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Between Chances and Challenges

An Economic Policy Analysis for the Hashemite Kingdom of Jordan

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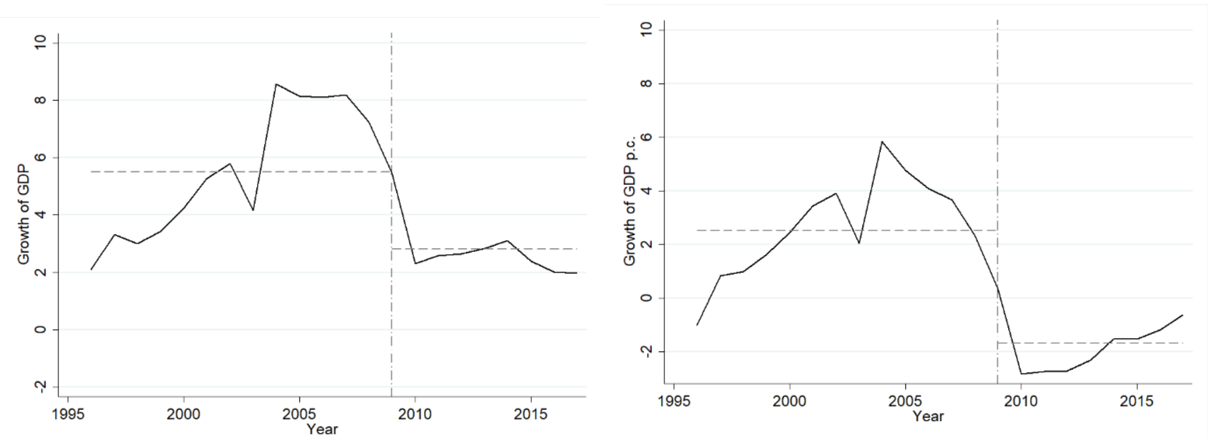
1. The Jordanian Economy: A Tale of Two Different Decades

The economic history of the Hashemite Kingdom of Jordan throughout the last twenty years is a tale of two very different decades. Between the mid-1990s and the late 2000s, the Kingdom exhibited an impressive economic performance. Output grew at an average annual rate of around 5.8 percent and the volume of exports tripled (Hausman et al., 2019). Annual tax revenues doubled and, decreasing from 120 to 60 percent, public debts nearly halved relative to GDP (Central Bank of Jordan, 2019).

The years 2009 and 2010 marked a decisive turning point to this record. As shown in the left panel of Figure 1, after a period of rapid acceleration, GDP growth peaked at around 8 percent between 2004 and 2007 and thereafter fell sharply to an average rate of 2.6 percent between 2009 and 2017. While growth in per capita terms (right panel) has been more moderate throughout the whole period due to an annual rise in population numbers of around 2.9 percent, it averaged 2.5 percent before 2009 and reached a value of nearly six percent in 2004. With an average of -1.7 percent, it turned negative after 2009, yielding a cumulative loss in GDP per capita of nearly 12 percent between 2009 and 2017.

Figure 1: Growth of GDP (absolute and per capita)



The left panel shows the annual growth rate of GDP in absolute terms between 1996 and 2017; the right panel provides the growth rate in per capita terms for the same period; horizontal (dashed) lines show the average growth rate before and after 2009; the vertical line indicates the year 2009; own figures, based on data from the World Bank (2019a).

This dramatic shift in economic performance can largely be attributed to the global financial crisis in 2009 and, even more so, to the regional turmoil caused by the Arab spring. In particular, the outbreak of civil war in Syria and the rise of the Islamic State in Iraq led to the closure of major trade routes and thereby to a loss of major export markets. In addition, the inflow of more than 1.5 million refugees put substantial pressure on public budgets. This was exacerbated by rising energy costs due to major disruptions in the supply of natural gas from Egypt, which had to be substituted by the import of expensive liquefied gas for electricity generation, the costs of which could not fully be passed on to consumers (El-Rayyes, 2014). As a result of subsequent austerity measures, public investment decreased from nine percent of GDP in 2004 to 4.2 percent in 2015 (IMF, 2017), thus contributing in a pro-cyclical way to the slowdown of GDP growth.

Against this background, the present report addresses the question how the Jordan economy can return to a growth trajectory that is positive in per capita terms and – ideally – is inclusive in nature by promoting a rise in decent jobs and employment. The next section outlines the key obstacles towards achieving this goal. Thereafter, the main opportunities inherent in the prevailing economic structures are summarized. Based on this analysis, the last section derives recommendations on potential economic reforms that are able to stimulate inclusive economic growth.

2. Challenges: Three Main Barriers to Inclusive Economic Growth

The main structural barriers towards achieving higher economic growth can be summarized along three major lines. These encompass

i) constraints on fiscal policies and public investment,
ii) the current setup of the Jordanian labor market and
iii) a small domestic market in an otherwise instable geo-political environment.

a. Constraints on Fiscal Policies and Public Investment

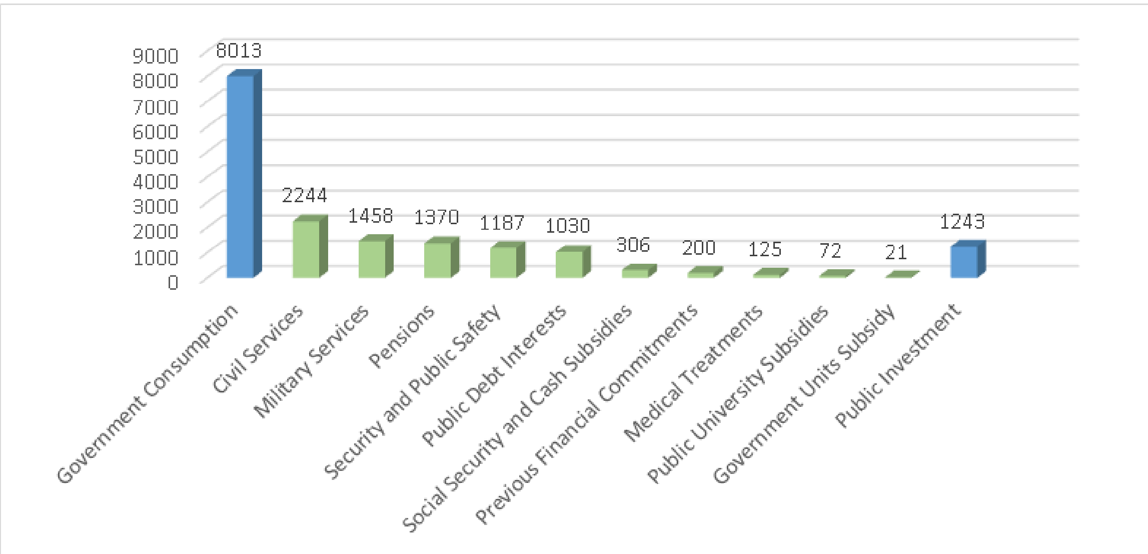
The room for maneuver of fiscal policies and public investment is limited by a number of factors. First, sluggish output growth and financial pressures from the refugee and the energy crises had substantial repercussions on public budgets during the last decade. As shown in the left panel of Figure 2, while public debt had fallen from around 115 percent in 1996 to around 60 percent in 2008, it has increased steadily thereafter up to nearly 100 percent in 2016. As a result, the annual sum of interest payments on external debt nearly tripled between 2010 (270 million Jordanian Dinars) and 2016 (740 million Jordanian Dinars; right panel)). The agreement between the Hashemite Kingdom of Jordan and the international community to bring the debt-to-GDP ratio down to 77 percent by 2021 (Economic Policy Council, 2018) will further curtail the room for additional spending.

Figure 2: Public Debt and Interest Payments

The left panel shows the debt-to-GDP ratio for the years 1996 to 2017; the gray dashed line marks the value of 77 percent, which is the targeted ratio for the year 2021; the right panel shows the annual sum of payments made for interests on external debt in million JDs; own figures; data on debt-to-GDP are taken from the Central Bank of Jordan (2019); data on the annual sum of interest payments are provided by the World Bank (2019a).

Second, expenditures for defense, public safety and social services make up a substantial share of the public budget, which is unlikely to be brought down in the near future. As shown in Figure 3, the total public budget will amount to 9.3 billion Jordanian Dinars in 2019. In 2018, GDP equaled 41.9 billion Jordanian Dinars and can, at current growth rates, be expected to rise to 43 billion Dinars in 2019, which yields a public expenditure quota of around 22 percent in 2019. 28 percent of the public budget are assigned to military services, security and public safety (16 percent to the military alone). Taking into consideration that a share of public pensions is spent for the alimentation of former members of the armed forces, total expenditures for the military and police equals around one third of the public budget, which is consistent with a share of eight percent of GDP reported by Coface for Trade (2019). In light of the current political unrest in the wider region, this share is unlikely to decrease in the near future. Closely related, expenditures for public services, which mainly encompass salaries for employees in the public sector, make up around one quarter of the public budget. Given persistently high unemployment rates (see Section 2.2) and the overarching maxim to maintain political stability, it is highly unlikely that these expenditures can be reduced substantially.

Figure 3: Composition of the Public Budget



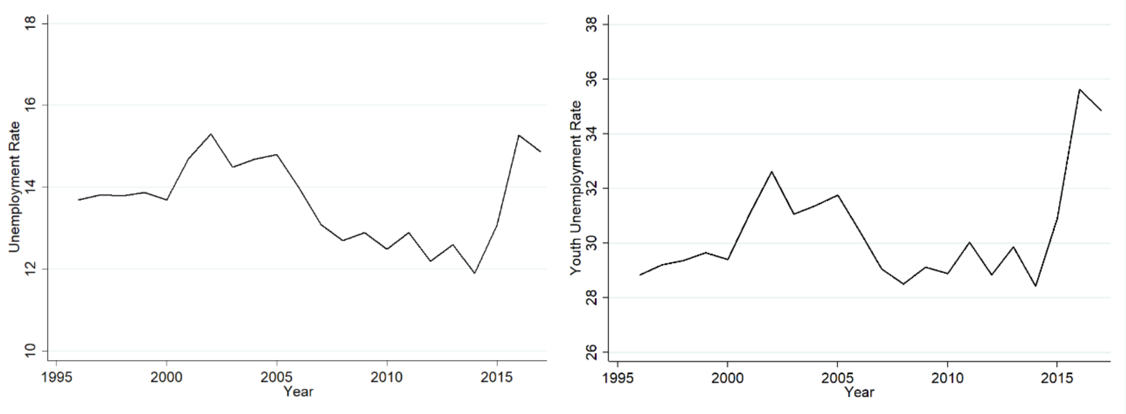
The figure shows the composition of the public budget for the year 2019 in absolute values (in million JD); green bars split up government consumption into sub-categories; own figure, based on data from the General Budget Department (2019).

On the revenue side, tax increases that are substantial enough to allow for expansionary fiscal policies are to date politically unfeasible. The broad resistance in large parts of the population against such attempts has recently become evident by widespread protests against the intended introduction of an income tax, which was perceived as benefitting the political elites at the expense of the ordinary citizen (El-Rayyes, 2014). As a result, there will in the near future be little room for expansionary fiscal policies that are able to provide a stimulus for economic growth. It is only in the medium to long run that such potential might be set free through a reduction of the debt burden of public households, even though most likely in a pro-cyclical way.

b. The Setup of the Labor Market

As in many other Arab countries, unemployment is persistently high in Jordan, in particular among the youth. As shown in the left panel of Figure 4, the overall unemployment rate has slightly decreased over time from around 14 percent in 1996 to 12 percent in 2014 and then again jumped up to nearly 16 percent in the aftermath of the refugee crisis. Youth unemployment follows essentially the same pattern, albeit at a much higher level of around 30 percent.

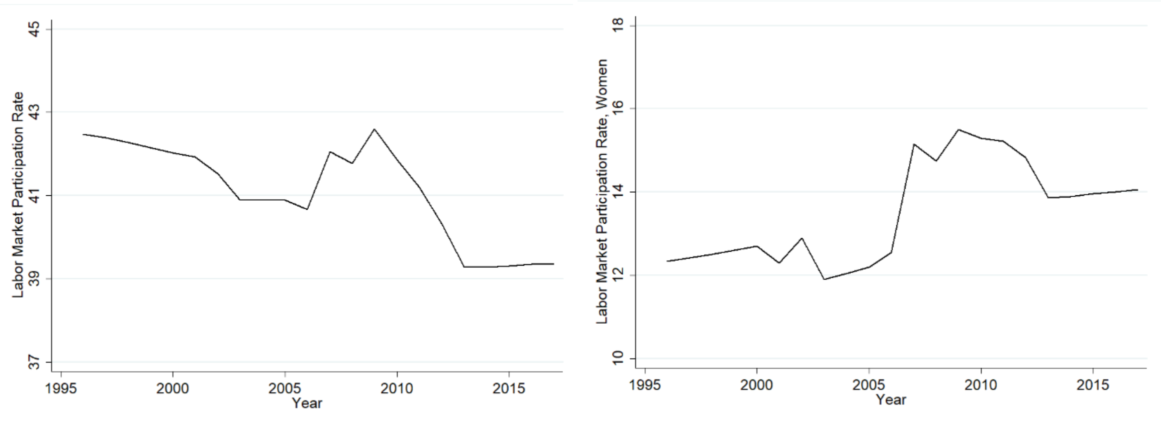
Figure 4: Unemployment Rates



The left panel shows the overall unemployment rate for the years 1996 to 2017; the right panel provides the youth unemployment rate for the same period; own figures, based on data provided by the World Bank (2019a).

In addition, the Jordanian labor market is shaped by a very low participation rate. As shown in the left panel of Figure 5, in 2016 less than 40 percent of the working age population were either employed or officially registered as unemployed. This share has even decreased from a value of nearly 43 percent in 1996. In addition, with a share of around 14 percent, the labor force participation rate of women is one of lowest in the world. High unemployment and low labor market participation rates are essentially different sides of the same coin inasmuch as they indicate an overall shortage of available jobs. In light of these numbers, any acceleration of economic growth will need to be accompanied by the creation of jobs in order to absorb an under-employed and growing workforce.

Figure 5: Labor Market Participation



The left panel shows the overall labor market participation rate for the years 1996 to 2017; the right panel provides the labor market participation rate of women; own figures, based on data provided by the World Bank (2019a).

One of the major obstacles towards achieving higher economic growth rates is rooted in the large share of the informal sector in Jordan, which employs between 30 and 45 percent of the labor force (El-Rayyes, 2014; Sowell, 2017) and contributes between 10 and 25 percent to GDP (UNDP, 2010). These numbers suggest that about one million workers out of the total workforce of around three million persons are working without a work contract and, hence, are uncovered by labor laws and social protection. As a result, employment relations in the informal sector are highly unstable and working conditions are poor (UNDP, 2014; Agulhas Applied Knowledge, 2019). The key problem with regard to economic growth is that under these circumstances neither employers nor workers have an interest to invest into long-term employment relations that allow for the formation of job-specific human capital or into physical capital like professional worker equipment. In consequence, workers in the informal sector are trapped in a state of persistently low-productivity. As a result, wages for more than 40 percent of these workers range on or below the minimum wage (UNDP, 2014).

Similarly, the high degree of labor market segmentation by nationality, gender and education leads to substantial inefficiencies in terms of job matching and contributes to the low productivity of labor. Many occupations in Jordan are dominated by specific nationalities. While the public sector relies on Jordanian workers, other sectors nearly exclusively employ migrant workers, e.g., Egyptian labor migrants in agriculture and female workers from Asia in domestic work (Razzaz, 2017). This type of stratification is inefficient as it curtails the options for each worker, Jordanian or non-Jordanian, to obtain a job that suits her education, capabilities and interests best. The same argument applies to the system of sponsorships for labor migrants, where migrant workers are tied to one specific employer for a minimum period of one year. Since these migrants are, however, often needed only seasonally or for even shorter periods, 83 percent of non-Jordanians hold a work permit that does not match their current employer (Razzaz, 2017). The resulting constant state of illegality suppresses any investment into long-term career planning and the formation of sector- or job-specific human capital.

c. A Small Domestic Market in an Otherwise Instable Geo-Political Environment

Another main challenge to economic growth is rooted in the small size of the domestic market conjoint with an instable geo-political environment. After a prolonged period of export growth, the closure of trade routes to and through Iraq and Syria led to a reduction in the volume of exports by 13 percent (Hausman et al., 2019). The sectors hit most severely encompassed agriculture, transportation and tourism. Despite a growing population, domestic demand was only partly able to compensate the loss in export markets. Although the borders with Iraq and Syria were re-opened in 2018, trade is still hampered by complex border procedures, a large risk premium on exports into both countries and tariffs newly imposed by the Syrian regime on imports from Jordan. Consequently, while trade is slowly picking up, it is still far from reaching pre-war levels. To date, the high degree of uncertainty associated with political instability renders investment into previously export-oriented industries like agriculture and manufacturing less attractive. This has, in turn, important implications for the identification of strategic sectors that are able to yield inclusive economic growth by opening up new export markets and creating jobs and employment.

3. Chances and Opportunities: Significant Potential for Economic Growth

Despite these challenges, the structure of the Jordanian economy exhibits a number of opportunities that, if seized properly, may well provide a solid basis for sustainable and inclusive economic growth.

One of Jordan's major assets lies in its highly educated workforce. The average years of schooling among the Jordanian population above the age of 25 amounts to 9.1 years (Danish Trade Council for International Development and Cooperation, 2016). In 2012, around two thirds of the 150,000 young people exiting the education system held a degree from a college or university (ILO, 2015). Enrolment rates into tertiary education are particularly high among women. Effectively integrating these well educated workers into the labor market provides one main lever to foster economic growth through a positive effect on labor productivity.

In addition, the Hashemite Kingdom of Jordan is endowed with an abundance of solar energy, a flourishing information and communication industry, a number of world-class tourist attractions and a physical infrastructure in place that connects all parts of the country. Making the most out of these advantages will require the identification and subsequent strategic support of those sectors in the economy that exhibit a high growth potential and are well suited to exploit these advantages. The next section will provide an analysis of the sectoral composition of the Jordan economy and outline the major steps required to foster growth in these key sector.

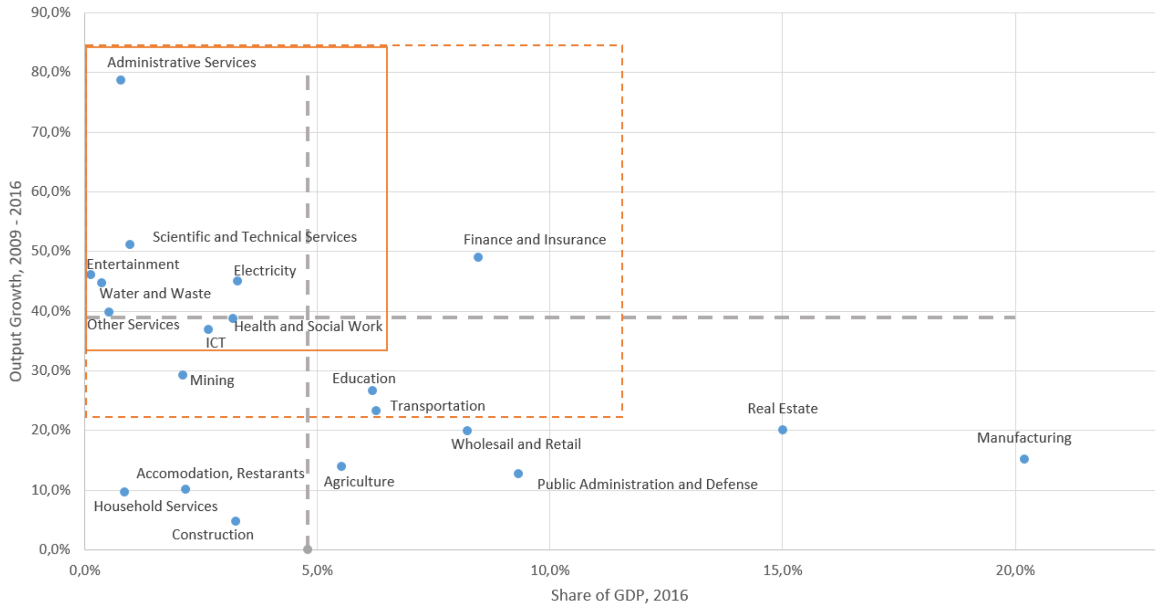
Notwithstanding the difficulties it renders in terms of export markets, the prevailing political instability in the wider region also provides an opportunity for the Hashemite Kingdom of Jordan to establish itself as a regional hub for investments in key industries. In particular, a stable legislative environment in combination with a far-reaching openness to trade and investment make Jordan a potentially attractive location for international companies, in particular in the ICT industry, to serve the wider region from here.

Finally, the fact that an elaborate system of labor laws and social security provisions is already in place provides an important prerequisite for economic growth to unfold positive effects on employment across all segments of the labor market. As will be argued below, if existing laws and provisions are consequently monitored and strategically adjusted so as to set incentives for employers to create and maintain decent jobs, this will substantially change the composition of employment in Jordan with respect to both the quantity and quality of jobs.

4. Recommendations: Fostering Inclusive Economic Growth

This section will develop recommendations on how inclusive economic growth can be achieved by means of well-devised economic policies and reforms. To do so, the industrial composition in Jordan will in a first step be surveyed with the intent to identify those sectors that may serve as engines for future economic growth. Based on data provided by the Department of Statistics (2017), industries are aggregated into 20 different sectors. Subsequently, the cumulative growth of each sector over the period from 2009 to 2016 is related to its contribution to GDP in 2016. The most promising sectors for future economic growth are those that have exhibited high growth rate in the past while not yet being fully saturated. Figure 6 provides the results. Cumulative growth rates over the period between 2009 and 2016 vary between 4.8 percent (Construction) and 78.6 percent (Administrative Services).The share that each sector has contributed to GDP in 2016 ranges between 0.1 percent (Entertainment) and 20.2 percent (Manufacturing). Of particular interest are those sectors that are located in the upper left quadrant of the figure, which due to the positive autocorrelation of growth rates and their still comparatively small contribution to GDP are likely to keep on growing in the future ('rising stars').

Figure 6: Sectoral Growth and Industrial Composition



The figure relates cumulative output growth by industry between 2009 and 2016 to the share that each sector has contributed to GDP in 2016; dashed lines show the average unweighted output growth between 2009 and 2016 (horizontal line) and the mean contribution to GDP in 2016 (vertical line); own figure, based on data provided by the Department of Statistics (2017).

The most promising sectors in terms of potential growth encompass Administrative, Scientific, Technical and Other Services, Entertainment, Electricity, Water and Waste Management, Health and Social Work, Information and Communication Technologies as well as, to a somewhat lesser extent, Finance and Insurance, Mining, Education, and Transportation. These results are broadly in line with those provided by the London Initiative (2019) and Hausman et al. (2019), who also identify high-skilled professional services, the information and communication sector, transportation, energy and tourism as key sectors for promoting economic growth. Importantly, most of these sectors are not only able to contribute to export-led growth, but are also well devised to absorb part of the highly qualified labor force and thereby enhance labor productivity. Water management and electricity are, turn, of major strategic importance for enhancing ecological sustainability and reducing the current dependence on imports of energy and fossil fuels, which will both have long-term impacts on aggregate economic output (Mohaddes/Raissi, 2011).

Fostering economic growth in these strategic sectors requires an integrated policy approach that unites different fields of action in a consistent way. Major aspects encompass the attraction international and domestic investment, the education and provision of a well-trained workforce for these sectors and, finally, a reform of labor market institutions to enable growth in these sectors to trickle down to the broader economy. The remainder of this section outlines activities and reforms within each of these policy fields.

Substantial public and private investment is needed to further unleash the potential of these key sectors as engines of future economic growth and employment. This encompasses investment into firms, infrastructure and human capital. In particular, the water and energy sector requires investment into renewable energy, the transmission grid and into water capture and desalination facilities. Given the limited fiscal space of the Jordan government, much of this investment will need to be raised from private sources, both domestic and international. In addition, significant innovation in the service and ICT-industry will only be possible with major international investment into products and into knowledge capital. Despite these needs, foreign investment has been stagnating in recent years and even fallen in 2018 (Agulhas Applied Knowledge, 2019).

As a result, the Hashemite Kingdom of Jordan will, even more than before, need to establish and market itself as a competitive regional hub that is attractive in particular for highly productive service and ICT-companies that aim to serve the wider market from here. To attain this goal it will be crucial to effectively communicate Jordan's major comparative advantages, which encompass political stability, a reliable institutional setting, a well-developed infrastructure, high levels of human capital, comparatively low wages (the average monthly wage ranges around 550 Jordanian Dinars) and its location within a globally convenient time zone (Economic Policy Council, 2018). During the past decade, the Jordan has made significant progress in presenting and establishing itself as a hub for tradable services, in particular in the ICT-sector. As a result, the export of services has grown from 1.1 billion Jordanian Dinars in 2000 to around five billion in 2014 (London Initiative, 2019). At the same time, however, additional efforts are required to further improve the business climate and the ease of investing in Jordan. This becomes particularly evident from the fact that with a score of 61 (out of 100 possible points) Jordan currently ranks only place 104 on the Ease-of-Doing-Business Index of the World Bank (World Bank, 2019b). As one step in this direction, the Jordanian government has announced to set up a special judicial chamber for economic cases to raise the speed of litigation (Economic Policy Council, 2018). To further pursue this way, the most binding constraints on investment need to be identified, e.g., through a structured dialogue between the government, domestic and international businesses, and potential investors. In addition, the Jordanian government might well consider to draw on its broad experience with public-private partnerships (IMF, 2017) and encourage the establishment of partnerships between international enterprises, domestic firms and government agencies. This will be of particular value with regard to information and communication technologies in order to accelerate the digitization of the economy and the public sector (Economic Policy Council, 2019). Finally, limited access to credit remains one major obstacle in particular for domestic investment (World Bank 2009b). In order to alleviate this problem, the allocation of public credits to priority industries could be part of a coherent and concerted effort.

In addition, the education and training system must be geared to the demands of these strategically important sectors. While the share of college graduates per cohort is substantial, university curricula tend to be disconnected from the practical requirements of firms, which becomes evident inter alia by a general absence of internships and hands-on approached to teaching (UNDP, 2010). In addition, a general lack of professional career guidance leads to inefficient educational choices, which are largely driven by the prestige of college education without consideration of real job opportunities (UNDP, 2014). Both factors contribute to a substantial and growing mismatch between the qualifications of graduates and the effective labor demand of firms. As a result, about 15,000 university graduates enter unemployment or inactivity each year and unemployment rates are particularly high among this group (El-Rayyes, 2014). At the same time, while a system of vocational training has been in place in Jordan for more than 40 years, with enrolment rates of around four percent it plays virtually no role in the educational mix. This is partly rooted in its reputation of as a second-best option for students who have missed admission to university, but also in a general lack of support from employers and unions towards vocational training. In light of this status quo, implementing a demand-driven approach to education will require a major overhaul of the educational system as well as the establishment of professional career guidance services. This could ideally be achieved by multipartite dialogue and planning between major public institutions (Ministry of Labor and the Economic and Social Council), employer organizations (Chambers of Industry and Commerce), international enterprises, the universities in Jordan as well as the Vocational Training Foundation and the E-TVET Council and Fund.

Steps need to be taken for growth in key sectors to trickle down to the wider economy. One of the main obstacles to inclusive growth across all sectors is rooted in the large share of the informal economy conjoint with a stratification of the labor market by nationality. A substantial share of informal employment is made up by migrant workers, who due to the absence of family obligations in Jordan often accept inferior employment conditions. As a result, violations of labor laws are widespread with effective daily wages in some cases being as low as five Jordanian Dinars (Razzaz, 2017). In addition, the fact that work relations for both Jordanians and non-Jordanians are often closed for short periods impedes investments into job-specific human capital and long-term career planning (UNDP, 2014). One major step towards raising the productivity of labor will therefore be to formalize informal employment. Such formalization can be achieved through a combination of improved monitoring and the setting of positive incentives. Regarding the former, to date only 230 labor inspectors are assigned to controlling the compliance with labor laws in a labor market of around three million workers (Danish Trade Council for International Development and Cooperation, 2016). Enhancing the capabilities of public authorities will be of key importance for improving the system of monitoring. In addition, making labor migrants de facto eligible for benefits from the social security system will set positive incentives for them to formalize their employment. In addition, disconnecting the issuance of work permits from the presence of one specific sponsor provides an important lever towards creating a greater flexibility and, hence, an improved matching efficiency in the labor market.

Finally, political effort is needed to raise the participation of women in the labor market. With a share of university graduates of 53 percent among young women in Jordan, this is not only a matter of growth to become inclusive, but also provides a key step towards raising the productivity of labor. Beyond cultural norms, one major reason for low participation rates is rooted in the working conditions in the private sector, which are often perceived as hazardous or incompatible with family obligations (Business Development Center, 2017). With labor laws on working hours, timeliness of payment and workplace safety already in place, a crucial role is played by their credible enforcement. Effectively protecting the rights of workers would create safer working environments and thereby contribute to a more positive and supportive attitude towards the employment of women. In addition, labor laws need to become more flexible in order for employment to be more compatible with family obligations. This pertains in particular to the promotion of part-time work. To date, one impediment in this direction lies in the fact that the minimum wage is defined on a monthly rather than an hourly basis. As a result, employers have no incentive to employ workers on a part-time basis as they would still need to pay the minimum wage. In addition, raising the duration of full-paid maternity leave, which with ten weeks is currently among the lowest among Arab states (Danish Trade Council for International Development and Cooperation, 2016), would contribute to a better compatibility between work and family.

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