oriented projects to be built with private and some Government capital.

Dubai's relative lack of FDI has been mainly due to the ability of local Dubai interests, mainly the government and royal family, to fund many of the important developments themselves, which has allowed them to retain control over the pace and quality of investment. It has also allowed them to undertake audacious investments that private and foreign investors would have tended to view very skeptically. Now that Dubai's plans have become even more ambitious, and as the territory has proven its ability to plan and implement huge developments, Government has already begun to revert to a more catalytic role, contributing funds or land as required, but turning more and more to private capital to take on a larger share of both the risks and the rewards.

This unique approach has made Dubai one of the most attractive and competitive investment locations, not only in the MENA region, but in the world.

V. SECTOR FOCUS

A. Overview

This section seeks to identify the sectors and industries in which Jordan has the greatest actual or potential competitive advantage relative to the other countries in the region and thus the industries which Jordan should most vigorously promote as part of its targeted FDI development strategy.

Trends in investment can provide some indication of the relative importance of different industries for each of the countries and also an indication of whether they are growing or declining in importance. It is here that investment approvals, as opposed to actual dollars invested, can be a useful guide. Domestic investment, as well as foreign direct investment, can also provide useful indications as to the perceived relative competitiveness of different industries in a single country. Two important caveats must, however, be highlighted. First, investment is often guided substantially by government policy, including incentives and promotion strategies aimed at directing investment towards one set of industries rather than another. Governments follow such strategies and policies based on their perceptions of the economic and social benefits (e.g., employment, skills development) of focusing in certain industries, even though the country may possess no significant competitive advantage in these areas. Second, a focus on the relative weights of certain industries in attracting investment can miss nascent industries that could contribute a great deal to future development while possibly over-emphasizing industries that may be poised for a decline.

Table 50: Top Sectors for FDI by Country

Jordan	**Egypt**	**Israel**	**Tunisia**	**Dubai**
Tourism (36%)	Chemicals (27%)	Communications (42%)	Tourism (25%)	Basic metals (35%)
Food (26%)	Tourism (17%)	Software (20%)	Building materials (20%)	Chemicals, rubber, plastic (16%)
Textiles, clothing (14%)	Engineering (15%)*	Biotechnology & pharmaceuticals (16%)	Textiles, clothing (13%)	Metal products, machinery (12%)
Chemicals (6%)	Food (14%)	Other Technology (13%)	Chemical, Rubber (9%)	Glass, ceramic, stone (11%)
Mining/Mining products (3%)	Metal (13%)	Internet (9%)	Electric, Electronic (7%)	Food processing (9%)
Cosmetics, detergents (2%)	Textiles, clothing (8%)	Tourism (3%)	Telecommunications (7%)	Tourism (8%)
Engineering (2%)*	Pharmaceuticals (5%)	Textiles, Clothing (3%)	Metal, Mechanical (6%)	Paper, printing (5%)
Rubber, plastic (2%)			Food Processing (5%)	Textiles, garments (4%)
Software, IT (1%)				

* Engineering comprises mechanical, electrical and metal products industries

The above table conceals a great deal of variation. The figures for Jordan reflect the proportions for the six years from 1996 to 2002, since fluctuations in any given year skew the proportions significantly. For example, FDI in the tourism sector in 2000 exceeded $480 million, or 78% of total FDI investment approvals. In 2001, the $400 million in investment in the food industry came to about 70% of total approvals.

This table also excludes information on the relative growth in different industries. In Israel, investment in the Internet went from nearly 30% of the total in 2000 to 9% in 2001, due largely to the crash in dot.com stocks. At the same time, the share of biotechnology increased from 8% to 16% (of total investment that had fallen by around 50%). In 1998, tourism accounted for about 10% of investment, whereas in 2001 it amounted to 3%, largely a function of political unrest.

In Jordan too, FDI in tourism fell from 45% of total FDI in 1997 to 5% in 2001, partly because of over-investment in previous years but partly also because of the worsening political situation in the region.

In Dubai, tourism appears to account for a relatively modest share – 8% – of gross fixed capital formation, at least according to 1998 figures, the most recent available. But the real proportion could be far higher. A significant proportion of Dubai's investment in real estate, transport and communications and construction is directly connected with tourism sector development. Indeed, if appropriate portions of these investments are included, tourism development may represent closer to 35% of total investment.

Perhaps the most important information contained in this table is the similarity between Jordan's investment profile and that of other MENA countries.

As Montague Lord points out in his assessment of the economic impact of FTA, conducted before ratification of the agreement, "In *natural resource-intensive products*, Jordan continues to have a clear comparative advantage in manufactured fertilizers, as do Morocco, Tunisia and, to a lesser extent, Israel and Egypt. Jordan also has a strong comparative advantage in animal and vegetable oils, as do Tunisia and Morocco. In the case of crude materials, however, it shares a comparative advantage with Morocco. Jordan also has a comparative advantage in food and live animals (along with Morocco and Egypt), paper and paperboard, non-metallic mineral manufactures, albeit much smaller than Israel, and similar to that of Turkey, Egypt and Tunisia. … Among *unskilled labor-intensive products*, Jordan and all other Middle East countries emerge with a comparative advantage in footwear, clothing and textile yarn… Among the *human capital and technology-intensive products*, Jordan again shares a comparative advantage with other Middle East countries in all but one product: inorganic chemicals (Jordan, Egypt, Israel, Tunisia, Morocco); essential oils, perfume materials (Jordan, Egypt and Turkey); medicinal and pharmaceutical products (Jordan, Egypt and Israel); plastic materials, regenerated cellulose (Jordan and Israel); and dyeing, tanning, and coloring materials (only Jordan)."[75]

According to this analysis, Jordan has very few unique comparative advantages in most of the products it produces, relative to other countries in the region. This suggests that all countries will focus on producing and exporting similar ranges of products and that they are likely to attract FDI in those same industries and product categories. These industries certainly merit further investigation to determine the degree to which Jordan can derive a competitive advantage from those industries in which it already has a comparative advantage.

To achieve a meaningful near-term competitive advantage in attracting export-oriented FDI, Jordan must either identify new industries and products in which it can exploit certain comparative advantages in physical, financial or human capital, or it must try to exploit to the maximum possible extent its only truly significant competitive advantage as represented by the FTA and QIZ programs. Given that Jordan is one of only two countries in the MENA region – the other being Israel – that have a free trade agreement with the United States, a more detailed examination of the exact benefits conferred by that agreement (and by its "cousin," the QIZ program) is required to determine where Jordan can most effectively concentrate its targeted FDI promotion strategy. Over the longer term, Jordan can try to create new competitive advantage in the areas such as education and infrastructure over which it has substantial control.

[75] Lord, Montague, Economic Impact and Implications for Jordan of the U.S. – Jordan Free Trade Agreement, AMIR Program, February 2001, pp 19-20

With a small domestic market, Jordan's investment focus has been and will continue to be mainly on export-oriented industries, which implies a need to identify those product categories in which Jordan has or can develop a competitive advantage. Notwithstanding the importance of Jordan's ability to access the European market under the EU Association agreement, the U.S. – Jordan Free Trade Agreement represents a far more important competitive advantage relative to other countries in the MENA region. Apart from the Gulf states, most of the MENA countries, including Israel, have a free trade agreement with the European Union. Tunisia's foreign trade is entirely oriented towards Europe while other countries, including Egypt, Morocco, Lebanon and Turkey all export far more to Europe than to the United States. Of the countries in the region, only Israel and Jordan currently have free trade agreements with the U.S., though the U.S. is in discussions on establishing a QIZ program with Turkey and Israel and with Morocco on setting up a US-Morocco FTA. Jordan also has the QIZ program. These programs give Jordan an immediate competitive advantage in trade, which can translate into a competitive advantage in attracting FDI. It makes sense, therefore, to focus on attracting FDI to manufacture products that can benefit from preferential access to the U.S. market.

This approach suggests a level of focus far more detailed than that of "sector," which could be defined as broadly as "food processing" or even manufacturing. A focus on specific product categories could be as narrow as "olive oil" or even "virgin olive oil of weight, including container, of less than 18kg."

Figure 57, below, shows Jordan's principal exports to the United States as of 1999, before the enactment of the Free Trade Agreement. By comparing this product list with the tariff benefits under FTA (i.e., the difference between the normal MFN import tariff imposed by the U.S. and the tariff rate under FTA), it is possible to identify a list of products that may represent an immediate opportunity to expand trade and attract FDI.

Though longer-term prospects should not be ignored, including those represented by emerging technologies, wholly new industries, and markets other than the U.S., the purpose of this ITS is to propose a **medium-term** investor targeting strategy. This implies that, absent a compelling and unique new market access opportunity such as the QIZs, the ITS should focus mainly on industries that already exist in Jordan rather than trying to attract entirely new industries as the linchpin of JIB's promotion campaigns.

At the same time, even though specific market access advantages adhere to products identified by an 8-digit HS (harmonized system for tariff classification) code, an approach based on attracting investment only for those specific products risks ignoring or missing other potential investments that may fall outside those narrow product definitions. For example, plastic and other packaging materials do not benefit from any significant market access benefits under FTA and so the scope for export-oriented FDI in this area may be limited. But improving the quality of packaging and labeling is identified as a critical element in increasing Jordan's competitiveness in pharmaceuticals, cosmetics and food.

It therefore makes sense to broaden the investor targeting strategy to focus on the development of clusters, each centered on a specific industry in which Jordan has a *comparative advantage*. By developing the industry as a cluster and focusing on upgrading all the inputs and supports the industry requires, the comparative advantage can be transformed into a *competitive advantage*. This suggests that as JIB targets certain potential investors in, say, food processing, it should also target critical suppliers to those investors. A successful example of this approach can be found in Poland's experience of privatization and promotion of inward FDI in the early 1990s. When

Gerber Foods decided to invest in Poland, the Polish Government was able to induce Owens-Illinois to invest in a state-owned manufacturer of glass jars that the Government had decided to privatize. Owens-Illinois was the principal supplier of glass jars to Gerber in the United States and in several other countries in which Gerber had manufacturing plants. It proved far easier to get Owens-Illinois to invest in Poland in a sort of cluster-based development involving Gerber, a company with which it already had a strong relationship, than it would have been to get them to invest in the absence of Gerber's investment. The prospect of getting Owens-Illinois to invest also was an important factor in Gerber's decision to invest in Poland.

Following this sort of cluster-based approach may help sharpen or redefine Jordan's competitive advantage in ways that can help it overcome its basic similarity in natural resources and human capital to other, neighboring countries.

Figure 56, below, shows a number of product categories in which Jordan has a considerable advantage stemming from FTA tariff preferences and in which Jordan already has some production and export capacity. These industries will be the subject of further investigation as potential targets for investor targeting.

Table 51: Products with Preferences under U.S.-Jordan FTA

	HTS Codes	MFN Tariff	Current	Total 2002 US imports	Jordan share of imports
			FTA Tariff	$0	$0
Olive oil					
Virgin <18kg	15091020	$0.05/kg	0	200,602	11.8
Virgin >18kg	15091040	$0.034/kg	0	47,894	0
Non-virgin <18kg	15099020	$0.05/kg	0	168,133	4
Non-virgin >18kg	15099040	$0.034/kg	0	20,010	0
Vegetable Oil	15162090	$0.088/kg	$0.022/kg	21,918	12.3
Vegetables (incl. olives), pickled	20019038	9.60%	0%	119,630	0
Fruits					
Dates	8041020	$.132/kg	0	653	2.5
Melon seeds	20081950	6.40%	1.60%	995	8.5
Other seeds	20081990	17.90%	7.10%	8,671	0
Confectionery					
w/o cocoa	17049090	10.40%	4.10%	6043	0
candied nuts	17049010	4.50%	0%	2,912	3.4
Cosmetics, nes	33079000	5.40%	0%	56,266	0
Bath salts	33073010	5.80%	0%	8,218	136.6
Other bath preparations	33073050	4.90%	0%	44,881	4.6
Organic/aromatic skin creams	33049950	4.00%	0%	1,539	0
Pesticides	29189020	7.20%	2.30%	47,267	0
	29242116	7.20%	2.30%	25,917	0
	29242947	7.10%	2.20%	78,372	0
	29331923	7.20%	2.30%	23,937	0
Electrical					
Air-conditioning	84151090	2.20%	0%	13,881	22.1
Air conditioning	84158201	2.20%	0%	131,799	627.4
Water heater parts	85169090	3.90%	0%	82,104	0
Stone	6802….				
Travertine		3.7%-4.2%	0%	229,637	44.2
Marble		1.9%-4.9%	0%	177,130	60.1
Limestone		4.90%	0%	216,060	183.7
Granite		3.70%	0%	549,453	12
Other		6.0%-6.5%	0%	176,215	72.3
Jewelry					
Gold plate	71142000	3.00%	0%	7,860	5.1
Precious or	71132050	5.20%	0%	32,496	0
semiprecious	71162015	6.50%	1.60%	29,271	9.7
stones	71162005	3.30%	0%	62,272	0
Costume Jewelry	71171990	11.00%	4.40%	478,922	0
Plastics					
Baths,					
washbasins	39221000	6.30%	1.50%	75,142	0
Lids, stoppers	39235000	5.30%	1.30%	304,227	77.9
Packaging	39239000	3.00%	0%	603,309	306.8
Bottles, jars	39233000	3.00%	0%	342,333	0.3
Tableware,	39241020	6.50%	0%	137,810	5.3
kitchenware	39241030	5.30%	0%	44,910	0
	39241040	3.40%	0%	475,041	19.3

Batteries					
Nickel-cadmium	85073080	2.50%	0%	327,824	40.3
Other	85078080	3.40%	0%	686,079	0

Source: U.S. International Trade Commission Interactive Database

Table 52: Jordan's Major Merchandise Exports to the United States, 1999 (US$ in thousands)

HS	Description	Value	Percent	Value	Percent	Value	Percent	Main Products
I	Live animals; animal products	-	0.00%	355	1.20%	355	0.80%	Frozen turkey and fish
II	Vegetable products	102	0.80%	7	0.00%	110	0.30%	Thyme and bay leaves
III	Animal or vegetable fats & oils	267	2.00%	-	0.00%	267	0.60%	Vegetable fats from hydrogenated palm oil
IV	Prepared foodstuffs; beverages, spirits and vinegar; tobacco	388	2.90%	606	2.10%	994	2.40%	Tobacco and food preparations
V	Mineral products	299	2.30%	-	0.00%	299	0.70%	Sodium chloride and marble and travertine
VI	Products of the chemical or allied industries	604	4.60%	467	1.60%	1,071	2.60%	Cosmetics, pharmaceuticals and organic chemicals
VII	Plastics and articles thereof; rubber and articles thereof	196	1.50%	5	0.00%	201	0.50%	Plastic packaging
VIII	Raw hides and skins, leather, fur skins and articles thereof	2,549	19.40%	19	0.10%	2,568	6.10%	Suitcases and handbags
IX	Wood and articles of wood	7	0.00%	-	0.00%	7	0.00%	Wood frames
X	Pulp of wood or of other fibrous cellulosic material	15	0.10%	-	0.00%	15	0.00%	Paper and printed books
XI	Textiles and textile articles	3,069	23.40%	8	0.00%	3,078	7.30%	Articles of apparel and carpets
XII	Footwear, headgear, umbrellas	11	0.10%	-	0.00%	11	0.00%	Footwear
XIII	Articles of stone, plaster, cement	57	0.40%	-	0.00%	57	0.10%	Worked stone and ceramic products
XIV	Natural or cultured pearls, precious or semi-precious stones	3,621	27.50%	-	0.00%	3,621	8.60%	Articles of jewelry plated with gold
XV	Base metals and articles of base metals	851	6.50%	501	1.70%	1,352	3.20%	Aluminum waste and scrap, and tools
XVI	Machinery and mechanical appliances; electrical equipment	876	6.70%	706	2.50%	1,582	3.80%	Air conditioning machines
XVII	Vehicles, aircraft, vessels and other transport equipment	-	0.00%	25,276	87.80%	25,276	60.30%	Re-exports of aircraft and parts thereof
XVIII	Optical, precision, medical instruments and apparatus	-	0.00%	737	2.60%	737	1.80%	Cameras and projectors
XX	Miscellaneous manufactured articles	177	1.30%	89	0.30%	266	0.60%	Wooden furniture
XXI	Works of art, collectors' pieces and antiques	50	0.40%	-	0.00%	50	0.10%	Works of art
	Unspecified	6	0.00%	16	0.10%	22	0.10%	
	Total	**13,143**	**100.00%**	**28,792**	**100.00%**	**41,936**	**100.00%**	

Not all of the industries identified in this preliminary screen will necessarily be priorities for investor targeting. Large and important industries may have reached a peak in attracting FDI and

though they may remain important parts of the national economy, their potential to attract additional investment or the need for aggressive promotion to attract further investment may be limited. In Dubai, for example, aluminum processing is the largest single industry and the largest recipient of FDI after oil. Yet Dubai has no need to promote further investment in this sector, since it is dominated by a single company, whose investment needs are well understood and whose technical and financial partners are well placed to contribute further investment as required.

Other industries may have experienced rapid growth in FDI in recent years, possibly as a function of preferential access to key markets. Changes in market conditions may affect the ability of certain countries to attract significant future investment in these industries. Morocco, for example, has experienced a decline in investment in textiles and garments, though this could revive if a free trade agreement with the U.S. is signed. Tunisia has also experienced some decline in this area as Turkey and Eastern European countries have come to fill a larger proportion of European demand for clothing.

Given these criteria and the appropriate caveats, this report will examine the following sectors and industries in Jordan and attempt to select the six with the greatest potential and/or need for a concerted investor targeting campaign by JIB and other entities. This assessment will take into account Jordan's competitiveness relative to other countries regionally and globally. In selecting these sectors and industries for further analysis, we have used several distinct, but overlapping, criteria based on the elements discussed above. These include the following.

Historical Investment Trends Industries that have attracted large absolute amounts of direct investment in the past five to ten years have been included. Also, industries that have ranked among the top ten in attracting direct investment and those that have shown high rates of investment growth, even if absolute numbers remain relatively small, are considered to merit further analysis. Industries such as chemicals and fertilizers (high absolute and relative investment), tourism (high absolute and relative investment), and IT (rapid growth in investment) qualify for further consideration on this dimension.

Revealed Comparative Advantage Industries in which Jordan already specializes may reflect nothing more than Government subsidies or market distortions, but could reflect sustainable competitive advantages. Much of Jordan's food processing industry falls into this category, as do chemicals and fertilizers.

Preferential Market Access Products for which the MFN tariff into the U.S. or Europe is high, but which benefit from reduced or zero tariff under FTA, the Euro-Med agreement or the QIZ program (which also gives quota-free access) are worthy of further consideration. These product categories include stone, olive oil, cosmetics, jewelry, textiles and clothing, and plastics.

Unique or Highly Competitive Inputs Dead Sea products, Jordan being one of only two countries with access to the Dead Sea, naturally qualify for further consideration. Other mineral products, such as potash, phosphates, and bromine, though not unique to Jordan, are also potential sources of competitive advantage and warrant further inquiry.

Existing or Emerging Industry Sales and investment in sectors such as medical tourism and software-related products and services have shown strong growth in recent years, even if absolute indicators remain low. These emerging investment and trade trends may reflect existing

or potential competitive advantages and the potential to develop competitive clusters. Strong existing industries include pharmaceuticals and chemicals.

High Level of Government Support Section I of this report discussed the ability of governments to create new sources of competitive advantage by investing in education and infrastructure, by providing direct support to selected industries or by increasing domestic market size through increased government spending. A combination of these kinds of government support could make an existing industry much more competitive and could create opportunities for other industries to emerge. IT products and services are a prime example of an industry that has received a high level of government support in Jordan and that may thrive as a result of that support.

Regional Integration Some industries (e.g., tourism and medical tourism) have an established presence in regional markets that could be reinforced by moves towards greater regional economic integration. Other industries, which in other circumstances might have more limited potential to attract FDI, might be given a significant boost by regional integration. One of the most significant potential sources of competitive advantage for Jordan lies in broadening and deepening economic ties to Israel, via the QIZs and other mechanisms. The ability to combine Israel's advantages in high technology with Jordan's significant potential in labor-intensive elements of the same industries could lead to development of genuine cross-border clusters that can compete globally. Cosmetics, stone, food, and many other industries can potentially lend themselves to such a cross-border approach and are evaluated further in this report.

The sectors/industries selected for further analysis based on these dimensions are as follows.

Sector/Industry	Dimension
Tourism	High levels of investment, high employment, potential from regional integration
Textiles and Clothing	High FDI, rapid growth in FDI, preferential market access, regional integration aspects
Hospitals and Medical Services	High potential as a traded service, high levels of investment, regional integration potential
Food Processing	Significant investment and employment, preferential market access for some products, rural and urban employment
Chemicals	Existing industry, certain products with preferential market access potential
Machinery/Electrical Appliances	Strong existing domestic producers, preferential market access
Mining and Mining Products	Existing reserves and industry, potential for preferential market access
Cosmetics	Unique resources from the Dead Sea, preferential market access, existing industry, rapidly growing world market, regional integration potential
Stone	Resources and existing industry, potential for regional integration and preferential market access
Information and Communications Technology	Rapid growth in FDI, strong government support

(ICT)	
Plastics, Printing and Packaging	High investment, regional integration potential, high growth, preferential market access
Pharmaceuticals	Significant investment, access to regional markets
Alternative Energy	Existing resources, growing market, regional

B. Tourism

Tourism is one key sector that all countries in the region seek to promote and develop and one that this report will examine in greater detail. Tourism also lends itself to greater regional integration than many other industries, especially where Jordan, Egypt, Israel and even Saudi Arabia are concerned, since the potential for expanding tourism in the Aqaba region is tremendous. Jordan's tourism industry has suffered in the past because many tourists include a short visit to Jordan as an extension to a visit to Israel. To make Jordan itself, or the region itself, a destination in its own right, will be one of the biggest challenges.

The World Travel and Tourism Council (WTTC, in partnership with the Christel DeHaan Travel and Tourism Research institute, has developed an index to the relative competitiveness of different countries.

2002	Price Competitive-ness Index	Human Tourism Index	Infrastructure Index	Environment Index	Technology Index	Human Resources Index	Openness Index	Social Index
Bahrain	67.07	23.01	..	44.64	27.65	83.33	42.55	50.79
Cyprus	60.54	38.93	76.31	65.75	38.79	85.71	75.56	44.64
Egypt	79.81	3.77	62.59	73.91	2.91	55.95	35.39	21.91
Israel	27.36	7.35	..	67.31	58.01	90.48	60.95	60.23
Jordan	85.86	11.86	64.87	79.12	4.71	75.00	40.57	24.98
Kuwait	26.55	6.28	..	23.35	19.68	70.24	38.00	64.76
Lebanon	47.35	..	66.55	52.90	23.98	80.95	24.27	38.60
Morocco	82.07	5.34	50.98	71.62	2.55	40.48	62.75	19.93
Qatar	..	..	..	..	25.14	76.19	..	54.35
Saudi Arabia	76.51	..	68.83	59.88	7.57	66.67	8.28	32.95
Syria	30.78	8.07	56.39	60.96	4.49	65.48	32.41	22.29
Tunisia	82.30	9.61	..	79.64	4.53	66.67	66.20	25.25
Turkey	74.91	4.22	59.82	63.26	19.23	73.81	60.22	35.01
U.A.E.	54.17	..	..	40.95	41.45	69.05	75.76	43.61
Average	61.18	11.85	63.29	60.25	20.05	71.43	47.92	38.52
Std. Deviatio	21.99	11.03	7.79	16.25	17.15	12.79	20.66	14.97

Green lights signify a country ranks in the top one-third of the sample, yellow in the middle third and red in the bottom third. On each dimension, the higher a country's score the more competitive it is. Jordan ranks very high compared to its neighbors in the region. Of the 14 countries listed here, Jordan ranks number 1 on price competitiveness, a measure taking into account overall cost of living and also hotel prices. On the Human Tourism Index, a measure of participation in the tourism industry and the impact of the tourism industry, Jordan is also the most competitive in the region. On the Environment Index, which measures population density, air quality and government commitment to environmental protection, Jordan ranks number 2, very slightly behind Tunisia. In openness, Jordan ranks behind Morocco, Israel, Tunisia and UAE, and ahead of Egypt. This is a misleading indicator, however, since it takes into account measures of economic openness (e.g., tariffs) that are of little relevance to a tourist and probably not to a tourism developer, since most imports of tourism equipment would be exempted from

duty. This indicator also comprises visa requirements, but is again misleading. Jordan technically does require visas of most foreign visitors; however, these are readily available at the point of entry for payment of JD 10 and thus do not constitute a significant impediment. The same is true of Egypt. Israel, which does not require visas of most visitors from North America and Europe, nevertheless subjects many of them to stringent questioning. Personal experience suggests that both Jordan and Egypt are far more open in this regard than Israel.

Jordan ranks low on the technology index, though again this is misleading. The measures of technological advancement such as Internet hosts and teledensity are far more important to the business visitor than to the recreational tourist. Business-standard hotels in Jordan have excellent Internet access, while mobile telephones are available for hire and can connect throughout the country. Of far greater importance to visitors is the cost of telecommunications, which in Jordan is fairly competitive.

Finally, the social index shows that Jordan lags behind Israel and the UAE, though it is equal to or ahead of Tunisia, Morocco and Egypt. The social index includes the U.N. Human Development Index, discussed above, as well as measures such as television sets per 1000 population, percentage of population with access to daily newspapers, computers per 1000 population and so on. Again, apart from the Human Development Index, which may indicate the level of education and ability of tourism staff and the prevalence and visibility of poverty, none of these measures is very important to most tourists.

On the infrastructure index, which measures sanitation, water and roads, Jordan scores well, though many competing countries are not scored. Jordan probably scores behind Israel and UAE, roughly evenly with Tunisia, and well ahead of Egypt.

The indicators in the WTTC rankings are a useful guide. It is comforting to know that on one of the most important dimensions of tourism destination decisions – price competitiveness – Jordan ranks higher than any country in the Middle East and ahead of most countries in the world.

A development strategy for the tourism sector in Jordan is urgently needed. The 1997 ITS prepared by TSG identified a number of tourism projects deserving of government support and efforts to attract investment, but did not place these in the context of an overall strategy. Over the years, several donor-funded tourism reviews and development plans have been prepared, the most recent one in 1996 by a Japanese consulting firm with funding from the Japan International Co-operation Agency (JICA).

Since this last assessment was completed, several major developments have taken place. From 1997 through 2001, Jordan embarked on a massive, private sector-led hotel construction boom, which has resulted, in the present political and tourism environment, in substantial overcapacity. The Aqaba Special Economic Zone, with a large tourism element, will influence tourism development not only in the Aqaba region but throughout the country for years to come.

The intensification of the *intifada* in the Palestinian Territories and the intensification of the Israeli response has caused a precipitous drop in tourism visits to Israel, which has in turn almost eliminated cross-border tourism visits between Israel and Jordan. In the aftermath of the September 11 attacks on the United States, many Arab tourists, especially from the Gulf countries, have felt less comfortable traveling to the U.S. or Europe and so have spent more of their holiday time in other Arab countries, including Jordan. Still, international visits to Jordan declined by 11% in the last four months of 2001 and visits in the first quarter of 2002 were

12.5% lower than during the same period in 2001.[76] Hotel occupancy rates fell from 39.5% in 2000 to 30.5% in 2001, and still further in 2002, while the average number of nights spent by tourists has fallen by nearly 14%. In the Middle East as a whole, the decline in visits has been closer to 30%. For Jordan, the fall in visits would have been much more severe if it were not for a 25% increase in visitors from other Arab countries between 2000 and 2001. According to some estimates, total tourist visits in 2002 were as much as in 2001, but a far higher percentage of visitors came from other Arab countries. This shift, if it is part of a long-term trend, is certain to have a significant impact on future spending and investment patterns.

There is substantial evidence that the increase in inter-Arab tourism is a trend that may substantially affect investment and spending patterns in the industry throughout the MENA region. Even before the current *intifada*, the aftermath of September 11, 2001 and the current Iraqi crisis, this trend was clearly observable. According to the World Tourism Organization, in 1996 more than 70% of outbound tourists from MENA countries visited other MENA countries. Despite Tunisia's reputation as a destination for European tourists, it is estimated that about 20% of tourism activity caters to domestic Tunisian tourists.[77] This implies that Jordan, as well as other Middle East countries, may need to review their tourist promotion policies and their planning for future tourism development. Without losing the knowledge of and focus on the lucrative European and North American tourist trade and the demands of tourists from those markets, new development will need to take account of the preferences and needs and spending patterns of Arab tourists.

This orientation is already reflected in new developments in Dubai and Jordan, in which tourism developments increasingly include vacation home complexes, aimed mainly at frequent visitors from within the region. Dubai's new Dubai Marina and Palm Island developments include huge housing components aimed less at Emirati or expatriate residents and far more at visitors from Saudi Arabia and other Gulf countries.

In a development meant to rival Dubai's tourist boom, the Aqaba Zone has about ten major tourism projects underway, most of them involving both domestic and foreign investment. These projects include the following.

- Transforming the Royal Diving Club into an integrated diving resort
- Construction of three luxury hotels
- Construction of an integrated resort town complex including a marina, several hotels, a village with shops and restaurants, villas and apartments, a gold club and more
- Several shopping and dining areas
- A "dolphinarium"
- A "traditional" souk
- A convention center

Funding for the projects comes from both domestic and international investors. The Royal Diving Club, for example, is being developed by the Jordanian Project for Tourism Development, a company with investment from Orascom, a major Egyptian telecoms and industrial group, as well as Jordan's Social Security bank and other state and private investors.

[76] Dajani, Dalya, "Tourism sector posts 10% decline but industry eyes new prospects," *Jordan Times,* July 11,2002
[77] Tohamy, Sahar, "The Competitive Position of the Tourism Industry in the MENA Region," in *Globalization and Firm Competitiveness in the Middle East and North Africa Region,* Samiha Fawzy, editor, The World Bank, June 2002 pp. 239-240

The pattern of tourism investment throughout the region suggests that regional investors play a far more significant role than European or North American investors. Future investment promotion efforts should therefore focus mainly on other MENA countries and, possibly, Asian countries (Indian investors, for example, have made significant investments in tourism developments in Dubai). Though European and North American investment cannot be ruled out, it is likely that European and North American involvement in the tourism sector will be confined largely to management and marketing via widely known international hotel and resort chains.

In the absence of a current evaluation of the tourism sector in Jordan it is difficult at this stage to recommend a detailed promotion strategy. An updated assessment of the sector, taking account of the new developments outlined above, must be carried out. The challenge will be for Jordan to prepare a plan for tourism development taking into account the many uncertainties the industry faces, including the following.

- The increase in Arab visitors as a proportion of all visitors, as well as the difference in lodging and recreational preferences and spending patterns that entails
- The possibility of increased integration in tourism among Jordan, Egypt, Israel, and Saudi Arabia, as well as the possibility that this may not occur in the foreseeable future
- The prospect of European and North American tourist visits returning to or surpassing previous levels once the political situation in the region stabilizes
- The impact of developments in Aqaba on tourism in the rest of the country
- Potential for specialty tourism products such as medical tourism

One area which can be seen as a subset of tourism, is the development of medical services. Dubai, with its $2 billion Health Care City development, seeks to become a dominant player in the Middle East for research-based medical specialties, including cardiology and oncology. Lebanon has long been a destination for plastic surgery. Jordan, with a climate favorable to establishment of private hospitals and a large population of Western-trained medical professionals, already has the nucleus of such an industry. Many countries, including the U.S. and the U.K., have tried to develop a medical services industry focused on the Middle East market, but have encountered problems of climate and culture. Certain very wealthy individuals may continue to visit their favorite doctors and clinics in London, New York, or Houston, but there is a large unmet demand in the region for high-quality private medical services in a familiar Arab environment. Jordan has a higher population of doctors, dentists, and nurses relative to population than any other country in the region. Private hospitals and clinics account for nearly 40% of the total number of hospital beds in the country. Public sector expenditure on health services amounts to 9% of GDP, a level commensurate with that of many European countries.[78] Yet public expenditure accounts for only 53% of total spending on health services, with private households and private companies contributing a further 47%.

The private health sector currently comprises 52 private hospitals, of which 35 are in Amman. The number of beds provided by the private health sector has increased by 22% from 1997 to 2000. During 2000, private hospitals admitted 175,000 inpatients, or 31% of total inpatient admissions. Of these, nearly 25,000, or 14%, were foreign. The number of foreign inpatient admissions was projected to grow by nearly 24%, to more than 30,000, in 2001.

Obstetrics and gynecology are the largest category of procedures performed in private hospitals in Jordan, and probably among the least likely to attract significant numbers of medical tourists.

[78] Arafat, Abeer, *Sector Report: Health*, Jordan Export and Finance Bank, January 22, 2002

But general surgery, orthopedics, urology, ENT, ophthalmology, plastic surgery, and cardiology are important surgical specialty areas.

Al-Khalidi Medical Center (KMC) in Amman reports that some 30% of its inpatients come from other Arab states, including Sudan, UAE, and Libya. KMC has contracts with the Health Ministries of these countries to provide certain health services. Saudi Arabia and Yemen are important sources of patients. To accommodate families of inpatients the hospital built an adjacent 30-suite hotel.

The Eye Specialty Hospital also contracts with the governments of Libya, Yemen, Saudi Arabia, and Sudan and also performs a large volume of outpatient laser procedures on resident and visiting expatriates from Europe and North America. Non-Jordanian patients represent about 35% of the total.

Many other private hospitals, especially in Amman, treat significant numbers of foreigners, though exact numbers are unavailable. According to the report on the sector conducted by the Export and Finance Bank, the private health sector suffers from overcapacity (or under-occupancy) and under-capitalization, which prevents them from acquiring the most advanced medical equipment. Since Dubai's health Care City will certainly not suffer from this constraint, the growth of medical tourism in Jordan may depend to a substantial degree on improving the financial facilities, including leasing, available to the private health sector. Jordan will have to differentiate itself from Dubai. One clear way of doing so will be cost; however, Dubai is likely to attract significant numbers of Jordanian health professionals by offering higher salaries. Price competition is a persistent feature of the private health care market, and this could increase further with the entry into the regional market of large new facilities in Dubai.

A more detailed study of the potential for attracting medical tourism into Jordan, including a strategy for development of the sector and attracting FDI, should be conducted. A scope of work for this survey is presented in Appendix C.

An additional scope of work to develop a broader-based tourism investment strategy is also included in Appendix C.

C. Food Processing

Food processing is another industry that has exhibited robust growth in many countries in the region, especially in Tunisia, Egypt, and Jordan. With the exception of Tunisia, which is the fourth-largest exporter of olive oil and the world's largest exporter of dates, development of food processing in the region has been oriented largely towards meeting domestic and regional demand. Even in Tunisia, exports account for only 14% of total processed food production. Only 10% of the food processing companies in Tunisia produce entirely for export; these are concentrated mainly in the refrigeration and export of frozen and chilled fish, mainly to Spain, Italy, and Japan.

The export component of the food industry in other countries in the region is even smaller and oriented largely to other Arab countries. Several multinational food companies have invested in Jordan, but their production is geared almost entirely towards the domestic and regional Arab markets.

For example, Best Foods Jordan is a joint venture between Best Foods Inc. of the United States (now owned by Unilever) and Jordan Food Processing Company, which has invested in production lines for vegetable oil, Knorr soups and bouillon cubes, and Farm Foods canned products (e.g., *foul, hommous*, chick peas, whole peas and ketchup) for both domestic and regional markets, including Lebanon, Palestine, Qatar, Oman, Syria, and UAE.

Nestlé has invested substantially in Jordan, especially in mineral water bottling, but this is entirely for the domestic market.

The Arab Danish Industrial Company is a Danish-Jordanian joint venture established in 1984, specializing in the manufacture of bulk and retail-packaged tomato paste. In 1988, the local investors bought out the foreign investors, though the two groups maintain close technical co-operation. Again, this enterprise is oriented exclusively towards the domestic and Arab markets.

Adnan Khudari and Sons, a packager of herbs, spices, and vinegar, has exported successfully to Europe and the Gulf region. In addition, in 2001, it exported $1.2 million in products to the United States under the U.S.-Jordan FTA.

In spite of its domestic and regional focus, food is the second most important industry in attracting FDI to Jordan; it is also the second largest in overall investment, as indicated by JIB approvals. The Jordan Industrial Estates Corporation (JIEC) counts 41 food companies among its investors, ranking behind only textiles, chemicals, plastics, and engineering in number. Jordanian companies have an important presence in regional markets for tomato-based products, pasta, biscuits, vegetable oils, condiments, and spices, as well as its important U.S. market access benefits under the Free Trade Agreement.

Jordan has a huge revealed comparative advantage of 14.49 in vegetable oil processing, meaning that its share of world exports of vegetable oil is 14.49 times greater than its share of total world exports of all products. Though Tunisia, Turkey, and Morocco also have significant comparative advantages in this product category, their revealed comparative advantage is substantially less than that of Jordan.

This comparative advantage does not necessarily translate into a competitive advantage. The net profit of Jordan Vegetable Oil Industries Company, one of Jordan's largest producers, fell by 50% from 2001 to 2002, which the company attributed to entry into the local market by foreign firms, especially from the UAE.[79]

Vegetable oil is a case of unique and possibly temporary advantage that has emerged as a result of geopolitical conditions. Most of the foreign investment in Jordan's food industry has come from other Arab countries and the Indian subcontinent, and is oriented towards supplying the Iraqi market under the U.N.-supervised oil-for-food program, under which Jordan is one of the main conduits for products supplied to the Iraqi market. In the aftermath the war in Iraq, Jordan's privileged position will erode, as Iraq has a much freer hand to source products worldwide. Production of vegetable oil and other foodstuffs, also aimed to a large degree at the Iraqi market, has increased substantially in UAE and Saudi Arabia as well, indicating the potential for an eventual glut in the region.

Tomato processing is a large component of Jordan's agro-industrial sector, historically dominated by the state. Three major state-owned companies with close links among them

[79] "Jordan Vegetable Oil Industries Report 50% Fall in Net Profit," *The Jordan Times* (7 March 2003)

account for most of Jordan's production of processed tomato products. The first and largest of them, the Agricultural Marketing and Production Company (AMPCO), was set up in 1984 to absorb the surplus of domestically-produced tomatoes, which itself was a result of government subsidies to farmers through the provision of cheap inputs, such as water. AMPCO processes about 1,550 tons of fresh tomatoes per day [at its orignial plant]. Two additional factories in Mafraq, with combined capacity of about 900 tons per day, have also been set up as subsidiaries of AMPCO. In September 2001, the Government approved the sale of Shafa Tomato Paste Factory in Mafraq to the Jordan Farmers' Union (JFU) and is considering the sale of other AMPCO facilities to the JFU. Because of the different locations of the factories and producing areas, Jordan can produce a fairly constant supply of fresh tomatoes from February through November. The three factories together process about 60,000 tons of fresh tomatoes per year and produce about 8,000 tons of tomato paste per year, as well as significant amounts of tomato juice, ketchup, and other products.[80] Though the MENA region is a significant producer of tomatoes with over 10% of world production, Jordan's share of this total is very small. Tunisia, for example, produced 560,000 tonnes of tomatoes in 2002; Turkey 1,500,000 tonnes; Morocco 180,000 tonnes; and Israel 158,000 tonnes, compared to the 60,000 tonnes produced in Jordan.[81] Based the World Processing Tomato Council estimated value of $67 per ton for 2002, the value of Jordan's total tomato crop probably does not exceed $4 million per year. So, in spite of the importance of tomato production relative to Jordan's total agricultural production, the industry is tiny relative to world or even regional production. Thus, it is unlikely to attract anything more than niche investment.

Indeed, the tendency in the region seems to be towards reducing production. Tunisia, which used to produce close to a million tons per year, reduced its acreage under production from 21,700 ha. to 15,300 ha. This decision was taken by the producers' association as a way of getting rid of stocks built up because of over-production during the two previous years. Tunisia is currently seeking new investment in its food industry, in order to reorient that industry towards products with greater export potential. According to FIPA, of the 130,000 tons per year of double tomato concentrate produced in Tunisia, 80,000 are consumed locally, but the export demand for the remainder is simply not there. Therefore, Tunisia is seeking foreign investment to develop other products, including ketchup, peeled tomatoes, crushed tomatoes, and dried tomatoes, of which FIPA estimates 70% could be exported. Tunisia also seeks foreign investment in the production of sauces and semi-prepared meals; the processing of vegetables and fruits, such as table olives, capers, artichoke hearts, and similar products packed in brine; and the expansion of olive oil production. Tunisia will require additional investment in horticulture (e.g., asparagus, green beans, artichokes, and other products) to supply the raw materials for these new production facilities.

In the region, Egypt appears to have the greatest competitive advantage in most agro-industrial activities. This is a function of its abundant water resources, cheap labor, and large domestic market. Exports represent a small proportion of total food production, thus reducing Egypt's vulnerability to fluctuations in world demand and prices. The historical pattern for food sector investment has been to produce for the domestic market and then gradually to expand into export markets. This pattern is easier to achieve in countries with large domestic markets in which foreign investors can make substantial profits before venturing into export markets. In a country with a small domestic market, such as Jordan, potential investors will need to focus on exports from the start.

[80] *Tomato Processing in Jordan*, Association Méditérranéenne Internationale du Traitement de la Tomate, 2002, http://www.tomate.org/pdf/JORDAN2002_EN.pdf
[81] World Processing Tomato Council

There is undoubtedly some potential for increasing agro-industrial exports from Jordan, although available information suggests that this is likely to be in niche areas. Olive oil is one product that has been the subject of many studies and demonstrated substantial potential in the U.S. market. Since Jordan is unlikely to become a bulk exporter of any agricultural product, its challenge is to seek ways of adding more value domestically and seeking valuable niche markets.

For example, if the appropriate distribution channels for high-quality, packaged olive oil can be developed, other products could be distributed through the same channels. These might include fresh or preserved horticultural products, high-quality vinegars, some of them flavored with Jordanian-grown herbs, and other niche products appealing to both the high-end gourmet market and the overseas Arab market. Given the length of the growing season in Jordan, it might be possible to supply certain fresh fruits and vegetables to the European market, especially when they are out of season in Europe. Israel and Tunisia have both achieved substantial successes in this, as have many sub-Saharan African countries.

The potential for this kind of development in Jordan will be limited by the scarcity of water. Much more detailed investigation of the true economic value of certain products must be carried out. For example, though Jordan can produce strawberries, it is not certain whether they genuinely add value if the true cost of the water used to produce them is taken into account. Jordan has advanced micro-irrigation technology which could overcome this disadvantage, but it is premature to identify specific agro-industrial products, apart from olive oil, in which Jordan can develop a successful export-oriented industry.

A feasibility study, possibly in collaboration with the Ministry of Agriculture, should be undertaken to identify specific product categories, which have potential for attracting FDI and whose development is consistent with national policies on water use and agricultural development.

In the meantime, JIB and JEDCO can jointly support existing agro-industrial producers, helping them to exhibit at the appropriate international exhibitions and other events, to join relevant world or regional producer and marketing organizations, and to engage specific overseas companies as potential customers and/or investors.

JIB can also work with existing packaging companies in Jordan to help them identify foreign investors capable of upgrading the quality and range of available packaging, which in turn can increase the international competitiveness of Jordanian food producers. This proposal is discussed in greater detail below, in connection with development of Jordan's cosmetics and pharmaceuticals industries.

D. Textiles and Clothing

Textiles and clothing have traditionally been a strong driver of FDI and export growth for many developing countries; Jordan is no exception. From 1996 through 2002, Jordan has attracted nearly $400 million in total investment in the textile and clothing sector, almost entirely in the QIZs. This investment represents about 14% of Jordan's total industrial investment during the period. This sector has one of the highest proportions of FDI to total investment, amounting to about $287 million or 74% of the total. Jordan's exports to the U.S. have increased from $30.9 million in 1999 to $412.2 million in 2002. Most of this increase is attributable to the surge in

investment in and exports from the QIZs, almost all of which has been in the apparel industry.[82] In 2002, QIZ clothing exports accounted for about 22% of Jordan's total exports and roughly 10% of total industrial sector employment.[83]

Therefore, the future prospects of the textile and clothing industry in Jordan and worldwide will have a tremendous impact on Jordan's future FDI promotion strategies.

The expansion of textile and garment production in developing countries has been motivated by two overriding concerns. The first is the search for low-cost production. Because of the labor-intensive character of garment manufacturing, this means a search for cheap labor. The second is the search for market access This is driven mainly by the Mutifibre Arrangement (MFA) system, which allocates import quotas to countries in the developing world, and its successor framework under the WTO, the Agreement on Textiles and Clothing (ATC).

As a general rule, the garment industry in the MENA region owes its existence to the MFA. The exception to this rule is Egypt, which has a large domestic market, an important cotton-producing industry, and low-wages . In the 1980s, the UAE developed a significant garment industry, motivated by unused quota for exports to the U.S. market, fuelled by investment from South and East Asia, and staffed by workers from the Indian subcontinent. The Moroccan and Tunisian garment industries developed in response to preferential access to E.U. markets; these industries have recently declined, however, as Turkey and countries in East and Central Europe have benefited from similar or even more favorable market access conditions. Owing to the liberalization of E.U. market access for Turkish products, Turkey's apparel exports more than doubled from $3.4 billion in 1990 to $7.3 billion in 1998.

Israel developed a substantial textile sector, owing mainly to free trade agreements with both the U.S. and the E.U.; however, the high cost of labor in Israel has rendered the Israeli textile industry largely uncompetitive, even with the quota and duty preferences conferred by its FTA. Investment in Israel's textile industry has declined precipitously, with many Israeli companies instead investing in Turkey and the Israel-Jordan QIZs. Outside the region, Mexico has also developed a substantial textile sector. Mexico's textile and apparel exports grew from $100 million in 1990 to some $7 billion in 1998 under the North American Free Trade Agreement (NAFTA).[84]

Jordan's own textile and apparel industry owes its existence almost entirely to the U.S.-Israel-Jordan QIZ regime, which allows quota-free and duty-free access to the U.S. market for textile products containing at least 11.7% Israeli content[85] and a minimum of 35% Jordanian and Israeli content combined.

The critical question for the Jordanian textile sector is what will happen as the world textile trading regime changes, as it will do on 1 January 2005 when the ATC will end and the entire system of import quotas for textile products will disappear. This will be the final step of a four-phase progressive reduction of quotas. It is instructive to examine what has happened since January 2002, when the third phase of quota elimination came into effect. China's apparel

[82] *Trade With Jordan*, Foreign Trade Division, U.S. Census Bureau, http://www.census.gov/foreign-trade/balance/c5110.html, 2002
[83] UNIDO estimates. Cited in Someya, Masakazu, Hazem Shunnar, andT.G. Srinvasan, "Textile and Clothing Exports in MENA: Past Performance, Prospects and Policy Issues in Post-MFA Context," World Bank, August 2002
[84] Desai, Mihir, "Review of Global Trade and Investment in Apparel: Implications for Africa," Multilateral investment Guarantee Agency, World Bank, August 2002, p. 6
[85] The Israeli content level has been reduced to 8% as a temporary measure, but the minimum Israeli content is scheduled to return to 11.7% in June 2003.

exports to the U.S. grew by 15%, even as overall U.S. imports fell by more than 11%.[86] As the remaining quotas disappear, China's dominance is certain to increase. Other low-cost producers, including more than 20 African countries that already benefit from duty-free access for a wide range of textile products under the Africa Growth and Opportunity Act (AGOA) and which are also very low-wage producers, may also be expected to increase their market share at the expense of other, more costly production locations.

The system of preferential tariffs will not change immediately, although under WTO rules and agreements these are to be reduced to more "normal" levels over time. In the absence of any firm commitment on the reduction of tariffs, it is certain that tariffs imposed by European and North American countries on textile imports will remain high, thus perpetuating a significant advantage enjoyed by Jordan and other countries that have free trade agreements with the U.S. and Europe. MFN tariffs on clothing imports range between 9% and 13% for the U.S. and between 10% and 12% for the E.U. (It is interesting to note that the average U.S. and E.U. tariffs on manufactures, by comparison, is about 4%.)[87].Thus, even after 1 January 2005, Jordanian garment manufacturers will continue to benefit from an average 12% cost advantage over countries that export under MFN status. The question is whether this advantage is sufficient for Jordan to remain competitive, in view of transport and labor costs, as well as labor productivity.

The abolition of the ATC will lead to greater competition in textiles and apparel as highly efficient manufacturers no longer face artificial constraints (i.e., quotas) on their exports to major markets. This implies that certain countries, whose sole export advantage lies in the quota system, will face the loss of most of their textile industries within a fairly short time. This is almost certain to be the case for manufacturers in the Gulf countries, including UAE and Bahrain.

Almost all developing-country exporters of textiles will also encounter the problem of "fallacy of composition," which holds that "on its own a small developing country can substantially expand its exports without flooding the market and seriously reducing the prices of the products concerned, but this may not be true for developing countries as a whole, or even for large individual countries such as China and India. A rapid increase in exports of labour-intensive products involves a potential risk that the terms of trade will decline to such an extent that the benefits of any increased volume of exports may be more than offset by losses due to lower export prices… fallacy of composition in labour-intensive manufactures may become a problem if there is a simultaneous export drive by developing countries in these manufactures, which would result in falling export prices and/or earnings. It can also become a problem, reflected in falling wages, when there is increased competition among these countries as locations for foreign direct investment (FDI) in simple processes of otherwise high-tech activities organized in international production networks. Government policies can exacerbate the problem by offering transnational corporations (TNCs) tax concessions and other incentives. The question of the probability of markets for labour-intensive manufactured exports from developing countries becoming oversupplied, and especially the policy responses this would call for, are thus important elements in the design of export-oriented development strategies."[88]

The imminent abolition of quotas on textile products will certainly involve increased competition and increased volumes of products from China in major markets, with a strong probability of reduced prices. It is not certain how this may affect Jordan. Even with a 12% cost advantage

[86] Desai, *op. cit.*, p. 9
[87] Krakoff, Charles, "West African Regional Integration: Implications for the Textile Sector in the ECOWAS Region," Private Sector Forum on West African Regional Integration, Development Associates, Inc., 2002
[88] "Competition and the Fallacy of Composition," *Trade and Development Report 2002*, United Nations Conference on Trade and Development, Chapter IV, pp.114-115

conferred by the QIZ tariff concessions and, in subsequent phases, similar advantages from the U.S.-Jordan FTA, it is far from certain that Jordan can compete with China or other low-wage, highly-productive countries, such as Vietnam. For Mauritius, a middle-income country in which apparel remains a mainstay of the economy, the impact of abolishing MFA quotas is estimated at a decline in apparel exports of 18% to 26%.[89]

If Jordan can compete with such countries, the follow-on question is whether it should do so, since the sector as a whole will face falling wages. The UNCTAD report cited above notes that this problem is most acute for middle income countries such as Jordan, which have not yet succeeded in diversifying and upgrading into more skill-intensive manufactures and which consequently "may face a squeeze between the top and bottom ends for manufactures."[90]

Viewed solely in terms of cost, Jordan is unlikely to be able to compete effectively with the likes of China or Vietnam. On the other hand, governments in Europe and especially the U.S. are likely to take anti-dumping measures and create other non-tariff barriers against the larger countries, especially those with which it has no preferential trade agreements. There are many examples of this happening even in advance of the expiration of the ATC. Nevertheless, just as the garment industries in Mexico and the Caribbean/Central America region – all middle income countries with preferential access to U.S. clothing markets - will suffer from the abolition of quotas, so too will Jordanian manufacturers.

Jordan may be able to exploit the 19 months remaining under the ATC quota system to attract additional FDI into the QIZs. It is unlikely that investors, having made a significant commitment to building production capacity in Jordan, will disinvest in the near future. However, in light of the profound changes occurring in the global apparel industry, it is doubtful whether Jordan can experience the same pace of growth in FDI over the next several years that it has experienced recently. Consequently, the textile sector is not recommended as one of the main sectors in which JIB should concentrate its investment promotion activities at present. It is recommended that JIB undertake a comprehensive evaluation of Jordan's competitive position in the evolving international textile and apparel trade and develop an appropriate investment and trade development strategy.

E. Cosmetics

The 1998 ITS identified Dead Sea cosmetics as a promising area for investment. With an international market estimated at $50 million, a unique resource shared only by Israel, a higher quality of basic product (i.e., carnelite and mud), and input costs roughly 60-80% lower than those prevailing in Israel, Jordan possesses an undoubted competitive advantage in this area. Jordanian carnelite is said to have a higher magnesium content and lower sodium content than Israeli carnelite. In addition, Jordanian products are treated by natural evaporation rather than the chemical processes used by Israeli manufacturers. Jordan also has a greater abundance of raw materials than Israel, though this could be a function of underdevelopment of the Jordanian industry.

A 1997 analysis of the sector conducted by the Ministry of Planning calculated Jordan's share of this market at less than 10% or $4.7 million, of which 90% was exported in bulk. Thus, Jordan's participation in the higher value-added packaged cosmetics segment of the market was negligible

[89] Mattoo, Aaditya, Devesh Roy, and Arvind Subramanian, "The Africa Growth and Opportunity Act and its Rules of Origin: Generosity Undermined?" International Monetary Fund Working Paper WP/02/158, September 2002, p. 14
[90] *Ibid.,* Overview, p.IX

at about $470,000. The sector was characterized as fragmented, underdeveloped, and lacking the organization and capital to expand production and increase added value. The small volume of sales of packaged products was primarily on the local market to tourists, since packaging quality was poor, products were not certified in major export markets, and Jordanian consumers preferred imported European cosmetics.

The potential impact of developing the industry and shifting from exporting in bulk to exporting packaged cosmetics can be enormous. In addition to capturing a larger share of the market, Jordanian producers can increase domestic added value exponentially. Carnelite (i.e., Dead Sea salts containing magnesium chloride, potassium chloride, and sodium chloride) and Dead Sea mud sells for approximately $250 per ton, while packaged bath salts or other cosmetic preparations can command wholesale prices of more than $20 per kilogram.

Since 1997, the industry has transformed considerably, and at least 30 companies are now manufacturing and packaging Dead Sea cosmetic products for export. Major companies include El-Maydan Company, producing the Kawar line of products; Bloom Dead Sea Gift Enterprise; Jordan Company for Dead Sea Products, producing the LaCure line; and Rivage Dead Sea Products. Though Europe has historically been the largest export market for Dead Sea products, taking 45% of Jordanian production, U.S. market penetration has increased as a function of the U.S.-Jordan FTA. Bloom, for example, exported about $110,000 in products to the U.S. in 2002. In addition, several companies sell internationally through their websites. The Israeli company AHAVA nevertheless retains an estimated 90% share of the U.S. market and, together with other Israeli producers, commands a similar share of European markets.

The MOP assessment identified the Arab Potash Company (APC) as a major constraint to development, since it has a monopoly on extraction of Dead Sea minerals. Though the prices of raw materials supplied by APC are highly competitive, many cosmetics producers have complained about APC's unresponsiveness and frequent failure to meet customer specifications. Additionally, APC's own subsidiary, Numeira, sells into the same export markets as other Jordanian cosmetic producers, often undercutting their prices.

Alhough Jordan undoubtedly has the ability to attract significant investment in Dead Sea products, an alternative approach might be to consider Dead Sea products as a subset of a larger natural cosmetics and natural products industry that could be developed using other products in which Jordan also has a significant competitive advantage. Rather than focus exclusively on Dead Sea products which will by definition remain a niche product, Jordan has the potential to participate in the much larger natural cosmetics and herbal market and to create a true cosmetics cluster, which incorporates its advantages in raw materials from the Dead Sea, its ability to produce other important raw materials, its growing packaging and printing industries, and its potential to attract production and marketing know-how, as well as access critical markets through the QIZ relationship with Israel. In addition, there is considerable overlap between the pharmaceutical and cosmetics industries in terms of both raw materials and applications; these could be explored and developed further.

The Jordan Valley is one of the original sources and an important producer of many of the world's herbs and medicinal plants, including thyme, lavender, marjoram, valerian, bay laurel, borage, lovage, rosemary, and sage, the essential oils of which are prized for natural remedies, aromatherapy, and homeopathic treatments. Jordan also produces high-quality olive oil and could produce grapeseed oil, both of which are frequently used as base oils to mix with essential and aromatic oils. Other cosmetic products, such as henna, are also cultivated in Jordan. Egypt

and Israel are both important producers of these and similar products, and Egypt's foreign investment promotion agency, GAFI, lists extraction of medicinal herbs and plants as one of its priority areas for investment in activities related to the pharmaceutical sector.

Jordan could also produce jojoba beans, which grow well in hot and semi-arid climates and whose oil is highly prized for cosmetic purposes. Jojoba also has important uses in pharmaceutical production. Tunisia, for example, is currently seeking investors to develop a 200-hectare jojoba plantation at a cost of $2.3 million. This plantation is envisaged to supply 800 tons of seeds to European markets, which are currently supplied mainly by the United States. Rather than exporting the seeds or the oil, which sells for approximately $75 per gallon in bulk, Jordanian cosmetic producers could invest in growing jojoba for use in manufacturing cosmetic products domestically for retail sale, which can command wholesale prices of 20 or 30 times as much and can be worth even more when blended into other cosmetic products. Israel is currently the third-largest jojoba producer in the world, after the United States and Mexico. The total world market for jojoba oil is estimated at up to 2,500 tons per year, from production of about 100,000 to 200,000 tons of jojoba seeds.

Various sources estimate the U.S. market for herbal products at $4-6 billion and the European market at $6-8 billion, with annual growth rates of up to 25%. This market includes a wide range of products, dominated by herbal medicinal and dietary supplements. U.S. imports of essential oils in 2000 were $243 million, a 17% increase over 1994. In 2002, the U.S. imported over $110 million of non-citrus essential oils. Essential oils themselves are duty-free under WTO bound-in rates; however, with further preparation into cosmetics and medicinal products, they could be subject to MFN tariffs of up to 5.4%. Under the U.S.-Jordan FTA and QIZ programs, as well as the Jordan-EU Association Agreement, however, they would be duty-free.

In 1997, the global market for natural personal-care products was estimated at $2.8 billion, with annual growth estimated at between 8% and 10%. (In Germany, the annual growth of the market for "green" cosmetics was estimated at between 10% and 20%.) In the U.S. market, 38% of skin care products, 23% of hair care products, and 12% of bath products were labeled as "natural."[91] Because the "natural" appellation is not always subject to rigorous standards, its definition tends to be elastic. Nevertheless, products perceived as natural – and this includes both Dead Sea and herbal products – is the fastest-growing segment of the market. Facial skin care accounted for an estimated 46.1% of the total natural cosmetic or "cosmeceutical" market in 1999. ("Cosmeceuticals" are topical cosmetic-pharmaceutical hybrids intended to enhance the health and beauty of skin.)[92] World production of essential oils was estimated in 1995 at $1 billion. If this has kept pace with the growth in the natural cosmetic and herbal dietary supplement markets, total production will have grown to at least $2 billion in 2002. Developing countries account for 55% of this production. While China and India are the largest producers, several MENA countries, especially Egypt and Morocco, are among the larger suppliers. Total E.U. imports of essential oils amounted to over $500 million in 2000, with nearly $200 million coming from developing countries. Egypt was the largest supplier of both geranium and jasmine oils, exporting more than $4.25 million of these two products alone to the E.U. Tunisia also was a significant supplier of citrus-based essential oils.

Large retailers of natural cosmetics, such as The Body Shop, have cooperative trade programs to develop sustainable, long-term relationships with suppliers in developing countries. Other

[91] Dürbeck, K., *E.U. Market Survey 2002: Natural Ingredients for Cosmetics,* Center for the Promotion of Imports from Developing Countries, June 2002, p. 11
[92] *Ibid.,* p. 12

companies, such as Yves Rocher, have similar programs in place. Although this could be a promising avenue for Jordan to develop its natural cosmetics industry, it should be seen as only an intermediate step in a progression to domestic manufacturing of packaged cosmetic products.

The main target investors would be U.S. and European cosmetic manufacturers and distributors, as well as Israeli cosmetics companies such as AHAVA. The QIZs could be an ideal setting in which Jordan's competitive advantages in raw materials and labor could be combined with Israeli production technology and, most important, market knowledge and penetration in Europe and the U.S.

Spillovers from development in this sector would certainly comprise improvement of packaging quality and development of the plastics and printing industries. Again, Israeli companies, especially through the QIZs, could be a significant source of investment.

F. Pharmaceuticals

The pharmaceuticals industry remains an important one for Jordan. Alhough relatively small by world standards, it is considered competitive, at least regionally. Jordan has a considerable comparative advantage in pharmaceuticals, as its revealed comparative advantage (i.e., Jordan's share of total world pharmaceuticals exports divided by its share of total world exports of all commodities) is 5.87. This is far higher than that of any other MENA country. Jordan is the only net pharmaceutical exporter in the region, and its companies export between 70% and 90% of their output.

In addition to a comparative advantage, Jordanian manufacturers have some competitive advantages relative to other countries in the region. Egypt and Israel are the other two major pharmaceuticals producers. The Israeli industry is focused to a large degree on biotechnology, although the largest Israeli producer concentrates on high value-added generics. Its major export markets are in Europe and North America. Alhough Egypt's pharmaceutical industry is almost four times as large as Jordan's, Egyptian producers export only 6% of their output. Both the Egyptian and Jordanian pharmaceutical industries allocate a very small percentage of revenues to R&D – about 2%, compared to average of 15% to 20% in developed-countries. Jordan does allow some favorable tax treatment of R&D expenditures, although this is decided on a non-transparent, case-by-case basis. Jordan can immediately increase its competitive advantage over Egypt by allowing its companies to treat R&D expenditures as expenses in the year the cost is incurred, thus allowing for much more favorable tax treatment.

Jordan also has better intellectual property rights enforcement than Egypt. Alhough both countries have signed the TRIPS agreement, enforcement is far better in Jordan. A 2001 review of the Egyptian pharmaceutical industry cited lack of IPR enforcement as a significant barrier to FDI and, especially, investment in R&D.[93] The same review cited Jordan as the principal regional competitor for the Egyptian industry because it exports 40% of its production and because of its greater marketing prowess.

The 1998 ITS identified pharmaceuticals as one of the core industries in which Jordan should actively promote FDI. If anything, Jordan's potential in this sector has increased in the past five years. The world pharmaceutical market has increased from the an estimated $250 billion in 1997 to an estimated $435 billion in 2003. In 2000, UNIDO estimated the MENA market at $5.6

[93] *The Egyptian Pharmaceutical Industry*, Business Studies Series, American Chamber of Commerce in Egypt

billion annually or about 1.7% of the world total. [94] Egypt accounts for about 20% of total consumption, while the GCC countries, especially Saudi Arabia, account for much of the rest. The Saudi market alone is estimated at about $1 billion annually.

The MENA region has emerged as one of the fastest-growing regions in the world for pharmaceutical production, consumption, and investment. Middle East pharmaceutical consumption grew at an annual rate of 10.6% from 1998 to 2002, compared to global market growth of 7.8%. The MENA market is expected to be among the fastest-growing for at least the next three to five years.

The regional pharmaceutical industry supplies a small fraction of the total demand, most of which is met by European and North American drug companies, as well as low-cost producers from the Indian subcontinent.

The Jordanian pharmaceutical industry has always been outward-looking and has focused as much on exports outside the MENA region as it has on sales within it. Given the focus of the Jordanian industry on generic drug production, global industry and market trends suggest improving opportunities for Jordanian manufacturers. The global market for generic drugs is expected to double over the next two years to nearly $35 billion, as several major drugs come off patent.[95]

The Jordanian pharmaceutical industry has grown at an annual average of 15% over the past decade, confounding the predictions of many experts who forecast a contraction as a result of Jordan's accession to the WTO. Nevertheless, the industry faces important, new challenges. Much of the industry's success in recent years has been due to a loophole in European Union policy, which has prohibited EU companies from undertaking R&D on product preparation on drugs that remain under patent. Jordanian companies, not subject to this restriction, have thus been able to conduct research aimed at manufacturing generic equivalents of drugs that will soon come off patent, which allows an earlier entry into EU markets on expiry of drug patents. This loophole is expected to be closed soon, thus eliminating a significant competitive advantage for Jordanian companies. At the same time, various non-tariff technical barriers imposed by major MENA markets (Saudi Arabia, Iraq and Algeria account for about three-fourths of Jordan's exports.), as well as the tendency of those countries to buy cheaper drugs from producers on the Indian subcontinent will restrict opportunities for growth in exports to these markets. The continued growth of the Jordanian pharmaceutical industry, therefore, depends on expanding its presence in European and North American markets, which are by far the largest, richest, and most competitive markets in the world.

The impressive growth of Jordan's pharmaceutical industry masks a great variation in the competitiveness of individual firms. Only two companies have accounted for the rapid growth in exports to Europe. Only four companies out of the 17 in the industry are large enough or sophisticated enough to compete internationally. This observation is confirmed by the announcement in November 2002 of the acquisition of Al Razi Pharmaceuticals by the Jordan Pharmaceuticals Manufacturing Company (JPM). Al Razi is a marginal participant in the industry with declining sales and mounting losses, while JPM is one of the four largest and most competitive companies.

[94] "Middle East to Witness 'Fastest' Growth in Pharmaceutical Markets," *Khaleej Times*, Dubai, 3 January 2003
[95] Desai, Mihir, "The Jordan Pharmaceutical Cluster: Analysis and Recommendations," AMIR Program, Amman, July 2002, p. 4

In order to succeed in the changing global environment, the Jordanian pharmaceutical industry will need to become more competitive and move into higher value-added production, where it will be less vulnerable to cheap bulk generics produced by Indian, Egyptian, and East European companies.

Currently, most Jordanian pharmaceutical enterprises focus on the production of standard product categories, typically therapeutic drugs, such as paracetamol, and standard antibiotics, such as penicillin and amoxicillin, for which world demand is large, but for which competition, both domestic and global, is intense and based mostly on price. Diversification in generic drug production could lead to increased exports, increased earnings, and a better ability to withstand increased international competition.

Desai's assessment of the Jordanian pharmaceutical industry recommended production of more specialized, high value-added, niche generic pharmaceuticals, such as the injectibles, hormones, and cytotoxics. Reorienting production in this direction could help Jordanian manufacturers to become less dependent on bulk generics, diversify their product portfolios, enter niche markets in which price is not the main or only basis of competition, and engage in more research-oriented work that would reduce their current dependence on imported chemicals.

This expansion into specialized, niche-focused, research-based, and high value-added products can be achieved, and the industry has undertaken initiatives to move in this direction. This kind of shift can also mitigate some of the negative effects of the lack of economies of scale prevalent in the industry in Jordan. In general, Jordan's pharmaceutical factories are considered too small to achieve minimum efficient manufacturing scale. In the U.S. and Europe, the average investment in a generic pharmaceutical plant is about $500 million. In Jordan, the average investment size is between $4.0 and $40 million. A move into higher value-added, niche products may reduce the need to construct massive generics plants; but it is clear that substantial fixed capital investment in R&D and production will be required.

The industry will need to attract multinational drug companies to manufacture in Jordan, under license or in joint venture with Jordanian companies, based on the relatively low cost and high skills base of Jordanian scientists, chemists, and engineers. This will require a focused campaign aimed at promoting Jordanian drug exports, as well as increasing contacts and business relationships with potential investors. Detailed investor research must be undertaken to identify the most promising potential investor targets. These may not be the largest U.S. and European drug companies, for which the total size of the Jordanian industry is insignificant and which tend to move slowly and bureaucratically; rather, these will more likely be middle-tier companies with more of a niche market focus. Israeli companies may also be a potential investment target. The Israeli venture capital market devotes some 20% of its investment to biotechnology and health sciences. Teva, the largest Israeli pharmaceutical company, is primarily an export-oriented manufacturer of generics which competes on product quality and its ability to be first to market on drugs newly off-patent by virtue of its superior R&D skills. There could be substantial potential for joint product development and production with such a company.

Further development of the pharmaceutical industry will both contribute to and require improvement of plastics and packaging capacity in Jordan. The quality of packaging and labeling for Jordanian pharmaceuticals is mediocre, but the plastics, packaging and printing industries in Jordan are competitive and could upgrade the quality of their product, especially as growing demand from the cosmetics and food industries should increase demand for packaging and printing of all kinds.

Many of the specific elements of a pharmaceutical export and investment development strategy have been identified in considerable detail by Desai in his 2002 report on pharmaceutical cluster competitiveness. These detailed recommendations are presented in Appendix D.

G. Fertilizers and Chemicals

Jordan has a huge revealed comparative advantage in potassium chloride (potash) and phosphate-based fertilizers. Its share of world exports of fertilizers is 36 times greater than its share of total world exports of all products, while its revealed comparative advantage in the U.S. market is more than 20. Jordan also has a high revealed comparative advantage in inorganic chemicals, mainly bromine derivatives. In the MENA region, Jordan is far from unique in this comparative advantage. Morocco and Tunisia also have very substantial comparative advantages in this sector. Jordan is endowed with substantial phosphate and potassium reserves, as are both Morocco and Tunisia.

Jordan's comparative advantage in fertilizers is based on its natural resource endowments, as well as reasonable production and shipping costs. Jordan is the sixth-largest producer of phosphate in the world and the seventh-largest potash producer.[96] The 1998 ITS identified the lack of domestic supplies of di-ammonium phosphate (DAP) as a constraint to further development of the industry; however, the Nippon-Jordan Fertilizer Company, started in 1997, built a 300,000 ton-per-year DAP plant, which had reached full capacity by 1998. A $106 million joint venture investment by APC and Kemira Oy of Finland to produce potassium nitrate and dicalcium phosphate fertilizers was also approved by the Ministry of Finance in 2000.

Jordan enjoys some competitive advantage relative to Morocco and Tunisia. Jordan has a greater proximity to the main export markets in Asia, which accounts for about 70% of Jordan's fertilizer exports, by exporting through Aqaba. The ITS conducted in 1998 reported that Jordan was at a competitive disadvantage in shipping to Asia because of high shipping costs in Aqaba, but this disadvantage has lessened considerably. The cost of shipping per TEU from Aqaba to Hong Kong is now equivalent to or less than that of a similar shipment from Tunis or Casablanca to Hong Kong. As the Aqaba port development continues, the number and frequency of vessels will increase and the shipping costs should become even more competitive.

Jordan has attracted significant investments in other chemical industries. The Jordan Bromine Corporation, a large Jordanian-U.S. joint venture, received approval in 2000 to build a $145 million plant to produce bromine derivatives, with expected sales to reach $150 million per year within four years of expected plant completion in 2003. The Jordan Magnesia Company also received Ministry of Finance approval in 2000 for a $102 investment to produce magnesium chloride.

Because of the size and complexity of these investments, they often show up in JIB final approvals several years after they have received the initial go-ahead from the Ministry of Finance. The MOF approvals, announced with great fanfare, were essentially agreements to allow these companies to set up individual Free Zones for these projects. Final approval by JIB in many cases did not come until much later. For example, the Jordan Bromine Corporation was announced in 1998 and received MOF Free Zone approval in 2000, but did not get final JIB approval to begin construction until 2002. Similarly, the Finnish joint venture with APC was

[96] Michalski, Bernadett, "The Mineral Industry in Jordan," U.S. Geological Survey, 1997, http://minerals.usgs.gov/minerals/pubs/country/1997/9218097.pdf

originally announced in 1998 and received MOF Free Zone approval in 2000, but did not get final JIB approval to begin construction until 2002.

These JIB approvals, in turn, will not be reflected in official FDI statistics for another several years, in view of the time to complete the projects and the scheduling of payments. Consequently, the large surge in investment in the chemicals sector recorded in JIB approvals in 2002 ($174 million, of which $93 million is foreign investment) is more reflective of a large increase in interest and investment planning in the late 1990s, rather than current interest.

Given this lag between the formation of a project plan and the final investment approval by JIB, it is possible to forecast new developments in the industry several years in advance. The current batch of projects, including several fertilizer projects and the bromine project, will show up over the next two years in official FDI statistics, assuming that the promoters continue with the projects in view of the regional political situation. However, no major new investments in fertilizers and chemicals have been announced in the past two years, indicating a possible slowdown in investor interest in the sector.

It is questionable, therefore, how much additional investment Jordan will be able to attract in this sector. In addition to the Japanese, U.S., and Finnish investments, the fertilizer industry has attracted several other mega-projects with foreign investment from companies including BASF, Norsk Hydro, and Haifa Chemicals, as well as several Indian and Pakistani companies. The scope for additional investments, apart from expansions of existing projects, may be limited.

The industry remains highly constrained by the monopoly of state-owned enterprises over the production of raw materials. Jordan Phosphate Mines Company (JPC) and Arab Potash Company (APC) have full monopolies on production of raw phosphates and potash, respectively. The main vehicle for foreign investors has been through joint ventures or other collaborative agreements with JPMC and APC. Potential investors seeking to set up independent new ventures may face certain constraints on supply and may also have higher raw material costs than companies already operating in collaboration with the two monopolies, which may have beneficial privileged transfer-pricing arrangements. The scope for new joint ventures with the two monopoly companies is unclear, since they may be seen to some degree as “cannibalizing” or otherwise detracting from existing ventures with other foreign partners.

The world market outlook for fertilizers does not indicate any large increase in demand. Indeed, fertilizer production declined from a peak of 158.3 million tons in 1988/89 to less than 140 million tons in 1994/95, before growing slowly to reach 147.2 million tons in 1998/99. This amounts to an average growth rate of less than 3% per year over five years and only 0.2% from 1997/98 to 1998/99. Most of the decline in production in the early 1990s came from a collapse in demand and production in the former Soviet Union, while most of the subsequent increase in production has come from developing countries in Asia. The growth in Asian production is higher than the overall growth in world production because production in Europe and North America fell significantly in the late 1990s, with many plants closing due to poor profitability. Though China and India together account for the bulk of growth in demand and production during the 1990s, growth in Jordan’s production has been exceptionally robust, amounting to 16.7% between 1997 and 1998 alone.[97] Subsequent growth in Jordan’s production as a function of new plants announced and completed in the period 1997 to the present has probably remained at a similarly high level.

[97] “Fertilizer Sector Situation in Developing Asia and Outlook,” *Agro-Chemicals News in Brief, Special Issue,* December 2000, http://www.fadinap.org/nib/nib2000sp1/Chap3.PDF

Although world demand is relatively flat, there is significant variation among countries. Many Asian countries, including Malaysia, India, Thailand, Indonesia, Vietnam, and Turkey, show growth rates much higher than the world average. To Jordan's great advantage, the demand for phosphate and potash-based fertilizers appears to be growing faster and facing fewer market access restrictions than for nitrogen-based fertilizers. Although total imports of nitrogen-based fertilizers by developing countries in Asia fell by nearly 40% from 1995 to 1999, phosphate imports grew by about 10% and potash imports by 27% over the same period.[98]

One important contributing factor to this disparity is the greater protection given by many countries to nitrogen-based fertilizers. China, for example, has banned urea imports since 1997. Many of the major fertilizer consuming countries, including India, Indonesia, Vietnam, and China, have ample natural gas supplies to serve as feedstock for urea and ammonia production, and may be able to produce nitrogen-based fertilizers at a lower cost than imported product, regardless of the level of protection of the industry. Phosphate and potassium fertilizer production still depends on a supply of raw materials, thus resulting in much freer trade in these products than in nitrogen-based products. Urea production continues to increase steadily with Indonesia, for example, to increase its capacity by nearly 25% from 2000 to 2003. According to *Agro-Chemicals News*, the supply and price for phosphate fertilizers are likely to remain relatively stable (far more so than for nitrogen, where production capacity is growing far faster than demand), although this could change slightly as large DAP plants in India and Australia come on-stream.[99]

The implications of this assessment are that demand for Jordanian fertilizers is likely to remain fairly stable and that Jordan, by virtue of its position as a major world producer of raw materials, is likely to retain its market share. The modest forecast growth in world demand and the advent of new production capacity in Asia and Jordan, indicate that a need for investment in large new plants will be minimal over the next several years. Construction of large new DAP plants in India and Pakistan indicate a likely reduction in those countries' imports. Though no overcapacity is predicted such as that which already exists for urea, no significant expansion in import demand for potassium and phosphate fertilizers is likely to occur for the next several years.

The structure of Jordan's existing fertilizer industry, moreover, does not appear to lend itself to new entrants in the near term, with most new investment likely to come from existing participants.

Given the long lead time in project development in fertilizers and other chemicals, it would be useful for JIB to commission a longer-term assessment of the growth and investment potential for the sector, taking into account the possibility of liberalization and/or privatization of the supply of raw materials. A proposed scope of work for such an assessment is included in Appendix C.

H. Software and IT

The IT sector in Jordan has registered by far the most rapid growth in FDI of any sector, averaging over 300% per year from 1997 through 2002. This growth rate reflects, in large part, the small size of the sector relative to Jordan's economy: only one per cent of Jordan's total FDI

[98] *Ibid.*
[99] *Ibid.*, p. 25

since 1997 has been in the IT sector. These figures may, however, understate the importance of IT in the current and future development of Jordan's economy. IT, especially in software and services, is not a highly capital-intensive industry. Development of a vibrant IT sector may also be a critical step in a country's evolution from an economy based on low-margin labor-intensive manufacturing to one based on knowledge-intensive and high value-added activities.

Over the past several years, Jordan's government, driven in part by the personal interest and commitment of H.M. King Abdullah II, has identified the IT sector as one of its central economic development priorities. The REACH Initiative and other government-backed programs have been explicitly designed to propel Jordan's IT sector into the first tier in the MENA region and even to compete globally with countries such as India.

Jordan faces many challenges in its efforts to achieve a meaningful competitive advantage in IT. The 1998 ITS developed by The Services Group pointed out that Jordan possessed a comparative advantage in IT, at least regionally, by virtue of the quality of its education system and the analytical skills possessed by its work force. However, as pointed out in Section II, above, the quality of Jordan's tertiary education, especially in quantitative disciplines, is not as evident as is often assumed, though clearly the demand for skilled Jordanian professionals, especially in the Gulf countries, tends to indicate that Jordanians can be regionally and even globally competitive. The 1998 ITS also pointed out that Jordan's main competitive advantage in IT, namely the relatively low salary cost for skilled Jordanian workers, could easily become a competitive disadvantage, since such workers are able to earn much higher salaries in the Gulf countries. This "brain drain" can still contribute to growth in Jordan's own IT sector as some people, having gained experience and having amassed some savings during a period of overseas work can return home with the know-how, capital and contacts to start new enterprises in Jordan.

The question for Jordan is whether and where it can identify a competitive advantage in IT, especially given the endowments and ambitions of many of its neighbors.

Israel, of course, has a much larger IT sector than the rest of the MENA region combined, with a pool of investment capital far greater than the amounts available in the rest of the region. Backed by government policies and incentives and drawing on contacts, networks and know-how through the Jewish Diaspora, Israel's IT sector has many unassailable competitive advantages. However, given the current lack of direct commercial links between Israel and its Arab neighbors, there is ample scope for Jordan to participate in the market without having to compete head-to-head against Israeli companies. At the same time, Jordan's substantial cost advantage relative to Israel and its more highly-developed commercial relations with Israel suggest a potential for future co-operation between Jordanian and Israeli companies in the IT sector.

Egypt, mentioned in the 1998 report as a competitor to Jordan in the area of IT services and software, has, if anything, become more competitive in comparison to Jordan. Egypt benefits from a large domestic market, which creates greater internal demand for IT services. As discussed in Section II, above, the quality of Egyptian education and IT staff is comparable to Jordan's. Egypt can offer a much larger pool of talent, despite shortages in both Egypt and Jordan, and average salaries that are equivalent to or slightly lower than those in Jordan. Though Jordan has sought to develop its IT sector in part by increasing government spending on e-government and other IT-related initiatives, Egypt's IT spending dwarfs that of Jordan. Annual sales in Egypt for IT software and services industry were estimated by International Data Corporation at over $300 million in 2000, with a projected annual growth rate of as much as 30%, indicating that the current industry size is now closer to $1 billion. Of this amount,

government spending accounts for an estimated 70% of domestic demand. Software exports, which amounted to about $50 million in 2000, are expected to reach as much as $500 million by 2005, concentrated mainly in packaged and tailored applications.[100]

Of all the countries in the region, Egypt appears to have the best chances of replicating the success of India in becoming a major global supplier of IT services. India's success owes a great deal to high government spending on IT, and thus a large domestic market, together with a large pool of skilled and well-educated professionals available at a fraction of the cost of similarly-skilled workers in developed countries. Egypt offers a similar set of advantages, including an estimated 25,000 software developers and over 2,000 IT companies,[101] the recent introduction of universal free Internet access (causing Internet usage to triple in one year), far lower basic telecommunications charges than Jordan, and the availability of cheap, locally-assembled PCs, often with government-subsidized purchase prices.

By some estimates, as many as 75% of Egypt's computer engineers work abroad, mainly in the Gulf countries, but also in Europe and North America. The Ministry of Communications and Information Technology in Egypt (MCIT) has sought to address this problem with plans to train 5,000 new IT specialists each year, in co-operation with major international companies, such as Microsoft, Cisco, Oracle, Hewlett-Packard, Lucent, and Sun.[102] Both Government and the private sector report a lack of management and marketing skills in many respects more acute than the shortage of technical expertise. Computer science graduates apparently prefer working on the technical side, while IT firms must compete with both foreign and domestic companies in all other sectors for the limited pool of management and marketing talent.

Already many major IT companies have begun to use Egypt as a platform for serving Middle East and even global markets. Microsoft Egypt has begun performing most of its beta-testing of Arabic software in the Egyptian market and has bought several Arabic applications such as Arabic-language spell-checker from Egyptian software developers for integration into arabized versions of its major operating and applications software packages. Microsoft is also considering the possibility of sourcing more software development from Egypt within the next few years, as well as also possibly centralizing customer support call centers for the Arab region in Egypt. Though the local skill level is not yet sufficient to engage in new technology development, as opposed to adaptation, Microsoft expects this to improve significantly over the next two to three years.

The Egyptian Government has created a new IT park, known as the "Pyramids Smart Village," to encourage international IT companies to locate regional facilities in Egypt, supported by high-speed telecommunications, specialized training and business incubation facilities, and basic infrastructure, such as buildings and office space. Government plans to replicate this development in several other locations in Egypt.

One of the major obstacles facing IT companies, especially foreign investors, operating in Egypt has been the overvaluation of the exchange rate and the consequent difficulty in obtaining foreign currency. Though Egypt still suffers from foreign exchange shortages, the decision in February 2003 by the Central Bank to allow the Egyptian pound to float freely should alleviate this problem. Unless Jordan follows suit, the Jordanian IT industry will suffer from a competitive disadvantage relative to Egypt.

[100] *Information Technology in Egypt,* American Chamber of Commerce in Egypt, April 2002
[101] Ramadan, Karim, Country Manager, Microsoft Egypt, personal communication, December 2002.
[102] "Sharpening Its Focus: Software Exports Lead the Sector and Incentives Lure Foreign Companies," *Emerging Egypt 2002*, Oxford Business Group/American Chamber of Commerce, pp. 93-95

Jordan does, however, possess some competitive advantages in software and IT services that may persist for some time. Bureaucracy, as well as arbitrary taxation and Customs regimes in Egypt can add up to 20% to the cost of imported software, which is already subject to "normal" import tariffs of 5% and sales tax of 10%. Export licensing procedures are equally cumbersome and arbitrary, while the process of government tendering and contracting is far from transparent. Jordan has a further competitive advantage in better protection of intellectual property rights. Official government estimates, which correspond closely to private sector estimates, indicate that 57% of the software sold in Egypt is pirated, compared to a world average of 37%. This represents a significant improvement over previous rates of up to 80%. Part of the problem stems from the large domestic PC assembly industry, with many local manufacturers installing pirated software as a matter of course. Though this would seem to make it relatively easy to stamp out a significant amount of piracy by cracking down on a fairly small number of easily identified violators, this has not happened. Though Government has co-operated with and received training from the World Intellectual Property Organization (WIPO), passed stringent new laws to protect intellectual property rights, and collaborated with major international software companies, such as Microsoft and Oracle, piracy remains a much graver problem in Egypt than in Jordan, though the gap between the two countries is likely to narrow over time.

Dubai has also become a regional IT powerhouse, mainly through establishment of the Dubai Internet City and Dubai Media City, both of which will soon be complemented by the Dubai Knowledge Village, aimed at developing the skills required by the IT and media industries. The Government of Dubai has invested substantially to create these facilities with the aim of creating a regional IT, telecommunications, and media cluster benefiting from Dubai's low-tax operating environment, first-rate connectivity, and other infrastructure, as well as access to a huge pool of talent from the Arab world and the Indian subcontinent, access to huge markets in the same regions, a high degree of economic and social openness, an attractive living and working environment, and attractive salaries for expatriate workers. Aimed explicitly at creating an IT cluster, Dubai Internet City has attracted some 400 companies in software development, business services, web based & e-commerce services, consultancy, education & training, sales & marketing, and back office operations, including Microsoft, Cisco, Oracle, and IBM. Dubai Media City has also attracted investments by over 400 companies, including major media and news companies, such as NBC, CNN, and Reuters; major advertising agencies such as Saatchi and Saatchi, Y&R, and Burnett; and hundreds of other news, media, production, advertising, and marketing companies. Both the Internet and Media cities have attracted substantial investment from the Indian subcontinent and other Gulf countries, which is drawn by the more open operating environment, including less onerous regulation and lower taxation.

Several domestic companies have emerged as important players in the IT sector, stimulated by Dubai's e-government initiative and the Internet City. For example, Mindscape, a local firm, has just relocated its headquarters to the Internet City. With over 100 professional staff, Mindscape is a significant integrator and provider of business solutions, especially to the financial industry, with contracts and clients throughout the Middle East, Europe, and Asia-Pacific region.

In a separate development, the Dubai Airport Free Zone is the site of a recently-concluded joint venture between the Dubai Government, Intel, and IHP, a German research institute, to build a $1.7 billion chip fabrication plant, to produce new-generation chips using silicon-germanium-carbon technology, which will have a wide range of applications in mobile computing and communications. This venture grew out of a joint venture among the three parties to build a $1.3 billion chip foundry in Potsdam, East Germany, in which the Dubai Airport Free Zone was the

principal financial investor. One of the conditions of the participation by the Dubai Government was that a sister plant be established in Dubai. The German plant began trial production in early 2003 and expects to commence commercial production before the end of the year. Construction of the Dubai plant is expected to begin in 2004 or 2005. The Airport Free Zone has also attracted significant investments from Dell, Boeing, Thompson-CSF (now Thales), and IBM, and has become known informally as the "Silicon Oasis."

These developments highlight one of Dubai's great competitive advantages relative to Jordan: the availability of almost limitless capital and the willingness of Government to underwrite huge investments to attract the technologies and companies it needs to achieve its development goals. The Government's investment in the German chip fabrication plant was a way of ensuring that it could attract a similar, highly-advanced, high-tech venture to Dubai. Intel's financial contribution to the German plant was only 25% of the total investment, and the future plant in Dubai is also likely to be financed principally by the Dubai Government. This limits Intel's financial risk in a region it might otherwise avoid entirely, whereas if it or a similar company were to invest in Jordan, it would have to come up with a far higher proportion of the total investment cost.

During his Middle East visit in September 2002, when he delivered a keynote speech at the Jordan ICT Forum, Intel Chairman Craig Barrett also visited Dubai, which he cited as a model for technological progress and development.

Also, the new Sheikh Rashid Technology Park in the Jebel Ali Free Zone has been set up to attract large-scale applied research facilities in IT, transport, petroleum, and other sectors, which it is hoped will lead to more investment in high-tech R&D and manufacturing.

Jordan's IT sector is tiny by comparison to Egypt's, with an estimated 100 value-adding companies in the entire ICT sector, employing about 3,000 technical staff out of total employment of about 5,000. Total domestic sales of the ICT industry were estimated at about $26 million in 2002, a substantial increase over 2001 sales of less than $9 million, but still tiny compared to the Egyptian market. Major areas of concentration are accounting packages, Web-based applications, arabization, CBT Banking, system integration, health, insurance packages, and software conversion. The major customers are banks, hospitals, hotels, insurance companies, universities, and Government. These figures, provided by int@j itself, are unreliable. Other information sources, as well as int@j itself, also report total industry sales in 2002 of over $60 million and exports of more than $26 million.

The REACH Initiative, launched in 1999 with royal support and placed under the tutelage of the Ministry of Information and Communication Technology, set ambitious goals for development of Jordan's IT sector, including the creation of 30,000 new jobs and achievement of $550 million in annual sector exports and $150 million in annual FDI by 2004. The Chairman of int@j, in the third annual review of the REACH initiative conducted in September 2002, admitted that these targets now appeared too ambitious and that achieving $550 million in exports, especially, would be "more challenging than anticipated."[103] Though he attributed this to the worldwide decline in IT revenues and share prices, it is equally likely that these goals were over-ambitious from the beginning.

[103] "int@j Submits Reach 3.0," *Jordan IT News*, 2002

A survey of domestic investors in Jordan's IT sector conducted by int@j in 2001 gave a mixed picture of the investment climate for ICT activities.[104] Major complaints included: excessive regulation, lack of skilled manpower (due largely to the brain drain to the Gulf countries), lack of management and marketing skills, and unavailability of capital. Though foreign investment could be expected to alleviate some of the capital shortage, other problems cited are fundamental to Jordan's competitiveness in IT investment and could remain problematic. Though REACH has spearheaded important regulatory reforms and public awareness campaigns, this has not translated into meaningful investment in the sector. Apart from France Télécom's acquisition of 40% of Jordan Telecom, and Orascom (Egypt) building the first mobile telephony network, Fastlink, the only significant foreign investment has been Microsoft's investment in Estarta Solutions, a joint venture involving One World Jordan and a regional venture capital group. The amount of Microsoft's own investment is not known. Intel and Sun Microsystems have also participated in training and incubator programs in collaboration with local institutions.

The tremendous government support offered to the ICT sector, mainly through the REACH Initiative, has not been matched by a huge inflow in FDI in the sector. Since the REACH initiative was launched in 1999, the Jordan Investment Board has approved total investment of about $25 million in the ICT sector, of which about $20 million has been from foreign sources. The proportion of these approvals that has resulted in real investment is unknown. However, since the bulk of the investment approvals (two-thirds of the dollar value of total investment and 80% of the foreign component) were granted in 2002, it is likely that some portion of these projects have been cancelled as a result of political turmoil in the region. Even if all of these approvals do ultimately result in actual investment, it is highly unlikely that Jordan will come anywhere near meeting its stated target of $150 million in annual ICT investment by 2004.

This is not to suggest that the ICT sector has no future. On the contrary, it can become an important source of investment and skills development for Jordan. It is doubtful, however, that the ICT sector can, at least in the near term, become the mass employer, a major source of FDI, and the principal engine of economic advancement that Government envisages. Jordan is surrounded by Israel, which has vast amounts of capital and some of the world's most advanced technology; Dubai, which also has vast capital resources, a more favorable tax regime, and the ability to attract almost limitless numbers of skilled workers; and Egypt, which has lower operating costs, a huge domestic market, and a larger pool of skilled workers. For Jordan to compete in this environment and to develop its IT sector will require it to identify areas in which it will not have to compete against better-funded and lower-cost rivals.

The most likely immediate source of growth is likely to come from donor-supported government spending on e-government and other related initiatives, in which local firms can legitimately enjoy some market access advantages, while a much smaller proportion will come from export-oriented and commercially-motivated FDI. Without denying its long-term potential, it could be counter-productive to focus on ICT as the centerpiece of Jordan's future development.

The mandate for promoting FDI in the ICT sector is somewhat divided, with both the Ministry of Information and Communications Technology (MOICT) and JIB sharing responsibility. Also, the current Jordanian Ambassador to the United States is the former Chairman of int@j and is thus someone with a keen interest and substantial credibility in the industry. It is essential, therefore, for JIB to develop and co-ordinate its FDI promotion strategy in the ICT sector with int@j, MOICT and the Embassy in Washington. MOICT Minister Zu'bi is seen by many as the chief spokesman for the industry in Jordan and has also referred to himself as the industry's chief

[104] *Investments in Jordan's ICT Sector*, Information Technology Association of Jordan (int@j), October 2001

salesman, so it is important for JIB to support his personal initiatives in this area. In this connection it might be appropriate for JIB, int@j and the Ministry to consult closely and regularly and to develop joint strategies in which JIB may facilitate promotion initiatives undertaken by int@j and the Minister as well as undertaking its own efforts.

JIB should work closely through these partners to identify specific target investors and/or niche subsectors in which Jordan has the potential to attract a small number of core investors, and should build a highly focused strategy to attract those specific investments.

I. Other Sectors

There exist many other sectors and industries in which Jordan has some significant potential to attract FDI in the near term, yet which should not become core areas of focus for JIB. This may be due to a relative lack of congruence with Jordan's principal development goals (i.e., attracting know-how, generating large numbers of jobs, developing skills) or the relatively limited scope for potential investment, which may amount to only one or two projects. These nevertheless represent potentially attractive niche industries, for which JIB can develop cost-effective promotion strategies. The main industries identified are jewelry, stone, and alternative energy. These industries are attractive potential candidates for QIZ manufacturing, in which Israeli companies might be among the principal investors and technical partners. Promoting investment in these and related industries could help diversify the QIZ program, ensuring that Jordan continues to benefit even if textile investment slows. Additionally, alternative energy is a potentially attractive area for FDI.

1. Jewelry

In 1999, Jordan exported over $3.6 million in jewelry products, mainly finished gold-plated jewelry, to the United States, representing more than 10% of total Jordanian exports to the U.S. in that year. In 2000, Jordanian jewelry exports to the U.S. had increased to $8.3 million, including gold, silver, and base metal finished product and components. The U.S. import duty on jewelry ranges from 5.0% to 8.6%, thus providing Jordanian manufacturers with a competitive advantage in the U.S. market. Since jewelry falls into tariff phase-out category G of the U.S.-Jordan FTA, Jordanian jewelry exports are already duty-free into the U.S. under the FTA. The QIZs, however, represent another opportunity to attract investment in the industry by combining Israeli capital and expertise with the lower labor costs available in Jordan. More capital-intensive processes, such as manufacturing gold or gold-plated chains, can be done in Israel competitively, but many of the assembly processes can be done by hand more cheaply in Jordan. Since the raw materials in many kinds of jewelry represent a high proportion of the final value, using the QIZs as a site for jewelry fabrication should afford greater flexibility in cumulation of origin and meeting local content requirements.

Given the changes in the global textile trade discussed above, both Israel and Jordan need to identify and develop other manufacturing products in the QIZs. Israel is thus one potential source of investment capital and know-how; JIB, together with the Ministry of Industry and Trade, could benefit from widening current discussions with their Israeli counterparts in the context of the QIZ program to try to develop such projects. Other potential sources of investment could be the United States, Italy, and Dubai, all of which have large domestic jewelry industries that might seek to source some production from Jordan. In the U.S., the jewelry industry is concentrated in and around Providence, Rhode Island. JIB and the Embassy in Washington could develop contacts with the major industry associations and manufacturers in that region and

include visits to Providence and the major trade exhibitions in other investment missions to the U.S., without necessarily creating a program of promotion and trade missions focusing exclusively on that sector.

One reason for proceeding cautiously is the recent slump in the worldwide jewelry industry. In spite of the steep rise in demand for gold bullion, global manufacturing of gold jewelry fell by 12% in 2002 to an eight-year low. [105]

2. Stone

Stone, particularly marble, travertine, granite, and limestone for flooring and cladding, has been researched and discussed extensively in the context of Jordan's potential exports under the U.S.-Jordan Free Trade Agreement. The U.S. imports over $1 billion of stone per year, with import duties ranging from 1.9% to 6.5%. Jordan exported about $375,000 of stone to the U.S. in 2002. Most of Jordan's exports have been in the lower value-added and lower-tariff product groups – simply sawn or sawn and polished slabs and tiles, which have relatively low labor content and a fairly high level of mechanization in product finishing.

Demand, however, is growing fastest in the higher-value textured and hand-finished stone tiles, which require labor-intensive hand-chiseling and which tend to be subject to higher import duties in the U.S. Jordan, which can export all stone products to the U.S. duty-free under both FTA and the QIZ program, as well as under the E.U. Association Agreement, has an exploitable competitive advantage.

The experience of the stone industry in Israel and Palestine is instructive, since it has increased exports more than tenfold, from less than $3 million to nearly $40 million, over the past several years. At least a dozen companies, most of them Arab-owned, are now exporting finished stone, for which some of the main quarries are in the occupied territories in and around Hebron and Bir Zeit. The industry started its export expansion with the support of the Manufacturers Association, which began exhibiting at the major exhibitions in Verona, Italy and Orlando, Florida, thus establishing contact with big importers and distributors in Europe and North America.

Jordan's existing stone production has grown by some 250% since 1999, reaching a total production value of about €47 million, with export sales of about €2 million. The Jordan Stone and Tile Exporter Association (JOSTONE) has helped companies in the industry establish contact with importers and distributors in Europe and North America. JOSTONE counts only 11 members, a small fraction of the estimated 600 companies operating in the sector, most of which are tiny, independent quarrying operations with an average of two or three employees. Many of these are threatened by increases in quarrying fees and other regulations proposed by the Jordanian Government.

The Jordanian stone sector has also received substantial assistance from the United Nations Industrial Development Organization (UNIDO) and the European Union. The E.U.-funded EJADA program has identified the Gulf countries and the E.U. as main target export markets for Jordanian stone and, in October 2002 commissioned a market study of at least three Gulf countries as target export markets. UNIDO and EJADA have also been instrumental in facilitating the acquisition of European stone-working machinery from Europe.

[105] "Foreseeing the Future: Gold Traders have Nothing to Lose but Their Chains," *The Economist,* 15 March 2003, p. 77

The high cost of labor in Israel and Palestine indicates a high potential for QIZ operations, in which Jordan could perform many of the labor-intensive, yet value-adding operations, using both Israeli/Palestinian and Jordanian stone. Average wages for unskilled workers in the stone sector in Palestine are US$500 per month,[106] more than double the average wage for unskilled or semi-skilled workers in Jordan. Though quarrying operations must obviously be carried out where the stone is found, finishing operations could be shifted to a lower-wage location such as Jordan. The possibility of cumulating Israeli and Jordanian content under the QIZ program makes this potentially a more attractive option for the U.S. market than exporting exclusively Jordanian product under the FTA. Contacts already exist between the Jordanian and Israeli industries, as Israel is one of the main destinations for Jordanian stone exports. (The others are Saudi Arabia, the U.S., East Asia, the E.U., and other Gulf countries.) Jordan also imports significant amounts of Palestinian stone.

The scope for attracting FDI in the stone sector is limited by restrictions on foreign ownership of quarrying operations in Jordan, meaning that foreign investment would be limited either to a minority share in an integrated stone producer or a majority share in a finishing operation that sourced stone from third parties in Israel or Jordan. Additionally, the high weight-to-value ratio of stone products makes them very sensitive to transport costs, meaning that the distance from the quarry to the finishing plant and from there to the port, together with differential port charges and ocean freight costs, could make the difference between a profitable and an unprofitable investment.

JIB should collaborate with JOSTONE, EJADA, and JEDCO on further development of Jordanian stone exports. Based on market research conducted by EJADA, JIB can further refine its targeting strategy with regard to potential investors from Arab and E.U. countries. JIB can also assist JOSTONE in pursuing existing export contacts with respect to potential investment by European, Far Eastern, Arab, and North American purchasers and distributors of Jordanian stone. Together with the Economic Affairs Directorate of the Ministry of Industry and Trade, JIB can pursue discussions with the Israeli QIZ Department, as well as with the Israeli Manufacturers' Association General Division to identify and develop potential QIZ manufacturing investments.

3. Alternative Energy

The potential for alternative energy as an attractive sector for FDI in Jordan is based largely on an assessment conducted by the German GTZ development agency in collaboration with the Jordanian Ministry of Energy and Mineral Resources and the National Energy Research Center (NERC) on potential wind farm sites in Jordan. In 1996, the German and Jordanian governments financed a 1.125 MW wind farm at Hofa. In 2002, they conducted feasibility studies for additional sites near Aqaba and Shawbak.

Both Egypt and Iran have received World Bank assistance to develop private sector wind farms, following successful development of wholly government-financed wind projects. The World Bank has assisted countries in developing regulatory mechanisms that create a more favorable environment for private sector energy producers and has also introduced the concept of a "mandated market share," requiring utilities to obtain a certain proportion of their energy from renewable sources. The World Bank Global Environment Fund provides and funds technical assistance, including technical feasibility studies, market assessments, and regulatory assistance to enable countries to attract private sector investment and develop renewal energy sources in the energy sector. The GEF is currently assisting the Government of Egypt in developing an $80

[106] "Stone and Marble," The Palestine Trade Center, http://www.paltrade.org/Paltrade/business/stone.htm

million wind farm project in which some 65% of the funding will come from private sector sources.

In addition to the ongoing assessment funded by GTZ, Interwind, a Swiss engineering and development company, has been conducting assessments for a 75MW to 90 MW wind farm in Jordan. In addition to providing consulting services to governments and private companies in wind power development, Interwind has also developed its own wind farms in Turkey and Switzerland.

In addition to wind power, Jordan's NERC has spearheaded the development of projects using solar and wind power in water desalination.

The growing world interest in renewable energy sources, Jordan's demonstrated potential in wind and solar power applications, and its technological lead in certain areas, including desalination, amount to a potential competitive advantage that Jordan can develop. In Jordan, the Ministry of Energy and Natural Resources and the NERC have taken the lead in these developments and will likely continue to do so. Donor funding, especially from German sources, has been instrumental in developing pilot projects and feasibility studies, though other E.U. sources and the World Bank are poised to play a significant role as well.

It would be premature for JIB to develop an immediate strategy for promoting FDI in alternative energy; however, it can develop closer co-operation with the Ministry of Energy and Natural Resources, the Ministry of Planning, and the NERC to develop a clearer picture of the economic potential and the FDI potential of this sector. Most of the work conducted to date in Jordan has focused on technical feasibility rather than economic and commercial feasibility. Before an FDI promotion strategy can be developed, JIB must obtain a clearer sense of the potential for development of the sector, including an identification of the market potential in Jordan and neighboring countries, as well as an analysis of the regulatory environment pertaining to private power production in Jordan and energy sales to neighboring countries. A Scope of Work for this assessment is included in Appendix C.

VI. INVESTMENT PROMOTION AGENCIES

Of the five countries evaluated in this survey, Tunisia and Jordan have the most effective and professional investment promotion agencies, followed by Dubai, Israel and Egypt, in that order.

Tunisia has an edge over Jordan in two key areas:

- **Information** In its publications and also on its website, the Tunisian Foreign Investment Promotion Agency (FIPA) provides a wealth of macroeconomic data, reliable information on FDI patterns, industry, sector and project profiles, details on the investment environment, and comparative assessments of costs relative to other countries. Though the Jordan Investment Board website is well-presented, it offers far less information than the FIPA site. Much of the information is available only through links to other agencies, whose information resources are poorly organized. Tunisia appears to have a much higher degree of information co-ordination and sharing among different branches of Government, since other agencies' information is well-organized and easy to find. For example, information on domestic and foreign investment is supplied by the Central Bank of Tunisia, accessible via a link from the FIPA site. The Central Bank site is the equal of the FIPA site in ease of navigation and accessibility and quality of information. In Jordan, links to most other sites involve a significant drop in quality of presentation and of information. In Jordan, reliable information on FDI is very hard to obtain from any source, and its reliability is suspect. Information provided by JIB differs from that provided by the Central Bank, which is at odds with information from ASEZA. JIB offers little in the way of sector profiles, which it could easily do, not necessarily by developing its own but simply by compiling links to the many industry and sector studies that have been carried out by various donors, consultants and ministries and making them accessible, by industry or topic, through the website. One of the most valuable tools offered by FIPA is its benchmarking activities, in which it provides continual updates of various factor costs in Tunisia in absolute terms and also in comparison to other countries. This includes information on the cost of labor, utilities, land, transport, telecommunications and other key inputs. Similar information is hard to obtain in Jordan from any source, and is not available from JIB. Someone without prior knowledge of Jordan and its industrial composition, and lacking any knowledge of other sources of information, would find it hard to obtain the necessary detail on investment opportunities by visiting the JIB site, while the opposite is true for FIPA. FIPA also provides most of its information in print as well as electronically.

- **Investment Approvals** Jordan continues to struggle with the issue of investment approvals and the concept of the "one-stop-shop." Though there are many causes of this, one underlying reason appears to be tension within and between ministries and other agencies over competing authority and a concomitant unwillingness to delegate authority. Thus, JIB at one point had representatives of other ministries and agencies physically present in the JIB building, supposedly empowered to grant the approval of their respective institution; however, this never worked well in practice because there were too many exceptions requiring approval from someone with greater authority than the person handling the request. There has often been a discrepancy between the intent of a law, its interpretation and its application in the field, which in turn has led to tremendous confusion over pre-approvals and other obstacles. Consequently, it is very difficult for a potential investor to know in advance what exactly are the documentary and other requirements to obtain all the licenses and approvals needed to set up and operate a business in conformity with the law. It would be misleading to suggest that Tunisia has resolved this problem entirely; however, its system

appears to work more smoothly than Jordan's. Tunisia has a separate agency, l'Agence pour la Promotion de l'Industrie (API), which handles registration and approvals for all companies, foreign and domestic. Housed in a building separate from FIPA, API's ground floor has counters operated by different agencies and ministries, all apparently with full authority to grant the necessary approvals within their competence. The system is ISO 9002 certified. Tunisian law has also eliminated many approval requirements, at least in those industries in which it wants to encourage a maximum of investment. Thus, company registration and other approvals are all housed in the same location, under the direction of a single agency, and essentially separate from the promotion function exercised by FIPA. In the context of the planned re-engineering of the company registration function in the Ministry of Industry and Trade, the assumption of responsibility for other approvals and licensing requirements has been proposed and could contribute significantly to eliminating this bottleneck.

- **Co-ordination** FIPA has the sole mandate in Tunisia for promoting FDI. Though this has been proposed for JIB, this mandate has not yet been granted. Consequently, JIB is one of several agencies with some investment promotion responsibilities, the others including ASEZA, JIEC, and FZC. These agencies often convey contradictory messages and give the impression of a lack of focus.

Dubai has a far less active investment promotion agency, though this is changing as the Government and ruling family begin to use their capital as a catalyst for many major investment initiatives rather than the sole or principal source of funding. An example of this is the Dubai Health Care City, still in the planning phases, in which the Government will give a plot of land as its sole equity contribution to Phase I, and does not plan to invest any capital in subsequent phases.

In keeping with this shift, Dubai in 2001 created the Dubai Development and Investment Authority and has given it significant responsibilities as a facilitator and packager of major development projects, as well as giving it some powers in the area of investment approvals. Yet DDIA, in spite of its designation as the principal investment promotion agency for Dubai, does relatively little external promotion. Whether electronically or in print, DDIA provides no macroeconomic information, no sector profiles, no FDI statistics and only a basic overview of the tax and incentive regime.

To the extent that DDIA carries out external promotion it tends to be very highly targeted, focusing on a single project and a very small set of investors. This eliminates the need to provide broad-based information and promotion services. DDIA also acts as a catalyst for SME development and has set up a group of equity funds and loan facilities, with total capital of about $200 million, intended to assist SMEs in start-up and expansion phases by making equity investments of up to about $320,000 in start-ups and up to $1 million for expansions, and by providing an array of soft loans. DDIA also provides incubator services to the companies it funds.

The main investment approval authority in Dubai remains the Dubai Department of Economic Development, which has authority for all foreign and domestic investment approvals, except those in the Free Zones, including Jebel Ali, the Airport Free Zone, and the Internet and Media Cities. Here, Government has delegated all approval authority to the Zone authorities themselves, including visas and work permits and all business licensing, including the assessment and collection of registration fees. The marketing departments of each of the zones

do the bulk of Dubai's external investment promotion. This makes it somewhat more difficult for the less sophisticated investor to make the right contacts and obtain the right information; however, this is very much in keeping with Dubai's policy of trying to attract the most sophisticated industries and skills in the world. The Zone authorities tend to apply a stringent set of criteria to assess a company's suitability to be allowed to locate in one of the zones, but once approved, a potential or actual investor can benefit from a wide range of facilitation services.

Like Tunisia, Israel has two investment agencies, one charged with promotion and the other responsible for approvals. In contrast to Tunisia, however, the Israel Investment Center, which is a division of the Ministry of Industry and Trade, concerns itself only with approvals of applications for incentives rather than for all investment projects. Consequently, the Center gets involved in only a third of Israel's total industrial investment. Approvals for incentives other than the capital grants or tax holidays are handled by other authorities, principally the office of the Chief Scientist in the Ministry of Industry and Trade, which administers the R&D grant scheme. The Israel Investment Promotion Center (IPC), likewise a division of the Ministry of Industry and Trade, exercises responsibility for investment promotion. The IPC used to operate overseas investment promotion offices, but these have all been closed and responsibility for overseas promotional activities has been passed to the Israeli Foreign Service, which has commercial attachés in about 30 embassies. Partly as a function of this loss of responsibility, many IPC staff members appear demoralized and unmotivated. IPC offices are in a fairly rundown building in Jerusalem. IPC officers engage in minimal promotion or facilitation activity.

The IPC website provides some basic information on the investment climate in Israel, including full details of the incentive schemes. It also provides links to other sources of information, including the Israeli Manufacturers' Association and the Bank of Israel, which is the main source of data on FDI and trade. Unfortunately, much of the information provided by the BOI and even IPC, including such key information as the breakdown of FDI and overall investment by industry, is available only in Hebrew, making it difficult for the foreign investor without a command of the language.

The Israeli government clearly has invested relatively little in promoting itself as an investment location. Other groups, such as the Manufacturers' Association have much more information, but even their data and publications are of limited usefulness and tend to be out of date. The Israel Venture Capital Association and its research arm, both entirely private groupings, provide much more comprehensive and detailed information and in general behave more dynamically.

This may be a consequence of the relative openness of the Israeli economy and the recent explosion of high-tech industries. Whereas in many of the Arab countries being a government employee confers prestige and often a higher salary than someone with similar skills could obtain in the private sector, in Israel the private sector pays higher salaries and is seen as more exciting and prestigious than government service. In addition, and perhaps more important, the success of the Israeli economy has tended to advertise itself. Having secured a reputation as a globally competitive player in several industries, Israel may feel less of a need to engage in vigorous investment promotion. This may be a short-sighted view, with which Ireland, which has achieved a level of FDI and industrial development at least as impressive as Israel's, would surely disagree.

Egypt's General Authority for Free Zones and Investment needs a great deal of improvement before it even reaches the level of professionalism of Israel's Investment Promotion Authority.

GAFI, which operates the one-stop shop for investment approvals, oversees the free zones, and promotes FDI, is characterized by bureaucracy, lack of transparency, and a near-total disregard for the investor. Its offices in downtown Cairo are in decrepit buildings unmarked by signs or any other indication. GAFI claims to have developed an award-winning new website, yet it has never been possible to access it. The old website, which is of a reasonable quality, is only intermittently accessible and subject to such bandwidth constraints that much of its information cannot be downloaded. Routine requests for information (e.g., FDI statistics) are denied categorically with a response that the enquirer must submit a written request to GAFI's Director General. GAFI officials fail to honor appointments, usually on the grounds that they have been called into a meeting with the Minister or Director General. It is hard to imagine any potential investor, having once encountered GAFI, deciding to pursue the matter any further.

GAFI operates a "one-stop shop," for investment approvals, housed in its Investor Reception and Advice Department, staffed by representatives of 27 other agencies with some responsibility for investment approvals. This is soon to increase to 72, yet even the 72 apparently do not constitute the full complement of approvals necessary to do business. On average, the investor must visit another seven to 10 offices in addition to those making up the one-stop shop in order to operate legally. For this system to work even within its limited scope would require the representatives of the 27 or 72 other agencies to be physically present to issue or stamp the documents. However, on a recent visit to the Investor Reception and Advice Department, only five people could be observed at their desks, of whom two were asleep and three reading the newspaper.

VII. CONCLUSIONS AND NEXT STEPS

Jordan's investment environment has changed substantially since the last Investor Targeting Strategy was developed in 1998. The advent of Free Trade Agreements with the U.S. and the European Union, as well as the introduction of the QIZ Program, have given Jordan an unprecedented degree of access to the world's major consumer and industrial markets. At the same time, other countries, including Tunisia, Israel, Morocco, Egypt, and Turkey have benefited from some of the same liberalization of market access and, like Jordan, have successfully exploited that access. Jordan has developed a clothing and textile industry, which is based in the QIZs and has become a leading source of export revenues and FDI. Exports to the U.S., driven by the QIZs and the FTA, have risen dramatically, making the U.S. one of Jordan's largest trading partners.

Jordan has derived substantial competitive advantage from these developments, since it is the only country in the Middle East to enjoy free trade agreements with both the U.S. and the European Union, as well as with the Arab countries.

The commercial and political environment has also changed. At the same time as the QIZ program has increased economic links with Israel, the *intifada* and the war in Iraq threaten these links and make it more difficult to build on them further. The world trade in textiles is undergoing its greatest transformation in the past 40 years, as the system of quotas on textile and clothing imports is set to be abolished in little more than 18 months and as clothing trade gradually conforms to WTO rules. The information and communications technology sector, worldwide and in the MENA region, has experienced explosive growth in investment, revenues, and company values, followed by an equally rapid collapse. At the same time, the Internet and mobile communications have expanded tremendously in Jordan and neighboring countries in ways that have already altered the economic, and possibly even the political, landscape.

The war between the U.S. and Iraq promises to change Jordan's economy in profound, but as yet unforeseen, ways, affecting everything from trade patterns to energy prices to foreign exchange rates to aid flows.

From these changes has emerged some sense of Jordan's way forward in the increasing worldwide competition to attract FDI.

Perhaps the most important conclusion of this report is that Jordan should focus on the development of competitive clusters rather than "sectors" or industries. A cluster-based approach requires taking into account the many inputs and factors of production, as well as regulatory and legal considerations involved in making a product and trying to ensure that they all contribute positively to making the products internationally competitive. This approach requires looking at competitiveness in a much wider context.

The discussion of the cosmetics industry above indicates this point clearly. The focus to date has been purely on Dead Sea cosmetics, a product category in which Jordan indisputably has a competitive advantage, but also a product with a very small market. The discussion indicates ways in which Jordanian industry, with the participation of foreign investors, can address a much larger market by incorporating other products and inputs in which it has or can develop competitive advantage into products with a much wider potential appeal. As a result, Jordan can compete in the multibillion dollar "natural" cosmetics market rather than restricting itself to the $50 million Dead Sea products market. This approach is potentially much more interesting to

foreign companies and increases the likelihood that Jordanian companies can attract the technology, capital, and marketing know-how they need to compete successfully in these markets.

The discussion of cosmetics illustrates the way in which a cluster-based approach focused on one industry can have substantial spillover effects into other industries and contribute to development of clusters centered on those industries as well. Packaging, identified as a crucial requirement for the cosmetics industry, is also an essential component of a successful pharmaceutical or export-oriented food industry.

This report has identified two industrial clusters, cosmetics and pharmaceuticals, that can attract additional FDI through a cluster-based approach that might, for example, target packaging, printing, advertising, and marketing companies as potential investors.

Absorbing some of the lessons from Dubai, Jordan can adopt more of a cluster-based approach to tourism development as well. Medical tourism is a prime example. If divorced from overall tourism development, medical tourism is destined to remain a niche industry; whereas, if integrated into an overall tourism development strategy, it can become a much larger industry, while also contributing to demand for and investment in other tourism developments.

The second main conclusion is that the QIZ program and increased economic and investment ties with Israel are and will remain an important dimension of Jordan's competitive advantage relative to other Arab countries. The potential contribution of Israeli companies to Jordan's competitiveness in production, technology, and marketing, as well as the unique market access provisions of the QIZs, is a resource that Jordan cannot afford to squander, regardless of the political difficulty that may be involved in deepening economic ties. In pharmaceuticals, packaging, cosmetics, ICT, stone, and jewelry, the QIZs and Israeli know-how can make the difference between a slow development of niche industries and the development of much larger industries that can help achieve Jordan's development goals, which include the doubling of per capita GDP between 2000 and 2020.

JIB's role in this development will become far more demanding and sophisticated, as it seeks to develop and implement strategies in complex industries, involving a host of economic and political variables and actors. By following this basic strategy, while extending it and modifying it as conditions change, and with the extensive help of donors, JIB can become one of the essential contributors to realization of the goals set forth in the Jordan Vision 2020 statement of Jordan's economic and social development.

A further recommendation is for JIB itself to upgrade the breadth and quality of information offered to prospective investors. Some of this, especially in the area of FDI statistics, may come through e-Government initiatives; however, other kinds of investment-focused information, such as sector profiles and production cost data, will need to be performed by JIB itself or contracted to outside consultants. A scope of work for this upgrade is included in Appendix C.

APPENDIX A: SCOPE OF WORK FOR THIS CONSULTANCY

Activity:	512 Investment and Export Development Research and Policy
SOW Title:	Analysis of Jordan's Key Regional Competitors for Foreign Direct Investment
Modification:	4
SOW Date:	November 6, 2002
SOW	Draft
Total LOE:	81 days
Task and Consultant:	LOE/F/Analysis of Jordan's Key Regional Competitors for Foreign Direct Investment CEK Charles E. Krakoff LOE/D/ Analysis of Jordan's Key Regional Competitors for Foreign Direct Investment JID

I. Specific Challenges Addressed by this Consultancy

In June 1998 under the AMIR 1 Program, The Services Group carried out the first Investor Targeting Strategy (ITS) for Jordan's investment promotion agency, known then as the Investment Promotion Corporation and today as the Jordan Investment Board (JIB). The ITS developed of a marketing plan to attract inward investment in six sectors: downstream potash and phosphates, textiles and apparel, Dead Sea cosmetics, information technology, tourism, and pharmaceuticals. These six sectors were selected through the consultant's subjective evaluation of Jordan's economic structure and current industrial and trade mix, as well as discussions with stakeholders.

The ITS devotes most of its effort to prioritizing these six sectors for promotion. It evaluates each of these sectors against three "screens." First, the "comparative screen" compares the technical requirements of each sector with Jordan's relevant comparative advantages. Jordan's comparative advantages are defined by the strategy's location audit, which broadly benchmarks Jordan against Middle Eastern and North African competitors (i.e., Egypt, Israel, Cyprus, Bahrain, Tunisia, Morocco, and Lebanon) in areas deemed most likely to shape the corporate location decisions of potential investors (i.e., general economic environment, political risk, access to trade, investment environment, financial sector, labor regime, transportation regime, infrastructure). Second, the "competitive screen" determines Jordan's attractiveness as an export platform for each sector in light of local and international industry trends, as well as recent investments worldwide. Third, the "policy screen" compares characteristics of each sector with policy objectives articulated by the JIB, namely increasing employment, increasing foreign exchange earnings, attracting high value-added manufacturing processes, and diversifying the economy. A variety of weights are assigned and ratings are made, in order to arrive at a score within each screen. The three scores are then averaged, giving heaviest weight to the comparative screen and lightest weight to the policy screen, to arrive at total score for each sector and the priority that should be given to its promotion.

This analysis suggests that first priority should be given to tourism; second priority to potash and phosphate, Dead Sea cosmetics, and pharmaceuticals; and third priority to information technology and apparel and textiles. The strategy concludes by identifying target industries within sectors (e.g., Arabization of software applications within information technology), identifying target markets for each sector, indicating the level of effort that should be devoted to each market, and setting promotional targets. The JIB subsequently implemented most of these recommendations and, to this day, bases its sectoral marketing strategy on these original ITS

guidelines.

The JIB now needs a new ITS for two important reasons. First of all, a great deal has changed in Jordan (e.g., accession to the WTO, entering into Free Trade Agreements with the United States and the European Union, and extensive privatization of state-owned enterprises), as well as in the world market since the first ITS was completed. Such changes affect the sectors in which Jordan is competitive for investment, as well as the way in which Jordan markets itself as a destination for investment. Best practice suggests that an ITS be updated every three years; it has been over four since the JIB's first ITS was completed. By following an outdated ITS, the JIB may be out of synch with investors, effectively promoting the wrong product to the wrong customers! Second of all, the JIB needs to identify all appropriate sectors to target for investment promotion, including new sectors. The first ITS explains in detail why and how the JIB should market Jordan in the six sectors considered, but it offers little explanation as to why those sectors are considered in the first place. It would appear as if it simply picks industries that are already active in Jordan or "winners," with an interest in developing them further. This may have been an appropriate approach four years ago. Today, however, it is not. Since the first ITS, Jordan has articulated ambitious development goals in the form of Jordan Vision 2020, the Socal and Economic Transformation Plan, and other efforts. If the JIB is to do its part to help Jordan realize these goals, it needs a complete picture on which to base a more comprehensive and accurately-focused sectoral marketing strategy. The first step towards creating this picture is to take a variety of rigorous and objective approaches towards identifying a long list of sectors for which Jordan is potentially competitive for investment.

II. Objective

A key objective of this consultancy is to contribute to creating a new investor targeting strategy for the Jordan Investment Board. It will strive to meet this objective by determining which sectors currently are appropriate potential targets for investment promotion, based on two approaches: (1) a benchmark analysis of Jordan's competitiveness as a regional destination for investment against its key regional competitors and (2) an analysis of regional investment trends.

This work will be carried out by a foreign consultant, under the supervision of Barry O'Connell, PSPI IVP Sub-Component Leader, and Greta Boye, PSPI Component Leader. A local counterpart consult will assist in this assignment.

III. Specific Tasks of the Consultant(s)

Under this Scope of Work, the Consultant(s) shall perform, but not be limited to, the tasks specified under the following categories:

A. Background Reading Related to Understanding the Work

Consultant(s) shall read, but is/are not limited to, the following materials related to fully understanding the work specified under this consultancy:

- **Charles E. Krakoff**
- **JID**
    1. AMIR 2.0 Technical Proposal
    2. AMIR 2.0 Report "Improving Jordan's Investment Promotion" (June 2002)
    3. Investment Task Force Executive Summary and associated reports (January 2002)
    4. AMIR 1 Report "Investor Promotion Strategic Plan" (June 1998)
    5. AMIR 2.0 Report "A Sustainable Trade and Investment Strategy for Jordan" (May 2002)

6. AMIR 2.0 Report "JIEC Market Demand Study for Serviced Industrial Estates (April 2002)
7. AMIR 2.0 Report "The 2002 Investor Roadmap of Jordan" (October 2002)
8. Relevant reports published by ATASP
9. Reports and other materials published by Jordan's key competitor locations
10. UNCTAD "World Investment Report 2002" (2002)
11. World Economic Forum "Arab Competitiveness Report 2002-2003" (2002)

B. Background Interviews Related to Understanding the Work
The Consultant(s) shall interview, but is/are not limited to, the following individuals or groups of individuals in order to fully understand the work specified under this consultancy:

- **JID**
  1. Greta Boye, PSPI Component Leader, AMIR 2.0 Program
  2. Barry O'Connell, PSPI IVP Sub-Component Leader, AMIR 2.0 Program
  3. Brad Fusco, Investment Promotion Advisor, AMIR 2.0 Program
  4. Reem Badran, Director General, Jordan Investment Board
  5. Naseem Rahahla, Director of the Competitiveness Unit, Ministry of Planning
  6. Vince Ruddy, Chief of Party, Aqaba Technical Assistance Support Project (ATASP)
  7. José Ceron, Investment Promotion Component Leader, ATASP
  8. Saleh Kilani, Director of Investor Services, Aqaba Special Economic Zone Authority
  9. Jamal-Al-Jabiri, USAID

C. Tasks Related to Achieving the Consultancy's Objectives
The Consultant(s) shall use his/her education, considerable experience, and additional understanding gleaned from the tasks specified in A. and B. above to:

- **Charles E. Krakoff**

1. Determine Competing Locations (Lead)
Adopting the perspective of investors interested in making a variety of investments in the Middle East region, determine those general characteristics that would guide such investment decisions. These characteristics might include, but not be limited to, the following.

- Macroeconomic profile
- Industrial base
- Labor force characteristics
- Location
- Trade and market access
- Investor perception

Draw up a list of countries that are similar to Jordan in some or all chosen general characteristics, as well as successful in attracting investment.

From this list, develop a short list of four countries that are Jordan's key regional competitors for investment projects in manufacturing and internationally-traded services.

2. Compare Factor Endowments and Costs

2.1 Determine What Factors are Going to be Compared (Lead)
Adopting the perspective of investors interested in making a variety of investments in the Middle East region, determine those specific factors that would be of interest when choosing an

investment location. These might include, but not be limited to, the eight key parameters that drive the selection of an investment location as described in the ITF Report.

- Country Image
- Corporate Environment (including regulatory framework)
- Factor Costs, which might include, but not be limited to, the following
  - Labor, which might include, but not be limited to, the following
    - Wages in a variety of sectors and at a variety of levels
    - Wage overhead
  - Land or buildings, which might include, but not be limited to, the following
    - Purchase
    - Lease
    - Any relevant maintenance fees
  - Transportation, which might include, but not be limited to, the following
    - Shipping cargo rates from principal port to selected destinations
    - Road transportation costs from capital to selected national and international destinations
    - Air cargo rates from capital to selected destinations
    - Air fares from capital to selected destinations
  - Utilities, which might include, but not be limited to, the following
    - Electricity
    - Fuel
    - Water
    - Waste disposal
  - Communications, which might include, but not be limited to, the following
    - International private leased circuits
    - Telephone facilities (land and mobile service)
    - Domestic and international calls (from capital)
    - Internet service
- Economic Base
- Labor Market, which might include, but not be limited to, the following
  - Labor force characteristics
  - Relevant regulations
  - Relevant entitlements
- Infrastructure, which might include, but not be limited to, the following
  - Land or buildings
  - Transportation
  - Utilities
  - Communications
- Ease of Set-Up and Operation (including business start-up costs)
- Quality of Life

These might also include, but not be limited to, such factors as the following.

- Internal and regional market characteristics
- Trade and market access (including trade agreements in force or in negotiation)
- Taxation, which might include, but not be limited to, the following
  - Property tax rates

- Local tax rates
- Service charges
- Double Taxation Agreements in force or in negotiation

- Investment incentives, which might include, but not be limited to, the following
  - Tax holidays
  - Subsidies

2.2 Collect Data
Using consistent measures, collect data on chosen factors for Jordan's four key regional competitors.

2.3 Report Data
Determine report format, bearing in mind that Jordan's profile will be used as the basis of marketing materials for investors. Draw up a country profile for each country, including both the specific data collected on chosen factors, as well as general, relevant information, such as population, GDP, trade figures, public debt, and rate of inflation.

2.4 Analyze Data
Rank the five countries based on the data collected, taking into consideration any scheme of weighting that might be appropriate from the perspective of investors interested in making a variety of investments in the Middle East region.

3. Identify Regional FDI Trends

3.1 Determine What Data is Going to be Collected (Lead)
These data might include, but not be limited to, the following.

- Nationality of investors
- Source of investment
- Structure of investment (e.g., debt-equity, licensing, outright purchase, merger and acquisition)
- Value of investment
- Type of operation (e.g., manufacturing, service, distribution, back-office)

3.2 Collect Data on Projects in Jordan's Four Key Regional Competitors
This detailed data should include all investments proposed, registered, and implemented in the last five years. It should be collected from regional investment promotion agencies, central banks, or other appropriate institutions. Otherwise, it may be available through such database services as IAC-Insite, Predicasts' F&S Index, and Lexis-Nexis.

3.3 Analyze Industry Sectors in Jordan's Four Key Regional Competitors
Using a consistent form of industry classification, such as the International Standard Industrial Classification (ISIC), classify by industry sector the projects undertaken in the last five years in all of the countries considered. Identify those six sectors that account for the most significant share of total investment, by number of projects, within each country. In addition, identify those countries that are the most significant sources of total investment across all of the countries.

Within the six sectors identified, list the following for each country.

- Actual number of projects approved
- Number of related jobs projected

- Amount of related capital investment projected
- Any significant "clustering" of activities by location

3.4 Compare Each Country's Share of Inward Investment
Of the investment that has occurred in the five countries considered, calculate Jordan's share of both total investment and investment in each of the six sectors identified. In addition, determine whether Jordan's shares of investment have been growing or shrinking.

4. Identify Sectors for which Jordan is Potentially Competitive for Investment
Based on the comparison of factor endowments and costs, as well as investment trends, provide a general evaluation of Jordan's regional competitiveness for attracting FDI. Then, suggest those sectors for whose regional investment Jordan has the potential to compete successfully. These suggestions should be explained and form a long list for further investigation.

5. Build Technical Capacity for Sustainability

5.1 Provide an annex which describes in detail the way in which the preceding tasks were accomplished, so that this work may be replicated or updated in the future by a member of Jordan's investment promotion effort. This applies to those tasks whose method is not obvious from the deliverable report. For example, it may be clear from the report how factor cost data was ranked, but not from which organizations it was collected.

6. Describe Investment Promotion Efforts of Regional Competitors
Using a uniform format, report on the key agencies and organizations responsible for FDI promotion and facilitation within each of Jordan's four key regional competitors, inlcuding, but not limited to, the following.

- Name(s) of organization(s)
- Legal status (public, semi-state, etc.)
- Resources (human, local and overseas offices, annual budgets, sources of funding)
- Strategies for FDI attraction and facilitation
- Promotional activities (including collecting copies of promotional materials and "product" offerings)

7. Provide Recommendations
Recommend changes that will lead to the improvement of Jordan's FDI promotional efforts and results (Lead)

7.1 Draft Scopes of Work
In line with these recommendations, draft indicative Scopes of Work for further appropriate follow-up by the AMIR Program (Lead)

- **JID**

1. Determine Competing Locations
Adopting the perspective of investors interested in making a variety of investments in the Middle East region, determine those general characteristics that would guide such investment decisions. These characteristics might include, but not be limited to, the following.

- Macroeconomic profile
- Industrial base

- Labor force characteristics
- Location
- Trade and market access
- Investor perception

Draw up a list of countries that are similar to Jordan in some or all chosen general characteristics, as well as successful in attracting investment.

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2. Compare Factor Endowments and Costs

2.1 Determine What Factors are Going to be Compared
Adopting the perspective of investors interested in making a variety of investments in the Middle East region, determine those specific factors that would be of interest when choosing an investment location. These might include, but not be limited to, the eight key parameters that drive the selection of an investment location as described in the ITF Report.

- Country Image
- Corporate Environment (including regulatory framework)
- Factor Costs, which might include, but not be limited to, the following
  - Labor, which might include, but not be limited to, the following
    - Wages in a variety of sectors and at a variety of levels
    - Wage overhead
  - Land or buildings, which might include, but not be limited to, the following
    - Purchase
    - Lease
    - Any relevant maintenance fees
  - Transportation, which might include, but not be limited to, the following
    - Shipping cargo rates from Aqaba to selected destinations
    - Road transportation costs from Amman to selected national and international destinations
    - Air cargo rates from Amman to selected destinations
    - Air fares from Amman to selected destinations
  - Utilities, which might include, but not be limited to, the following
    - Electricity
    - Fuel
    - Water
    - Waste disposal
  - Communications, which might include, but not be limited to, the following
    - International private leased circuits
    - Telephone facilities (land and mobile service)
    - Domestic and international calls (from Amman)
    - Internet service
  - Economic Base
  - Labor Market, which might include, but not be limited to, the following
    - Labor force characteristics

    - Relevant regulations
    - Relevant entitlements
- Infrastructure, which might include, but not be limited to, the following
    - Land or buildings
    - Transportation
    - Utilities
    - Communications
- Ease of Set-Up and Operation (including business start-up costs)
- Quality of Life

These might also include, but not be limited to, such factors as the following.

- Internal and regional market characteristics
- Trade and market access (including trade agreements in force or in negotiation)
- Taxation, which might include, but not be limited to, the following
    - Property tax rates
    - Local tax rates
    - Service charges
    - Double Taxation Agreements in force or in negotiation
- Investment incentives, which might include, but not be limited to, the following
    - Tax holidays
    - Subsidies

2.2 Collect Data

Using consistent measures, collect data on chosen factors for Jordan.

2.3 Report Data

Determine report format, bearing in mind that Jordan's profile will be used as the basis of marketing materials for investors. Draw up a country profile for Jordan, including both the specific data collected on chosen factors, as well as general, relevant information, such as population, GDP, trade figures, public debt, and rate of inflation.

3. Identify Regional FDI Trends

3.1 Determine What Data is Going to be Collected

These data might include, but not be limited to, the following.

- Nationality of investors
- Source of investment
- Structure of investment (e.g., debt-equity, licensing, outright purchase, merger and acquisition)
- Value of investment
- Type of operation (e.g., manufacturing, service, distribution, back-office)

3.2 Collect Data on Projects in Jordan

This detailed data should include all investments proposed, registered, and implemented in the last five years. It should be collected from regional investment promotion agencies, central banks, or other appropriate institutions. Otherwise, it may be available through such database services as IAC-Insite, Predicasts' F&S Index, and Lexis-Nexis.

3.3 Analyze Industry Sectors in Jordan

Using a consistent form of industry classification, such as the International Standard Industrial Classification (ISIC), classify by industry sector the projects undertaken in the last five years in Jordan. Identify those six sectors that account for the most significant share of total investment by number of projects. In addition, identify those countries that are the most significant sources of total investment in Jordan.

Within the six sectors identified, list the following.

- Actual number of projects approved
- Number of related jobs projected
- Amount of related capital investment projected
- Any significant "clustering" of activities by location

4. Build Technical Capacity for Sustainability

4.1 Provide an annex which describes in detail the way in which the preceding tasks were accomplished, so that this work may be replicated or updated in the future by a member of Jordan's investment promotion effort. This applies to those tasks whose method is not obvious from the deliverable report. For example, it may be clear from the report how factor cost data was ranked, but not from which organizations (or from whom within the organization) it was collected.

4.2 Demonstrate to selected member(s) of Jordan's investment promotion effort the way in which the preceding tasks were accomplished, so that they may replicate or update this work in the future.

5. Provide Recommendations

Recommend changes that will lead to the improvement of Jordan's FDI promotional efforts and results

5.1 Draft Scopes of Work

In line with these recommendations, draft indicative Scopes of Work for further appropriate follow-up by the AMIR Program

IV. Time frame for the Consultancy

Unless otherwise specified, the following time frame will govern the timing for the completion of this consultancy:

	Start	LOE	To Post	From Post	Field Work	3rd Country	U.S.A.
CEK	10 Nov 2002	63	0 days	0 days	28 days	35 days	0 days
JID							

17 Nov 2002	18	0 days	0 days	18 days	0 days	0 days

V. LOE for the Consultancy.

This consultancy will require the effort of the following consultants:

Consultant Name	Travel	Field	U.S.	3rd	Total
CEK	8	20	0	35	63
JID	0	18	0	0	18
Subtotal	8	38	0	35	81

VI. Consultancy Qualifications

The Consultant(s) shall have the following minimum requirements:

- **CEK**

1. Educational Qualifications

• At least a Master's degree in a recognized discipline.

2. Work Experience Qualifications

• At least 10 years of international experience working with governments and government institutions to enhance their effectiveness and efficiency in establishing and implementing foreign direct investment promotion and facilitation functions.

- **JID**

1. Educational Qualifications

• At least a Master's degree in a recognized discipline.

2. Work Experience Qualifications

• At least 5 years of experience working with governments and government institutions to enhance their effectiveness and efficiency in establishing and implementing foreign direct investment promotion and facilitation functions.

APPENDIX B: LIST OF PERSONS CONTACTED

A. Jordan

Jordan Investment Board
Ms. Reem Badran, Director General
Mr. Mohammed Asfour, Consultant

Jordan Export Development Corporation
Mr. Farouk Hadidi, Director General

Ministry of Industry and Trade
H.E. Dr. Salah Al- Bashir, Minister
Mr. Amer Hadidi, Director, Economic Affairs Department

AMIR Program
Mr. Steve Wade, Program Director
Ms. Greta Boye, Team Leader, Private Sector Policy Initiative
Mr. Barry O'Connell, Investment Promotion Advisor
Mr. Brad Fusco, Investment Promotion Advisor

USAID
Mr. Jim Barnhart
Mr. Jamal Al-Jabiri

B. Dubai

Dubai Development and Investment Authority
Mr. Kofi Rashid, Strategy and Planning
Mr. Wasfi Abu Ghalazeh

U.S. Consulate General
Mr. John Lancia, Commercial Attaché

Valmont Irrigation/Valmont Middle East FZE
Mr. C.P. Prakash, Finance Manager
Ms. Nahreen Lutty, H.R. Co-ordinator

Jebel Ali Free Zone Authority
Ms. Salma Ali Saif Hareb, Strategic Planning Manager
Abdalla Al Banna, Assistant Region Manager, America and Africa
Sherif Muhtaseb, Marketing Co-ordinator

Dubai Chamber of Commerce and Industry
Mr. Mahmoud Abu-Ali, Statistics Researcher, Research & Studies Department
Dubai Department of Economic Development
Ms. Noura Juma, Assistant Director, Business Registration Division
Mr. Saeed Rashid Saeed Al Suwaidi, Head of Statistics and Information Center
Mr. Abdel Rahman Mohammed Yousif Abu Zaid, Senior Researcher

Dubai Health Care City
Mr. Osama Shihabi

Dubai Technology, Electronic Commerce and Media Free Zone Authority
Mr. Sanjive Khosla, Senior Strategy and Financial Analyst

Dubai Media City
Ms. Leila Alami, Special Projects Manager

American Business Council of Dubai and the Northern Emirates
Mr. Paul De Benedictis, President
Ms. Angela Vidmar Atiyah, Executive Director

C. Egypt

General Authority for Free Zones and Investment
Mr. Abdel Iraqi, Deputy Director
Mr. Hassan Fahmy, Investor Reception and Advice Department
Eng. Hefni Khalifa, Information Sector
Eng. Hesham Saleh, Investment Promotion Department

American Chamber of Commerce in Egypt
Mr. Hisham Fahmy, Executive Director
Mr. Khaled Sewelam, Manager, Business Studies and Analysis Center

USAID
Mr. Anthony Chan, Supervisory Program Economist
Mr. Glenn Rogers, Program Economist

U.S. Embassy
Mr. Edward Yagi, Commercial Attaché
Ms. Jihan Maher Labib, Commercial Specialist

Egyptian Center for Economic Studies
Ms. Samiha Fawzy, Ph.D.

Microsoft Egypt
Mr. Karim Ramadan, Country Manager
Ms. Somaya El Sherbini, Office Manager

Procter & Gamble Egypt
Mr. Rami Zaki, External Relations Manager

Assistance for Trade Reform Project/Nathan Associates
Mr. David Merrill, Senior Vice President
Mr. Timothy Buehrer, Trade Economist
Mr. Rashid Benjelloun, International Trade Specialist

TAPR Technical Assistance for Reform and Project Management Program/Chemonics International

Ms. Yomna Mustafa, Project Specialist

D. Israel

Ministry of Industry and Trade

Investment Promotion Center
Mr. Gil Keinan, Director form Investments

Planning Economics and Pricing Administration
Mr. Howard S. Ross, Deputy Director

Israel Investment Center
Ms. Limor Nissan, Deputy Director

Foreign Trade Administration
Mr. Gabby Bar, Deputy Director, Middle East and North Africa Division

High-Tech Industries Administration
Mr. Josef Dancona, Director

Manufacturers Association of Israel
Mr. Michal Fischbein, Chemical, Pharmaceutical and Environmental Division
Mr. Meir Bar-El, Managing Director, Israel Stone Manufacturers Association; Director, General Division (Plastics, Cosmetics)
Mr. Zvi Goldstein, Director, Food Industries Association
Ms. Sima Amir, Senior Economist, Division of Foreign Trade

Israel Association of Electronics and Information Industries
Mr. Uri Har, Director General

Israel Export and International Co-operation Institute
Mr. Avner Portnoy, Director – Information Division

Bank of Israel
Mr. Eli Kadosh, Senior Economist

AVX Israel
Mr. Zvi Weissbart, Controller

Chief Applications Israel Ltd.
Mr. Eldad Galker, President and CEO
Dr. Feli Galker, Director

U.S. Embassy
Mr. Michael Carroll, Commercial Attaché
Ms. Irit van der Veur, Senior Commercial Specialist
Mr. W. Clark Price, Deputy Economic Counselor

Israel Venture Capital
Ms. Racheli Er-el, Director of Research
Ms. Efrat Zakai, Researcher

Other
Mr. David Framowitz, Investment Consultant

E. Tunisia

Foreign Investment Promotion Agency (FIPA)
Mme Fatma El Ghanmi-Krichen, Director, Studies and International Cooperation
Mr. John Fleming, Technical Advisor, European Union

Agence de Promotion de l'Industrie – API (Industrial Promotion Agency)
Mr. Ridha Dridi, Chef de Service, Service d'Assistance à la Constitution des Sociétés (Chief, Company Registration Service)

Institut Arabe des Chefs d'Entreprise
Mr. Fayçal Lakhoua, Conseiller (Counselor) and member of FIPA Executive Committee

SITELEC/Siemens
Mr. Nabil Mouelhi, Managing Director

U.S. Embassy
Mr. Edward V. O'Brien, Commercial Attaché
Ms. Kristi Hogan, Second Secretary, Economic Affairs
Ms. Charlotte Joulak, Senior Economic/Commercial Specialist

Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat (UTICA) – Tunisian Employers' Association for Industry, Commerce and Handicrafts
Mr. Abdelhamid Miladi, Executive Director of Economy and International Relations
Mr. Abdelatif Aroua, Chief, Studies Department
Mr. Karim Hamzaoui, Chief, Vocational Training Department
Mr. Fetli Dridi, Industrial Department

Other
Professor Mokhtar Latiri, Advisor to the President of the Republic for Special Projects

APPENDIX C: SCOPES OF WORK FOR FUTURE CONSULTANCIES

Scope of Work 1	**Cosmetics Cluster**
Activity:	512 Investment and Export Development Research and Policy
SOW Title:	Foreign Direct Investment Promotion Strategy for Cosmetics Sector
Modification:	0
SOW Date:	March 28, 2002
SOW	Draft
Total LOE:	30 days
Task and	LOE/F/ Foreign Direct Investment Promotion Strategy for Cosmetics Sector
Consultant:	TBD

I. Specific Challenges Addressed by this Consultancy

In late 2002 and early 2003, the AMIR Program conducted an assessment of Jordan's competitiveness in attracting foreign direct investment (FDI), especially in comparison to neighboring countries in the Middle East and North Africa (MENA) region. This assessment sought to identify specific sectors and industries in which Jordan has or could develop a competitive advantage that could lead to increased inward FDI flows. This assessment took as its starting point the 1998 Investor Targeting Strategy carried out by The Services Group on behalf of the then-Investment Promotion Corporation (IPC, now the Jordan Investment Board or JIB), which identified six principal sectors as potential focus areas for IPC's future promotion efforts. The 2002-2003 assessment reviewed the sectors identified in the earlier study, as well as identifying and evaluation new ones that might show considerable promise. One recommendation of the more recent evaluation was to propose a cluster-based approach to investment promotion, which would consist of identifying industries with an actual or potential competitive advantage and to try to craft an integrated investment approach that would encompass a wider range of complementary and support industries that could contribute to the core industry's competitiveness and ability to attract FDI but which also could attract FDI in those related industries.

The 1998 assessment identified Dead Sea cosmetics as a promising area for investment. The more recent assessment concurred with this view, but proposed a much wider focus that would seek to develop or exploit competitive advantages in a range of cosmetic products and inputs ranging from agricultural inputs such as olive and grapeseed oils and essential and aromatic oils to packaging and labeling for finished products.

With an international market for Dead Sea products estimated at $50 million, a unique resource shared only by Israel, a higher quality of basic product (carnelite and mud) and input costs roughly 60% to 80% lower than those prevailing in Israel, Jordan possesses an undoubted competitive advantage. Jordanian carnelite is said to have a higher magnesium content and lower sodium content than Israeli carnelite. In addition, Jordanian products are treated by natural evaporation rather than by chemical processes used by Israeli

manufacturers. Jordan also has a greater abundance of raw materials than Israel, though this could be a function of underdevelopment of the Jordanian industry.

A 1997 analysis of the sector conducted by the Ministry of Planning calculated Jordan's share of this market at less than 10%, or $4.7 million, of which 90% was exported in bulk. Thus, Jordan's participation in the higher value-added packaged cosmetics segment of the market was negligible, at about $470,000. The sector was characterized as fragmented and underdeveloped and lacking the organization and capital to expand production and increase added value. The small volume of sales of packaged products was primarily on the local market to tourists, since packaging quality was poor, products were not certified in major export markets, and Jordanian consumers preferred imported European cosmetics.

II. Objective

The objective of this consultancy is to help JIB identify and attract foreign investors in a cosmetics cluster based on Jordan's competitive advantage in Dead Sea products, but which can more fully exploit tariff exemptions of certain classes of products under the U.S.-Jordan Free Trade Agreement (FTA) and the U.S.-Jordan-Israel Qualifying Industrial Zone (QIZ) program, and which can add much more value domestically by producing and packaging high-quality products for export.

The potential impact of development of the industry and shifting from exporting in bulk to exporting packaged cosmetics can be enormous. In addition to capturing a larger share of the market, Jordanian producers can increase domestic added value exponentially. Carnelite (Dead Sea salts containing magnesium chloride, potassium chloride and sodium chloride) and Dead Sea mud sells for approximately $250 per tonne, while packaged bath salts or other cosmetic preparations can command wholesale prices of more than $20 per kg.

Since 1997, the industry has transformed considerably and at least 30 companies are now manufacturing and packaging Dead Sea cosmetic products for export. Major companies include El-Maydan Company, producing the Kawar range of products; Bloom Dead Sea Gift Enterprise; Jordan Company for Dead Sea Products, producing the LaCure range; Rivage Dead Sea Products Though Europe has historically been the largest export market for Dead Sea products, taking 45% of Jordanian production, U.S. market penetration has increased as a function of FTA. Bloom, for example, exported about $110,000 in products to the U.S. in 2002. In addition, several companies sell internationally through their websites. The Israeli company AHAVA nevertheless retains an estimated 90% share of the U.S. market, while AHAVA and other Israeli producers also command a similar share of European markets.

An assessment of the Dead Sea products cluster conducted in 1997 by the Ministry of Planning Competitiveness Unit identified the Arab Potash Company (APC) as a major constraint to development, since it has a monopoly on extraction of Dead Sea minerals. Though the prices of raw materials supplied by APC are highly competitive, many

cosmetics producers have complained about APC's unresponsiveness and its frequent failure to meet customer specifications. Additionally, APC's own subsidiary, Numeira, sells into the same export markets as other Jordanian cosmetic producers, often undercutting their prices.

Though Jordan undoubtedly has the ability to attract significant investment in Dead Sea products, an alternative approach is to consider Dead Sea products as a subset of a larger natural cosmetics and natural products industry that could be developed using other products in which Jordan also has a significant competitive advantage. Rather than focus exclusively on Dead Sea products which will, by definition, remain a niche product, Jordan has the potential to participate in the much larger natural cosmetics and herbal market and to create a true cosmetics cluster, incorporating its advantages in raw materials from the Dead Sea, its ability to produce other important raw materials, its growing packaging and printing industries, and its potential to attract production and marketing know-how and to access critical markets through the QIZ relationship with Israel. There is considerable overlap between the pharmaceutical and cosmetics industries in terms of both raw materials and applications, and these could be explored and developed further.

The Jordan Valley is one of the original sources and an important producer of many of the world's herbs and medicinal plants, including thyme, lavender, marjoram, valerian, bay laurel, borage, lovage, rosemary and sage, the essential oils of which are prized for natural remedies, aromatherapy and homeopathic treatments. Jordan also produces high quality olive oil and could produce grapeseed oil, both of which are frequently used as base oils to mix with essential and aromatic oils. Other cosmetic products such as henna are also cultivated in Jordan. Egypt and Israel are both important producers of these and similar products, and Egypt's foreign investment promotion agency, GAFI, lists extraction of medicinal herbs and plants as one of its priority areas for investment in activities related to the pharmaceutical sector.

Jordan could also grow jojoba beans, which grow well in hot and semi-arid climates and whose oil is highly prized for cosmetic purposes. Jojoba also has important uses in pharmaceutical production. Tunisia, for example, is currently seeking investors to develop a 200-hectare jojoba plantation, at a cost of $2.3 million, to supply 800 tonnes of seeds to European markets, which are currently supplied mainly by the United States. Jordanian cosmetic producers could invest in growing jojoba for use in manufacturing cosmetic products domestically rather than exporting the seeds or the oil, which sells for approximately $75 per gallon in bulk, but which can command wholesale prices of 20 or 30 times as much when packaged for retail sale, and can be worth even more when blended into other cosmetic products. Israel is currently the third-largest jojoba producer in the world, after the United States and Mexico. The total world market for jojoba oil is estimated at up to 2500 tonnes per year, from production of about 100,000 to 200,000 tonnes of jojoba seeds.

Various sources estimate the U.S. market for herbal products at about $4 billion to $6 billion and the European market at between $6 billion and $8 billion, with annual growth

rates of up to 25%. This market includes a wide range of products, dominated by herbal medicinal and dietary supplements. U.S. imports of essential oils were $242.5 billion, a 17 per cent increase over 1994. In 2002 the U.S. imported over $110 million of non-citrus essential oils. Essential oils themselves are duty free under WTO bound-in rates; however, with further preparation into cosmetics and medicinal products they could be subject to MFN tariffs of up to 5.4% yet duty-free under the U.S.-Jordan FTA and QIZ programs and also under the Jordan-EU Association Agreement.

In 1997, the global market for natural personal-care products was estimated at $2.8 billion, with annual growth estimated at between 8% and 10% (in Germany the annual growth of the market for 'green" cosmetics was estimated at between 10% and 20%). In the U.S. market, 38 per cent of skin care products, 23 per cent of hair care products and 12 per cent of bath products were labeled as "natural." The "natural" appellation is not always subject to rigorous standards and so its definition tends to be elastic. Nevertheless, products perceived as natural – and this includes both Dead Sea and herbal products – is the fastest-growing segment of the market. Facial skin care accounted for an estimated 46.1% of the total natural cosmetic or "cosmeceutical" market in 1999 (Cosmeceuticals are topical cosmetic-pharmaceutical hybrids intended to enhance the health and beauty of skin). World production of essential oils was estimated in 1995 at $1 billion. If this has kept pace with the growth in the natural cosmetic and herbal dietary supplement markets, total production will have grown to at least $2 billion in 2002. Developing countries account for 55% of this production, with China and India the largest producers but with several MENA countries, especially Egypt and Morocco, among the larger suppliers. Total EU imports of essential oils amounted to over $500 million in 2000, with nearly $200 million coming from developing countries. Egypt was the largest supplier of both geranium and jasmine oils, exporting more than $4.25 million of these two products alone to the EU. Tunisia was a significant supplier of citrus-based essential oils.

Large retailers of natural cosmetics, such as The Body Shop, have cooperative trade programs to develop sustainable long-term relationships with suppliers in developing countries. Other companies such as Yves Rocher have similar programs in place. Although this could be a promising avenue for Jordan to develop its natural cosmetics industry, it should be seen as only an intermediate step in a progression to domestic manufacturing of packaged cosmetic products.

The main target investors would be U.S. and European cosmetic manufacturers and distributors, as well as Israeli cosmetics companies such as AHAVA. The QIZs could be an ideal setting in which Jordan's competitive advantages in raw materials and labor could be combined with Israeli production technology and, most important, market knowledge and penetration in Europe and the U.S.

Spillovers from development in this sector would certainly comprise improvement of packaging quality and development of the plastics and printing industries. Again, Israeli companies, especially through the QIZs, could be a significant source of investment.

Taking these trends and developments into account, the Consultant(s) will develop a targeted investment promotion strategy for JIB aimed at developing a much larger and higher value-adding cosmetics sector in Jordan, using foreign investment, technology, know-how and market access.

III. Specific Tasks of the Consultant(s)

A. Background Reading Required to Undertake this Consultancy

The Consultant(s) will read, without being limited to, the following documents.

1. AMIR 2.0 Report "Improving Jordan's Investment Promotion" (June 2002)
2. Investment Task Force Executive Summary and associated reports (January 2002)
3. AMIR 1 Report "Investor Promotion Strategic Plan" (June 1998)
4. AMIR 2.0 Report "A Sustainable Trade and Investment Strategy for Jordan" (May 2002)
5. AMIR 2.0 Report "The 2002 Investor Roadmap of Jordan" (October 2002)
6. AMIR 2.0 Report "Jordan FDI Competitiveness Assessment and Investor Targeting Strategy"

B. Interviews Required to Undertake this Consultancy

The consultant(s) will interview,, without being limited to, the following people:

1. Ms. Reem Badran, Director General, Jordan Investment Board
2. Ms. Greta Boye, Team Leader, PSPI, AMIR Program
3. Mr. Brad Fusco, AMIR Program
4. Mr. Naseem Rahahla, Director of the Competitiveness Unit, Ministry of Planning
5. Mr. Jamal Al-Jabiri, USAID
6. Managing Director, Arab Potash Corporation
7. Managing Director, Jordan Phosphate Mines Company
8. Managing Director, Numeira Cosmetics

C. Tasks Related to Achieving the Consultancy's Objectives

The Consultant will undertake the following tasks and produce the following deliverables:

1. Consult with the Ministry of Planning Competitiveness Unit on current developments in the cosmetics sector
2. Identify and meet with the major cosmetics producers in Jordan to understand industry developments and to understand constraints
3. identify and evaluate any technical, market and financial feasibility studies conducted relative to potential Jordanian production of important cosmetic products and inputs

4. Identify major packaging manufacturers in Jordan and identify constraints to upgrading production
5. Evaluate existing JIB programs for promoting FDI in the cosmetics sector
6. Identify domestic producers of other inputs such as olive oil, grapeseed oil, herbs and essential oils, and quantify their markets and evaluate their current domestic and export marketing strategies.
7. Identify, quantify and segment main potential export markets for Jordanian cosmetics
8. Identify, quantify and segment main international suppliers and purchasers of products and product inputs
9. Identify main potential sources of investment in the cosmetics sector, based on existing purchasing patterns, product profiles and prior FDI in developing countries
10. Produce, in consultation with JIB, a set of strategic guidelines and specific marketing plan for attracting FDI in the cosmetics cluster over the next 24 months, including personnel requirements, specific contacts and exhibitions, and a draft promotion budget.

IV. Time frame for the Consultancy

Unless otherwise specified, the following time frame will govern the timing for the completion of this consultancy:

Consultant	Start	LOE	To Post	From Post	Field Work	3rd Country	U.S.A.

V. Level of Effort for This Consultancy

This consultancy will require the effort of the following consultants:

Consultant Name	Travel	Field	U.S.	3rd	Total

VI. Qualifications of Consultants

Scope of Work 2	**Fertilizers and Inorganic Chemicals Sector**
Activity:	512 Investment and Export Development Research and Policy
SOW Title:	Foreign Direct Investment Promotion Strategy for Fertilizer and Chemical Sector
Modification:	0
SOW Date:	March 28, 2002
SOW	Draft
Total LOE:	30 days
Task and	LOE/F/ Foreign Direct Investment Promotion Strategy for Fertilizer and Chemicals Sector
Consultant:	TBD

I. Specific Challenges Addressed by this Consultancy

After a recent boom in investment in fertilizers and inorganic chemicals, the prospects for sustaining growth or even recent historical levels of FDI are in some doubt given developments in the worldwide structure of demand and supply of phosphate and potassium-based fertilizers, in which Jordan specializes.

Jordan has a huge revealed comparative advantage in potassium chloride (potash) and phosphate-based fertilizers. Its share of world exports of fertilizers is 36 times greater than its share of total world exports of all products, while its revealed comparative advantage in the U.S. market is more than 20. Jordan also has a high revealed comparative advantage in inorganic chemicals, mainly bromine derivatives. In the MENA region Jordan is far from unique in this comparative advantage. Morocco and Tunisia both have very substantial comparative advantages in this sector. Jordan is endowed with substantial phosphate and potassium reserves, as are both Morocco and Tunisia.

Jordan's comparative advantage in fertilizers is based on its natural resource endowments and reasonable production and shipping costs. Jordan is the sixth-largest producer of phosphate in the world and the seventh-largest potash producer. The 1998 ITS identified the lack of domestic supplies of di-ammonium phosphate (DAP) as a constraint to further development of the industry; however, the Nippon-Jordan Fertilizer Company, started in 1997, built a 300,000 ton-per-year DAP plant, which had reached full capacity by 1998. A $106 million joint venture investment by APC and Kemira Oy of Finland, to produce potassium nitrate and dicalcium phosphate fertilizers was also approved by the Ministry of Finance in 2000.

Jordan enjoys some competitive advantage relative to Morocco and Tunisia. Jordan has a greater proximity to the main export markets in Asia (which accounts for about 70% of Jordan's fertilizer exports) by exporting through Aqaba. An Investor Targeting Strategy (ITS) conducted on behalf of the Jordan Investment Board in 1997-1998 reported that Jordan was at a competitive disadvantage in shipping to Asia because of high shipping costs in Aqaba, but this disadvantage has lessened considerably. The cost of shipping per TEU from Aqaba to Hong Kong is now equivalent to or less than that of a similar shipment from Tunis or Casablanca to Hong Kong. As the Aqaba port development continues, the number and frequency of vessels will increase and the shipping costs should become even more competitive.

Jordan has attracted significant investments in other chemical industries. The Jordan Bromine Corporation, a large Jordanian-U.S. joint venture, received approval in 2000 to build a $145-million plant to produce bromine derivatives, with expected sales to reach $150 million per year within four years of expected plant completion in 2003.

The Jordan Magnesia Company also in 2000 received Ministry of Finance approval for a $102 investment to produce magnesium chloride.

Because of the size and complexity of these investments, they often show up in JIB final approvals several years after they have received the initial go-ahead from the Ministry of Finance. The MOF approvals, announced with great fanfare, were essentially agreements to allow these companies to set up individual Free Zones for these projects. Final approval by JIB in many cases did not come until much later. For example, the Jordan Bromine Corporation, announced in 1998, received MOF Free Zone approval in 2000, but did not get final JIB approval to begin construction until 2002. Similarly, the Finnish joint venture with APC was originally announced in 1998, received MOF Free Zone approval in 2000, and final JIB approval in 2002.

These JIB approvals in turn will not show up in official FDI statistics for another several years, in view of the time to complete the projects and the scheduling of payments. Consequently, the large surge in investment in the chemicals sector recorded in JIB approvals in 2002 ($174 million, of which $93 million in foreign investment) is less reflective of current interest and instead shows a large increase in interest and investment planning dating to the late 1990s.

Given this lag between formation of a project plan and final investment approval by JIB, it is possible to forecast new developments in the industry several years in advance. The current batch of projects, including several fertilizer projects and the bromine project, will show up over the next two years in official FDI statistics, assuming that the promoters continue with the projects in view of the regional political situation. However, no major new investments in fertilizers and chemicals have been announced in the past two years, indicating a possible slowdown in investor interest in the sector.

It is therefore questionable, how much additional investment Jordan will be able to attract in this sector. In addition to the Japanese, U.S. and Finnish investments, the fertilizer industry has attracted several other mega-projects with foreign investment from companies including BASF, Norsk Hydro, and Haifa Chemicals, as well as several Indian and Pakistani companies. The scope for additional investments, apart from expansions of existing projects, may be limited. The industry remains highly constrained by the monopoly of state-owned enterprises over the production of raw materials. Jordan Phosphate Mines Company (JPC) and Arab Potash Company (APC) have full monopolies on production of raw phosphates and potash, respectively. The main vehicle for foreign investors has been through joint ventures or other collaborative agreements with JPMC and APC. Potential investors seeking to set up independent new ventures may face certain constraints on supply and may also have higher raw material costs than companies already operating in collaboration with the two monopolies, which may have beneficial privileged transfer-pricing arrangements. The scope for new joint ventures with the two monopoly companies is unclear, since they may be seen to some degree as “cannibalizing” or otherwise detracting from existing ventures with other foreign partners.

The world market outlook for fertilizers does not show any huge increase in demand. Indeed, fertilizer production declined from a peak of 158.3 million tons in 1988/89 to less than 140 million tons in 1994/95, before growing slowly to reach 147.2 million tons in

1998/99, an average growth rate of less than 3% per annum over five years and only 0.2% from 1997/98 to 1998/99. Most of the decline in production in the early 1990s came from a collapse in demand and production in the former Soviet Union, while most of the subsequent increase in production has come from developing countries in Asia. The growth in Asian production is higher than the overall growth in world production, because production in Europe and North America fell significantly in the late 1990s, with many plants closing due to poor profitability. Though China and India together account for the bulk of growth in demand and production during the 1990s, growth in Jordan's production has been exceptionally robust, amounting to 16.7% between 1997 and 1998 alone. Subsequent growth in Jordan's production as a function of new plants announced and completed in the period 1997 to the present has probably remained at a similarly high level.

Though world demand is relatively flat, there is significant variation among countries, with many Asian countries, including Malaysia, India, Thailand, Indonesia, Vietnam and Turkey, all showing growth rates much higher than the world average. To Jordan's great advantage, the demand for phosphate and potash-based fertilizers appears to be growing faster and facing fewer market access restrictions than for nitrogen-based fertilizers. Though total imports of nitrogen-based fertilizers by developing countries in Asia fell by nearly 40% from 1995 to 1999, phosphate imports grew by about 10% and potash imports by 27% over the same period.

One important contributing factor to this disparity is the greater protection given by many countries to nitrogen-based fertilizers. China, for example, has banned urea imports since 1997. Many of the major fertilizer consuming countries, including India, Indonesia, Vietnam and China, have ample natural gas supplies to serve as feedstock for urea and ammonia production, and may be able to produce nitrogen-based fertilizers at a lower cost than imported product, regardless of the level of protection of the industry. Phosphate and potassium fertilizer production still depends on a supply of raw materials, thus resulting in much freer trade in these products than in nitrogen-based products. Urea production continues to increase steadily with Indonesia, for example, to increase its capacity by nearly 25% from 2000 to 2003. According to *Agro-Chemicals News,* the supply and price for phosphate fertilizers are likely to remain relatively stable (far more so than for nitrogen, where production capacity is growing far faster than demand), though this could change slightly as large DAP plants in India and Australia come on-stream.

The implications of this assessment are that demand for Jordanian fertilizers is likely to remain fairly stable and that Jordan, by virtue of its position as a major world producer of raw materials, is likely to retain its market share. The modest forecast growth in world demand and the advent of new production capacity in Asia and Jordan, indicate that a need for investment in large new plants will be minimal over the next several years. Construction of large new DAP plants in India and Pakistan indicate a likely reduction in those countries' imports. Though no overcapacity is predicted such as that which already exists for urea, no significant expansion in import demand for potassium and phosphate fertilizers is likely to occur for the next several years.

The structure of Jordan's existing fertilizer industry, moreover, does not appear to lend itself to new entrants in the near term, with most new investment likely to come from existing participants.

Given the long lead time in project development in fertilizers and other chemicals, JIB has commissioned this consultancy to conduct a longer-term assessment of the growth and investment potential for the sector, taking into account the possibility of liberalization and/or privatization of the supply of raw materials, and to develop a 2-year investment promotion strategy based on this assessment.

II. Objective

The objective of this consultancy is to help JIB identify and attract foreign investors in the fertilizer and inorganic chemicals sector, in which Jordan has successfully attracted significant FDI in recent years, but in which future investment flows may drop considerably.

III. Specific Tasks of the Consultant(s)

A. Background Reading Required to Undertake this Consultancy

The Consultant(s) will read, without being limited to, the following documents.

1. AMIR 2.0 Report "Improving Jordan's Investment Promotion" (June 2002)
2. Investment Task Force Executive Summary and associated reports (January 2002)
3. AMIR 1 Report "Investor Promotion Strategic Plan" (June 1998)
4. AMIR 2.0 Report "A Sustainable Trade and Investment Strategy for Jordan" (May 2002)
5. AMIR 2.0 Report "The 2002 Investor Roadmap of Jordan" (October 2002)
6. AMIR 2.0 Report "Jordan FDI Competitiveness Assessment and Investor Targeting Strategy"

B. Interviews Required to Undertake this Consultancy

The consultant(s) will interview,, without being limited to, the following people:

1. Ms. Reem Badran, Director General, Jordan Investment Board
2. Ms. Greta Boye, Team Leader, PSPI, AMIR Program
3. Mr. Brad Fusco, AMIR Program
4. Mr. Naseem Rahahla, Director of the Competitiveness Unit, Ministry of Planning
5. Mr. Jamal Al-Jabiri, USAID
6. Managing Director, Arab Potash Corporation
7. Managing Director, Jordan Phosphate Mines
8. Managing Director, Jordan Bromine Corporation
9. Managing Director, Jordan Magnesia Corporation

C. Tasks Related to Achieving the Consultancy's Objectives

The Consultant will undertake the following tasks and produce the following deliverables:

1. Consult with the Ministry of Planning Competitiveness Unit and the Jordan Investment Board on current developments in the fertilizer and chemicals sectors
2. Review literature and consult with Ministry of Natural Resources and Ministry of Environment on mineral resource reserves and on environmental constraints to expansion of mining and chemical production.
3. Identify and evaluate any technical, market and financial feasibility studies conducted relative to potential Jordanian production of important chemical and fertilizer products and inputs
4. Identify trends in major export markets and evaluate the competitiveness of Jordanian products in those markets with respect to price, quality, packaging and other critical dimensions
5. Evaluate existing JIB programs for promoting FDI in the chemicals and fertilizer sector
6. Identify main potential sources of investment in the chemical and fertilizer sector, based on existing purchasing patterns, product profiles and prior FDI in developing countries
7. Produce, in consultation with JIB, a set of strategic guidelines and specific marketing plan for attracting FDI in the chemical and fertilizer sector over the next five to 10 years, including both near-term activities and longer-term strategic initiatives

IV. Time frame for the Consultancy

Unless otherwise specified, the following time frame will govern the timing for the completion of this consultancy:

Consultant	Start	LOE	To Post	From Post	Field Work	3rd Country	U.S.A.

V. Level of Effort for This Consultancy

This consultancy will require the effort of the following consultants:

Consultant Name	Travel	Field	U.S.	3rd	Total

VI. Qualifications of Consultants

Scope of Work 3	**Textiles and QIZ Development**
Activity:	512 Investment and Export Development Research and Policy
SOW Title:	Foreign Direct Investment Promotion Strategy for Textiles and other QIZ Manufacturing
Modification:	0
SOW Date:	March 28, 2002

SOW	Draft
Total LOE:	30 days
Task and	LOE/F/ Foreign Direct Investment Promotion Strategy for Textile and other QIZ Manufacturing
Consultant:	TBD

I. Specific Challenges Addressed by this Consultancy

Textiles and clothing have traditionally been a strong driver of FDI and export growth for many developing countries, and Jordan is no exception. From 1996 through 2002, Jordan has attracted nearly $400 million in total investment in the textile and clothing sector, almost entirely in the QIZs, representing about 14% of Jordan's total industrial investment during the period. This sector has one of the highest proportions of FDI to total investment, amounting to about $287 million or 74% of the total. Jordan's exports to the U.S. have increased from $30.9 million in 1999 to $412.2 million in 2002. Most of this increase is attributable to the surge in investment in and exports from the QIZs, almost all of which has been in the apparel industry. QIZ clothing exports accounted for about 22% of Jordan's total exports in 2002, and roughly 10% of total industrial sector employment.

The future prospects of the textile and clothing industry worldwide and in Jordan will therefore have a tremendous impact on Jordan's future FDI promotion strategies.

The expansion of textile and garment production in developing countries has been motivated by two overriding concerns: 1) the search for low-cost production which, because of the labor-intensive character of garment manufacturing, means a search for cheap labor; and, 2) the search for market access, driven mainly by the Mutifibre Arrangement (MFA) system, which allocates import quotas to countries in the developing world, and its successor framework under the WTO, the Agreement on Textiles and Clothing (ATC).

Apart from Egypt, which has a large domestic market and an important cotton-producing industry, and which remains a low-wage country, the garment industry in the MENA region owes its existence to the MFA. In the 1980s, the UAE developed a significant garment industry, motivated by unused quota for exports into the U.S. market, fuelled by investment from South and East Asia, and staffed by workers from the Indian subcontinent. The Moroccan and Tunisian garment industries developed in response to those countries' preferential access to E.U. markets, but have recently declined as Turkey and countries in East and Central Europe have benefited from similar or even more favorable market access conditions. Owing to liberalization of EU market access for Turkish products, Turkey's apparel exports more than doubled from $3.4 billion in 1990 to $7.3 billion in 1998.

Israel developed a substantial textile sector owing mainly to free trade agreements with both the U.S. and the E.U.; however, the high cost of labor in Israel has rendered the Israeli textile industry largely uncompetitive even with the quota and duty preferences

conferred by its FTA. Investment in Israel's textile industry has declined precipitously, with many Israeli companies instead investing in Turkey and the Israel-Jordan QIZs. Outside the region, Mexico, which in 1990 exported $100 million of textile and apparel, by 1998 was exporting some $7 billion under the North American Free Trade Agreement (NAFTA).

Jordan's own textile and apparel industry owes its existence almost entirely to the U.S.-Israel-Jordan QIZ regime, which allows quota-free and duty-free access to the U.S. market for textile products containing at least 11.7% Israeli content and a minimum of 35% Jordanian and Israeli content combined.

The critical question for the Jordanian textile sector is what will happen as the world textile trading regime changes, as it will do as of January 1, 2005. As of that date, the ATC will end and the entire system of import quotas for textile products will disappear. This will be the final step of a four-phase progressive reduction of quotas. It is instructive to examine what has happened since January, 2002, when the third phase of quota elimination came into effect: China's apparel exports to the U.S. grew by 15%, even as overall U.S. imports fell by more than 11%. As the remaining quotas disappear, China's dominance is certain to increase. Other low-cost producers, including more than 20 African countries that already benefit from duty-free access for a wide range of textile products under the Africa Growth and Opportunity Act (AGOA) and which are also very low-wage producers, may also be expected to increase their market share at the expense of other, more costly production locations.

The system of preferential tariffs will not change immediately, although under WTO rules and agreements, these are to be reduced to more "normal" levels over time. In the absence of any firm commitment on reduction on tariffs, it is certain that tariffs imposed by European and North American countries on textile imports will remain high, thus perpetuating a significant advantage enjoyed by Jordan and other countries that have free trade agreements with the U.S. and Europe. MFN tariffs on clothing imports range between 9% and 13% for the U.S. and between 10% and 12% for the E.U. (the average EU and US tariffs on manufactures is about 4%). Thus, even after January 1, 2005, Jordanian garment manufacturers will continue to benefit from an average 12% cost advantage over countries that export under MFN status. The question is whether this advantage is sufficient, in view of transport and labor costs and labor productivity, for Jordan to remain competitive.

The abolition of the ATC will lead to greater competition in textiles and apparel as highly efficient manufacturers no longer face artificial constraints (i.e., quotas) on their exports to major markets. This implies that certain countries, whose sole export advantage lies in the quota system, will face loss of most of their textile industries within a fairly short time. This is almost certain to be the case for manufacturers in the Gulf countries, including UAE and Bahrain.

Almost all developing-country exporters of textiles will also encounter the problem of "fallacy of composition," which holds that "on its own a small developing country can

substantially expand its exports without flooding the market and seriously reducing the prices of the products concerned, but this may not be true for developing countries as a whole, or even for large individual countries such as China and India. A rapid increase in exports of labour-intensive products involves a potential risk that the terms of trade will decline to such an extent that the benefits of any increased volume of exports may be more than offset by losses due to lower export prices… fallacy of composition in labour-intensive manufactures may become a problem if there is a simultaneous export drive by developing countries in these manufactures, which would result in falling export prices and/or earnings. It can also become a problem, reflected in falling wages, when there is increased competition among these countries as locations for foreign direct investment (FDI) in simple processes of otherwise high-tech activities organized in international production networks. Government policies can exacerbate the problem by offering transnational corporations (TNCs) tax concessions and other incentives. The question of the probability of markets for labour-intensive manufactured exports from developing countries becoming oversupplied, and especially the policy responses this would call for, are thus important elements in the design of export-oriented development strategies."

The imminent abolition of quotas on textile products will certainly involve increased competition and increased volumes of products from China in major markets, with a strong probability of reduced prices. It is not certain how this may affect Jordan. Even with a 12% cost advantage conferred by the QIZ tariff concessions and, in subsequent phases, similar advantages from the U.S.-Jordan FTA, it is far from certain that Jordan can compete with China or other low-wage and highly productive countries such as Vietnam. For Mauritius, a middle-income country in which apparel remains a mainstay of the economy, the impact of abolishing MFA quotas is estimated at a decline in apparel exports of 18% to 26%.

The follow-on question is whether, even if Jordan can compete with such countries, it should try to do so, since the sector as a whole will face falling wages. The UNCTAD report cited above, notes that this problem is most acute for middle income countries such as Jordan, which have not yet succeeded in diversifying and upgrading into more skill-intensive manufactures, and which, consequently, "may face a squeeze between the top and bottom ends for manufactures."

Viewed solely in terms of cost, Jordan is unlikely to be able to compete effectively with the likes of China or Vietnam. On the other hand, governments in Europe and especially the U.S. are likely to initiate and enforce anti-dumping measures and other non-tariff barriers against the larger countries, especially those with which it has no preferential trade agreements. There are many examples of this happening even in advance of the expiration of the ATC. Nevertheless, just as the garment industries in Mexico and the Caribbean/Central America region – all middle income countries with preferential access to U.S. clothing markets – will suffer from the abolition of quotas, so too will Jordanian manufacturers.

Jordan can possibly exploit the 18 months or so remaining under the ATC quota system to attract additional FDI into the QIZs. It is unlikely that investors, having made a

significant commitment to building production capacity in Jordan, will disinvest in the near future. However, in light of the profound changes occurring in the global apparel industry, it is doubtful whether Jordan can experience the same pace of growth in FDI over the next several years that it has experienced recently. Consequently, the textile sector is not recommended as one of the main sectors in which JIB should concentrate its investment promotion activities at present.

This consultancy is aimed at evaluating Jordan's competitive position in the evolving international textile and apparel trade and at developing an appropriate investment and trade development strategy. A secondary objective of this consultancy is to evaluate other potential areas of focus for future investment in the QIZs.

II. Objective

The objective of this consultancy is to help JIB develop a strategy for promoting FDI in the QIZs, specifically with reference to current and future trends in the textile and garment industry worldwide, but also with reference to the promotion of other industries with significant potential for development in the QIZs.

III. Specific Tasks of the Consultant(s)

A. Background Reading Required to Undertake this Consultancy

The Consultant(s) will read, without being limited to, the following documents.

1. AMIR 2.0 Report "Improving Jordan's Investment Promotion" (June 2002)
2. Investment Task Force Executive Summary and associated reports (January 2002)
3. AMIR 1 Report "Investor Promotion Strategic Plan" (June 1998)
4. AMIR 2.0 Report "A Sustainable Trade and Investment Strategy for Jordan" (May 2002)
5. Someya, Masakazu, Shunnar, Hazem, and Srinvasan, T.G., "Textile and Clothing Exports in MENA: Past Performance, Prospects and Policy Issues In Post MFA Context," World Bank, August 2002
6. Desai, Mihir, "Review of Global Trade and Investment in Apparel: Implications for Africa," Multilateral investment Guarantee Agency, World Bank, August 2002
7. Krakoff, Charles, "West African Regional Integration: Implications for the Textile Sector in the ECOWAS Region," Private Sector Forum on West African Regional Integration, Development Associates, Inc., 2002
8. AMIR 2.0 Report "The 2002 Investor Roadmap of Jordan" (October 2002)
9. AMIR 2.0 Report "Jordan FDI Competitiveness Assessment and Investor Targeting Strategy"

B. Interviews Required to Undertake this Consultancy

The consultant(s) will interview,, without being limited to, the following people:

1. Ms. Reem Badran, Director General, Jordan Investment Board

2. Ms. Greta Boye, Team Leader, PSPI, AMIR Program
3. Mr. Brad Fusco, AMIR Program
4. Mr. Naseem Rahahla, Director of the Competitiveness Unit, Ministry of Planning
5. Mr. Jamal Al-Jabiri, USAID
6. Mr. Amer Hadidi, Director, Economic Affairs Department, Ministry of Industry and Trade
7. Mr. Gabby Bar, Deputy Director, Middle East and North Africa Division, Israel Ministry of Foreign Trade
8. Mr. Nadeem Muasher, Chairman, Zay Industries, Jordan
9. Mr. Rami al-Qusus, Advisor, Ministry of Industry and Trade

C. Tasks Related to Achieving the Consultancy's Objectives

The Consultant will undertake the following tasks and produce the following deliverables:

1. Consult with the Ministry of Planning Competitiveness Unit and the Jordan Investment Board on current developments in the textile and garment sectors
2. Review literature and evaluate Jordan's future ability to remain cost-competitive in U.S. and European markets
3. Identify and evaluate any technical, market and financial feasibility studies conducted relative to Jordanian production of garments and other textile products, as well as stone, jewelry and other products with potential for QIZ manufacturing. These should include industries and products with potential for joint Israeli-Jordanian production and should include medical instruments and plastics.
4. Evaluate Jordan's potential to remain competitive in textile and garment production after the abolition of quotas, based on production costs and continuing tariff exemptions. Identify specific products in which Jordan may have the greatest competitive advantage and identify producers/potential investors that focus on these specific product areas
5. Prepare an objective set of criteria for evaluating the suitability of non-textile industries for location in QIZs, based on tariffs, quotas, cost-competitiveness, availability of uniquely competitive inputs
6. Evaluate existing JIB programs for promoting FDI in the textile sector and in the QIZs in general
7. Produce, in consultation with JIB, a set of strategic guidelines and specific marketing plan for attracting FDI in the QIZs over the next 24 to 60 months, focusing on both textile and non-textile industries.

IV. Time frame for the Consultancy

Unless otherwise specified, the following time frame will govern the timing for the completion of this consultancy:

Consultant	Start	LOE	To Post	From Post	Field Work	3rd Country	U.S.A.

V. Level of Effort for This Consultancy

This consultancy will require the effort of the following consultants:

Consultant Name	Travel	Field	U.S.	3rd	Total

VI. Qualifications of Consultants

Scope of Work 4	**Medical Tourism**
Activity:	512 Investment and Export Development Research and Policy
SOW Title:	Foreign Direct Investment Promotion Strategy for Medical Tourism
Modification:	0
SOW Date:	March 28, 2002
SOW	Draft
Total LOE:	30 days
Task and	LOE/F/ Foreign Direct Investment Promotion Strategy for Medical Tourism
Consultant:	TBD

I. Specific Challenges Addressed by this Consultancy

Jordan has a small but growing medical tourism industry. Medical tourism is defined as international travel to obtain medical treatment. Wealthy Arabs have long traveled to the United States or United Kingdom for medical treatment, but this phenomenon has extended to the middle classes as well. Arab patients are drawn to other Arab countries by improving standards of medical care available in certain countries, as well as by the common language and culture and the lower cost as compared to European and North American destinations. The two critical elements of a successful medical tourism industry are high-quality clinics, hospitals and specialists, generally found in private rather than in state medical facilities, and other tourism facilities. Arab patients often travel with many family members, so proper accommodation and recreational facilities for accompanying family members are very important.

The private health sector in Jordan currently comprises 52 private hospitals, of which 35 are in Amman. The number of beds provided by the private health sector has increased by 22% from 1997 to 2000. During 2000, private hospitals admitted 175,000 inpatients, or 31% of total inpatient admissions. Of these, nearly 25,000, or 14%, were foreign. The number of foreign inpatient admissions was projected to grow by nearly 24%, to more than 30,000, in 2001.

Obstetrics and gynecology are the largest category of procedures performed in private hospitals in Jordan, and probably among the least likely to attract significant numbers of medical tourists. But general surgery, orthopedics, urology, ENT, ophthalmology, plastic surgery and cardiology are important surgical specialty areas.

Al-Khalidi Medical Center (KMC) in Amman reports that some 30% of its inpatients come from other Arab states, including Sudan, UAE and Libya. KMC has contracts with the Health Ministries of these countries to provide certain health services. Saudi Arabia and Yemen are important sources of patients. To accommodate families of inpatients the hospital built an adjacent 30-suite hotel.

The Eye Specialty Hospital also contracts with the governments of Libya, Yemen, Saudi Arabia and Sudan and also performs a large volume of outpatient laser procedures on resident and visiting expatriates from Europe and North America. Non-Jordanian patients represent about 35% of the total.

Many other private hospitals, especially in Amman, treat significant numbers of foreigners, though exact numbers are unavailable. According to the report on the sector conducted by the Export and Finance Bank, the private health sector suffers from overcapacity (or under-occupancy) and under-capitalization, which prevents them from acquiring the most advanced medical equipment. Jordan, with a climate favorable to establishment of private hospitals and a large population of Western-trained medical professionals, already has certain established competitive advantages in this sector. Jordan has a higher population of doctors, dentists and nurses relative to population than any other country in the region. Private hospitals and clinics account for nearly 40% of the total number of hospital beds in the country. Public sector expenditure on health services amounts to 9% of GDP, a level commensurate with that of many European countries. Yet public expenditure accounts for only 53% of total spending on health services, with private households and private companies contributing a further 47%

Jordan is not alone in trying to develop its medical tourism industry. Dubai, in 2002, launched an ambitious $2-billion Health Care City development, through which seeks to become a dominant player in the Middle East for research-based medical specialties, including cardiology and oncology. Though this development is in its early planning stages, Dubai's record in similarly ambitious development programs suggests it will become a formidable competitor in the near future. Lebanon has long been a destination for plastic surgery. Many countries, including the U.S. and the U.K., have tried to develop a medical services industry focused on the Middle East market, but have encountered problems of climate and culture. Certain very wealthy individuals may continue to visit their favorite doctors and clinics in London, New York or Houston, but there is a large unmet demand in the region for high-quality private medical services in a familiar Arab environment.

Since Dubai's Health Care City will certainly not suffer from the financial constraints facing the industry in Jordan, the growth of medical tourism in Jordan may depend to a substantial degree on improving the financial facilities, including leasing, available to the private health sector. Jordan will have to differentiate itself from Dubai. One clear way of doing so will be cost; however, Dubai is likely to attract significant numbers of Jordanian health professionals by offering higher salaries. Price competition is a persistent feature

of the private health care market, and this could increase further with the entry into the regional market of large new facilities in Dubai.

II. Objective

The objective of this consultancy is to help JIB develop a strategy for promoting FDI in the medical tourism sector, specifically with reference to competition from Dubai and the financial constraints facing the private health care sector in Jordan.

III. Specific Tasks of the Consultant(s)

A. Background Reading Required to Undertake this Consultancy

The Consultant(s) will read, without being limited to, the following documents.

1. AMIR 2.0 Report "Improving Jordan's Investment Promotion" (June 2002)
2. Investment Task Force Executive Summary and associated reports (January 2002)
3. AMIR 1 Report "Investor Promotion Strategic Plan" (June 1998)
4. AMIR 2.0 Report "A Sustainable Trade and Investment Strategy for Jordan" (May 2002)
5. Arafat, Abeer, *Sector Report: Health*, Jordan Export and Finance Bank, January 22, 2002
6. AMIR 2.0 Report "The 2002 Investor Roadmap of Jordan" (October 2002)
7. AMIR 2.0 Report "Jordan FDI Competitiveness Assessment and Investor Targeting Strategy"

B. Interviews Required to Undertake this Consultancy

The consultant(s) will interview,, without being limited to, the following people:

1. Ms. Reem Badran, Director General, Jordan Investment Board
2. Ms. Greta Boye, Team Leader, PSPI, AMIR Program
3. Mr. Brad Fusco, AMIR Program
4. Mr. Naseem Rahahla, Director of the Competitiveness Unit, Ministry of Planning
5. Mr. Jamal Al-Jabiri, USAID
6. Director, Al-Khalid Medical Center
7. Director of Licensing Department, Ministry of Health
8. Mr. Abeer Arafat, Jordan Export and Finance Bank
9. Director General, Jordan Tourism Board
10. Mr. Rami al-Qusus, Advisor, Ministry of Industry and Trade
11. Mr. Ibrahim Osta, AMIR Program
12. Mr. Vince Ruddy, Chief of Party, ATASP Program

C. Tasks Related to Achieving the Consultancy's Objectives

The Consultant will undertake the following tasks and produce the following deliverables:

1. Consult with the Ministry of Planning Competitiveness Unit, the Jordan Investment Board and the Jordan Tourism Board on current developments in the tourism and medical services sectors
2. Review literature and evaluate Jordan's future ability to remain cost-competitive in U.S. and European markets
3. Identify and evaluate any technical, market and financial feasibility studies conducted relative to Jordanian tourism and medical services
4. Assess any regulatory and legal constraints to licensing and operating private medical facilities and determine the extent to which private medical facilities can benefit from government investment incentives
5. Identify general tourism facilities of importance to medical tourism and highlight areas in which these may need to be improved
6. Review the financial constraints facing private medical facilities and identify potential domestic and foreign sources of funding and specific financial instruments, such as leasing, that could make the sector more competitive
7. Evaluate existing JIB and JTB programs for promoting FDI in the medical and tourism sectors. Review other countries' medical tourism promotion strategies, including Lebanon, South Africa and Brazil.
8. Produce, in consultation with JIB and JTB, a set of strategic guidelines and specific marketing plan for attracting FDI in the medical tourism sector over the next 24 to 60 months.

IV. Time frame for the Consultancy

Unless otherwise specified, the following time frame will govern the timing for the completion of this consultancy:

Consultant	Start	LOE	To Post	From Post	Field Work	3rd Country	U.S.A.

V. Level of Effort for This Consultancy

This consultancy will require the effort of the following consultants:

Consultant Name	Travel	Field	U.S.	3rd	Total

VI. Qualifications of Consultants

Scope of Work 5	**Pharmaceutical Sector**
Activity:	512 Investment and Export Development Research and Policy
SOW Title:	Foreign Direct Investment Promotion Strategy for the Pharmaceutical Cluster
Modification:	0
SOW Date:	March 28, 2002
SOW	Draft
Total LOE:	30 days

Task and Consultant: LOE/F/ Foreign Direct Investment Promotion Strategy for the Pharmaceutical Cluster
TBD

I. Specific Challenges Addressed by this Consultancy

The pharmaceuticals industry is important for Jordan. Though relatively small by world standards, it is considered competitive at least regionally. Jordan has a considerable comparative advantage in pharmaceuticals: its revealed comparative advantage – Jordan's share of total world pharmaceuticals exports divided by its share of total world exports of all commodities – is 5.87. This is far higher than for any of the other MENA countries. Jordan is the only net pharmaceutical exporter in the region, and its companies export between 70% and 90% of their output. Pharmaceuticals account for 12% of Jordan's manufacturing GDP.

In addition to a comparative advantage, Jordanian manufacturers have some competitive advantages relative to other countries in the region. Egypt and Israel are the other two major pharmaceuticals producers. The Israeli industry is focused to a large degree on biotechnology, though the largest Israeli producer concentrates ion high value-added generics. Its major export markets are in Europe and North America. Though Egypt's pharmaceutical industry is almost four times as large as Jordan's, Egyptian producers export only 6% of their output. Both the Egyptian and Jordanian pharmaceutical industries allocate a very small percentage of revenues to R&D – about 2%, compared to a developed-country average of 15% to 20%. Jordan does allow some favorable tax treatment of R&D expenditures, though this is decided on a non-transparent case-by-case basis. Jordan can immediately increase its competitive advantage over Egypt by allowing its companies to treat R&D expenditures as expenses in the year the cost is incurred, thus allowing for much more favorable tax treatment.

Jordan also has better intellectual property rights enforcement than Egypt. Though both countries have signed the TRIPS agreement, enforcement is far better in Jordan. A 2001 review of the Egyptian pharmaceutical industry cited lack of IPR enforcement as a significant barrier to FDI and, especially, to investment in R&D. The same review cited Jordan as the principal regional competitor for the Egyptian industry because it exports 40% of its production and because of its greater marketing prowess.

The 1998 ITS identified pharmaceuticals as one of the core industries in which Jordan should actively promote FDI. If anything, Jordan's potential in this sector has increased in the past five years. The world pharmaceutical market has increased from the $250 billion estimated in 1997 to an estimated $435 billion in 2003. UNIDO in 2000 estimated the MENA market at $5.6 billion annually, or about 1.7% of the world total. Egypt accounts for about 20% of total consumption, while the GCC countries, especially Saudi Arabia, account for much of the rest. The Saudi market alone is estimated at about $1 billion annually.

The MENA region has emerged as one of the fastest-growing regions in the world for pharmaceutical production, consumption and investment. Middle East pharmaceutical consumption grew at an annual rate of 10.6% from 1998 to 2002, compared to global market growth of 7.8%. The MENA market is expected to be among the fastest-growing for at least the next three to five years.

The regional pharmaceutical industry supplies a small fraction of the total demand, most of which is met by European and North American drug companies as well as low-cost producers from the Indian subcontinent.

The Jordanian pharmaceutical has always been outward-looking and has focused as much on exports outside the MENA region as it has on sales within the Middle East. Given the focus of the Jordanian industry on generic drug production, global industry and market trends appear to be improving opportunities for Jordanian manufacturers. The global market for generic drugs is expected to double over the next two years to nearly $35 billion, as several major drugs come off patent.

The Jordanian pharmaceutical industry has grown at an annual average of 15% over the past decade, and has confounded the predictions of many experts who forecast a contraction as a result of Jordan's accession to the WTO. Nevertheless, the industry faces important new challenges. Much of the industry's success in recent years has been due to a loophole in European Union policy, which has prohibited EU companies from undertaking R&D on product preparation on drugs that remain under patent. Jordanian companies, not subject to this restriction, have thus been able to conduct research aimed at manufacturing generic equivalents of drugs that will soon come off patent, which allows an earlier entry into EU markets on expiry of drug patents. This loophole is expected to be closed soon, thus eliminating a significant competitive advantage for Jordanian companies. At the same time, various non-tariff technical barriers imposed by major MENA markets (Saudi Arabia, Iraq and Algeria account for about three-fourths of Jordan's exports), and those countries' tendency to buy cheaper drugs from producers on the Indian subcontinent, will restrict opportunities for growth in exports to these markets. The continued growth of the Jordanian pharmaceutical industry therefore depends on expanding its presence in European and North American markets, by far the largest and richest, but also the most competitive, markets in the world.

The impressive growth of Jordan's pharmaceutical industry masks a great variation in the competitiveness of individual firms. Only two companies have accounted for the rapid growth in exports to Europe. Only four companies out of the 17 in the industry are large enough or sophisticated enough to compete internationally. This observation is confirmed by the announcement in November 2002 of the acquisition of Al Razi Pharmaceuticals by the Jordan Pharmaceuticals Manufacturing Company (JPM). Al Razi is a marginal participant in the industry with declining sales and mounting losses, while JPM is one of the four largest and most competitive companies.

In order to succeed in the changing global environment, the Jordanian pharmaceutical industry will need to become more competitive and move into higher value-added

production, where it will be less vulnerable to cheap bulk generics produced by Indian, Egyptian and East European companies.

Currently, most Jordanian pharmaceutical enterprises focus on the production of standard product categories, typically therapeutic drugs such as paracetamol, and standard antibiotics such as penicillin and amoxicillin, for which world demand is huge, but for which competition, both domestic and global, is intense and based mostly on price. Diversification in generic drug production could lead to increased exports, increased earnings, and a better ability to withstand increased international competition.

Desai's assessment of the Jordanian pharmaceutical industry recommended production of more specialized, high value-added, niche generic pharmaceuticals such as the injectibles, hormones, and cytotoxics. Reorienting production in this direction could help Jordanian manufacturers to become less dependent on bulk generics, to diversify their product portfolios, to enter niche markets in which price is not the main or only basis of competition, and could allow them to engage in more research-oriented work that would reduce their current dependence on imported chemicals. The Jordan pharmaceuticals enterprises can achieve this goal of diversifying the product portfolio through the following strategies:

This expansion into specialized, niche-focused, research-based, and high value-added products can be achieved, and the industry has undertaken initiatives to move in this direction. This kind of shift can also mitigate some of the negative effects of the lack of economies of scale prevalent in the industry in Jordan. In general, Jordan's pharmaceutical factories are considered too small to achieve minimum efficient manufacturing scale. In the U.S. and Europe, the average investment in a generic pharmaceutical plant is about $500 million. In Jordan, the average investment size is between $4.0 and $40 million. A move into higher added value niche products may reduce the need to construct massive generics plants, but it is clear that substantial fixed capital investment in R&D and production will be required.

The industry will need to attract multinational drug companies to manufacture in Jordan, under license or in joint venture with Jordanian companies, benefiting from the relatively low cost and high skills base of Jordanian scientists, chemists and engineers. This will require a focused campaign aimed at promoting Jordanian drug exports and at increasing contacts and business relationships with potential investors. Detailed investor research must be undertaken to identify the most promising potential investor targets. These may not be the largest U.S. and European drug companies, for which the total size of the Jordanian industry is insignificant, and which tend to move slowly and bureaucratically, but middle-tier companies with more of a niche market focus. Israeli companies may also be a potential investment target. The Israeli venture capital market devotes some 20% of its investment to biotechnology and health sciences. Teva, the largest Israeli pharmaceutical company, is primarily an export-oriented manufacturer of generics which competes on product quality and its ability to be first to market on drugs newly off patent by virtue of its superior R&D skills. There could be substantial potential for joint product development and production with such a company.

Further development of the pharmaceutical industry will contribute to, and will also require, improvement of plastics and packaging capacity in Jordan. The quality of packaging and labeling for Jordanian pharmaceuticals is mediocre, but the plastics, packaging and printing industries in Jordan are competitive and could upgrade the quality of their product, especially as growing demand from the cosmetics and food industries should increase demand for packaging and printing of all kinds.

II. Objective

The objective of this consultancy is to help JIB develop a strategy for promoting FDI in the pharmaceutical cluster, including not only in pharmaceutical companies and production themselves, but also in related industries that contribute importantly to the international competitiveness of the industry, including, for example, packaging.

The AMIR 2.0 Report on the Pharmaceutical Cluster identified several recommendations pertaining to Export and Investment Promotion, which it viewed as closely linked. These recommendations included:

Export Promotion Programs
Jordanian enterprises must strengthen export development activities. This is important from a cluster perspective for a number of reasons: increased exports will improve enterprise competitiveness by increasing extending production runs and bringing factories to minimum efficient scale (MES). The absence of MES in Jordan enterprises threatens the long-term sustainability of the cluster. The various programs described are lobbying Arab governments to remove technical barriers to trade, developing a coherent strategy to enter high growth markets in North America and Europe, improving market intelligence, undertaking matchmaking of firms, improving product dissemination, and ensuring due diligence of Jordanian products entering European North American markets to avoid litigation.
Investment Promotion Programs
Investment in Jordanian companies is critical from three reasons. First, increasing the minimum efficient scale of production runs; second, developing new product lines; three, strengthening entry into new markets in North America and Europe, thereby shifting dependence on Jordan's traditional markets. The various programs described are providing investment incentives to MNCs, undertaking detailed investor research, creating a public relations campaign targeted at MNCs, and attracting investment in support services.

Other areas identified as critical components of success in achieving export and investment growth were:

Strengthening Demand Base
Domestically, Jordanian-manufactured pharmaceuticals are not regarded as superior to imports. Local doctors are biased towards prescribing imported

medicine from companies with large R&D facilities, such as Pfizer and Merck. In addition, Jordanian law requires pharmacists to prescribe branded pharmaceuticals when a certain pharmaceutical product is specified, and the bias is thus skewed towards foreign products. Strengthening demand base does not mean providing preferential treatment to local products, but raising awareness of the quality of local products at the source – the prescribing entities. The proposals made in the report are mainly to develop a media campaign aimed at opinion leaders.

Strengthening Partnership with Local Government

As the pharmaceuticals cluster continues to grow, future issues are likely to arise that would require government participation in order to continue to successfully grow the pharmaceuticals enterprises. The proposals mentioned here are to strengthen government-industry coordination on main issues, participate in drafting directives, and the establishment of a public-private force to address cross cutting issues.

III. Specific Tasks of the Consultant(s)

A. Background Reading Required to Undertake this Consultancy

The Consultant(s) will read, without being limited to, the following documents.

1. AMIR 2.0 Report "Improving Jordan's Investment Promotion" (June 2002)
2. Investment Task Force Executive Summary and associated reports (January 2002)
3. AMIR 1 Report "Investor Promotion Strategic Plan" (June 1998)
4. AMIR 2.0 Report "A Sustainable Trade and Investment Strategy for Jordan" (May 2002)
5. Arafat, Abeer, *Sector Report: Health*, Jordan Export and Finance Bank, January 22, 2002
6. *The Egyptian Pharmaceutical Industry*, Business Studies Series, American Chamber of Commerce in Egypt, 2002
7. AMIR 2.0 Report "The Jordan Pharmaceutical Cluster: Analysis and Recommendations," July 2002
8. AMIR 2.0 Report "The 2002 Investor Roadmap of Jordan" (October 2002)
9. AMIR 2.0 Report "Jordan FDI Competitiveness Assessment and Investor Targeting Strategy"

B. Interviews Required to Undertake this Consultancy

The consultant(s) will interview,, without being limited to, the following people:

1. Ms. Reem Badran, Director General, Jordan Investment Board
2. Ms. Greta Boye, Team Leader, PSPI, AMIR Program
3. Mr. Brad Fusco, AMIR Program
4. Mr. Naseem Rahahla, Director of the Competitiveness Unit, Ministry of Planning
5. Mr. Jamal Al-Jabiri, USAID
6. Director, Al-Khalid Medical Center
7. Director of Licensing Department, Ministry of Health

8. Director, Drugs Directorate, Ministry of Health
9. Mr. Abeer Arafat, Jordan Export and Finance Bank
10. Director General, Jordan Tourism Board
11. Mr. Rami al-Qusus, Advisor, Ministry of Industry and Trade
12. Mr. Maher Matalka, Executive Director, Jordan Pharmaceuticals Manufacturing Association
13 Dr. Mohammed Al Atrash, General Manager, Arab Pharmaceuticals
14 Mr. Samir Mansour, PHARMA
15 Mr. Aref Al-Farra, Ministry of Industry and Trade
16 Dr Fatma Afifi, Dean of Pharmacy, Jordan University
17 Maisaa Al Saket, Ministry of Health

C. Tasks Related to Achieving the Consultancy's Objectives

The Consultant will undertake the following tasks and produce the following deliverables:

1. Consult with the Ministry of Planning Competitiveness Unit and the Jordan Investment Board on current developments in the pharmaceuticals sector
2. Review literature and evaluate Jordan's future ability to become and remain competitive in U.S. and European markets, and identify strategies to shift market focus away from traditional Arab markets and refocus on Europe and North America
3. Identify and evaluate any technical, market and financial feasibility studies conducted relative to Jordanian pharmaceutical cluster
4. Assess any regulatory and legal constraints pertaining to the pharmaceutical sector
5. Review the financial constraints facing the sector and identify potential domestic and foreign sources of funding and specific financial instruments, such as leasing, that could make the sector more competitive
6. Produce, in consultation with JIB and JTB, a set of strategic guidelines and specific marketing plan for attracting FDI in the pharmaceutical sector over the next 24 to 60 months. This will include:
    a. Strategy to remove trade barriers in Arab countries
    b. Development of niche areas ion foreign markets in which Jordan can be competitive
    c. Develop a plan for carrying out detailed investor research. The Jordanian pharmaceuticals enterprises will need to conduct in-depth and detailed investor research in order to find and to target those MNCs that would be best suited as investors
    d. Conducting analysis and preparing a campaign aimed at providing international pharmaceutical companies with a compelling set of reasons to invest in Jordan
    e. Conduct background research and specific market studies (to be commissioned separately) on markets and companies in North America and in Europe and identify specific targets for investors

f. Assisting JAPM to developing local company database (on brochure, CD and website) Commission market research studies (for the EU, Eastern Europe).
g. Helping JIB and/or JAPM to develop a database of potential investors
h. Identifying market intelligence information and databases that JAPM and/or JIB should purchase or to which they should subscribe (e.g., IMS Strategic Intelligence Data and Generic Planning (SIDGP) Software).
i. Identify and subscribe to market intelligence reports from specialized market research companies and commission, if necessary, specific market entry analysis
j. Identifying overseas professional and industry associations which Jordan may join as an associate member
k. Attend international industry conferences as another means of getting global market intelligence.
l. Plan participation in exploratory trade missions, exhibitions, and conferences
m. Assisting JIB and JAPM to commission a profile of the Jordanian industry in SCRIP or a similar publication to raise international awareness of Jordan's potential as an investment location

IV. Time frame for the Consultancy

Unless otherwise specified, the following time frame will govern the timing for the completion of this consultancy:

Consultant	Start	LOE	To Post	From Post	Field Work	3rd Country	U.S.A.

V. Level of Effort for This Consultancy

This consultancy will require the effort of the following consultants:

Consultant Name	Travel	Field	U.S.	3rd	Total

VI. Qualifications of Consultants