



JORDAN
Economic Development in the 1990s and
World Bank Assistance

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Acronyms

ASAL	Agricultural Sector Adjustment Loan
CBJ	Central Bank of Jordan
CEM	Country economic memorandum
CFF	Compensating Finance Facility of the IMF
EFF	Enhanced Fund Facility
EIU	Economist Intelligence Unit
ERDL	Economic Reform and Development Loan
ESAL	Energy Sector Adjustment Loan
ESW	Economic and Sector Work
FX	Foreign exchange
GDP	Gross domestic product
GNP	Gross national product
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IMF	International Monetary Fund
ITPAL	Industry and Trade Policy Adjustment Loan
JD	Jordanian Dinar
JIC	Jordan Investment Company
JPMC	Jordan Phosphate Mines Company
OECD	Overseas Economic Cooperation Fund (Japan)
OED	Operations Evaluation Department
PER	Public Expenditure Review
PLO	Palestine Liberation Organization
PSA	Private Sector Assessment
PSD	Private Sector Development
PSRL	Public Sector Reform Loan
QIZ	Qualified Investment Zones
RED	Recent Economic Development (IMF document)
SDR	Special drawing rights
UN	United Nations
USAID	United States Agency for International Development
VAT	Value-added tax
WTO	World Trade Organization

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Preface

This is one of three background papers to the Jordan Country Assistance Evaluation (CAE) (Task Manager, Mr. Fareed M.A. Hassan) being prepared by the World Bank's Operations Evaluation Department (OED). The findings are based on a mission to the Hashemite Kingdom of Jordan in May 2002, a review of related Bank documents (both internal and published), publications of other institutions and discussions with current and former government officials, donor representatives, Bank staff, and the private sector.

S. Ramachandran prepared this background paper with help from Dinara Seijaparova. Frank discussions with current and former Bank staff and government officials helped clarify the events and issues. The country team now working on Jordan (Joseph Saba, Osman Ahmed, Dipak Dasgupta, T.G. Srinivasan, Carlos Silva-Jauregui, Paolo Zacchia and Osman Ahmed), Michael Lav (peer reviewer), Fareed M.A. Hassan (task manager), Ashok Khanna, George T.K. Pitman and Jack van Holst Pellekaan (team members) had useful comments on the paper.

The Ministry of Planning's responses to an earlier draft have been incorporated, where appropriate, in the text and are reproduced as an attachment to this paper.

Executive Summary

1. Almost every World Bank report in the 1990s observed that Jordan's economy was barely growing at the rate of its population, resulting in stagnant real *per capita* incomes. Even this was no mean achievement, considering the political and economic difficulties it faced. This background paper for OED's Country Assistance Evaluation describes the salient developments and the Bank's assistance, focusing on the macroeconomic developments during the 1990s.
2. Jordan's economy was poorly prepared to cope with the adversity it faced when the decade of the 1990s began: the oil price declines of the late 1980s had shattered its finances and the 1991 Gulf War caused further collateral damage. Adversity was an opportunity to undertake reforms and Jordan grasped the nettle, albeit timidly, with Bank support.
3. The aim of the Bank's support starting in the early 1990s was to foster economic growth by restructuring the economy. Jordan is a small open economy with few natural resources and little manufacturing but with skilled people working abroad and sending home sizable remittances. Economic growth was rightly emphasized as this would reduce the debt burdens and the economy's vulnerability to disruptions in worker remittances and bilateral government grants. Economic growth was expected to follow structural reforms; the Bank's multiple-tranche adjustment loans in the early 1990s rightly emphasized the removal of trade distortions and correcting the known policy shortcomings in such sectors as agriculture (especially water pricing and use) and energy. This attempt was not entirely successful, however, and unmet conditions delayed disbursements thereby jeopardizing the Bank's balance of payment support. So the Bank's strategy in 1995 took a different tack: a series of single tranche adjustment loans (the ERDLs) sought to support reforms as and when the Government appeared willing to implement them. While this tack seemed more successful in that the loan covenants were complied with and tranches disbursed as planned, some needed reforms were not done. In particular, some poorly directed government expenditures have continued.
4. The 1999 Bank's strategy, approved after the new King's accession, continued such single tranche adjustment loans, but shifted the focus to public sector reform. Two of the three Public Sector Reform Loans (PRSLs), have been approved and begin the much needed reform of the public sector. It is too early to evaluate their outcomes, but the Government still looms large in the economy.
5. It would be a mistake to belittle Jordan's structural reforms simply because growth fell short of *forecasts*, but one should be concerned when it falls short of its *potential*. Despite stagnant real *per capita* incomes, the economy doubtless benefited from trade, privatization and other structural reforms. Their link to growth is through efficient private (non-housing) investment—which has been anemic since the mid-1980s. The evaluation finds that the high growth projections of the 1990s (over 6 percent annual) were unrealistic, especially considering that private non-housing investment was low since the mid-1980s. Put differently, structural reforms may be necessary but not sufficient for growth. Disappointing growth adds to the pressure on the Government to “do something more,” perhaps investment subsidies or a reversal of the currency's recent appreciation. A real appreciation is not necessarily an over-valuation, and the exchange

rate regime seems appropriate (for reasons mentioned in section III) *provided that other policies are consistent with it*: in particular, fiscal policies. If the currency were over-valued, adjustment lending (under any label, such as programmatic budget support) would be inappropriate.

6. The Government cannot *directly* raise private investment, but it could do so indirectly by reducing wasteful government expenditures thereby raising national savings. Despite considerable analytical work identifying how government expenditures could be reduced and better directed (1991 and 1999 World Bank, internal documents), the Bank could have emphasized this issue more than it did. While some wasteful expenditures were curtailed, and a few large state-owned firms privatized, the Government still looms large in the economy: it spent about 40 percent of GDP throughout the decade—far higher than in comparable countries. As the Government cannot raise commensurate tax revenues, it struggles to finance the budget deficit, and worries about the stock of public debt, much of it external. Jordan therefore remains vulnerable to adverse events in the region.

7. This evaluation finds the Bank's economic and sector work (ESW) highly satisfactory, although some important sectors (e.g., labor markets) should have had greater attention, especially since high and persistent unemployment was of major concern. It would also have influenced policies to tackle poverty and reduce excessive government employment. While much of the Bank's ESW was well done and influential (e.g., on health, education, water, the Private Sector Assessment), some (for example, the public expenditure review) did not have the same effect on policy and many wasteful expenditures that were identified have continued.

8. Bank loans' *outcomes were moderately satisfactory* because they helped stave off Jordan's financial crises and helped support the stable currency but have not boosted investment or growth and despite privatization of some firms, has barely dented the public sector's role in the economy. *The Bank's performance was moderately satisfactory*: although its loans did not incorporate all of its analytical work, there were areas (e.g., government over-staffing) where the Government did not feel a consensus existed for reform and the Bank could have been more persuasive. The Government complied with the loan covenants, but resisted including important reforms (e.g., curtailing expenditures) as loan conditions that may have improved outcomes. There has been no marked change in institutions, and their development is therefore rated as modest. There does, however, seem to be a widespread (though not universal) agreement that the reforms (especially trade and privatization) were desirable, and sustainability is therefore likely.

9. This evaluation recommends that future Bank assistance should support a significant reduction in government expenditures, especially those that many PERs have already identified as being poorly spent. Given the high and persistent unemployment, a study of the labor market rigidities could provide the basis for measures to reduce unemployment and alleviate poverty.

1. A Background to the Economy

1.1 Jordan's geography and recent political history affect its economy more than in many countries. Jordan was established as Trans-Jordan from parts of the Ottoman Empire at the end of World War I, whereby Amir Abdullah was nominated as ruler (his brother, Emir Faisal, became ruler of Saudi Arabia). Over the following decades, Jordan's borders shifted following the addition of Palestine and the creation of Israel. Its population rose both through its high birth rate (28 per thousand) and the waves of migration (450,000 in 1948 war; 400,000 after the 1967 war; 300,000 after the 1991 Gulf War) to its current 5 million. Jordan's commerce and trade reflect strong ties with neighboring countries.

1.2 King Hussein, Abdullah's grandson who ruled from 1952 until his death in 1999, steered carefully through the shifting sands of the region's conflicts and his son, King Abdullah II, is expected to do the same. Policies do not always reflect public sentiments, and the King approves all major decisions, not just about economic policy but sometimes also their execution (e.g., many privatization transactions). The cabinet is drawn from a limited circle who share a similar outlook; so policies do not veer sharply when individuals change.¹ Under these circumstances, institutional development is difficult and private sector development is more complicated than passing laws.

The Economic Structure

1.3 Jordan is a small but open economy heavily dependent on worker remittances from abroad. Jordan has no oil, but its workers were drawn to the Gulf, especially after the 1970s. Their remittances of almost 20 percent of GDP augment Jordan's domestic savings,² permitting imports to greatly exceed its exports. *Per capita* GNP of US\$1,706 in 2000³ makes it a lower middle income country. The economy is vulnerable to oil price changes, which affect the volatility of worker remittances and some foreign government grants that finance the budget. Chart 1 shows the stagnant real per capita GDP in the 1990s.

1.4 About 92 percent of its land is semi-arid; so agriculture is concentrated in the Jordan River valley, with some non-irrigated crops grown upland. With only phosphate and potash (processed for use as fertilizer) for raw material, Jordan has little heavy industry. Most manufacturing firms (98 percent) employ fewer than 20 workers and are concentrated around Amman and Aqaba, Jordan's only port.

¹ The Minister of Planning notes that, "the role of the Cabinet is to build on the achievements and enhance the policies rather than change them." In addition, they point out that, "many of Jordan's policies have been positively changed towards opening and privatizing the economy."

² Worker remittances are treated as unrequited transfers, not service income in the national accounts; so GNP is not much different from GDP.

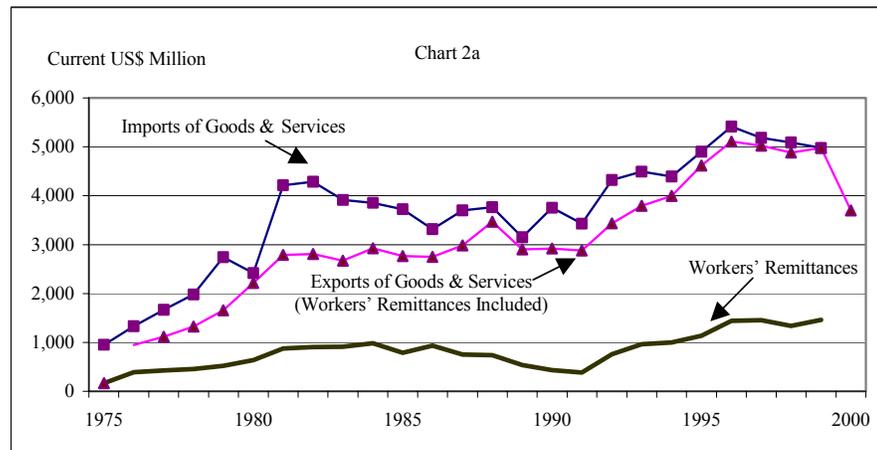
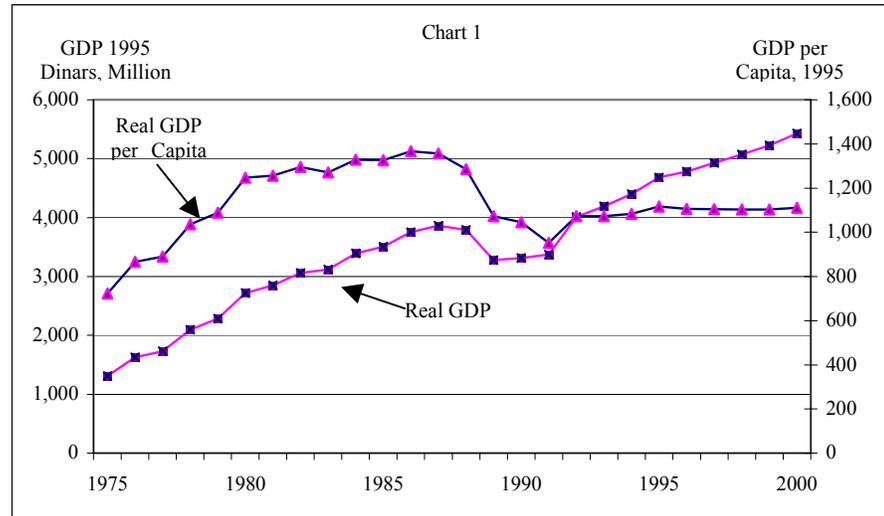
³ The Minister of Planning notes that Jordan had a population of 5.039 million, GDP of \$8.463.4 million, and accordingly, a per capita GDP of \$1,680 in 2000.

1.5 Imports are now about $\frac{2}{3}$ and exports about $\frac{1}{2}$ of GDP, reflecting the country's small size and its relatively open borders. About half its exports and a quarter of its imports are with its neighbors, but no country accounts for much more than 10 percent of its foreign trade.

India is Jordan's largest single export market (mostly for potash), but trade with Iraq remains large. Jordan applied Article 50 of the UN Charter, which permitted it to have special arrangements with Iraq as the

most affected country of the Gulf crisis.⁴ The relatively large trade deficit (US\$1.5 billion, or 18 percent of GDP) is almost offset by inflows from workers' remittances. These remittances declined as a proportion to GDP in the 1980s when oil prices fell, but slowly rose in the 1990s to about 20 percent of GDP as seen from chart 2a and b.

The current account fluctuates between a 5 percent of GDP surplus and deficit of similar magnitude that is financed by foreign borrowings and grants.



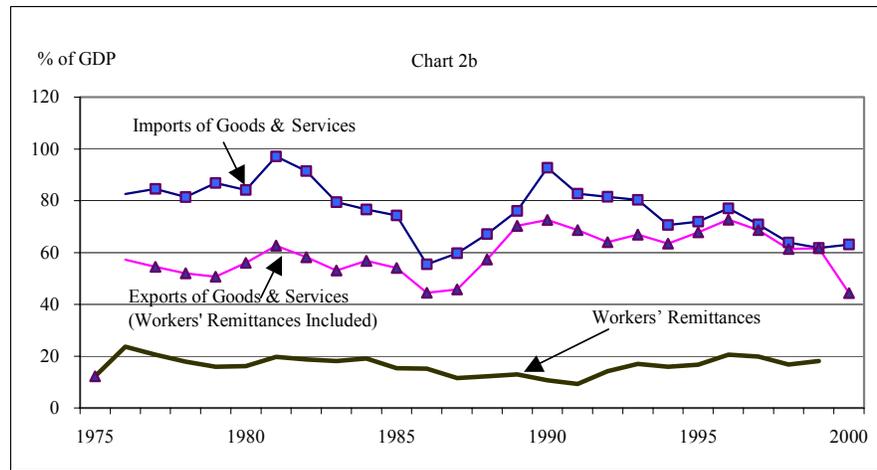
The 1991 Gulf War and Its Aftermath

1.6 Jordan's economy was sputtering since 1987 when oil prices declined thereby reducing worker remittances, and the 1990–91 Gulf War exacerbated the situation. Foreign grants fell and expatriate Jordanian workers were sent home. The budget deficit

⁴ Iraq provides nearly all of Jordan's oil and provides half of the oil as a grant and the other half at less than market prices (that are negotiated each year). Article 50 of the UN Charter allows Jordan to export food, medicine and household items (which Iraq's oil sale pays for through debiting the bilateral account with the CBJ, not convertible currency). In addition, Iraq is permitted "oil for food" trade with the proceeds from sales in the open market being administered through an escrow account, and Jordan (among other countries) exports to Iraq. With the opening of Qualified Industrial Zones, exports (mostly garments produced by Asian firms) to the United States seem large, but Jordanian value added is still small.

widened, foreign exchange reserves fell and Jordan could not service its external debts. Debts were then rescheduled, the currency depreciated and the Bank and Fund stepped up their assistance.

1.7 The frayed relations with the United States improved when Jordan signed a peace treaty with Israel in October 1994. Other countries were less forgiving, and Jordanians were only slowly and reluctantly allowed back to their host countries.



1.8 The boom in housing construction until mid-1996 bolstered GDP; but in late 1998 the authorities admitted that the economy was not growing at 5–6 percent that many had been led to believe but at a sluggish 1 percent. Consequently, the overall budget deficit was closer to 8–9 percent of GDP, not 4 percent that was forecast. This belated discovery around the time of King Hussein’s mortal illness, threw the stabilization program supported by the Fund off-track, but spurred the pace of privatization as described later.

Budgets, Deficits and Debts

1.9 Government finances have long been precarious as shown in charts 3, 3a and 3b, largely because expenditures are high and some of it is poorly spent. Tax revenues are around 16 percent of GDP—similar to India and Mexico—and non-tax “revenues” (from the transfers or profits⁵ from state enterprises like telecom and oil refining) fluctuate around 13 percent of GDP bringing total revenues (including grants) to around 30 percent of GDP now. Foreign grants have declined since 1980 (Chart 3a), but are still around 5 percent of GDP with Iraq and the U.S. being the largest donors. There also appear to be many earmarked taxes that do not pass through the budget.⁶

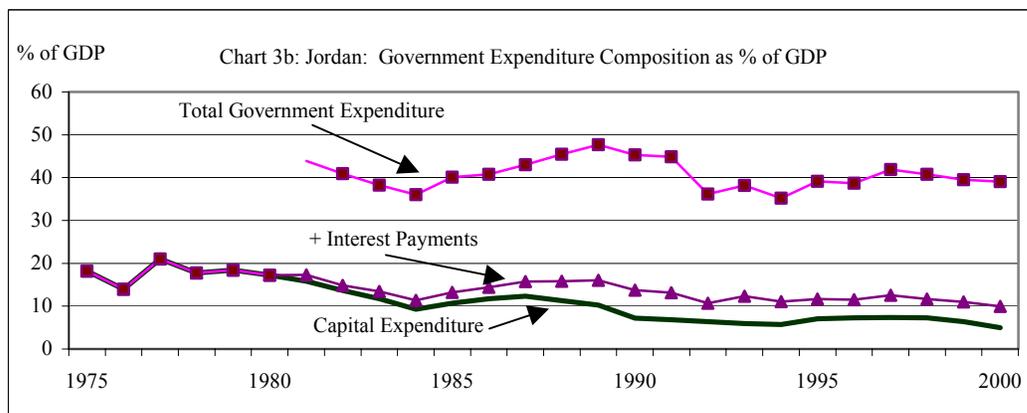
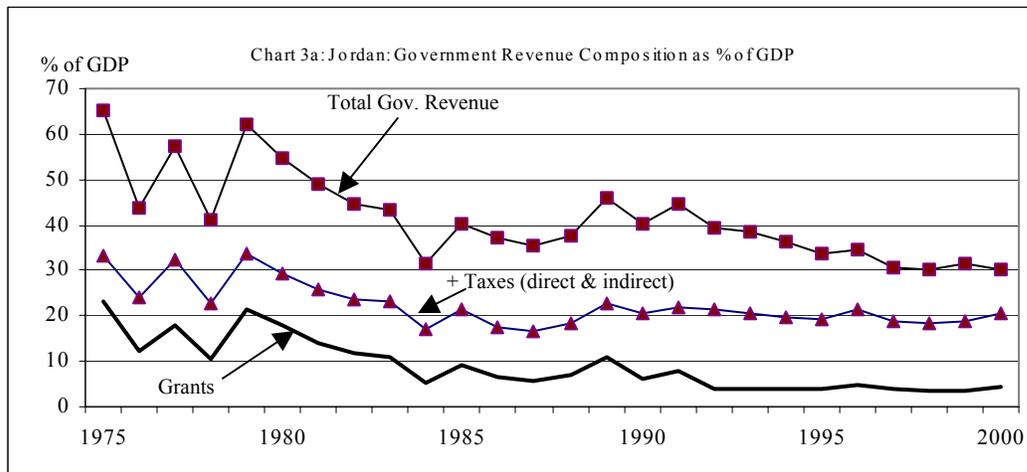
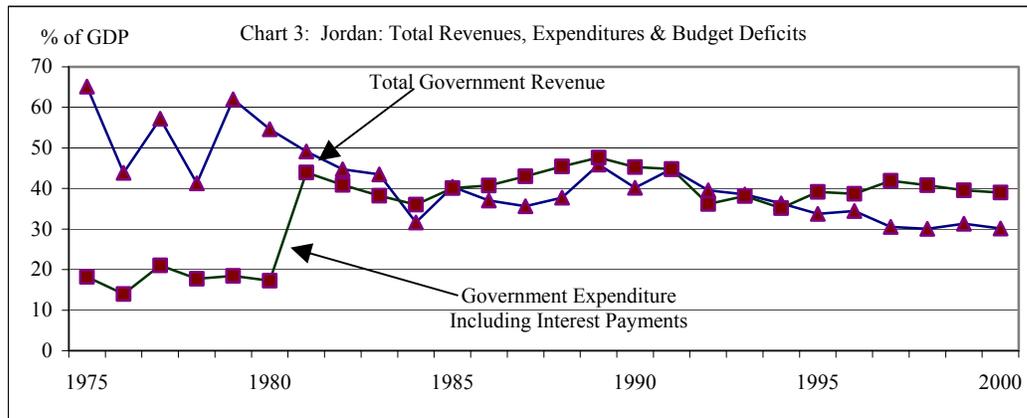
1.10 Jordan’s government expenditures, hovering around 40 percent of GDP range for the last two decades, are far higher than in comparable countries—even allowing for its greater military expenditures.⁷ Expenditures had risen in the 1970s when generous

⁵ Non-financial public enterprises are operationally autonomous, although many are funded by the central government. They may borrow domestically or abroad. While some enterprises, like Jordanian Telecommunications Co. with revenues of 4 percent of GDP and costs of 1.5 percent, are profitable, others like the airline are not. Even profitable companies may have greater profit potential; so their privatization is important.

⁶ All firms, for example, must be members of the association for their respective sector (e.g., trade or manufacturing) paying a fraction of their profits as fees. Former government Ministers and officials head these, and the association receives and goes on various similar trade delegations that add little value. There are similar taxes on wages that fund various educations and training commissions.

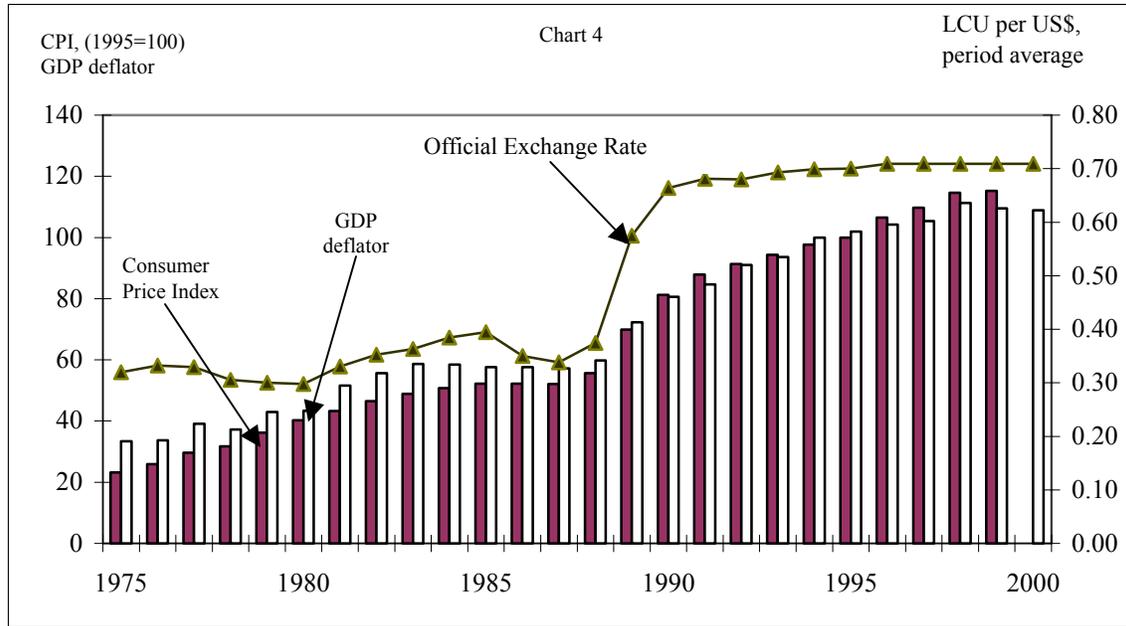
⁷ In 2000, the IMF reported that government expenditures of even Egypt, Morocco and Turkey (with large militaries and bloated civil services) are around 30 percent of GDP. Jordan spends almost 10 percent of GDP on its military, and some of this is obtained through tied aid.

neighbors shared their oil wealth through grants; but chart 3b shows that when these grants declined, the Jordanian Government reduced capital, not current spending.⁸



1.11 The resulting budget deficits are therefore large, but (except during the late 1980s), inflation has been kept low because the Government has borrowed large amounts rather than printing money. Chart 4 shows the level of the price indices and the exchange rates over time.

⁸ The Minister of Planning notes that, "the reduction in capital expenditures was due to an agreement with the World Bank and IMF, accompanied with the rationalization of current expenditures."

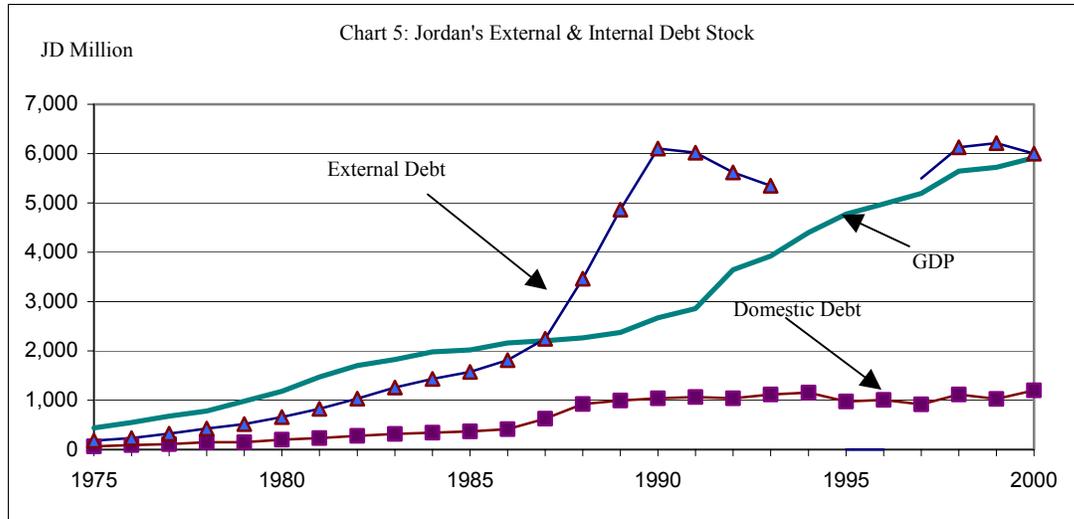


1.12 The domestic and foreign borrowings to finance the budget deficit has resulted in a large stock of public debt.⁹ So long as the economy grows more slowly than the rate of interest, the debt stock to GDP rises—even if the primary budget deficit were zero. Additional borrowings to finance a primary budget deficit causes the debt to GDP to rise even further.

1.13 Chart 5 shows that debts grew to over twice GDP in 1989, and the subsequent decline is mainly because several creditors forgave their debts and rescheduled payments several times (Paris Club in July 1989, February 1992, June 1994, May 1997, May 1999, and July 2002). In addition, the Government purchased and swapped some of its own foreign debt. The Bank's Debt and Debt Service Reduction operation supported the restructuring of commercial debts through the London Club, but even so, debts were 105 percent of GDP in 2000. Chart 5 also shows that about 80 percent of the total debt is *external*; and all the external debt is of (or guaranteed by) the Government. Japan is the largest creditor with 27 percent the external debt (Exim Bank, OECF) followed by the World Bank with 12 percent (1997 EIU).

1.14 Debt forgiveness without sound government finances is merely a palliative and would have to be repeated. External creditors agreed to reduce debts because of US political support for Jordan; but politics in the region is uncertain. Investors may be stymied when debt hangs over the economy, and creditor generosity rather than sound fiscal management keeps debts in check.

⁹ The 1989 World Bank internal document states that comprehensive debt data were only available from 1988, and that the increase in Jordan's indebtedness could be traced to the large current account deficits of 1982–84 and military spending after 1984.



1.15 Almost all the *domestic* debt (about a fifth of GDP), is held by the banking system: a little more than half by the CBJ¹⁰ directly and most of the remainder by the commercial banks (which qualify as liquidity reserve requirements). The public does not own a significant amount of the debt directly, but since their banking deposits slightly exceed GDP, almost a quarter of their deposits finance the Government, albeit at rates that are not entirely market determined. Without an active market for government paper, the authorities are able to keep interest rates low, although potential capital outflows prevent the interest rates from getting markedly out of line.

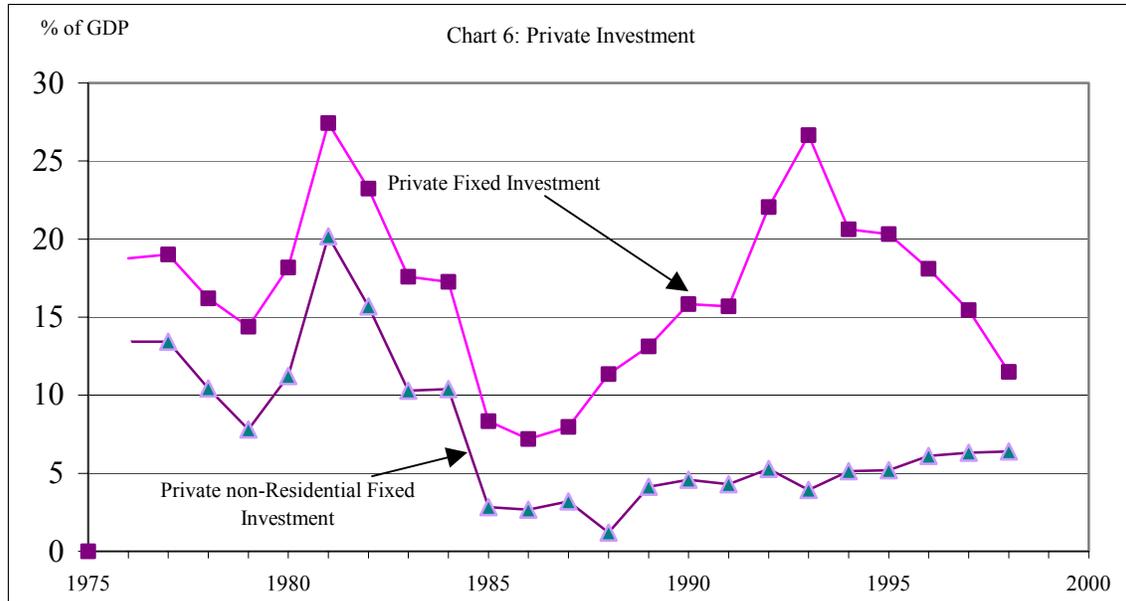
Low Growth No Surprise?

1.16 Jordan's low growth is not surprising considering its meager investment. Chart 3b shows the secular decline in government capital expenditures; but chart 6 shows that the seemingly robust 25 percent of GDP aggregate private investment in 1993 was mostly in housing: expatriate workers returning in the wake of the Gulf War built or improved their houses. *Non-housing* private investment has languished at around 5 percent of GDP for a decade (1985 to 1995), and while this rose slowly to about 8 percent of GDP, the projections of 6 percent annual growth through much of the 1990s were unrealistic.

Tackling Government Expenditures (not deficits)

1.17 The authorities have limited budget deficits to comply with various Fund programs; but cutting capital spending and suppressing interest on domestic debts have been easier than reducing recurring—and sometimes wasteful—expenditures.

¹⁰ The Minister of Planning points out that, "this is only valid when including the Treasury Overdraft Account at the CBJ." He also notes that "public deposits (excluding Treasury Overdraft Account at the CBJ) at the banking system did not exceed 10 percent of Jordan's GDP in 2000."



1.18 The Bank raised these expenditure issues at least since 1991 identifying several specific examples on how they could be better allocated to reduce waste. Some poorly directed spending was curtailed (e.g., non-targeted food subsidies, amounting to almost one percent of GDP), but Bank reports cite examples of others that could be easily tackled. Government spending on higher education could be reduced by raising tuition, part of which could pay for scholarships for the poor.¹¹ Health expenditures could be reduced if the Government did not build more hospitals but reimbursed/paid the poor to use private hospitals with excess capacity.

1.19 Besides the military, a significant part of the spending stems from excessive public employment. Such employment rose throughout the region in the wake of the oil boom of the 1970s; but while this is sometimes described as the “social contract” to distribute the oil wealth, there are more effective ways of doing so. Some 64 percent of all government expenditures are for wages, pensions, and interest payments (about 4 percent of GDP) that are not easy to quickly curtail. The civil service provides patronage more than service: the Government (including the 26 autonomous agencies) employs about 40 percent of all workers—more than in manufacturing. The rise in public sector employment contributed to the decline in labor productivity in utilities such as power and water and needed infrastructure investment has been neglected for decades.

¹¹ The Bank’s recent strategy paper on higher education questions this advice (generally, not specific to Jordan). Even if the private returns on education are high, there may be insufficient human capital investment if one cannot pledge it for credit. This may warrant government intervention, and this would be true *a fortiori* if there were social returns (“spillovers”) in addition. Such “spillovers” are widely accepted for primary education (especially for girls, as health and the number and spacing of children improve), but may also exist in higher education (empirical work is inconclusive). If so, government spending on higher education may be warranted even if the rich attend Universities disproportionately. Conversely, Lant Pritchett shows in a recent paper that spending on primary education could also be wasted (“Where Has All the Education Gone?” World Bank Economic Review, Vol. 15, No. 3, 2001). More simply, if a country needs schools, it also needs Universities to train the teachers.

1.20 Overpaying compounds the public sector over-staffing. It appears that government salaries (including all benefits) exceed those in the private sector in most grades¹², albeit by different amounts. In addition, pension liabilities are large, and the recent Fund arrangement tries to address this issue. The persistently high unemployment rate of around 14 percent¹³ may be because of Government induced rigidities (the Government is considering raising the already binding monthly minimum wage from JD80 to JD90).

Public Enterprises and Privatization

1.21 Many of the major enterprises were Government-owned and controlled. Besides the public utilities (e.g., the water, electricity and telephone companies) and ports, the Government also owned the railways (the line from Aqaba to the Potash mines), national airline, and sizable stake in the potash mining firm.¹⁴ The Government's (defined benefit) social security fund and the Jordan Investment Company (JIC) also held significant equity in firms, some of which are listed on the Amman Stock Exchange.

1.22 The JIC was set up in 1991 to "promote" investment by the private sector but seems to be somewhat parasitic, adding little value but providing current and former government officials with seats on corporate boards. JIC also uses its income from some firms to cross-subsidize others, and periodically transfers a "surplus" to the budget, but these now include proceeds from asset sales.¹⁵

1.23 These public enterprises—including Jordan Telecom that generated the bulk of the profit—could have operated more efficiently had they been better managed, and this was why privatization was important. A Privatization Council (consisting of the Ministers of Finance, Planning, Industry and Justice and the heads of the central bank and the Privatization Commission) and chaired by the Prime Minister sets policies, identifies candidates and approves transactions. Several major privatizations have occurred in the last few years (listed in Annex A) with the telecom generating the largest revenue.

¹² The 150,000 government employees are put in four grades (each with further steps), with the bulk in grades 2 (42,000), 3 (43,000) and 4 (56,000). The Government pays grade 4 staff an average of JD200/month, about 15 percent more than those in the private sector. In addition, there are 20,000 employed at day rates. These numbers do not include those employed as teachers, police, military and in the "autonomous" agencies. It appears that the teachers salaries are substantially higher (more than double) than those employed by private schools.

¹³ There are some 500,000 foreign workers (250,000 Egyptians in agriculture in the Jordan Valley, and an additional 150,000 in construction) who may not all be legally authorized to work and so are not subject to the minimum wage or social security taxes.

¹⁴ Jordan is the world's 6th largest phosphate producer, and the Jordan Phosphate Mines Co. is 42 percent owned by the Government's Jordan Investment Corporation with an additional 28 percent owned by the social security corporation (and 16 percent by the Government of Kuwait). Four mines are operational, and JPMC has joint ventures with Japanese and Indian interests for downstream activities. The Government also owns 53 percent of the Arab Potash Co. that extracts soluble salts from the Dead Sea (the governments of Iraq, Libya, and Kuwait own another 15 percent).

¹⁵ These budget transfers do not equal profits or even operating cash surpluses (because they could include proceeds from asset sales). So the true budget deficit may have been greater than what was shown (either by the Government, the Bank or the IMF). Neither the Bank nor the Fund appear to have sought more accurate measures.

Banking and Finance

1.24 Jordanian banks have three salient features. *First*, deposits are large: slightly more than GDP, suggesting that the general public trusts the privately owned banks (these data exclude the sizeable deposits in West Bank¹⁶ branches of Jordanian banks).

1.25 *Second*, between a fifth and a quarter of deposits now are dollar denominated (up from about 15 percent in 1993). The currency composition of the deposits reflects interest rate differentials and public perceptions of impending exchange rate changes. Banks are not exposed to a devaluation directly (the profitability of their borrowers may affect them indirectly) because they also make dollar denominated loans and keep balances in foreign banks or with the CBJ.

1.26 *Third*, banks lent almost three quarters of their deposits to the private sector (the rest to the Government directly or through the central bank). This private sector lending goes mostly to the larger, well-established firms, and although many of these loans are secured by real estate, the proceeds could be used for other activities of business groups. Over 70 percent of these loans have maturities less than a year; and while this avoids maturity mismatch risks, the Bank used it to justify lines of credit projects to increase term lending and “help private firms expand their productive capacity” (e.g., the 1996 Export Development Project for US\$40 million).

1.27 Banks appear to be sound, modern and efficient. The central bank has slowly loosened its non-prudential controls (deposit interest rates were freed in February 1990, lending rates in 1990, and the ceiling on foreign exchange (FX) holdings by residents raised in successive stages), but it shut down near-banks (e.g., currency exchanges that also accepted some deposits) in an effort to preserve a poorly designed exchange rate regime (since discontinued). The Arab Bank is the largest of the nine commercial banks; but envy more than evidence may prompt the allegation that competition is absent¹⁷ or that there are too many banks or branches.

1.28 The dinar is widely used both in Jordan and the West Bank, and the high currency stock in circulation (about 20 percent of Jordan’s GDP) earns considerable seignorage (10 percent interest saved on the 20 percent currency stock equals about 2 percent of GDP). Seignorage normally shows up as central bank profits; but since the CBJ and the

¹⁶ The West Bank was a part of Jordan until 1967 when Israel occupied it and froze the assets of the Jordanian banks’ many branches there. Despite this, however, the Arab Bank paid out funds to the many depositors who fled to Jordan thereby earning their gratitude, trust and confidence. When the Jordanian banks reopened their branches in 1991 under the Palestinian Authority’s aegis, they attracted a flood of deposits (much from inside mattresses). Although Jordanian banks have about half the 103 bank branches in the West Bank in 1999, they have about three-quarters of the West Bank’s banking deposits. Some 60 percent of these deposits are denominated in US dollars, a quarter in dinars and the rest (mostly in current accounts used to effect payments) in Israeli shekels. The banking data for Jordan, however, exclude the sizeable West Bank deposits in Jordanian bank branches. With few lending opportunities in the West Bank, the branches transfer the funds to their head offices in Jordan, much to the chagrin of the Palestinian Authority. The CBJ has the supervisory authority over *branches* of Jordanian banks abroad (including the West Bank); but the newly created Palestinian Monetary Authority wants these branches to be reconstituted as *subsidiaries* so that they would fall under its jurisdiction. This lingering dispute inhibits Jordanian officials conducting on-site supervision of commercial banks’ West Bank branches.

¹⁷ The wide connections of Arab Bank’s owners may well attract clients, deter competitors or undermine the Central Bank’s power; but this does not stem from its size.

banking system hold low yielding government paper, it accrues to the Government even without explicit CBJ profit remittances.

1.29 Non-bank financial intermediation is small, although market capitalization of the Amman Stock Exchange, at 77 percent of GDP, is one of the highest in emerging markets. Most of the listed shares are in the few large Government-controlled firms, so trading volume is small (the value of annual trades is about 5 percent GDP) and new issues are rare. Most firms borrow from banks rather than raise funds directly from the public, so there is not much of a tradition to disclose a firm's finances and banks lend to those they trust (a tendency that is reinforced by a poor court system that cannot quickly enforce claims).

2. The Bank's Approach

2.1 The Bank had long lent to Jordan for investment projects, and this increased in the 1980s. Loans to enterprises that had access to domestic and international financing (for example, Jordan Phosphate Mines borrowed US\$31 million in 1987 and US\$25 million in 1990 from the Bank, and the Arab Potash Company borrowed US\$15 million through the Dead Sea Industrial Exports Project¹⁸ in 1991) reflected the Bank's lending regardless of having commercial firms fend for themselves.

2.2 The *composition* of Bank lending began changing in the early 1990s,¹⁹ with more adjustment loans in conjunction with various IMF programs. The 1980s decrease in oil prices and with it, worker remittances and grants, raised the budget and current account deficits. Without the new loans, the net transfers from the Bank would have been large and negative; but even with the new loans, Chart 7a shows that net transfers were modest on average although gross disbursements were high. (Chart 7b shows that the Fund's net transfers were high.) This section describes the approach of the three of Bank's strategies (1993, 1995, and 1999) and the main adjustment loans under each.

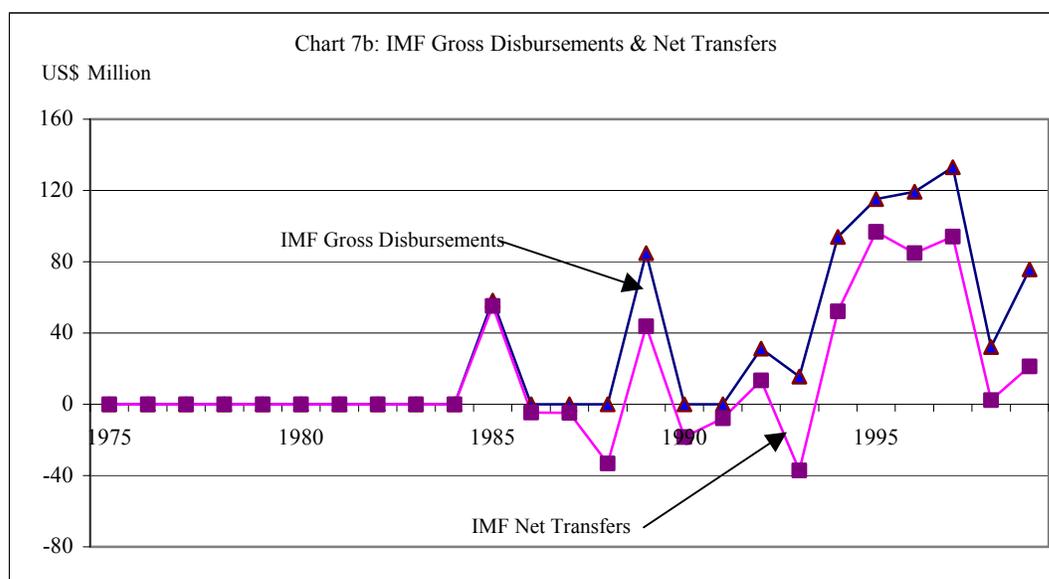
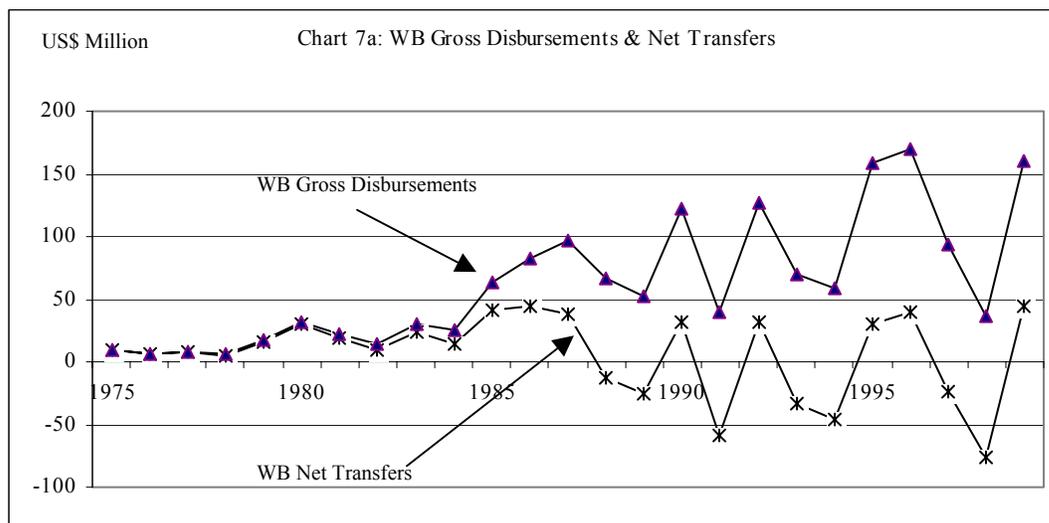
The 1990–95 Major Adjustment Loans

2.3 The US\$150 million **Industry and Trade Policy Adjustment Loan (ITPAL)** predated the 1993 strategy. The ITPAL was approved in December 1989 and accompanied a Fund standby arrangement and a CFF (of about US\$100 million over 18 months), to bolster Jordan's foreign exchange reserves and start its structural reforms. The ITPAL was in two tranches, the first for US\$75 million was released in early 1990, but the second tranche of US\$73.5 million was delayed by the Gulf War (September 1990 to February 1991). The rest of the loan was for technical assistance and social service delivery. The tranche release conditions were to reduce trade barriers, rationalize industrial infrastructure and review public expenditures. The second tranche was

¹⁸ The project was financed in parallel by the Islamic Development Bank.

¹⁹ Even so, the Bank approved a telecom project in mid-1994 for \$20 million although the Government decided in 1993 to privatize telecom within 3 years, perhaps because the 1988 project for \$36 million was cancelled in 1989 when the Government reduced its investments to cope with the economic downturn.

released²⁰ only after the dinar was devalued and additional budgetary measures were undertaken to restore macroeconomic stability.



2.4 After the Gulf War, a new Bank's strategy was approved in October 1993 simultaneously with the **Energy Sector Adjustment Loan (ESAL)**. The power sector remained financially unsound despite eight earlier Bank projects (between 1973 to 1990 for a total of US\$227 million) that financed physical investments with high economic rates of return, but could not ensure that power tariffs covered long run marginal costs. The ESAL, based on an energy sector study, sought to separate generation and distribution from transmission and restore their financial viability by allowing private sector involvement in generation and distribution. The ESAL was for US\$80 million in three tranches (with another US\$80 million as Japanese cofinancing). The loan closed in

²⁰ OED audited the loan in 1995 and rated outcome as satisfactory, institutional development as substantial, and sustainability as likely.

1997 after the US\$20 million second tranche of the ESAL was delayed by 2 years, and the US\$20 million third tranche by 2 ½ years²¹ because of delays in implementing what was agreed.

2.5 In 1995, the \$80 million **Agriculture Sector Adjustment Loan** was approved, along with a US\$7 million TA loan. These were to ensure the efficient use of water through better pricing and regulation and to restructure the institutions and to improve planning and investment in the sector (more details in the forthcoming background paper on water issues).

2.6 Although the region rated these two adjustment loans (ESAL and ASAL) as satisfactory, it viewed them as problematic because the conditions were not met and delayed disbursements jeopardized the stabilization program.²² Negotiating detailed conditions was also arduous, especially for the freeing of trade: so although many hurdles were dismantled, other distortions remained, and a sequel to the trade loan was envisaged (tentatively called the Trade and Finance Adjustment Loan that became the ERDLs).

2.7 The 1994 Country Economic Memorandum,²³ seeking more structural reforms, commented that these were needed in addition to monetary and fiscal stability (that the Government's 1993–97 Economic and Social Development Plan emphasized) for economic growth. These reforms in trade, banking and restructuring public enterprises formed the basis of the 1995 Bank's strategy.

What the 1995 Bank's Strategy Said

2.8 The strategy, approved in October 1995 shortly after a new Country Director took over, noted that the structural reforms since 1989 were in 3 main areas: (i) stabilization, mostly by reducing the foreign debt through forgiveness and rescheduling and the budget deficit; (ii) efficiency improvements through reductions in the trade tariff and discretionary regulations; and (iii) market orientation primarily through the privatization of state-owned firms.

2.9 The Bank supported these reforms through a series of *single tranche* adjustment loans. Jordan's own difficulties in meeting the ESAL tranche release conditions and the controversies generated by the cancellation of the Egypt SAL (handled by the same department) led many in the Bank to favor single tranche loans which are easier to prepare and manage. Arguing that reform cannot be planned years in advance, the Bank shifted from multi-tranche to multiple, single tranche adjustment loans on the grounds that this gave government reformers the flexibility to quickly change tack to bypass domestic opposition and that Bank staff could manage their task more efficiently.

²¹ OED audited the ESAL in 2001 simultaneously with the three ERDLs and although it rated outcome as moderately satisfactory, it pointed out the many difficulties: the electricity tariff structure was still inadequate, generation, transmission and distribution were not fully separated, the regulatory commission was not properly functioning and the sector remained mired in problems.

²² A subsequent OED evaluation of the ESAL confirms this view.

²³ "Jordan: Consolidating Economic Adjustment and Establishing the Base for Sustainable Growth," Report No. 12645-JO August 24, 1994.

2.10 The summary of the Board discussion of the 1995 Bank's strategy reveals concern about the continued poor state of the energy sector and the country's low savings and investment rate. Although the Bank's strategy recognized the low domestic savings rate²⁴ and the paltry level of private investment, its prescription for growth was to improve the business environment and to privatize firms (including telecom) that some in the cabinet opposed. The Bank's tactics were understandable although its reasoning was questionable. Switching ownership does not automatically increase private investment or reduce the budget deficit,²⁵ although the balance of payments improves with a sale to foreign investors. The Bank's strategy was strangely silent on reducing the level of government expenditures, despite the 1991 World Bank internal document revealing considerable waste.

2.11 The second Trade and Financial Policy Adjustment Loan under preparation became the first Economic Reform and Development Loan (ERDL-I) that together with its successors (ERDL-II and III) pursued the same objective as the earlier adjustment loans: to increase economic growth through closer integration with international markets and attract greater investment. The conditions clustered around removing trade barriers and hurdles to private investment. Each loan was approved when it was felt that sufficient progress had been made (and these were listed as conditions of Board presentation).

2.12 The ERDL-I for US\$80 million was approved simultaneously with the Bank's strategy in October 1995 (with an additional US\$80 million Japanese cofinancing and US\$12 million from Italy).²⁶ The conditions were clustered around continuing trade reforms (detailed tariff adjustments) with some minor changes in banking (harmonization of reserve requirements) and *preparations* to "privatize" the housing and industrial development banks (after removing their special privileges) and some major government holdings (e.g., telecom) began.

2.13 ERDL-II for US\$120 million was approved and disbursed in December 1996 (with another US\$8.9 million from the Netherlands). This supported the computerization of the stock exchange, drafting 6 new laws relating to business and improving customs clearance procedures. It also created a unit to shepherd the stalled privatization; but there were few transactions. It was not until a resident staff member was assigned to the unit, and after King Hussein died in 1999 (he had intervened with alternative proposals when the telecom deal came to him for approval) that major firms, and the telecom company in particular, were sold.²⁷

²⁴ The savings were actually lower than indicated by conventional national income account statistics in which no adjustment is made for the *depletion* of potash that was mined (or the use of water from aquifers). Also, to the extent that public sector "profits" transferred to the budget as non-tax revenue included disinvestments, the true budget deficit was larger than the stated one, and domestic savings smaller.

²⁵ The proceeds from a sale would equal the present value of the future income stream (that would be larger if the firm were better managed after privatisation); and if the proceeds were invested in bonds, cash flows would be unchanged. Alternatively, the Government could use the proceeds to retire some of its borrowings thereby reducing its non-tax revenues and also its interest expense leaving its overall budget deficit unchanged.

²⁶ In February 1996, the Fund replaced the on-going Extended Fund Facility (EFF) with a new and larger one (230 million SDRs); but chart 7b shows how the Fund's net transfers evolved.

²⁷ The Minister of Planning notes that, "privatization commenced prior to the death of His Majesty, the late King Hussein, and that it is a time-consuming process."

2.14 ERDL-II also had conditions dealing with the financial sector; but besides some minor changes in reserve requirements and better supervision (of banks and insurance), the goal was to eventually privatize and restructure the housing bank and the problem-ridden agriculture bank (that the ASAL did not succeed in remedying). The conditions were only the initial steps in this direction. Some technical improvements to the Amman Stock Exchange (clearing and settlements) were included.

The 1995–1998 Achievements

2.15 Although the three ERDLs were rated as satisfactory, Jordan's economic achievements during this period were modest at best. The economy barely grew at the rate of population increase in the 1990s, and the structure of government expenditures remained largely unchanged. Privatization had begun after many delays, but the expected flood of "green field" foreign investment had not materialized.

2.16 While all of the measures listed as ERDL tranche release conditions were desirable, none significantly reduced or improved government spending. There was, however, an improvement in tax collections despite teething problems in the widening of the general sales tax base and its evolution into the VAT. A slew of new laws were passed; but observers have pointed out many were drafted hastily and that the beneficiaries (e.g., businessmen) were barely consulted. Some of these laws have since had to be revised.

2.17 Privatization gives the new owners the incentive to operate efficiently (and a sale to foreigners brings in foreign exchange), but it does not increase private investment in the economy. Furthermore, privatization is used loosely: the Housing Bank, for example, was "privatized" by transferring the Government's 15 percent stake to the social security

fund.²⁸ Similarly, lower trade tariffs improve resource allocation; but they do not automatically increase investment or growth. The Bank pursued those issues that the counterparts thought were "achievable;" but even here, the progress was modest. The sale of some important firms was stopped by vested interests, and King Hussein was otherwise occupied (illness and the Israeli-Palestinian deadlock) to break the deadlock.

2.18 As if this were not enough, the authorities disclosed in late 1998 that the economy was growing at 1 percent, not 5 percent that the Fund had been told earlier, and that the budget deficit would be more in the 8–10 percent of GDP range rather than the projected 4 percent. With the Fund program off-track, ERDL-III was delayed.

The 1999 Bank's Strategy

2.19 ERDL-III for US\$120 million was approved in June 1999, after King Hussein's succession was clear and a new agreement with the Fund was reached. King Abdullah-II

²⁸ Subjecting the Housing Bank to the same laws and regulations as other commercial banks was one of the ERDL-II's requirements. The Housing Bank had been set up in 1973 under a special charter, but the Government of Jordan only held 15 percent; the Governments of Kuwait, Libya, Saudi Arabia, Qatar and Iran hold 18 percent, 16 percent, 16 percent, 9 percent and 3 percent respectively. Although a few individuals also own shares that are traded on the Amman Stock Exchange, it would be a stretch to call it a private commercial bank.

broke the privatization impasse and additional laws that ERDLs supported were passed. By this time, the country's foreign exchange reserves were comfortable, although they needed watching.

2.20 The Bank's strategy, approved in November 1999, updated the worrying developments since 1995 but absolved the Government by stating that the stagnation was a result of exogenous factors which were outside Jordan's control.²⁹ While the peace negotiations over the West Bank had stalled and the political euphoria had evaporated, these and the East Asian crisis were branded as the culprits, not the decades of low private (non-housing) investment and high government spending that was sometimes misdirected.

2.21 The Bank's strategy coincided with the Ministry of Planning's 5-year Economic and Social Development Plan (1999–2003) that sought to raise the rate of economic growth. The plan articulated the goals more clearly than how the Government would achieve them. The planned measures—continued privatization, etc.—echo (or *vice versa*) the Bank's strategy suggesting some agreement.

2.22 The Bank continued its support through multiple, single tranche adjustment loans, calling the new series Public Sector Reform Loans (PSRL-I for US\$120 million approved in May 2001, and PSRL II for US\$120 million in June 2002). The conditions relate to “inputs” (e.g., upgrading computers in courts, having a new civil service bylaw etc.), not “outputs” (e.g., levels of government service or reductions in expenditures known the Public Expenditure Reviews identified as poorly spent). The PSRL-I tries to tackle civil service reform, and a recent OED Review of Bank Assistance³⁰ in this area finds that adjustment loans are particularly ill suited to this. Although their outcomes are too early to evaluate, it may have been more prudent to support some of the measures³¹ through a Learning and Innovation Loan (LIL) or adaptable lending that allows adequate time for implementation.

3. An Assessment

3.1 This section assesses the Bank's diagnosis, advice and assistance. It finds that the Bank's *ESW was good and that the advice was generally sound*. One omission was the neglect of the labor market (a 1989 report was not followed up)—which is surprising, considering that unemployment was a high 14 percent and poverty was of great concern. An exception to good economic work was in continually projecting high rates of growth when there was ample evidence of low investment (both government and private non-housing) since 1985. Bank and Fund projections must be consistent; but such work undermines the Bank's credibility for sound and reliable economic analysis.

²⁹ A 2001, World Bank internal document states a similar view.

³⁰ “Civil Service Reform: A Review of World Bank Assistance,” Report No. 19599 (August 4, 1999).

³¹ The newly created Ministry of Administrative Affairs plans to mandate training for civil servants in the English language and computers; and this could prove costly and ineffective because there is no system to evaluate their effectiveness built in. Judiciary reform involves hiring more judges and training them in English and computers: but no changes are planned in the rest of the legal system (the curriculum for lawyers, the system of notaries, etc.) because these were not within the purview of the Ministry of Justice.

3.2 Not all the Bank's ESW found immediate acceptance; but the ideas circulated in the Government and when the King seemed interested in an issue (for example, privatization), the Bank's work provided the sound basis on which to proceed.

3.3 The Bank (and Fund) bridged Jordan's "financing gap" through large adjustment loans that supported reforms in sectors that the authorities agreed could be tackled (for example, trade reform, privatization). Unfortunately, the loans did not tackle issues (for example, wasteful government expenditures) that the ESW identified as important but which the Government was reluctant to address. Even in the "reformed" sectors, however, progress has been more modest than had been hoped for (for example, water, electricity). A government that spends a lot and does so poorly, crowds out the private sector—even if all the state owned firms were privatized and enough taxes were raised to balance the budget. While the Fund focused on keeping the budget deficit manageable, the Bank had already identified many wasteful expenditures as early as 1991 but had failed to persuade the Government to end them. ***The outcome of Bank lending is therefore rated as moderately satisfactory:*** despite privatization and trade reforms, non-housing private investment remains under 8 percent of GDP (up from 4 percent in 1995) and stagnant real per capita GDP.

3.4 ***Bank performance is rated as moderately satisfactory*** because it did not ensure that issues identified by the ESW were addressed despite the magnitude of lending. The authorities generally complied with the agreed covenants of the loans but resisted reforms in many important areas. ***Institutional development is rated as modest*** because there was no marked improvement in the institutions of economic policy making and execution. ***Sustainability is rated as likely*** because despite the initial foot-dragging on structural reforms, there is now wide agreement that these were needed and so are likely to be sustained. The explanations of this summary assessment now follow.

The Diagnosis and Prescription (Advisory Services)

3.5 Except for the overly optimistic growth forecasts, the Bank's Economic and Sector Work (ESW) was generally good, and its prescriptions were sound. One omission was of the labor markets: despite high and persistent unemployment and likely links to poverty, the Bank did not examine these issues after an initial report in 1989. The major themes of what was done are briefly outlined below.

Trade Reforms

3.6 Focusing on trade issues was well justified as the high tariff and non-tariff barriers of the 1980s were distortionary. Quantitative Restrictions covered 40 percent of domestic manufacturing and over 65 percent of import value, and replacing them with low and uniform tariffs was the right approach. Trade hurdles were lowered only slowly, however, with each step being painfully negotiated with the Bank under the ITPAL, suggesting that despite a very porous border, that the authorities were unconvinced of the merits of free trade. The Bank's view at the time (not just in Jordan but also in countries like Colombia) was that trade should be gradually freed and be complemented by credit lines for industrial recovery (hence perhaps the Export Development Project in 1996 providing a US\$40 million line of credit that was only partially used).

3.7 The pace of trade reforms increased after 1997, and the customs department estimates that the weighted average tariff rate fell from 16.6 percent in 1998 to 13.5 percent in 2000. Jordan joined the WTO in April 2000, and also signed trade agreements and partnership with the European Union (EU). The free-trade agreement with the US enabled Qualified Investment Zones (QIZ) to be set up for tariff and quota free exports to the United States.³² A Special Economic Zone has also been set up in Aqaba (the feasibility study was financed under the Export Development Project) with tax privileges, but it is too soon to tell how successful this has been. If trade taxes are low, such special zones are hard to justify.

Privatization and PSD

3.8 The thrust of Bank's advice on privatization—to quickly sell major firms like telecom and utilities—was sound. The privatization program was launched in 1996, but there were few transactions until King Abdullah II came to power and spurred the process on, helped by a resident Bank advisor appointed to the privatization unit.

3.9 The proceeds of privatization are held in a privatization fund with the law specifying how they could be spent. The intent is to prevent the proceeds from being wasted, and some of it has been used to buy back the external debt at a steep discount. It appears that the Bank was not much involved in formulating the privatization policies that were embodied in the law, and many remarked that it was better thus because it fully reflected domestic political sentiments. The Bank provided useful technical help in the transactions.

3.10 The Bank's work on private sector development was well done. The 1994 Country Economic Memorandum was followed by a short but comprehensive Private Sector Assessment³³ (PSA) in 1995 which concluded that the main constraint on the private sector was a slew of regulations that delayed investments and increased their costs. The Bank also coordinated what needed to be done with other donors: USAID financed considerable technical work.³⁴ Some of this work may not have immediate benefits: antiquated stock exchanges and registries, for example, have not inhibited private sector growth in India, China, Brazil—or even 19th century United States. It is easy to confuse things that are associated with prosperity with its cause; so only time will tell if these efforts will indeed improve firms' access to finance.

3.11 The PSA was sensitive to the diverse needs of small and large firms, and relied on a survey to rank regulations by their importance. The report discussed the regulatory framework needed to privatize firms. The chapter on the financial sector was equally clear and coherent: it pointed out that the problems were not in commercial banks but in

³² Under this arrangement, the QIZ's value added must be at least 35 percent, of which 11.7 percent must be from Jordan and 8 percent from Israel with the remainder from the West Bank, Gaza, Israel, US or Jordan. It appears that although exports from the QIZ's are increasing rapidly (making the US the largest single export destination), much of this are from textiles where the value added is far more modest than gross data would suggest.

³³ "Jordan: Consolidating Economic Adjustment and Establishing the Base for Sustainable Growth" (Report No. 12645-JO, August 24, 1994 in two volumes) and "Jordan: Private Sector Assessment" (Report No. 14405-JO, August 25, 1995).

³⁴ USAID's program in Jordan increased greatly after 1997, with annual grants of between \$100 million to \$150 million. It funded work that the Bank managed including advisors on privatization.

the specialized *government* banks (the Housing Bank, Industrial Development Bank, the Agricultural Credit Corporation etc.).

3.12 All the PSA's recommendations could not be made tranche release conditions; but choosing from such an array is tricky. Some changes favor larger enterprises, but others like the removal of onerous regulations benefit small entrepreneurs disproportionately. The measures chosen as tranche release conditions were generally those that could be satisfied by the planned disbursement dates; but the Bank could have put greater emphasis on changes that benefit the smaller enterprises who have less of a voice in the Government.³⁵ Improvements in customs or better stock exchange procedures (ERDLs' conditions) benefit the larger firms; but the PSA provided several examples that would have benefited small firms, such as allowing smaller, community based banks to operate. The Bank's PSA was more sensitive to these issues than its loans.

Macroeconomics

3.13 The Bank's growth projections were quite off the mark. Economic growth is the result of technological improvements that are usually embedded in physical or human capital; so growth of 6 percent is unlikely when private (non-housing) investment had declined to about 5 percent of GDP and government capital expenditures were around 7 percent of GDP. Some staff defend these high projections because this was Jordan's "historic" growth rate in the 1980s (ignoring the low investment) while others felt bound by the Fund's numbers; but in either case, this suggests serious shortcomings in the Bank's analytical work. Some senior Bank staff knew all along that the projections were unrealistic, but defended their use lest lower projections deter foreign investors. Such Bank analysis has little value and erodes its credibility.

3.14 The growth shortfall could lead to a hunt for scapegoats (for example, the exchange rate?) or miracle cures (for example, information technology?).³⁶ Disappointing growth prompts some to urge the Government to "jump start growth"³⁷ but while the Government can pull on the reins of private investment, it cannot push on them to increase it. Directly financing or subsidizing "high value adding" or job-creating projects that are better left to the private sector to find and operate become tempting. Some of the Government's recent initiatives (for example, emphasis on Information Technology) could get out of hand unless their effectiveness is closely and carefully monitored. It would have been better for the Bank to have linked structural reforms and privatization to efficiency rather than to growth. Growth would have been more likely (but not assured) if the Bank had urged lower government spending for this would increase domestic savings, and perhaps private investment. The Bank could have pushed harder for cuts in government expenditures, especially since its ESW provided ample examples where this could be done without undercutting the Government's social spending decisions.

³⁵ The Minister of Planning disagrees with the statement that smaller enterprises have less of a voice noting that, "there are different unions to represent them."

³⁶ A 1998 World Bank internal document states that during the past two year, Jordan has not been able to meet the expectations in economic growth due to a combination of factors like regional political uncertainty; loss of traditional export markets; adjustment after the 1992-94 construction boom; and necessary corrections in monetary and fiscal policy. It goes on to state that the main source of growth and employment would be in exports and tourism, thereby inviting subsidy seekers in these sectors and setting the stage for further disappointment if growth remained anemic.

³⁷ OED findings in 2001 corroborate the same.

3.15 One omission in ESW was an analysis of labor markets. Many officials are reluctant to reduce government employment lest people remain unemployed. The Bank has changed peoples' views in other sectors (for example, privatization) with patience, persistence and sound analytical work and may have been able to do so on this issue also. Government over-staffing is more pernicious than just its budget expense alone: employees with little to do lower morale; so fewer workers often raise output.³⁸ Redundant staff may create work for themselves through pointless regulations that impede the private sector. Many such regulations were identified in various Bank reports (for example, 1995 Private Sector Assessment), and some have been dismantled under the ERDLs despite resistance from the civil service; but the aggregate magnitude of government expenditures suggest that much remains to be done. A thorough study of the labor market could provide the analytical basis for a discussion of these issues.

Lending Amounts and Tranching

3.16 Bank adjustment loans, like loans from the Fund, are justifiable when the fiscal and/or the balance of payment deficits are deemed to be temporary and the exchange rate regime and levels appropriate. Jordan has a pegged exchange rate regime³⁹ with the dinar pegged to the US dollar at Jordanian Dinar (JD) 0.709/US\$ since October 1995. Although exchange rate (level and/or regime) is a Fund issue, the Bank's decision to lend is predicated on how the funds are spent, and defending an inappropriate peg is obviously wasteful.⁴⁰ The Bank's views on the exchange rate are re-examined before the level of lending and tranching are discussed.

The Exchange Rate

3.17 The Box examines the classic economic arguments, distinguishing among the exchange rate (i) regime, (ii) basket, and (iii) parity. There is also an important political

³⁸ An example in Jordan is the private firm hired to manage the Amman Water company of behalf of the Water Authority of Jordan. It had 1,600 seconded workers but found that it accomplished more with fewer workers who were given better incentives.

³⁹ Jordan has had a longer and happier experience with fixed exchange rates than with a float. It had a sterling based currency board from 1950 until the Central Bank of Jordan was established in 1964. The dinar was pegged to the SDR in 1975, but the band within which it could move was widened in the mid-1980s essentially allowing the dinar to depreciate. The widening divergence between the official and market rate (which commercial banks could offer) encouraged round-tripping, and in October 1988 (economic and political ties were severed with the West Bank in July), the CBJ floated the dinar.

When the "floating" dinar sank, depreciating by 21 percent in 1988, the authorities blamed "speculative" money changers who were shut down in February 1989. Commercial banks could only offer the official exchange rate of \$1.852/JD—effectively a 12 percent depreciation since December 1988. In May 1989, the dinar was pegged again to a basket of the 5 SDR currencies (with weights representing their trade shares with Jordan); but the CBJ could not prevent a devaluation. A dual exchange rate was re-established in July 1989 (with \$1.726/JD at the central bank and \$1.124/JD at the commercial banks). The two rates were unified at \$1.486/JD in February 1990 after the CBJ depreciated the dinar slowly; but this time it was a *crawling* peg with a depreciating dinar. At the end of 1990, the exchange rate was \$1.504/JD. Since 1995, however, the JD has been pegged at \$1.410/JD or, conversely, JD0.709/\$.

⁴⁰ Besides an inappropriate peg, capital flight would be another wasteful use of Bank funds. Diwan and Squire ("Economic Development and Cooperation in the Middle East and North Africa", Discussion Paper Series, Policy Research Department, The World Bank, 1993) also estimated capital flight from Jordan at 9.7 percent of GNP in 1985-89—amongst the highest in the region. They used the "World Bank residual" method where capital flight = (External Borrowing + Foreign Direct Investment).

—(Current Account Deficit + Increase in FX Reserves). This technique, however, fails to capture capital outflows through over-invoicing of imports and under-invoicing of exports. These estimates are not very accurate, and different techniques could yield widely different results.

dimension: Palestinians in the West Bank hold much of their savings in Jordanian banks denominated in dinars, and the Palestinian Authority has considered issuing its own currency (before the current *intifada*).

3.18 This discussion suggests that the CBJ's preference for a pegged exchange rate regime is quite defensible; but its ability to maintain the peg is limited by its foreign exchange reserves—supplemented when necessary by loans from the Bank and Fund. The views of the institutions are therefore important and Bank staff have expressed concern that the dinar's real appreciation (almost 20 percent since 1997 by some measures) have hurt exports and growth⁴¹.

Box 1: Exchange Rate Regime, Basket and Parity

Some worry that the dinar's real appreciation has made Jordan uncompetitive. Before blaming an over-valued currency for the low growth rate (of incomes or exports), three related issues should be distinguished: (i) the exchange rate *regime*; (ii) the *currency it is pegged to*; and (iii) the *level* of the peg.

The classic “optimal currency area” literature suggests that floating exchange rates protect a country from shocks originating abroad, but when *factor* markets are integrated (Jordan has few barriers to capital flows and many work abroad), a fixed exchange rate regime has merit. Furthermore, the more recent literature—skeptical of monetary policy's ability to influence real activity—focuses more on whether the domestic or the foreign central bank could be trusted to maintain a stable price level and avoid inflation. Jordan's short experience with floating rates in the late 1980s shows the dangers of freeing the CBJ of the discipline imposed by a pegged rate.

If a pegged exchange rate *regime* were appropriate, pegging to the US dollar seems appropriate because many Jordanians work in dollar based countries (the Saudi real and the Kuwaiti dollar are each pegged to the US dollar, and oil prices are generally dollar determined).

Some who accept the merit of pegging the dinar to the US dollar nevertheless worry that real effective exchange rate calculations show a 20 percent dinar appreciation since 1997; *but this alone is no argument for a change in the peg or the parity*. Structural/productivity changes could warrant a real exchange rate change; but economists cannot easily determine this. Even freely floating rates (e.g., the dollar-sterling or the dollar-yen) often have large and persistent real exchange changes for no obvious reasons. Exchange rates, like other asset prices, reflect expectations that are more volatile than actual movement in goods prices. Such real exchange rate variations are generally self-correcting, and frequent changes in parity (to maintain some real exchange rate level) undermines the credibility of the peg and risks the loss the nominal anchor so essential for a stable price level. Of course, a pegged exchange rate regime will fail if government policies are inconsistent with it: in particular, the budget deficit should be small enough to prevent the stock of public debt from mushrooming.

3.19 Such a real appreciation of the dinar, however, does not necessarily imply an over-valuation—and should not be confused with the choice of the *regime*—but it should prompt the authorities to be particularly careful in ensuring that fiscal policy (which it controls, unlike monetary policy which maintains the exchange rate peg) is prudent and consistent with the peg. Worker remittances and capital flows are of particular importance to Jordan, and are heavily influenced by public confidence—in the exchange rate peg and the implicit promise to maintain it, as well as other economic and political developments.

⁴¹ An internal Bank report noted that prices have been anchored by the peg of the Jordanian dinar to the US dollar, and inflation has been consistently low in recent years, although the peg could have hurt export performance” (§ 11).

Multi-tranche versus Multiple Single tranche Adjustment Loans (or “rewarding countries for actions, not promises”)

3.20 Single tranche loans, by their very nature, entail no disbursement delays that arise from unmet conditions linked to subsequent tranches; but this is not always a virtue. Avoiding disbursement delays has merit only if (i) the Government embraced the reforms but the specified conditions take longer than expected *and* (ii) the tranche is needed to maintain the exchange rate *peg that is justifiable*. Unless both held—regardless of whether the Fund counted on Bank disbursements in its program—the tranche should be delayed.

3.21 The move to single tranche lending in 1996 came because of disbursement delays of the earlier ITPAL and ESAL—where sectoral reforms are still incomplete. So while it is literally true that single tranche loans support actions “already undertaken,” it gives a misleading impression of structural reforms’ success. One loan could support the break up of the electric utility (generation, transmission and distribution); but if the Government balked at their privatization (the next step to ensure improved outcomes), the next loan could support reforms in another unrelated sector. Many sectors need reform, and an advance in one could be used to justify the next loan. Thus, even when Bank staff and government officials are well-intentioned, the danger of “opportunistically supporting reforms” is that incomplete reforms may result in unimpressive outcomes.

3.22 Multi-tranche loans have merit when future measures could be clearly specified at the outset. Outcomes may still prove elusive if the tranche release conditions are necessary but not sufficient; but it makes it harder to change horses mid-way. This apparent loss of flexibility may be to the country’s advantage if reformers have short tenures because they bind her successor. Even with an equally reforming successor, agreeing on the subsequent tranche conditions would cause less delay than agreeing on conditions with the new Minister learning the job.⁴² And if the successor were a non-reformer, there would be further delays.

3.23 The ERDLs’ loan covenants were met, but more importantly, they resulted in reduced trade barriers and some privatization. While one could question why the ERDLs were not multiple tranches, their main drawback is that identified problems in government expenditures were not fully addressed and that the level of such spending did not materially decrease.

3.24 This assessment of the Bank’s diagnosis, advice and assistance therefore concludes that while there were some gains, the large loans (61 IBRD loans and 12 IDA credits for about US\$2 billion) could have achieved more. Clearly macroeconomic stability—low inflation and a stable currency—was an impressive achievement, but deep-rooted fiscal problems remain. This was not because of the absence of analysis but the difficulty in persuading counterparts to undertake difficult reforms—but that after all is the purpose of structural adjustment loans.

⁴² The Minister of Planning disagrees because, “Reforms are a comprehensive national policy and are not based on an individual’s policy.”

Annex A: List of Privatization and Associated Laws

List of Privatization

1. Jordan Cement Factories: 33 percent sold to Lafarge for US\$102 million
2. Public Transport Corp: November 1998 contracts with 3 local operators. 10 year concessions for 4 routes in Greater Amman
3. Ma'in Spa Complex 30 year lease and invest agreement with Accor and local investor group
4. Aqaba Railway: 25 year lease and operate agreement with Raytheon-Wisconsin Central Sep 2000. Newly established Jordan Rail will operate and maintain and until Shideya extension
5. Jordan Telecommunications Co.: 40 percent sold to France Telecom for US\$508 million and additional 8 percent to Soc. Sec. Corp. Second GSM began operations in September 2000
6. Water Authority of Jordan: Management contract for Amman in April 1999 with Suez (Credit Lyonnaise des Eaux/Arabtech Jarnaeh). Unpaid water use fell from 54 percent to 47 percent
7. JIC portfolio: Divest 45 companies for US\$113 million

(Ongoing)

8. Royal Jordanian Airlines: Made joint stock in 2000; split activities
 - a. Duty free shop sold to Aldeasa (Spain) for US\$60.1 million in August 2000
 - b. Training Center expected to sell to Boeing for US\$18 million
 - c. Catering to be sold to (British) Alpha for US\$20.2 million
 - d. Engine Overhauling and Maintenance (to be sold)
 - e. Royal Jordanian core flying business
 - f. Royal Jordan Air Academy (expected by end 2001)
9. Postal Service: 4 year-mgt. contract to be awarded
10. Electricity: NEPCO split into generation, transmission and distribution. Bank involved
11. Petra Drilling Co.: Drilling separated from National Petroleum Co. and adv. For sale.
12. Assamra Water Treatment Plant: for BOT (USAID involved)
13. Petra Water Authority
14. Sundry: Ministry of Supply and Customs warehouses

(Identified for future privatization)

15. Jordan Phosphate Mining Co (GoJ owns 60.4 percent)
16. Arab Potash Co. (GoJ owns 52.9 percent): Its subsidiaries include:
 - a. Jordan Dead Sea Industries
 - b. Safi SALT
17. Airports and Civil Aviation
18. Aqaba Ports

Associated Laws

National Economy Protection Law (3/1992)
Telecommunications Law (12/1995)
Investment Promotion Law (16/1995)
Income Taxation Law (57/1995)
Companies Law (22/1997)
Stock Exchange Law (23/1997)
Customs Law (20/1998)
General Electricity Law (13/1999)
Privatization Law (25/2000)
JRTV Corporation Law (35/2000)
Intellectual Property Rights Law (various 1999–2000)
Banking and Deposit Insurance Law (2000)
Competition Law (July 2002)

Annex B: List of People Interviewed by the CAE Mission

List of Bank staff interviewed

Inder Sud (then Country Director)
 Spiros T. Voyadzis (then COD Division Chief)
 John Page (Director, PRMPR)
 Jayanta Roy (then Country Economist)
 Fauzia Najam (then Country Officer)
 Christian Petersen (Lead Economist, ECSPE)
 Carlos Silva-Jauregui (Senior Economist, MNSSED)
 T.G. Srinivasan (Senior Economist, MNSSED)
 Dimitri Vittas (Senior Adviser, OPD)
 Antonio Furtado (Division Chief, IMF)

Government officials and other counterparts

Ummia Tokan (Governor, Central Bank of Jordan)
 Ahmad Mustafa (Deputy Governor, Central Bank of Jordan)
 Ziad Fariz (former Governor, Central Bank of Jordan; former Minister of Planning; CEO Arab Banking Corp.)
 Michele Marto (Minister of Finance)
 Bassem I. Awadallah (Minister of Planning)
 Hala Bsaiso Lattouf (Secretary General, Ministry of Planning)
 Nael Al Hajaj (Director, Ministry of Planning)
 Tayseer R. Al-Sumadi (Ministry of Planning)
 Taher H. Kanaan (former Deputy Prime Minister; Secretary General, Higher Council for Science and Technology)
 Hatem Halawahi (former Minister of Agriculture; former MD Jordan Cement; President, Amman Chamber of Industry)
 Juma Abu-Hakmeh (Director General, Amman Chamber of Industry)
 Amin Y. Husseini (Secretary General, Federation of Jordan Chamber of Commerce)
 Reem Badran (Director General, Jordan Investment Board)
 Sireen Yashruti (Communications Manager, Executive Privatization Commission)
 Robert L. Wagner (Executive Privatization Commission)
 Ella C. Nuqut (Chairman, Nuqut Group of Industries)
 Hamdi M.S. Tabba'a (former Prime Minister)
 Thabet A. Taher (former Minister of Economy; former MD Jordan Phosphate; Arab Mining; Deputy Chairman, Jordan Businessmen Association)
 Fakhri Bilbeisi (Secretary General, Jordan Businessmen Association)
 Ali Yousef (Director General, Jordan Businessmen Association)
 Qutaiba Abu Qorah (Jordan Investment Corporation)
 Mohammad Thneibat (Minister of Administrative Development)
 Osamah Jaradat (General Director, Ministry of Administrative Development)
 Salah Eddin Al-Bashir (Minister of Industry and Trade)
 Bassel Hindawi (Director General, Insurance Regulatory Commission)
 Zuhair Khouri (Chairman, Housing Bank for Trade and Finance)
 Ilhab Saadi (Advisor, Housing Bank for Trade and Finance)

Mohammed Batayneh (Minister of Energy and Mineral Resources)
Azmi Al-Said Khreisat (Secretary General, Ministry of Energy and Mineral Resources)
Faris Nabulsi (Minister of Justice and Minister of State for Legal Affairs)
Nazem Aref (Secretary General, Ministry of Justice)
Philippe Carton (LEMA)

Roy J. Grohs (Program Officer and Economic Advisor, USAID)
Jon D. Lindborg
Jim N. Barhart
James Franckiewicz
Mellen D. Tanamly

Andreas Kuck (GTZ)
Muhammad Kadhim
H. Jochen Regner

Comments from the Ministry of Planning

THE HASHEMITE KINGDOM
OF JORDAN
MINISTRY OF PLANNING
AMMAN



Attachment
المملكة الأردنية الهاشمية
وزارة التخطيط
عمان

Ref.No. MB/2002/154
Date Oct. 7, 2002

الرقم
التاريخ
الموافق

Mr. René Vandendries
Acting Manager
Country Evaluation and Regional Relations
Operations Evaluation Department
The World Bank
Washington, D.C. 20433
USA

Dear Mr. Vandendries,

In reference to your letter dated September 10, 2002 and its attachment report on the Country Assistance Evaluation (CAE) prepared by the Operations Evaluation Department (OED) of the World Bank, I would like to thank you for your efforts at putting together this detailed report. However, it must be noted that I am very concerned about the accuracy of the information presented in the report. Furthermore, many of the statements mentioned in the report carry rather insulting undertones and ambiguous implications.

In addition to the following general comments, I am attaching a detailed commentary of the CAE so as to clarify what specific points we disagree with.

General Notes

- ◆ Since the year 2000, the Department of Statistics changed the base year for national accounts from year 1985 to 1994. Naturally, this has had a profound impact on the resulting calculations such as the GDP and figures related to the GDP. Accordingly, figures of the macroeconomic indicators in the draft report are inaccurate when compared to Jordan's official statistics.

THE HASHEMITE KINGDOM
OF JORDAN
MINISTRY OF PLANNING
AMMAN



المملكة الأردنية الهاشمية
وزارة التخطيط
عمان

Ref.No.

Date

الرقم

التاريخ

الموافق

- ◆ Many of the figures presented in the report need to be updated and revised in accordance with the most recent available official data. In addition, the methodology used in calculating some figures is not clear.
- ◆ There are numerous sentences and statements that are both incorrect and inappropriate to be included in the report.

I would appreciate it if you thoroughly look over these comments and adjust the report so as to reflect the true reality of our country. I look forward to coordinating our knowledge to produce an accurate and updated final report.

Please accept my high esteem and consideration

Sincerely,



Bassem I. Awadallah
Minister of Planning

cc: Mr. Joseph Saba

Comments on the Country Assistance Evaluation Report of the Hashemite Kingdom of Jordan

- **Specific Notes on section I: Economic Development in the 1990s and World Bank Assistance.**
 - ✓ Para 1.1, line 2, should be rephrased as follows: "Jordan was established as Trans-Jordan from parts of the Ottoman Empire at the end of World War I, whereby Amir Abdullah was nominated as ruler..." In addition, the last sentence of paragraph 1.1 should omit the phrase 'family and cultural' since there is no proof for this argument.
 - ✓ Para 1.2, line 1, King Hussein ruled from 1952 and not from 1948 as stated in the report. Moreover, lines 5-8 in the same paragraph, describe the difficulty in implementing institutional and private sector development as well as policy consistency as a result of the 'limited circle' of the cabinet 'who share a similar outlook.' There is no proof for this statement. The role of the Cabinet is to build on the achievements and enhance the policies rather than change them. In addition, many of Jordan's policies have been positively changed towards opening and privatizing the economy.
 - ✓ Para 1.3, line 2, it is the Arabian Gulf and not the Persian Gulf. Line 3 refers to workers' remittances as domestic savings instead of as national disposable savings. However, GDP does not vary significantly from GNP except when net income from abroad is negative or approximately zero, mainly when debt service is too large to absorb remittances (footnote 1, p1). Furthermore, line 5 states that per capita GNP in year 2000 was \$1,710. However, according to the Jordanian reports which are more accurate, per capita GNP in year 2000 was in fact \$1706 (footnote 2, p1). Accordingly, per capita GDP is \$1680 (GDP= \$8463.4 million, pop.=5.039 million).
 - ✓ Para 1.5, line 5, the report mentions the word **despite** implying that we are breaking the embargo. Also, in footnote 3 on page 2, concerning the legal position of trade with Iraq, it is noted that part of the oil arrangements is to compensate Jordan for the loss of grants from other Arab countries following the Gulf War. This statement is not true as the Arab grants to Jordan started declining since the early 1980s and almost stopped in 1987. During the 1980s, oil imports from Iraq to Jordan increased to providing

approximately 86% of Jordan's needs in 1990. In addition, Jordan applied Article 50 of the UN Charter, which permitted it to have special arrangements with Iraq as the most affected country of the Gulf crisis. Furthermore, while the statement in lines 9-11 of the same Paragraph is correct, the explanation provided in footnote 4, page 2 is inappropriate.

- ✓ Para 1.6, line 3, mentions that our historic ties with Iraq prevented Jordan from supporting Kuwait. This statement is not true since Jordan called for a peaceful solution to that crisis and did not support any party. It is therefore recommended to delete that sentence from the text. However, in the same Para, lines 5-7, the report refers to the Gulf War as the cause of the Jordanian economic crisis and currency depreciation. However, the economic crisis in Jordan hit in 1988 when Jordan launched its first Economic Structural Adjustment Program with the WB and IMF in 1989 (before the 90/91 Gulf crisis).
- ✓ Para 1.10, line 5, states that the government of Jordan reduced capital and not current spending. However, the reduction in capital expenditures was due to an agreement with the WB and IMF, accompanied with the rationalization of current expenditures (This argument applies for Para 1.17).
- ✓ Para 1.13, line 2, mentions that the decline in debt was mainly due to debt forgiveness and rescheduling. However, good Government management of debt enabled Jordan to purchase and swap a considerable amount of foreign debt. Furthermore, in July 2002 the Government reached a new agreement with the Paris Club to reschedule US\$ 1.2 billion of its external debt. (This argument applies for Para 1.14).
- ✓ Para 1.15, line 2, claims that a little more than half of the domestic debt is held by the CBJ. This is only valid when including the Treasury Overdraft Account at the CBJ. Line 4 of the same paragraph mentions that the public deposits at the banking system exceeds GDP. This is not true since public deposits (excluding Treasury Overdraft Account at the CBJ) at the banking system did not exceed 10% of Jordan's GDP in 2000.
- ✓ Para 1.18, lines 5-8, the recommendations provided for higher education and health are good solutions for the short-term. However, Government policy towards achieving these objectives aim for long-term solutions by offering scholarships as well as by

- providing equitable and sustainable health care for the poor who normally live in sub-urban and rural areas.
- ✓ Para 1.19, lines 4-10, the comments and figures apply to the year 1994, before the reform program were implemented. Therefore, it is recommended that these comments and figures be revised and updated.
 - ✓ Para 1.20, the footnote 12, p 9 claims that 500,000 foreign workers are not subject to the minimum wage or social security taxes. This comment needs to be corrected because legal foreign workers are entitled to all labor laws (minimum wage and social security taxes).
 - ✓ Para 1.24, line 2, mentions that the Jordanian public trusts privately owned banks. It is worth noting that the banking system in Jordan includes commercial and investment banks (privately owned), and specialized credit institutions. By law, it not accepted to have public deposits at privately owed banks. Therefore to correct the statement mentioned, it is not a trust issue but a legal one.
 - ✓ Para 1.27, line 2, The deposit interest rate was freed in Feb. 1990 and not in 1988 as mentioned. In addition, there are 9 and not 7 commercial banks in Jordan. Regarding footnote 16, it is due to confidence in the Arab Banks rather than the Arab Bank's royal connections that attract clients.
 - ✓ Para 2.2, line 7, mentions that there are three CASs (1993, 1995, 1999), while in fact there are only two CASs (1995, and 1999). However, the 1993 CAS referred to in the report was the first adjustment loans for industry and trade policy (ITPAL), and the second was for energy sector (ESAL).
 - ✓ Para. 2.4, correct the spelling of 'implanting' to 'implementing'.
 - ✓ Para. 2.13, states that it was not until the death of King Hussein in 1999 that major firms were sold. It should be noted that privatization commenced prior to the death of His Majesty, the late King Hussein and that it is a time-consuming process.
 - ✓ Para 2.21, lines 5-8, are irrelevant and inappropriate. Our work with the World Bank is based on consistent government policy and is not swayed by an individual Minister.
 - ✓ Para 3.3, line 3, mentions wasteful government expenditures (refer to comments on Para 1.17), without specifying which expenditures. The rationalizing of government expenditures is a

gradual process that has several social implications and hence cannot be assessed within few years of reform.

- ✓ Para 3.4, line 3, states that the authorities resisted reforms in many important areas without specifying which ones. As for institutional reform, it is a gradual process which requires time. The process of labor market reform (see Para 3.15) is part of both human resources development and economic performance, which are being emphasized by both the Government of Jordan and the World Bank.
- ✓ Para 3.7, the statement concerning the QIZs in lines 3-5 is misleading. There is no mention of the FTA with the USA, and EU partnerships. It merely claims that Jordan signed trade agreements that enabled QIZs to be set up for tariff and quota free exports to the US (although footnote 30 explains the percentage share of partners in the 35% value added required from QIZ).
- ✓ Para 3.12, line 6, although the comment made about small enterprises is not appropriate, it should be noted that there are different unions to represent them.
- ✓ Para 3.22, lines 5-8, argues that agreeing on the subsequent tranche instead of on conditions with the new Minister learning the job would cause less delay. Reforms are a comprehensive national policy and are not based on an individual's policy. This statement is therefore not accurate.
- ✓ Para 3.24, lines 5-7, With regards to the statement on Jordan's difficulty in undertaking reforms, it should be noted that Jordan is taking into consideration the social implications of reform and hence cannot implement them rapidly.