DISCUSSION PAPER

Overcoming Barriers to Foreign Direct Investment in Jordan

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Introduction

Jordan is classified by the UNCTAD investment benchmarking system as among the top twenty countries in the world in terms of attracting inflows of Foreign Direct Investment (FDI).[1] Supported by a successful privatization drive and a developed financial sector, Jordan has an almost fully liberalized trade system, no restrictions on the repatriation of capital and profit payments, a liberalized exchange regime, permitted full ownership of investment in most sectors, a moderate social and cultural climate,[2] an advanced infrastructure, and the highest rate of literacy in the region (UNDP, 2002, p. 151).

Fuelled by an accelerated privatization program and mounting real estate investments, foreign direct investment and other capital inflows have continued to pour into Jordan since 2004. Both inward FDI and portfolio investment inflows rose to record levels in 2005, reaching $1.7 billion (13 percent of GDP) in total (UNDP, 2002, p. 151). The Amman Stock Exchange (ASE) price index reached its zenith during 2005 with a 93 percent increase compared to the previous year. All of the ASE performance indicators for 2005 measured the highest levels recorded since the Amman Financial Market was established in 1978 (Amman Stock Exchange).

Flows of FDI to Jordan have been sporadic and, for the most part, externally or privatization driven, regional in origin, and focused on real estate investment. [3] In order to encourage inflows of FDI by way of improvements in the business environment and steadily enhanced national competitiveness, economic policies need to become more market friendly, encouraging entrepreneurship and the growth of the private sector. Policy failures and inconsistency among policies that affect FDI are the result of a non-existent formal economic vision or charter, frequent cabinet changes, and the lack of technical capacity in the public sector to evaluate the impact of economic policies.

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1 The author is indebted to Amela Karabegovic, Senior Research Economist at the Fraser Institute, for her valuable comments, suggestions, and improvements, and to three anonymous referees for their helpful comments.

2 Cultural and religious tolerance is best observed from the coexistence and representation of the various ethnic and religious groups in the government, legislature, and the private sector. Freedom of worship is encouraged and respected. Both Christian and Islamic religions are taught in public schools and the holidays of both religions such as Christmas, New Year, Break of the Fast Eid, the Eid of Sacrifice, and Hijra (Islamic New Year) are observed as public holidays.

3 Unlike neighboring post-socialist economies, Jordan did not have a significant concentration of nationalized industries to privatize. Nonetheless, it has made significant strides in privatizing the public utility companies and some of the mining companies. It does not have a clear policy on privatization (Capital Bank of Jordan, 2006, p. 9).

From 1921 to date, Jordan has witnessed 89 different government cabinets. None of the cabinets were elected. None have been appointed based on a declared economic or political platform or reform agenda. Furthermore, ministers are not necessarily appointed based on expertise or knowledge of the sector or the ministry they will head. These cabinets also undergo reshuffles during tenure; some ministers are quickly replaced, in some cases after only a few months in office. For example, since 2000, the Ministry of Industry and Trade has had nine consecutive ministers, with one minister appointed twice, and another whose tenure is less than five months. The Adnan Badran Cabinet, appointed in April 2005, was formed within half a day, remained in office until December 2005, and had one major reshuffle where several ministers were replaced.

With each cabinet reshuffle, a new interpretation by ministers and newly appointed staff of the unwritten national economic charter is undertaken. Policies are decided with no analysis as to the impact on the market because there are no government or private economic policy think-tanks to evaluate the consequences of government actions or to coordinate the interests of all economic sectors before issuing new policies.

There have been two concerted efforts in the past 8 years to create a unified national economic charter; both efforts have been officially sanctioned, however, neither has been implemented. The first attempt, *Jordan Vision 2020* (JV2020), a country-wide private sector initiative with representation from more than 27 business organizations, occurred in 1999. In partnership with the public sector, the participants were to formalize a long-range economic vision for Jordan that would double real per capita GDP by the year 2020 through the development of policies and procedures that would allow the private sector to expand and contribute a greater percentage to real GDP increases. JV2020 represented the first time that the private sector had involved itself in the planning of the macro economy; over the next 2 years participants put aside rent-seeking behaviors and, together with public sector officials, developed a document that was considered to be a workable program (for a copy of JV 2020, see http//www.JV2020.jo/pdf/jv-2020_e_new.pdf. For the implementation of the goals, see *JV2020.com*). In spite of the national hype and the formal recognition that the document received, both the JV2020 Phase I and the JV2020 Phase II, which was developed in 2006, remain outside the realm of implementation.

Another more recent attempt to draft a national charter for economic development and avoid the sporadic changes in policies by every new ministerial cabinet was through another national effort, the Jordan National Agenda, which was formulated in 2005 by stakeholders from the private and public sectors with the help and support of the government. The agenda was published in 2006. Just before its publication, the Badran Cabinet issued a statement saying that the agenda was non-binding and the Cabinet would treat it as another study. Consequently, the government selectively implemented few of the agenda's dictates.

The need for an economic charter or vision for the country does not imply that dirigiste actions should be promoted, nor that the JV2020 or the National Agenda are in any way reminiscent of the "plans" of centrally-planned economies. As was mentioned before, Jordan boasts a fully liberalized trade system, imposes very few restrictions on the repatriation of capital and profit payments, has a liberalized exchange regime, and permits full ownership of investment in most sectors.

In a country where over the past 15 years the government has changed ministerial cabinets and, therefore, policy on average every 10 months, some vision is needed to ensure a continuity of policy. Such continuity would stop the public sector changing policies overnight and enable the private sector to face less uncertainty regarding economic policy. In such a stable environment, a free market economy can flourish.

A stable business environment is a prerequisite for FDI inflows. Currently government expenditures account for 70 percent of GDP and 70 percent of all employees work for the government. Government influence cannot be ignored; the frequent changes of appointed ministerial cabinets must be countered by a stable economic charter or vision, the purpose of which is to promote a sound and healthy business environment based on free market economic principles. Among those principles is reduced government interference, reductions in the size and regulatory impediments arising from the frequent changing of the guard, and a reduction in the inherently paternalistic mindset vis-à-vis the private sector, so that FDI inflows can be not only attracted, but sustained.

To meet its development needs as first formalized in the *Jordan Vision 2020*, FDI inflows must become less dependent on regional events and more on the intrinsic strengths and attractiveness of the domestic business environment and economy (see *Jordan Vision 2020*). Jordan will have to significantly enhance inflows of FDI in a sustainable manner if it is to meet the goal of doubling per capita GDP from US$1,551 to US$3,102 by 2020.

When analyzing the FDI inflows to Jordan and the obstacles pertaining thereto, it is important to address and isolate the regional factors that have generated the ebbs and flows that characterize Jordanian FDI inflow patterns, particularly before 2002, the year Arab funds started to flow back into the region from the US and Western economies in the aftermath of September 11.[4] In doing so, the analysis focuses on the institutional impediments and subsequent necessary improvements required to create a more attractive climate to further attract and retain FDI inflows.

4 This point was clearly formulated during a presentation by the then Minister of Industry and Trade of Jordan, Ahmad Hindawi, to King Abdullah II in April 2005. The FDI inflows were shown to exhibit a sinusoidal pattern that was coincident with regional developments and upheavals. It is commonly agreed among policy makers in Jordan that the recent trend of rising FDI inflows (2003-2006) is a short-lived phenomena caused by adverse conditions in neighboring countries and rising oil prices.

The analysis is presented in four sections. The first section offers a view of FDI inflows[5]; the second assesses the barriers to FDI inflows; the third outlines solutions to overcome such difficulties; and the fourth puts forth the conclusions.

I. FDI Inflows into Jordan

According to *Jordan Vision 2020*, for nominal GDP to grow at 8 percent per annum, Jordan needs to attract over US$119.29 billion in investment over twenty years, or US$5.96 billion per year.[6] Jordan's performance relative to its potential in attracting FDI according to the United Nations Conference on Trade and Development (UNCTAD) ranking (the lower the rank the better the economy in terms of attracting FDI) is shown in figure 1.[7]

During the 1990s, Jordan's performance was below its potential. From 2000 to 2002, Jordan achieved above expectations in terms of attracting FDI but its performance in 2001 and 2002 was mainly a result of the September 11 attack, as stated earlier. This trend was short-lived however, as performance lagged behind potential in 2003 in response to expectations of a war in Iraq. As Jordan became the only viable outlet for Iraqi imports and reconstruction efforts and the home of nearly 700,000 displaced Iraqis in the aftermath of the Iraq War, FDI took off again and performance exceeded all expectations in 2004 and 2005. Regional events dictated the FDI inflows, in spite of the country's seemingly unchanged potential for attracting FDI.

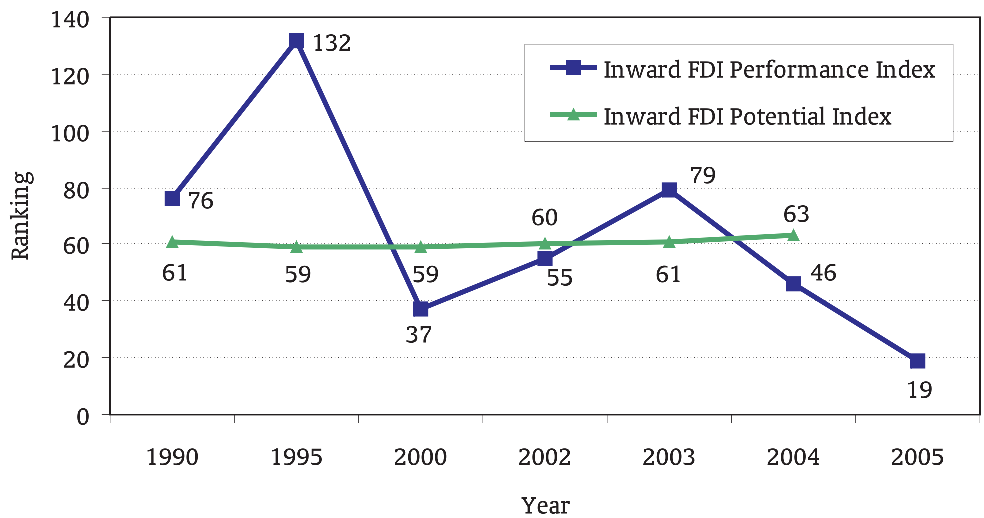
Most interestingly, even though by 1999 Jordan was well into its economic reform, it was not performing at potential in terms of FDI inflows. Most reforms focused on macroeconomic frameworks (stability of the Jordanian dinar, increasing foreign reserves, liberalizing trade, reducing foreign debt, streamlining the budget, and reducing the budget deficit), rather than microeconomic adjustments to directly enhance the productivity of labor, capital, and entrepreneurship. As a result, the climate necessary for fostering FDI did not emerge during the reform process.

5 The terms "FDI Inflows" and "Inward FDI" will be used interchangeably to enable consistency with the terminology used by some of the cited sources and indexes.

6 Presentation of Ahmad Hindawi, the then Minister of Industry and Trade, to King Abdullah II, April 2005.

7 The eight variables comprising the Inward FDI Potential Index are: GDP per capita, real GDP growth (for the past 10 years), exports as a percentage of GDP, number of telephone lines per 1,000 inhabitants, commercial energy use per capita, R&D expenditures as a percentage of gross national income, students in tertiary education as a percentage of total population, and country risk.

Figure 1: Inward FDI Performance and Inward FDI Potential Index Rankings for Jordan 1990-2005[a]



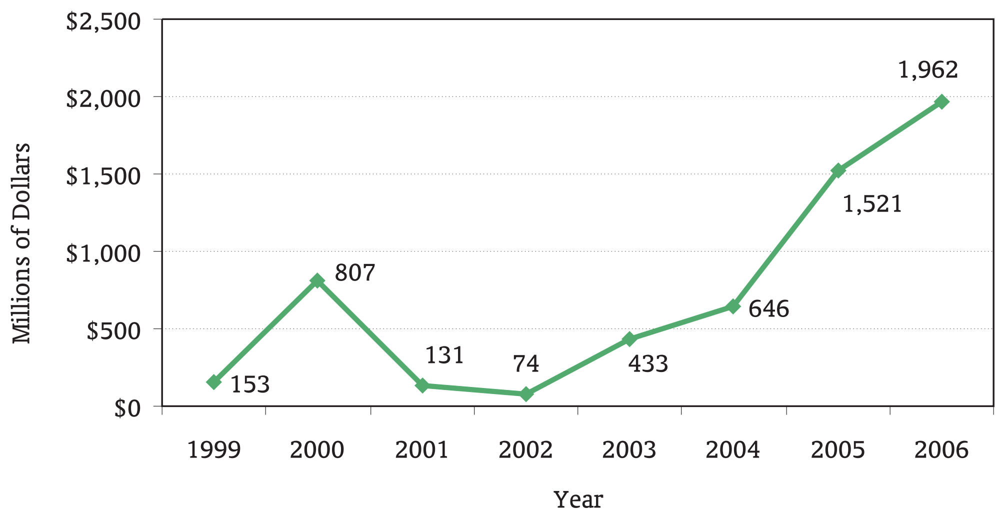
[a] = Three-year moving averages using data for the three previous years, including the year in question.
Source: United Nations Conference on Trade and Development, 2006.

For an FDI-friendly climate to emerge, sorely needed adjustments are required, such as better registration procedures for businesses—particularly limited liability companies; demand-driven training of labor and better training facilities; SME credit facilitation and overall improved access to finance; improved access to information and the unification of reference codes of databases; current information on sectors; the introduction of leasing; and competition and bankruptcy laws. In addition, enhanced education and curricula at schools and universities are required to encourage the development of an entrepreneurial mindset. Also desperately needed is the creation of institutional partnerships between the public and private sectors in the making of economic policy, and sophisticated infrastructure to encourage the growth of viable production clusters.

Other countries in the region, such as Tunisia, which have focused on microeconomic reforms in addition to macroeconomic stability since the 1980s (Escribano and Lorca, 2007), have consistently performed above their potential. Moreover, a comparison with several other countries in the Middle East and North Africa (MENA) region reveals that these countries have performed above Jordan in attracting FDI relative to their own potential (UNCTAD, 2006).

The inward flow of FDI since 1999 can be characterized as sinusoidal, as shown in figure 2 below. The privatization of Jordan Telecom and the resultant transfer of 40% of the shares of the government to a consortium led by France Telecom caused a peak in

Figure 2: Inward FDI Flows to Jordan, 1999-2006 (in $US million)



Source: Ministry of Industry and Trade, *www.mit.gov.jo*, Nov. 2006.

FDI followed by a trough in 2001 and 2002, followed by a steady increase in FDI since 2002. Moreover, the share of FDI has been on the rise both as a percentage of gross fixed capital formation and the GDP, placing Jordan in the top 20 countries in terms of the Inward FDI Index with a rank of 19 out of 141 countries in 2003-2005, up from a rank of 46 in 2002-2004, and a rank of 132 in 1993-1995 (UNCTAD, 2006).[8]

As noted earlier, beyond the privatization effort, regional events, namely, September 11 and the aftermath of the Iraq War, culminated in increased FDI flows into Jordan as Arab investors started moving some of their funds from the West into the moderate, politically stable regimes in the region. The rise in oil prices since 2003 accelerated the rate of FDI flows into Jordan from 2004 to 2006 as the oil economies of the Gulf sought investment opportunities both abroad and in the region.

One can conclude that in the unlikely event that the same privatization exercise can be repeated and given a return to normalcy in the region, FDI inflows, being not internally but externally driven, would most likely decline in coming years. Already there are indications that the liquidity hiatus enjoyed in 2004 and 2005 has ebbed; real estate prices are teetering and the stock market bubble, which culminated in an almost doubling of the average stock price toward the end of 2005, decreased by 33% in 2006 (Amman Stock Exchange at *www.ase.com.jo*).

8 The Inward FDI Performance Index ranks countries by the FDI inflows relative to their economic size.

II. An Assessment of the Barriers to FDI Inflows

The typical view of obstacles to attracting and retaining FDI inflows in developing countries focuses on risk factors such as infrastructure, arbitrary taxation and regulatory systems, exchange and capital control policies, and cultural differences, all of which restrict the operations of multi-national corporations (MNCs) (see, for example, Brewer, 1993; Kobrin, 1979; Thomas and Worrall, 1994; McCarthy, Puffer, and Simmonds, 1993; Schlegmilch, Diamantopoulos, and Petersen 1991). Consequently, MNCs resort to joint ventures as a means to reduce transaction and uncertainty costs when desiring entry into a developing country, usually resorting to ventures that do not involve the introduction of best products, production, and marketing and distribution systems and processes (see, for example, Inkpen and Beamish, 1997; and Smarzynska and Wei, 2001). Thus, failure to attract MNCs can be gauged as a failure to attract high value-added FDI—there are no MNCs operating solely in Jordan.

Current literature and indices, such as the *Doing Business* report (World Bank, 2006), the *Global Competitiveness Report* (Lopez-Claros, Porter, and Schwab, 2005), and the *Economic Freedom of the World Report* (Gwartney, and Lawson, 2006), offer measures of institutional factors that facilitate both the growth of domestic business and entrepreneurship, and the factors that attract FDI. These measures become paramount for economies that are typically small, such as Jordan, which possesses scarce and limited endowments of natural resources vis-à-vis other countries in the region, particularly the oil rich countries of the Gulf.

Notwithstanding the positive attributes of the Jordanian economy, flows of FDI have been sporadic as shown earlier and, on the main, are externally or privatization driven, regional in origin, and focused on real estate types of investment. Additionally, over 70% of all employees are employed by the public sector with approximately 200,000 Jordanians (close to one-fifth of the Jordanian labor force) working in the Gulf (Government of Jordan, 2006). Moreover, foreign investors voice complaints of high transaction costs and procedural impediments (see El Said and McDonald, 2002; Loewe *et al.*, 2006; and Al Rai Newspaper, 2006).

The goal of the JV2020 to attract over US$119.29 billion in investment over twenty years, or US$5.96 billion per year, given the institutional impediments to creating greater and steadier inflows of FDI that are high value-added by MNCs, becomes a tall order when considering the current status of doing business in Jordan. According to the World Bank report *Doing Business 2006*, Jordan ranked worse in the 2006 report than in 2005, as shown in table 1.

Doing Business 2006 provides rankings for many countries in terms of the ease of doing business, especially for small- and medium-sized domestic firms, in ten catego-

Table 1: Doing Business in Jordan

Item	2006 Report Rank (out of 155 countries)	2005 Report Rank (out of 135 countries)*	Change in Rank
Ease of Doing Business Rank (overall rank)	78	73	-5
Starting a Business	133	127	-6
Dealing with Licenses	70	68	-2
Employing Workers	30	30	0
Registering Property	110	110	0
Getting Credit	83	76	-7
Protecting Investors	118	114	-4
Paying Taxes	18	16	-2
Trading across Borders	78	85	7
Enforcing Contracts	75	72	-3
Closing a Business	84	79	-5

*Note: 2005 rankings have been recalculated to reflect changes to the 2006 methodology and the addition of 20 new countries. The higher the ranking, the worse off the economy in terms of facilitating for business development.
Source: World Bank, *Doing Business 2006.*

ries, with a rank of 1 being the best. (See Appendix 1 for a detailed explanation of each of the *Doing Business 2006* categories.)

The only area of improvement for Jordan was in the "Trading across Borders" category (up by 7 places to 85 from 78), attributable to the macroeconomic reforms undertaken in Jordan and the resultant growth. According to the report, Jordan fell back from 73rd in 2005 to 78th in 2006. The categories in which Jordan fared worse than the previous year were:

- Starting a Business (down from 127 to 133),
- Dealing with Licenses (down from 68 to 70),
- Getting Credit (down from 76 to 83),
- Protecting Investors (down from 114 to 118),
- Paying Taxes (down from 16 to 18),
- Enforcing Contracts (down from 72 to 75), and
- Closing a Business (down from 79 to 84).

Among the Arab countries, Jordan is ranked fifth overall behind Saudi Arabia (ranked 38th), Kuwait (ranked 46th), Oman (ranked 55th), and the UAE (ranked 77th). Moreover, Jordan significantly lags countries that it had expressed a desire to emulate over the past decade, such as Singapore (ranked 1st) and Ireland (ranked 10th). Thus, Jordan remains behind the benchmarks overall.

Table 2: Starting a Business in Jordan, the Region, and the OECD

Indicator	Jordan	Region	OECD
Procedures (number)	11	10.3	6.2
Time (days)	18	40.9	16.6
Cost (% of income per capita)	73	74.5	5.3
Minimum capital (% of income per capita)	864.4	744.5	36.1

Source: World Bank, *Doing Business 2006*.

As shown in table 2, Jordan is behind the region and the OECD countries in the Starting a Business category. Furthermore, entrepreneurs in Jordan can expect to spend an average of 18 days going through 11 steps to start a business, at a cost equal to 73.0% of the gross national income (GNI) per capita, or US$1,500. Also, they must deposit at least 864.4% of GNI per capita, or US$20,000, in a bank to obtain a business registration number.[9]

It is worth noting that non-tax revenues (stamps and fees) form a large share of government domestic revenues, a weakness which adds, in an opaque manner, to the tax burden of producers and consumers. In the first six months of 2006, the government non-tax revenue was US$726 million, almost 30 percent of its total domestic revenues, compared to US$1,066 million for the whole of 2005 (Central Bank of Jordan, 2006).

The steps, time, and costs of complying with licensing and permit requirements are shown in table 3.[10] It takes 16 steps and 122 days to complete the process, and costs 503.2% of income per capita, which is more than seven times the cost in OECD countries, and slightly higher than the average for the region. In terms of the number of procedures and the time it takes to secure licenses and permits, Jordan fares well in comparison to the region, and comes close to the OECD averages.

Another important ranking for Jordan is its standing among 117 major and emerging economies in the World Economic Forum's *Global Competitiveness Report (GCR) 2005-6* (Lopez-Claros, Porter, and Schwab, 2005). The report provides a comprehensive assessment of the strengths and weaknesses of national economies underpinned by the com-

9 According to the Jordanian Companies Law, there is a minimum capital requirement of US$45,000, which is more that 22 times the average per capita income, to start up a limited liability company. Registration fees include: US$270 paid to the Company Controller Department, US$550 in municipality fees (annual), and US$200 to register with the Jordan Chamber of Commerce (annual). In addition, these companies are required by law to be audited annually at a minimum fee of US$1,000 per year.

10 Measures relate to the friction costs of building a warehouse, including the costs of obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections.

Table 3: Dealing with Licenses

Indicator	Jordan	Region	OECD
Procedures (number)	16	19.9	14
Time (days)	122	206.9	149.5
Cost (% of income per capita)	503.2	499.9	72

Source: World Bank, *Doing Business 2006.*

petitiveness paradigm elaborated by Michael Porter (1998a, 1998b, and other numerous writings).

The GCR, which combines publicly available data with survey data from business people in various countries, identifies obstacles to growth and includes a detailed profile of each of the economies highlighted in the study, as well as providing a section containing data tables of global rankings which cover over 100 indicators, such as the Global Competitive Index. Unlike the *Doing Business* report, the GCR combines both macroeconomic and microeconomic data and utilizes surveys, rather than determining actual hurdles to establishing and operating a business based on some unified unit such as a warehouse or a limited liability company.

Jordan's rank in the *Global Competitiveness Report* has fallen from the 35th most competitive country in the 2004-5 report to the 45th most competitive in the 2005-6 report, as shown in table 4.[11]

Jordan's Growth Competitiveness Index (GCI), which measures a country's ability to create sustainable economic growth (macroeconomic environment, public institutions, and technology), fell from 34 in 2003 to 45 in 2005 because of the deterioration of the macroeconomic business environment: savings decreased, the current deficit increased, and inflation rose. The Business Competitiveness Index, which measures the development of the micro economy in terms of the national business environment and sophistication of company operations, also slipped, albeit not as drastically. It fell from a low rank of 41 in 2003 to 43 in 2005 as a result of decreased transparency in decisions made by boards of directors of companies located in Jordan. Also, businesses (the majority of which are family businesses) were rated low at a rank of 93 in terms of providing incentives to workers, and 83 in regards to the utilization of high quality management. On a positive note, according to the *Global Competitiveness Report (GCR) 2005-6*, Jordan is among the best in the world in terms of security effectiveness (ranked 9th), the protection of business property (ranked 10th) and the availability of scientists and engineers (ranked 14th).

11 See Appendix 2 for an explanation of the major indices of the GCR.

Table 4: The Rank of Jordan according to the Growth Competitiveness Index (GCI) and the Business Competitiveness Index (BCI) for the years 2003, 2004, and 2005

Index	Global Competitiveness Report 2003	Global Competitiveness Report 2004	Global Competitiveness Report 2005
Growth Competitiveness Index	34	35	45
Business Competitiveness Index	41	41	43

Source: Lopez-Claros, Porter, and Schwab, 2005.

Note, however, that the *GCR 2006* report witnessed an expansion in the number of ranked countries from 104 to 117 with the entry of 15 new countries and the exit of two (Angola and Zambia). The most prominent of the new entrants were Qatar and Kuwait which ranked at 19th and 33rd, respectively, in the Global Competitiveness Index.

Overall, the economies of Middle Eastern countries witnessed a fallback in their ranks last year from the previous year. Tunisia was the exception, ranked at 40th in 2005 compared to its rank of 42nd in the 2004 report. The comparison is presented in table 5.

As can be seen in table 5, Jordan ranked 6th in terms of the Global Competitiveness Index among the nine Arab countries evaluated in the *GCR 2006*, with UAE ranked first at (18th), followed by Qatar (19th), Kuwait (33rd), Bahrain (37th), Tunisia (40th), Egypt (53rd), Morocco (76th), and Algeria (77th). In *GCR 2005/06*, only seven Arab countries participated in the survey and Jordan ranked third after UAE (16th) and Bahrain (28th), ahead of Tunisia, Egypt, Morocco, and Algeria.

In both the *Doing Business Report* and *Global Competitiveness Report* rankings, Jordan performed better than the median rank, which places it in the upper 50 percent of countries worldwide. However, being ranked in the middle may be a difficult position in which to be: there is not the same urgency to improve as would exist if a country is ranked in the lower 50 percent. In other words, Jordan has to remove domestic barriers to productivity growth, and not become stuck in the middle among nations.[12] Furthermore, large economies such as China and India, enjoying large market size and great growth potential, can easily attract FDI inflows, as noted over the last several years. Their ability to attract FDI was not due to the low cost of entry, but rather due to the size of the reward. Given Jordan's scarce natural resources and relatively small market size, it should aspire and work toward becoming ranked at least among those in the top quartile in the world.

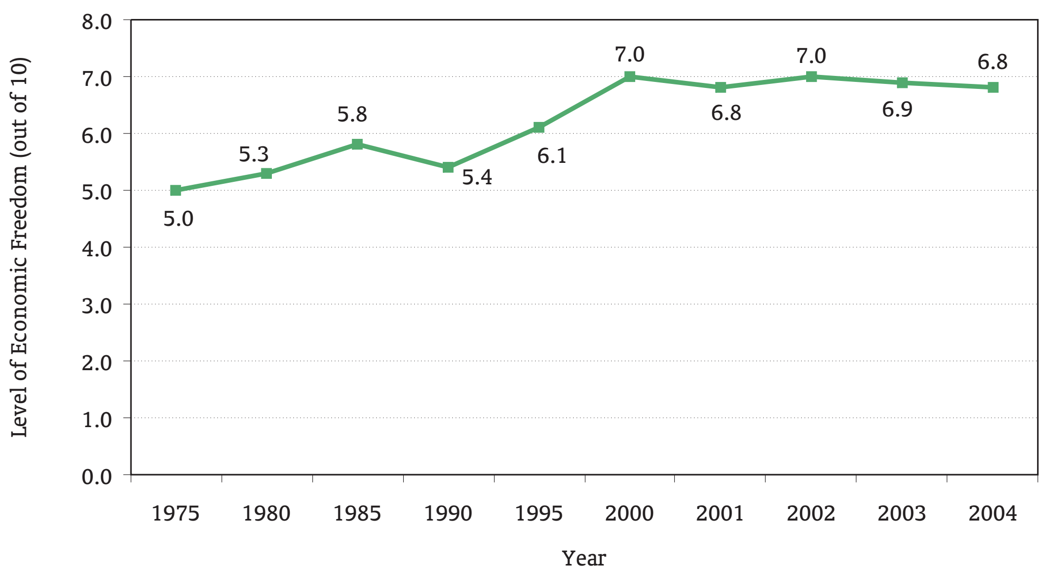
12 See, for example, the prescription given in Bruno Pietracci, Maria Joao Carioca, and Rui Pires Diniz, "Making Portugal Competitive," *The McKinsey Quarterly*, 2004, no. 3.

Table 5: Competitive Ranks of Arab Countries according to the Global Competitiveness Index of 2004 and 2005

Index	UAE	Qatar	Kuwait	Bahrain	Tunisia	Jordan	Egypt	Morocco	Algeria
Global Competitiveness Index (2005)—117 nations	18	19	33	37	40	42	53	76	77
Global Competitiveness Index (2004)—104 nations	16	n/a	n/a	28	42	35	62	56	71

Source: Lopez-Claros, Porter, and Schwab, 2005.

Figure 3: Level of Economic Freedom in Jordan (out of 10)



Source: *Economic Freedom of the World: 2006 Annual Report*, The Fraser Institute.

Another ranking, the *Economic Freedom of the World Annual Report*, shows that since 2001, Jordan has consistently scored well in terms of economic freedom with the index fluctuating slightly between 7.0 and 6.8 (the higher the index, the greater the economic freedom enjoyed by the economy) as shown in figure 3 (Gwartney and Lawson, 2006). Recent moves by the government to institute price controls, and the growing government size in terms of increased government consumption as a percentage of the GDP will most likely lower Jordan's rating when the index is calculated for upcoming

The *Economic Freedom of the World Annual Report* is a publication of the Fraser Institute in cooperation with members of the Economic Freedom Network (public policy institutes from around the world). The report, in which the Economic Freedom of the World (EFW) index is published, measures and ranks countries according to the degree of economic freedom present in five major areas:

1. **Size of government (expenditures, taxes, and enterprises)**
2. **Legal structure and security of property rights**
3. **Access to sound money**
4. **Freedom to trade internationally**
5. **Regulation of credit, labor, and business**

Within these areas, 21 components are incorporated into the overall index. Many of the components are themselves made up of several sub-components.

editions. Overall, the Economic Freedom of the World index seems consistent with the findings of the *Doing Business Report* and the *GCR 2005-06*.

In all the reports cited in this study, improvements created through concerted internal efforts have tended to be insignificant in relation to their impact on FDI inflows. This indicates that inflows of FDI have been motivated less by local factors than by regional factors, for example, the consideration of Jordan as a safer and more secure country relative to most of the countries in the region, and Jordan's relatively high level of enforcement of both property rights and the rule of law. The country's challenge is to create an internally-driven motivation, beyond security and safety, to attract FDI to the productive sector in order to gain the full benefit from the openness of the Jordanian economy and its trade liberalizing agreements.

Experience shows that the best way to attract FDI and receive its resultant benefits is not through passive liberalization alone, which while helpful in increasing inflows of FDI, is not sufficient to gain the most benefit for the national/host economies (see, for example, United Nations Conference on Trade and Development, 2003). Attracting types of FDI that offer greater potential for the benefit of Jordan, such as FDI in technological advancement, job creation, high value-added, or export oriented activities, is more demanding than just liberalizing FDI entry and operations.[13]

Only by creating an environment which encourages the growth of entrepreneurship and enterprises, will Jordan be able to compete in a sustainable manner with the large economies in the region which by their shear size are able to attract more FDI, *ceteris paribus*.

13 *Economic Freedom of the World 2006 Annual Report* makes an excellent argument for measuring the percentage of manufacturing exports as a percentage of exports as an indicator of development.

III. Removing Obstacles to FDI Inflows

Investors must be assured that decisions regarding investment incentives and procedures are conducted in a fair and transparent manner. Equally importantly, there must be a balance between the need to modernize policies, laws, and procedures, and the need to maintain a stable legislative environment. Entrepreneurial planning horizons should not be subjected to frequent policy reversals by appointed officials. Unless there are real sustainable partnerships between the public and private sectors, policies and procedures may be untimely, irrelevant, and cumbersome in terms of their implementation and impact (for elaboration, see Petkoski, Jarvis, and de la Garza, 2006).

Long term planning requires modernity, stability, and inclusion. This view was espoused by the Investment Task Force formed by King Abdullah II in 1999, comprising members of the private sector who came together as associations, lobby groups, and consultative committees to work with government on policy issues, and to play a constructive, not a rent-seeking role (Shafik, 1997).

The findings of the Investment Task Force suggested the following measures be implemented in order to improve the business environment and attract FDI: restructure the investment incentive scheme; restructurd the tax structure to narrow tax bands and unify and lower taxes; overhaul the institutional structure and set up of the organizations tasked with encouraging investment; and improving the legislative environment affecting the ease of doing business. The task force's findings were not acted upon at the time, but were used as a cornerstone of the investment component of the Jordan National Agenda, which was intended to be a vision for the economy for the coming decade (*Jordan National Agenda 2006-2015*).

The ultimate goal of these proposals is not to lead to greater involvement of the government in the economy, but rather the contrary—to work toward a more liberal free market economy that does not suffer from policy failures resulting from hap-hazard, ill-studied measures that restrict the growth of Jordanian enterprises and entrepreneurship. A continual discourse and feedback is necessary for a partnership between the private and public sectors to work. Furthermore, improvement should be measured against specific benchmarks and compared to the experiences and global best practices that worked.

A danger arises with private-public sector partnerships, which needs to be monitored and counterbalanced by collaboration with civil society. There is already a great fear in the region, and Jordan is no exception, that when the public and private sectors cooperate, crony capitalism will emerge, and the public will lose in the end.

Already, several governments in the region have become used to the idea of sharing power with the private sector because they realize that they need the private sector

"… the policy improvements and new investment laws undertaken by MENA countries are not sufficiently 'credible'… Governments that are monolithic in structure, e.g., with rulers who appoint members of the legislature and the judiciary, are unlikely to have credible policies… because nothing can prevent such rulers from quickly canceling the decrees that ushered in the reforms or new rulers from arising to replace the old ones and to issue new, reform-reversing decrees."

—Jeffrey Nugent (2001), *Explaining the Paradox: Generous Foreign Investment Laws but Little Foreign Investment in Arab Countries—The Role of Legal Shortcomings*, University of Southern California.

if they want to achieve economic growth. However, governments are still reluctant to involve civil society in the policy making process.

It is in everyone's interest to ensure that non-governmental organizations, trade unions, universities, consumer associations, and the media are brought into the discussion about public policy in a true sense of partnership. If they are left out, the relationship becomes unstable; one element will inevitably be stronger than the other, and consequently, development will be hampered and forestalled (Shafik, 1997).

The following are detailed proposals for improving FDI inflows into Jordan with the goal of ensuring that the FDI inflow trends become sustainable. The underlying premise of these proposals is that when policy is formulated, the policy design should be inclusive and consistent with national aspirations. In the absence of think tanks and long serving elected cabinets, some form of partnership with the private sector and its representatives should be formed, whereby the public sector lends its expertise and resources to the design and implementation of policy. Of course, the public sector is the final arbiter and executor of policies; however, it is thus better informed.

1. Implement the investment-related recommendations of the Jordan National Agenda

Bolstered by two earlier initiatives, the National Charter and Jordan First, and to counter the frequent changes of the executive branch of government—which often led to delays in the implementation of policies—Jordan launched the Jordan National Agenda (JNA) initiative in February 2005 to set national guidelines for the public sector to follow.[14]

As per the *Deepening Investment* component of the JNA, the following recommendations should be implemented:

- create sustainable partnerships between the private and public sector;
- harmonize the efforts of the four main bodies that deal with investment and investment promotion;

14 The JNA was published in 2006 in 10 volumes, the largest of which, *Deepening Investment*, occupied 553 pages, almost half of the whole agenda.

- establish a think-tank for policy analysis on trade, investment, and industry; and
- set up a Jordanian Competitiveness Observatory

In *Deepening Investment*, the JNA proposed to speedily empower the creation of the Jordan Agency for Enterprise and Investment Development (JAED), a body intended to be the quintessence of the best practices of Singapore, Ireland, and Costa Rica in attracting foreign direct investment, separating economic policy from execution, and monitoring performance and competitiveness.[15]

Furthermore, there is a dire need for Jordan to implement the complete body of policy and recommendations put forth in the JNA. Otherwise, the development framework, particularly in relation to the economy, will remain informal.

2. Establish the Jordan Agency for Enterprise and Investment Development (JAED)

This report recommends that the Jordanian government fully fund and establish JAED[16], a small government organization whose size is not to exceed 10 professionals. The organization's funding will be generated from the savings that will accrue from revamping the existing organizations. JAED is to assume a role in promoting a better business environment for Jordanian enterprises. The original concept of JAED was that it was to be modeled after the Irish agency Forfas, with some minor modifications to suit the Jordanian legislative structure. It is to perform the following:

- Synergize and better coordinate the efforts of the Jordan Investment Board (JIB), the organization tasked with investment promotion; the Jordan Industrial Estates Corporation (JIEC), in charge of industrial estates; the Jordan Agency for Enterprise Development (JEDCO), in charge of enterprise development and promotion; and the Free Estates Corporation. All these organizations, albeit government and answerable to line-ministers, behave independently of each other without a cohesive vision or strategy and exhibit little cooperation in terms of sharing knowledge and resources. With the implementation of JAED, many functions that are currently duplicated will be placed in one organization. With the realized synergies, overall downsizing of bureaucracy and better efficiency in the use of existing resources will occur.
- Establish a Competitiveness Observatory headed by an advisory board from the private sector with JAED acting as its executive arm. The observatory, a small unit within JAED, will gauge the competitiveness of the economy and publish policy analyses and reviews on hurdles, setbacks, and bottlenecks to competi-

15 At the time of writing, the JNA remains a document that is neither adopted nor implemented.

16 JAED had already been decreed by law number 71 for the year 2003 (see the *Official Gazette*, June 16, 2003).

tiveness. Detailed remedies covering all sectors are suggested annually to reduce the competitiveness gap. Thus, JAED would act as a policy think-tank to encourage competitiveness.

- Monitor the performance of all the above-mentioned organizations and suggest budget allocations based on desired goals and agreed annual plans
- Provide studies and research to the Minister of Industry and Trade, the subject organizations, and serve as a think-tank for the government regarding economic policy
- Publish an annual report, *Jordan Enterprise*, delineating policies, regulations and outlook on all issues related to the enterprise. The analysis is to cover industry, trade, and investment policies and regulations in order to facilitate frameworks that promote Jordanian enterprises. The publication is to be conducted under the supervision of a steering committee composed of representatives of the private sector and approved by the Minister of Industry and Trade.

On the institutional side, JAED will fill a necessary role required for maximizing FDI inflows and the benefits from FDI. The legislative and administrative frameworks of the relevant organizations were to be revamped under JAED to facilitate this goal. At the time of writing, the organization is yet to be properly established and funded, and the individual organizations themselves remain unchanged.

Civil society, the missing component in the recommendations of the JNA *vis à vis* JAED, must become involved in making and operating JAED through the Board of Directors. If that does not happen, there will be a fear that private sector representatives will attempt to garner private rent from policy prescriptions. Furthermore, since there is no other government policy think-tank, Jordan would do well to link JAED directly to the prime minister's office, which currently has limited capacity to analyze economic policy; the office currently relies on a part-time economic adviser and the abilities of individual ministers to explain their initiatives. Further, such a link would avoid the problem of changing ministers of industry and trade curtailing recommendations on a whim, and would give JAED better access to economic data and issues, especially when such files are not within the Ministry of Industry and Trade. JAED would be better able to serve the economy as the policy think tank of government.

3. Revamp investment incentives

Another area that needs to be revamped, but which goes beyond the recommendations of the JNA, is the investment incentive scheme, which is tied to the granting of tax holidays and reductions for investors. The current investment incentive scheme has been viewed as cumbersome to both investor and the Jordan Investment Board (JIB). Investors must apply for tax holidays and reductions, which vary according to the area in which the project is located. The Investment Incentives Committee, headed by the CEO of JAED, and composed of the heads of the Customs and Income Tax departments, in addition to the CEOs of JIB, JEDCO, and a representative from the private sector selected by the Minister of Industry and Trade, was to meet on a regular basis to decide on each applicant's tax incentives.[17] The committee's recommendations were to be approved by both the Minister of Finance and the Minister of Industry and Trade.

The committee met infrequently, and the approvals that were to follow its recommendations were not automatic. Moreover, the committee's recommendations were not upheld if either of the Customs or Income Tax CEO disapproved of the tax reduction or holiday grant, even when voted for by the majority of the committee. In addition, lack of clarity in some of the definitions in the Investment Promotion Law led to discretionary powers being granted to committee members, as well as subjective interpretations of the law, which tended to vary from one investment to another.

Concomitantly, disparities were being created between new and old investors. Since a basic definition of "investor" did not exist, the tendency was to discriminate against domestic investors in favor of foreign investors, regardless of the size of the investment. JIB employees, instead of acting as promoters of investment, became *de facto* auditors and monitors of investors, conducting site visits to investor locations to ensure that the equipment that was granted the incentive was used for that project and not sold to other ventures to benefit from the customs and tax breaks.

The solution to the bias against domestic investors is to lower taxes and customs rates across the board and reduce the complexity of the customs and tax codes so that tax incentives become unnecessary. However, restructuring Jordan's currently cumbersome investment incentive scheme should be viewed, from a policy perspective, as the very first step towards creating a more desirable tax environment for capital investment in Jordan. Unfortunately, in spite of changes to the Investment Promotion Law in 1984, 1987, 1988, 1995, 2000, 2003, and most recently in a failed attempt in 2006, the incentives remain inadequate.[18]

The representation of the private sector in the Investment Incentives Committee is based upon the recommendations of the Minister of Industry and Trade. However, the appointment process should be changed to include representatives of the trade, industry, and investment associations. Otherwise, with the frequent changes of ministers,

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17 Since there is no CEO of JAED, an acting Chairman of the Investment Incentives Committee was appointed in 2005 by the then Minister of Industry and Trade. In 2006, the new Minister of Industry and Trade, in a desire to help create JAED, appointed the CEO of JIB as acting CEO of JAED. In February 2007, a new Minister of Industry and Trade appointed a new CEO of JAED who resigned a month later, which led the Minister to appoint a new acting CEO of JAED.

18 The Jordanian Parliament rejected the government's proposed income tax law, which increased taxes on industry and, with it, the Draft Investment Promotion Law, which nullified the income tax and sales tax incentives, without suggesting a more effective type of incentive.

and the selection of representatives based on personal contacts, the door is open for cronyism and personal gain.

4. Streamline procedures

In Jordan, laws, usually drafted with the assistance of world class experts benchmarking international best practice, are presented for discussion in Parliament. These laws are implemented through by-laws that are only discussed at the Council of Ministers, and not in Parliament. Since the Council of Ministers does not have a policy analysis body, the prime minister relies on the concerned minister to explain the by-law and defend it. The quality of the outcome depends to a great extent on the minister's own abilities and level of involvement in the by-law.

The ministry in charge, and as it sees fit, may produce guidelines or regulations to further delineate and implement the laws and by-laws. The quality of legislation suffers drastically as the discussion is maintained within the ministry itself, and thus tailored to suit the agenda of the executives therein. Consequently, some ministries publish regulations that best suit their staff and often do not coordinate their efforts with those of other ministries. The impact of the regulations is to weaken the effectiveness of the law and the desired improvement, resulting in less than optimal procedures or solutions that are not globally coherent.

With the absence of an institutional voice for the private sector, and the lack of a think-tank such as an effective JAED to monitor the impact of policy on enterprise in general, policy and procedural failures only emerge after the procedure is enacted, causing harm and delay to stakeholders.[19] The private sector then reacts, and as a consequence, efforts are put in place to change the procedures, which incurs substantial transaction costs with little success.

Again, the establishment of JAED would ensure that all regulations and procedures were revised, and would ensure that procedures that relate to enterprises would be properly evaluated prior to their finalization. Jordan's greatest weakness in terms of enterprise development and, consequently, both FDI and DDI, lies in inefficient use of bureaucratic resources and time-consuming procedures.

19 One of the primary tasks of JAED would be to provide expertise in analyzing policies that affect Jordanian enterprises and advise the Minister of Industry, and upon request, the Prime Minister, on issues of competitiveness and enterprise-related policies.

5. Properly promote investment at home and abroad

Promoting Jordan as a country distinct from others in the region is necessary and important. In the eyes of foreign investors, Jordan needs to distinguish itself as an oasis of security, separate from the rest of the region, which is usually troubled by conflict and turmoil.[20] This is necessary if Jordan is to diversify its investment base from its primary on Arab investors who, through their proximity, joint heritage, and cultural commonalities, are already aware of this distinction.

Once Jordan has improved its business environment to encourage the emergence and growth of Jordanian enterprises unhampered by obstacles and red tape, the country will then need a sound investment promotion policy and well-funded implementation mechanisms and activities. Currently, each of the four concerned investment organizations promotes investment at home and abroad independently and separately from the others. Given the lack of resources of some of these organizations, promotion efforts lack the proper targeting and are limited to presentations to generic crowds or *ad hoc* assemblies by the CEOs of the organizations. Both the literature and quality of the promotional material suffer from poor data quality and poor presentation. Jordan is yet to send one targeted mission to a multi-national corporation to invite it to participate in an investment opportunity in Jordan. The impact, if any, of the existing promotional efforts is rarely measured to gauge their effectiveness or to lobby the Treasury for proper funding levels.

Joint, well-coordinated efforts combining the resources of organizations that have surplus funds, such as the Free Zones Corporation and the Jordan Industrial Estates Corporation, and others that have inadequate funds, such as JIB and JEDCO, would create synergies without allocating additional funds to these promotional efforts. Further, there is a need to create a mindset at home for more receptiveness of FDI as a means to secure a better future for Jordan. A promotional campaign would be a first step in the right direction in this regard. Teaching entrepreneurship within university curricula would be another; only one university offers entrepreneurship in its curriculum. Encouraging specialized centers within universities will help the growth of entrepreneurs and encourage more hiring of business degree graduates from Jordanian universities.

20 During a recent visit to Jordan, Singapore's President S.R. Natham reiterated the need for Jordan to distinguish itself from the rest of the region (*Jordan Times*, November 19, 2006).

IV. Conclusions

Jordan has performed well in recent years in terms of attracting FDI, which makes the suggestion that improvements are necessary seem frivolous. However, an investigation into the history of FDI inflows and their impact on the Jordanian economy demonstrates that these inflows have been driven more by regional developments than by internal improvements. Furthermore, the size and endowments of the Jordanian economy, and the published goals and aspirations of Jordan in light of the impending challenges, make the need for development of a better, more investment-friendly environment a necessity if the FDI pattern of the last two years is to be sustained.

It is warranted, and urgent, that internal factors be created that enhance the competitiveness of the Jordanian economy and generate inflows of FDI that are based on the competitiveness of the economy, not external circumstance. Areas of focus should include creating sustainable private-public partnerships to make up for policy discontinuities and inefficiencies, reducing and streamlining procedures, targeting multi-national corporations, and allocating resources to promote the resultant investment-friendly environment at home and abroad.

The remedies proposed in this paper embellish upon and are consistent with nationally recognized and formalized, albeit not implemented, frameworks. The proposals offer interim solutions to policy failures; the ultimate goal and prescription is a free and fully liberalized market economy.

Appendix 1: Categories in the Doing Business Report

The following is an explanation of each of the categories in the *Doing Business* report.

Starting a Business: This category measures the number of steps or procedures entrepreneurs can expect to go through to start a business: the time (measured in days) it takes on average; the cost (% of income per capita); and minimum capital required as a percentage of gross national income (GNI) per capita.

Dealing with Licenses: The number of procedures, time (in days), and cost to build a warehouse (percentage of income per capita) are delineated, including obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections.

Employing Workers: The difficulties that employers face in hiring and firing workers are listed. Each index assigns values between 0 and 100, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the three indices.

Registering Property: The ease with which businesses can secure rights to property is presented, and includes the number of steps and procedures, time (in days), and the cost involved in registering property (percentage of property value).

Getting Credit: This category measures credit information sharing and the legal rights of borrowers and lenders. It includes the Legal Rights Index and the Credit Information Index, which measure the scope, access, and quality of credit information available through public registries or private bureaus.

Protecting Investors: The indicators in this category delineate how investors are protected, including: transparency of transactions (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index), shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index), and the Investor Protection Index.

Paying Taxes: The index shows the tax that a medium-sized company must pay or withhold in a given year. It also measures the administrative burden incurred to pay taxes. The measures include the number of payments an entrepreneur pays per year; the number of hours spent preparing, filing, and paying the taxes; and the percentage of profits that are paid in taxes.

Trading across Borders: The costs and procedures involved in importing and exporting a standard shipment of goods after the agreement between the buyer and the seller has been concluded are detailed. Every official procedure involved is recorded, starting from the documents prepared for export, time required for export, costs to export, documents for import, and cost of importing.

Enforcing Contracts: The ease or difficulty of enforcing commercial contracts in a country is measured by following the evolution of a payment dispute and tracking the time, cost, and number of procedures involved from the moment a plaintiff files the lawsuit until actual payment occurs.

Closing a Business: The time and cost required to resolve bankruptcies is measured by identifying weaknesses in existing bankruptcy law and the main procedural and administrative bottlenecks in the bankruptcy process. Also included is the recovery rate, which is expressed in terms of how many cents on the dollar claimants recover from the insolvent firm.

Appendix 2: Explanation of the Major Indices of the Global Competitiveness Report

The *Global Competitiveness Report 2005-06* used two types of data in analyzing 117 countries:

- Quantitative data, which is the data obtained from published domestic and international statistical publications on the economic performance and technological ability of the country; and
- Qualitative data, which is data obtained from a field survey of the views and comments of business people and decision makers in the participating countries in the survey.

In order to evaluate and rank the competitiveness of the participating countries in the GCR, two main indices are used:

I) The Growth Competitiveness Index (GCI) measures the ability of the country to achieve sustainable economic growth rates in the medium and long terms. This index is compiled from three sub-indices that are weighted equally in constructing the GCI:
   - Macro Economic Environment Index: measures the level of development of the business environment at the macro economy level through the Macro Economic Stability Index, Country Credit Rating Index, and Government Waste Index.
   - Public Institutions Index: reflects the level of development of public sector enterprises through the Corruption Index and the Law and Contracts Index.
   - Technology Index: indicates the level of technical development through three indices (Innovation Index, ICT Index, and Technology Transfer Index).

II) The Business Competitiveness Index (BCI) assesses the factors affecting the level of productivity and, consequently, the current economic activity level as measured through per capita income. The BCI depends on two indices:
   - Quality of the National Business Environment: delineates the suitability of the business environment as it pertains to the quality of infrastructure, laws, and regulations that govern businesses. Several factors enter into the construct of this ranking including the level of development of the overall infrastructure, quality of research and development centers, and the availability of accredited standards and measures, in addition to the availability of scientists and engineers, and the effectiveness of anti-trust legislation.

- Company Operations and Strategy Ranking: reflects the level of technology, knowledge, capital, and managerial skills of companies. This ranking includes measures of the level of production processes and their use of modern technology, the position of firms in the value-added chain, the level of spending on research and development, the level of sophistication of marketing and distribution processes, and the emphasis placed on training employees in companies.

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Having graduated with a PhD in Economics that is focused on industrial organization and trade, Dr Yusuf Mansur's main areas of expertise lie in international trade and trade negotiations, privatization, competitiveness, industrial policy, telecommunications, restructuring and macro reform. His expertise extends from his very diverse background in the public, private, and NGO international sectors as well as academia and media.

His service, which spans both public and non-government sectors, includes: CEO of Jordan Agency for Enterprise and Investment Development (JAED); Senior Advisor to the Industrial Modernization Programme (IMP), providing policy and technical advice to Jordan Upgrading and Modernization Programme (JUMP); Resident Representative UNDP/Resident Coordinator to the UN in Kuwait; Senior Advisor in Industrial Policy to TDI-Industrial Modernization Program (IMP) also known as Euro-Jordanian Action for the development of Enterprise (EJADA); Director General of the Telecommunications Regulatory Commission (TRC); Telecom Privatization Steering Committee Member; Director of the Jordan-EU Association Technical Support Unit, Aid Coordination Unit, and Jordanian National Competitiveness Team at the Ministry of Planning; and Telecom Policy/Privatization Economist at the Ministry of Post and Communications.

After two years as head of UNDP Kuwait, Dr. Mansur returned to Jordan and entered the private sector establishing Enconsult as a regional economic consulting company providing businesses, non-governmental organizations, and public policy

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Dr. Mansur is a weekly columnist for four local and regional news papers, among which is the Jordan Times for over 13 years, having written over 1200 newspaper, magazine, and journal articles on issues related to FDI, competitiveness, economic reform and development, with a focus on trade, telecommunications, poverty and unemployment. Dr. Mansur is also the author of Fuzzy Sets and Economics: Applications of Fuzzy Mathematics to Non-Cooperative Oligopoly by Edward Elgar Publishing, 1995.

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This paper is one of a series of papers presented by the International Research Foundation of Oman and the Fraser Institute of Canada to encourage discussion on ways to increase economic freedom and on the impact of economic freedom on economic growth, quality of life, and other important indicators. It is posted on the the web site, http://www.freetheworld.com.

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