



Foreign Direct Investment in Jordan

Should We Care? Why and How?

July 2018



منتدى الاستراتيجيات الأردني
JORDAN STRATEGY FORUM



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The Jordan Strategy Forum (JSF) is a not-for-profit organization, which represents a group of Jordanian private sector companies that are active in corporate and social responsibility (CSR) and in promoting Jordan's economic growth. JSF's members are active private sector institutions, who demonstrate a genuine will to be part of a dialogue on economic and social issues that concern Jordanian citizens. The Jordan Strategy Forum promotes a strong Jordanian private sector that is profitable, employs Jordanians, pays taxes and supports comprehensive economic growth in Jordan.

The JSF also offers a rare opportunity and space for the private sector to have evidence-based debate with the public sector and decision-makers with the aim to increase awareness, strengthening the future of the Jordanian economy and applying best practices.

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Contents

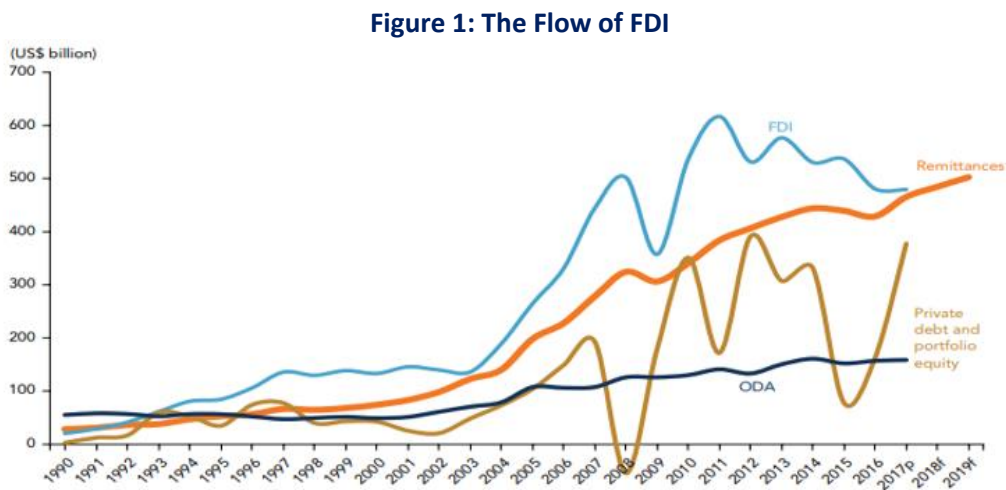
1. Background.....	4
2. FDI: Some Observations and Impact on Growth.....	6
3. FDI Regulatory Restrictiveness Index and World Bank Survey of Global Executives.....	8
4. Summary and Recommendations.....	13
Appendix A.....	14

1. Background

Foreign Direct Investment (FDI) is defined by the “net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors” (World Bank).

The issue of FDI has been attracting the attention of many stakeholders including academia, governments, think tanks, as well international organizations such as the World Bank and International Monetary Fund (IMF). Naturally, this interest is due to several reasons.

First, since the early 1990s, the flow of FDI has been larger than remittances, private debt and portfolio equity, and overseas development assistance (ODA).

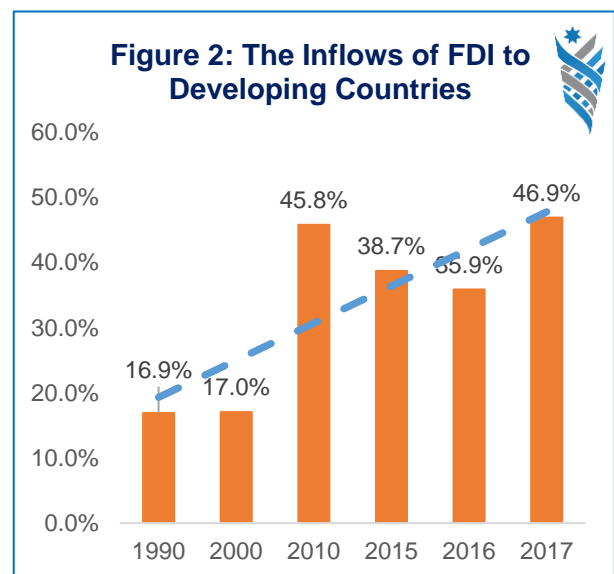


Source: Migration and Development Brief 29: The World Bank, April 2018.

Second, developing countries have been attracting a growing proportion of the global FDI inflows. While in 1990 developing countries attracted around 17% of the global the FDI flows, by the end of 2017 this proportion has increased to more than 46% (Figure 2).

Third, FDI is a source of much-needed capital to developing countries. Also, foreign investment “has a significant potential to transform economies through innovation, enhancing productivity, and creating better-paying and more stable jobs in host countries, in sectors attracting FDI as well as in the supportive industries” (Global Investment Competitiveness Report, 2017/2018).

Fourth, “linkages between foreign firms and local partners or suppliers can promote transmission of foreign firms’ technology, knowledge, and practices, as well as requirements that may help



domestic suppliers upgrade their technical and quality standards” (Global Investment Competitiveness Report, 2017/2018).

Fifth, “foreign investors are becoming increasingly prominent players in delivering global public goods, addressing climate change, improving labor conditions, setting global industry standards, and delivering infrastructure to local communities” (Global Investment Competitiveness Report, 2017/2018).

Given the possible benefits of FDI, one can appreciate why the subject matter of FDI has attracted so much research effort. Indeed, this effort covers a variety of issues like the impact of FDI on economic growth, impact of FDI on exports, why some countries attract more FDI than others (determinants of FDI), impact of FDI on business development in the host countries, impact of FDI on local wages, and others.

Within the context of the subject matter of FDI, recently (2018), two important and timely reports have been published.

1. The Organization for Economic Cooperation and Development (OECD) has published “**The FDI Regulatory Restrictiveness Index**” on 16 May 2018. This index gauges the “restrictiveness of a country’s foreign direct investment rules for a total of 68 countries by looking at four main types of restrictions: foreign equity restrictions; discriminatory screening or approval mechanisms; restrictions on key foreign personnel and operational restrictions” (OECD). The index ranges in value from 0 (no restrictions) to 1 (fully restrictive).
2. The World Bank published the 2017/18 “**Global Investment Competitiveness Report**” on November 15 2017. The report deals with the subject matter of FDI per se. It includes the results of a survey 754 international business executives involved with the operations of their multinational corporations in developing countries. The survey covers many issues including what drives corporations’ foreign investment decisions.

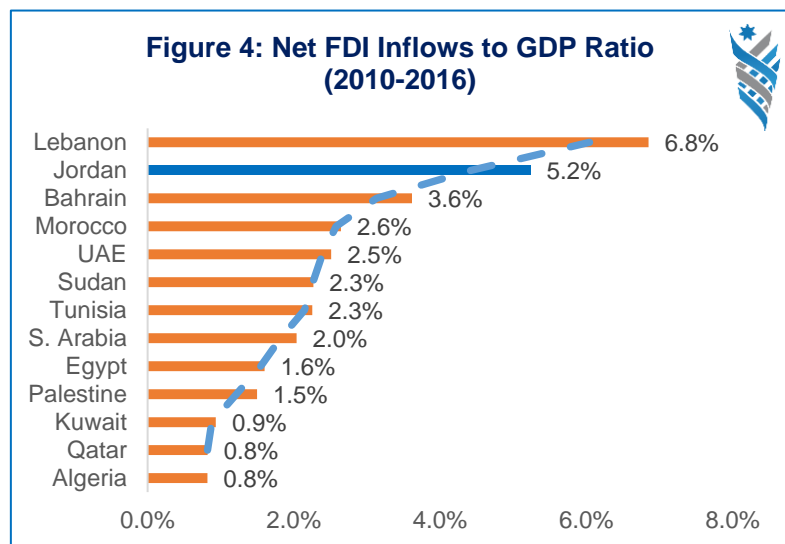
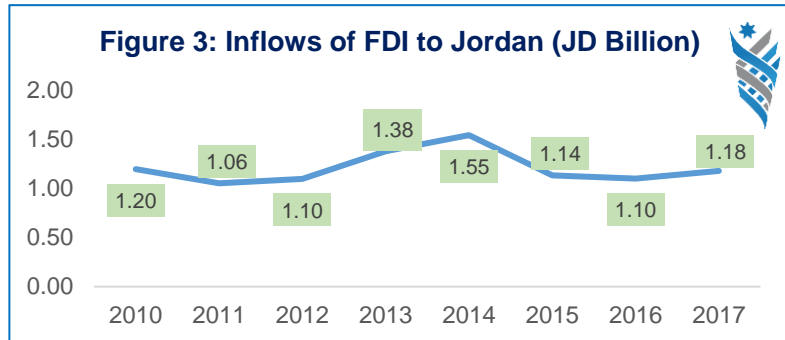
In this Analytical Paper, the JSF examines the issue of FDI in Jordan.

1. We compare the Jordanian experience in terms of attracting FDI with a number of regional economies. We also examine the impact of FDI on real economic growth.
2. We provide some analysis of Jordan’s ranking on the FDI Regulatory Restrictiveness Index. In addition, we discuss some of the main results of the World Bank’s survey of global executives that make foreign investment decisions (FDI).
3. Finally, we provide some recommendations whose objective is to maximize the inflow of foreign investments and their impact on economic growth.

2. FDI: Some Observations and Impact on Growth

The Jordanian economy has been attracting sizeable amounts of net FDI inflows. For example, since 2010, Jordan has managed to consistently attract around JD 1.2 billion in the form of FDI.

To compare the Jordanian experience with other countries, one needs to divide the inflows of FDI by the size of the economy (GDP). After all, countries differ in terms of their respective GDP nominal values. Based on this argument, we report (Figure 4) the inflow of FDI to GDP ratios for a number of regional economies. During the period 2010-2016, Jordan has been relatively successful in attracting FDI. Whilst the Jordanian ratio (5.2%) is lower than that in Lebanon (6.8%), it is higher than in Bahrain (3.6%), and much higher than that in Algeria (0.8%).

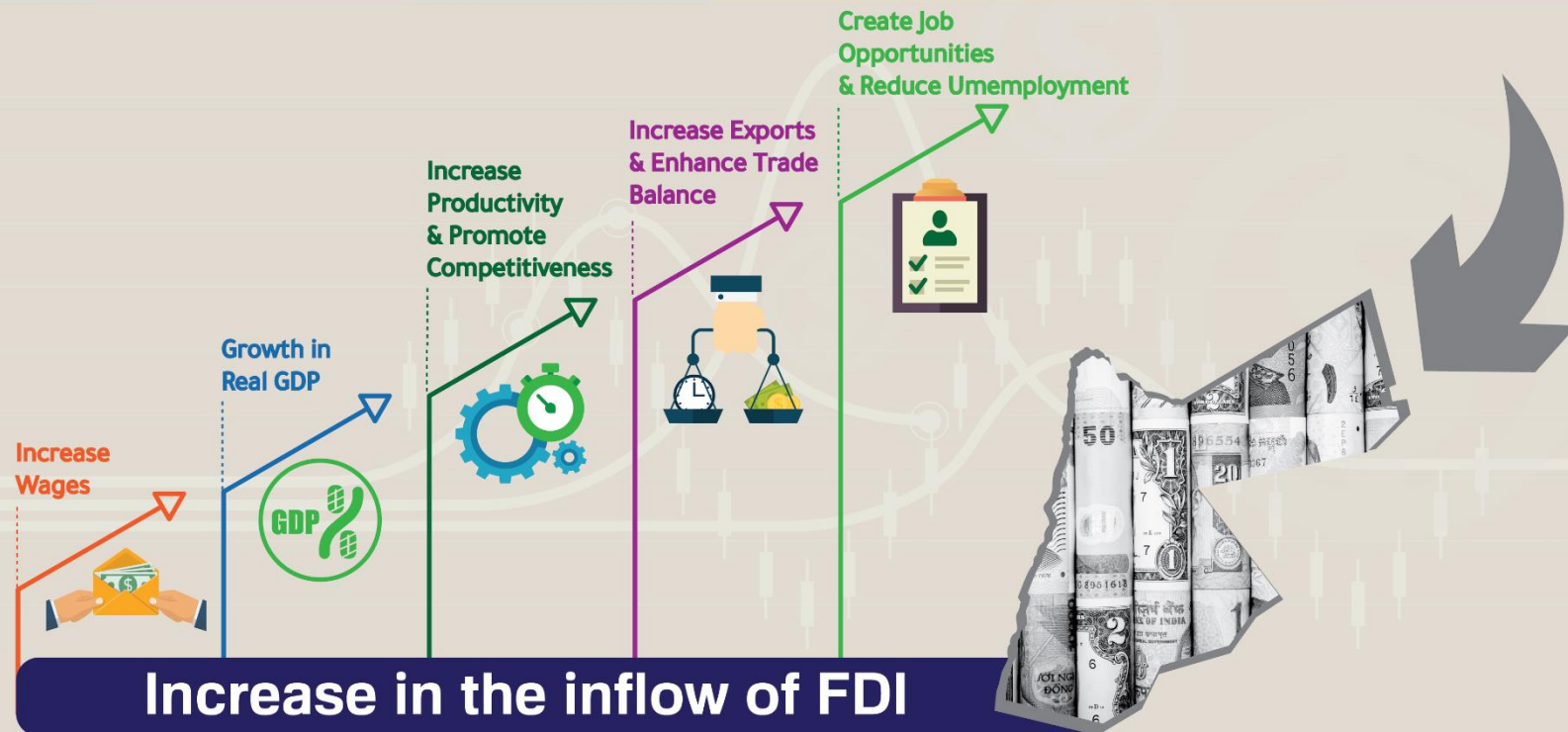


To examine the impact of net FDI on economic growth in Jordan, we use annual data (1994-2017) of real GDP (RGDP), and real net inflows of FDI (RFDI). For the technical reader, we outline the basic model, used techniques, and the detailed results in Appendix A.

The results could not be more than encouraging.

- A.** The impact of FDI on real economic growth is positive. When FDI increases, real GDP increases. The long-run FDI elasticity is equal to +0.34. This means that when real FDI increases by, for example, 1%, real GDP increases by 0.34%!
- B.** The relationship between FDI and growth is stable in the long-run.
- C.** The inflows of FDI reflect increasing power in explaining the variability (changes) of real GDP over time.
- D.** In the short-term, there is no relationship between FDI and economic growth.

Expected Positive Impact of Increases in Foreign Direct Investment to Jordan

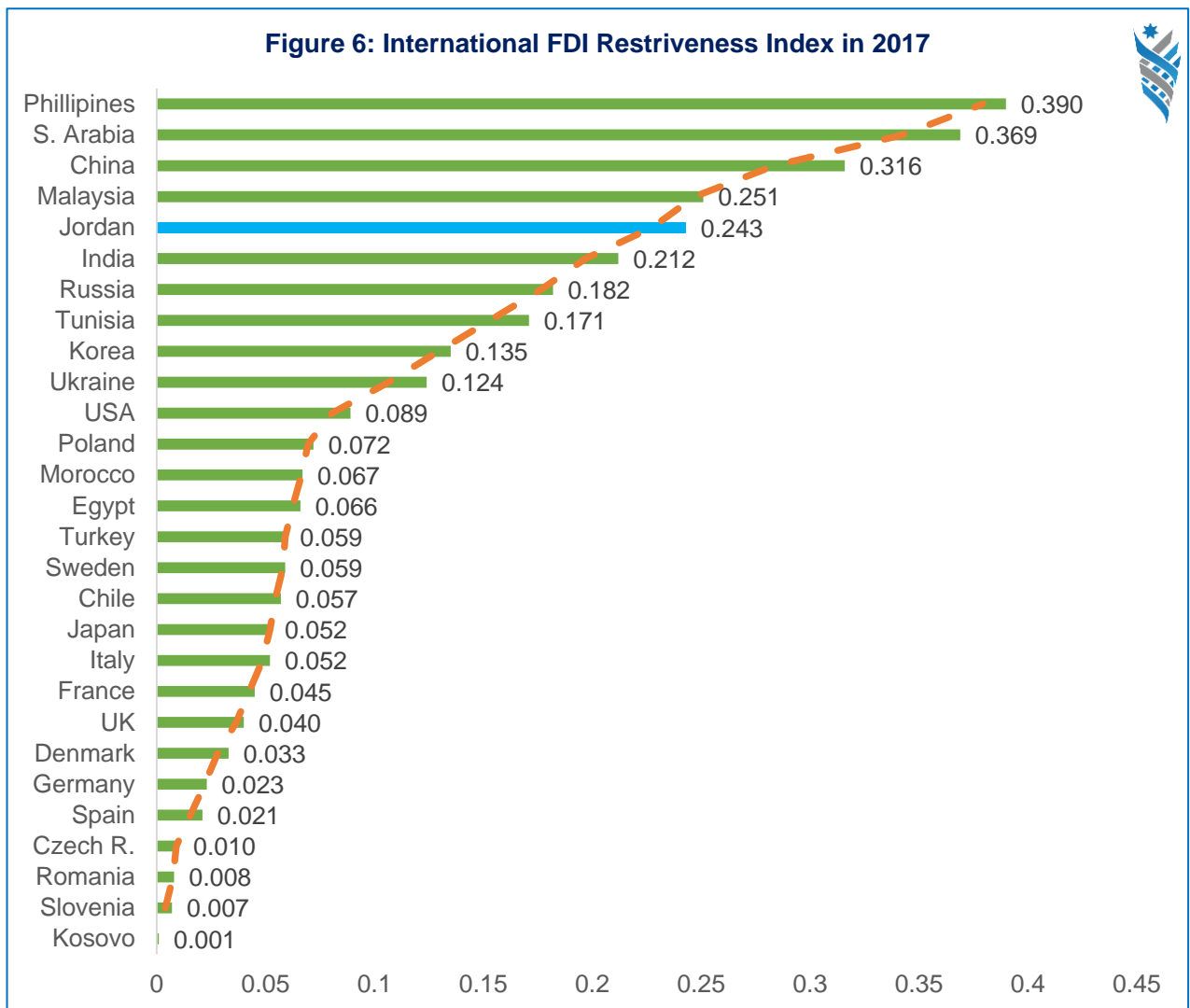
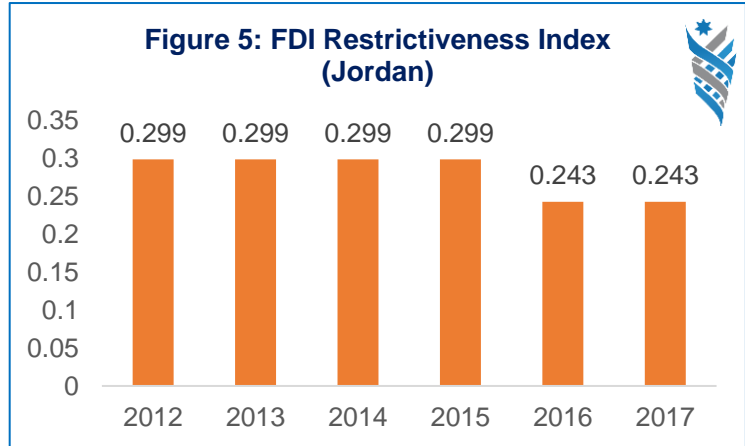


Date: July 2018
Source: JSF Study "Foreign Direct Investment in Jordan: Should We Care? Why and How?"

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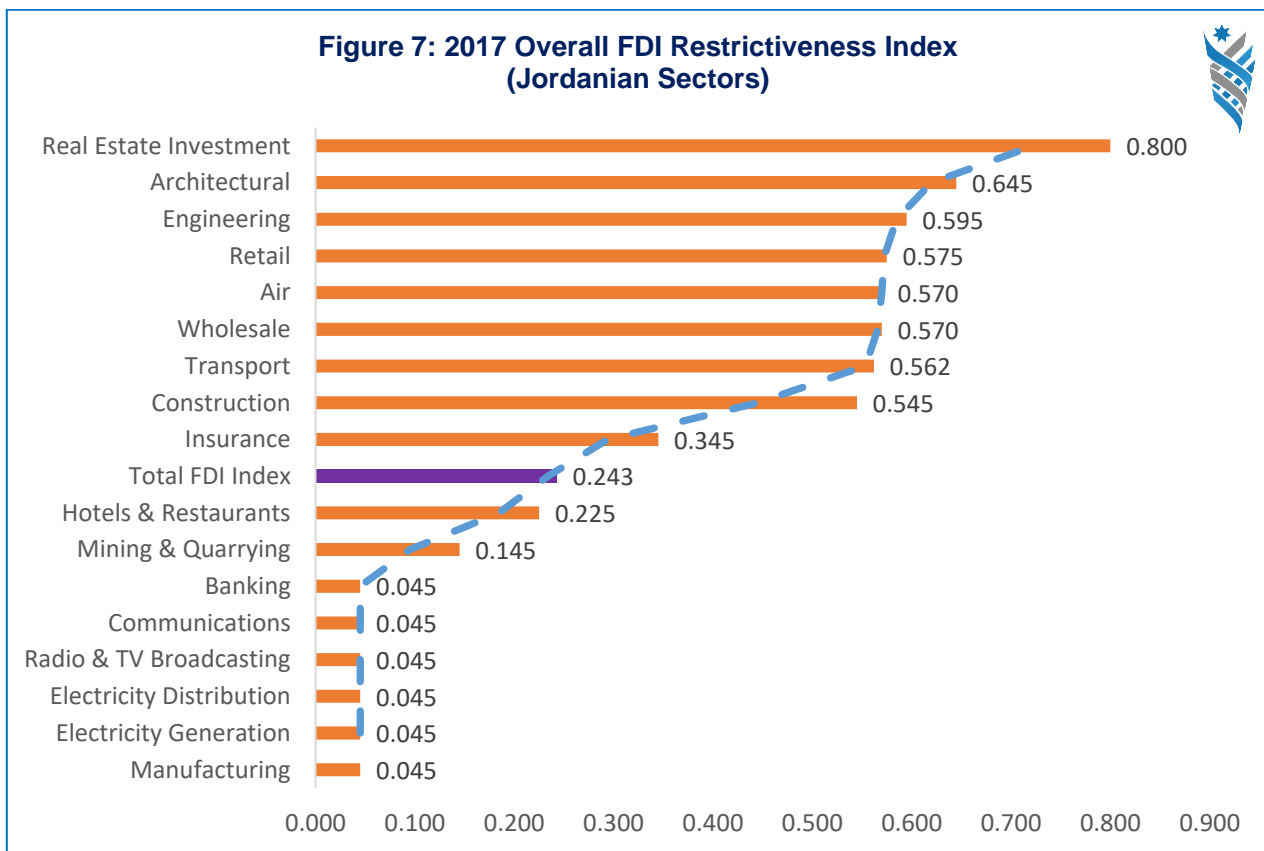
3.FDI Regulatory Restrictiveness Index and World Bank Survey of Global Executives

As stated previously, the OECD has published “The FDI Regulatory Restrictiveness Index” on 16 May 2018. This index gauges the “restrictiveness of a country’s foreign direct investment rules for a total of 68 countries by looking at four main types of restrictions: foreign equity restrictions; discriminatory screening or approval mechanisms; restrictions on key foreign personnel and operational restrictions” (OECD). The index ranges in value from 0 (no restrictions) to 1 (fully restrictive).



It is unfortunate to note that Jordan's 2017 score in the FDI Regulatory Restrictiveness Index is equal to 0.243. Notwithstanding the fact that Jordan's restrictiveness index has improved (Figure 5), **the 2017 score (0.243) ranks Jordan 63rd (out of 68 countries)**. Indeed, out of the 68 countries, only Malaysia, China, Saudi Arabia, and the Philippines have higher restrictiveness indices than Jordan (Figure 6). The country with the least restrictiveness index is Kosovo (0.001). With a score of 0.390, the Philippines ranks last (68th).

Jordan's overall restrictiveness index (0.243) is not uniform across all sectors. **First**, the manufacturing, electricity generation, and distribution, radio and TV broadcasting, communications, and the banking sectors have exactly similar restrictive indices. **Second**, the most restrictive sectors are architecture and real estate investment. **Third**, the scores of all sectors range between 0.045 (manufacturing) and 0.800 (real estate investment).



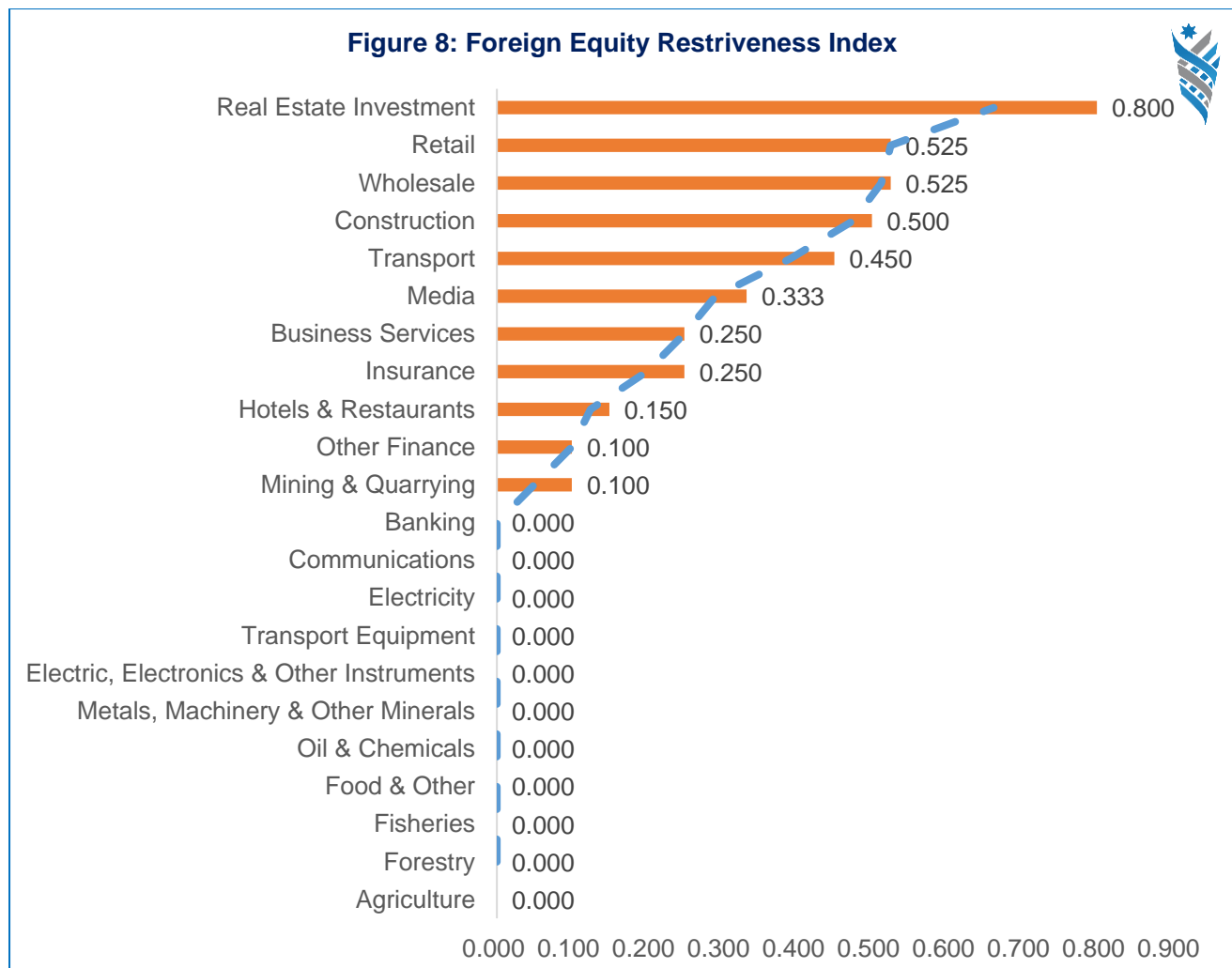
As previously stated, the FDI Index focuses on four main measures and these are foreign equity restrictions, screening and approval requirements, restrictions on key foreign personnel, and other operational restrictions. A look at the four sub-indices' scores reveals that Jordan's overall poor score and rank are largely due to the foreign equity restrictions (Table 1). Indeed, the value of this sub-index is equal to 0.181! It accounts for about 75% of the value of the overall FDI Restrictiveness Index.

Table 1: Scores of Sub-Indices of FDI Restrictiveness Index

Sub-Indices	Score
Foreign Equity Restrictions	0.181
Screening & Approval Requirements	0
Restrictions on Key Foreign Personnel	0.008
Other Operational Restrictions	0.053
Total FDI Restrictiveness Index	0.243

The value of the sub-index (foreign equity restrictions) varies greatly between sectors. For example, while the scores of many sectors like agriculture, oil and chemicals, and others are equal to zero (no regulatory impediments to FDI), others are extremely impeded, and these are real estate investment, retail and wholesale, construction, transport, media, business services, and few others (Figure 8). If no foreign equity is permitted the score is 1 (the sector is closed). Based on this observation, one wonders why some sectors are highly restricted to foreign ownership, while others are not restricted! Within this context, opening all sector would only “diversify” the net inflows of FDI, and hence become more beneficial to the national economy.

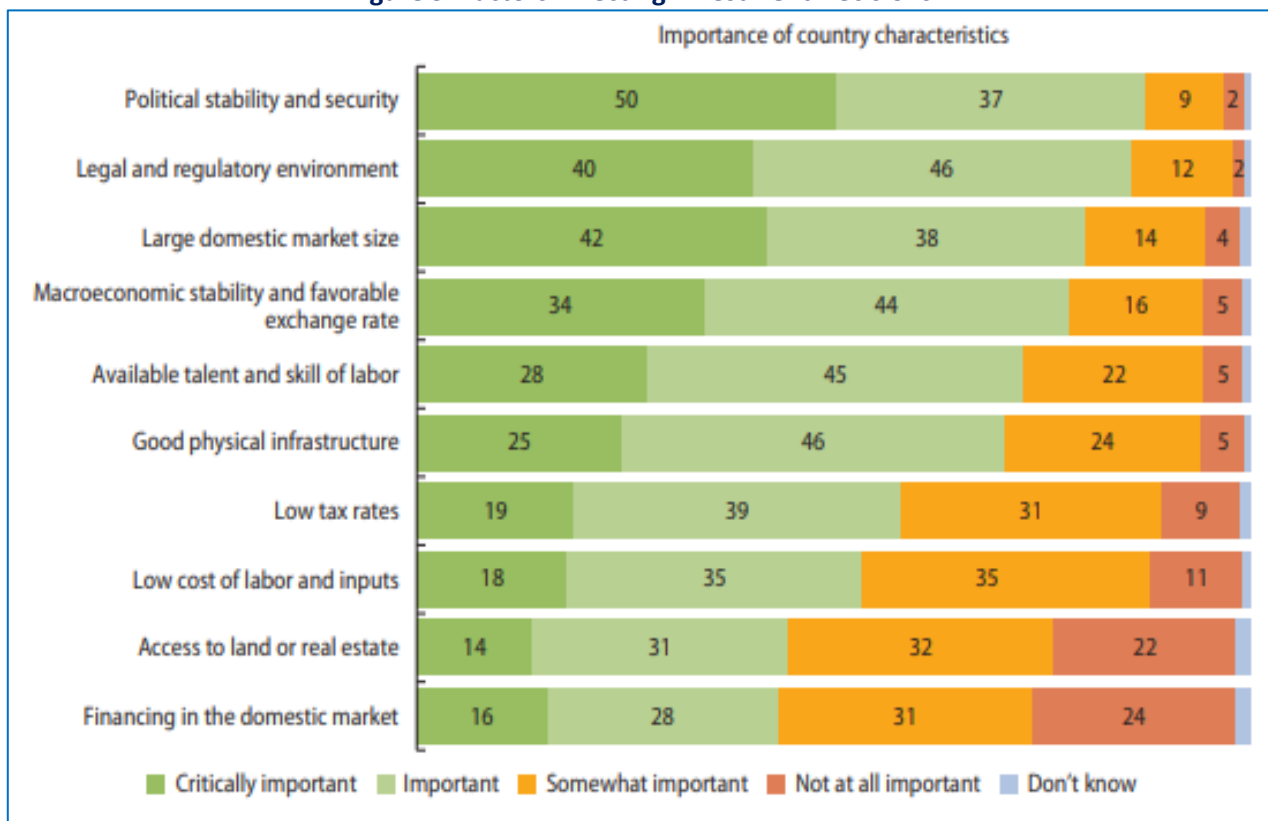
Figure 8: Foreign Equity Restrictiveness Index



As stated previously, the World Bank published the 2017/18 **“Global Investment Competitiveness Report”** on November 15 2017. The report deals with the subject matter of FDI per se. It includes the results of a survey 754 international business executives involved with the operations of their multinational corporations in developing countries (FDI) The survey covers many issues including what drives corporations’ foreign investment decisions. In this report, three findings are extremely important to note. These are quoted below.

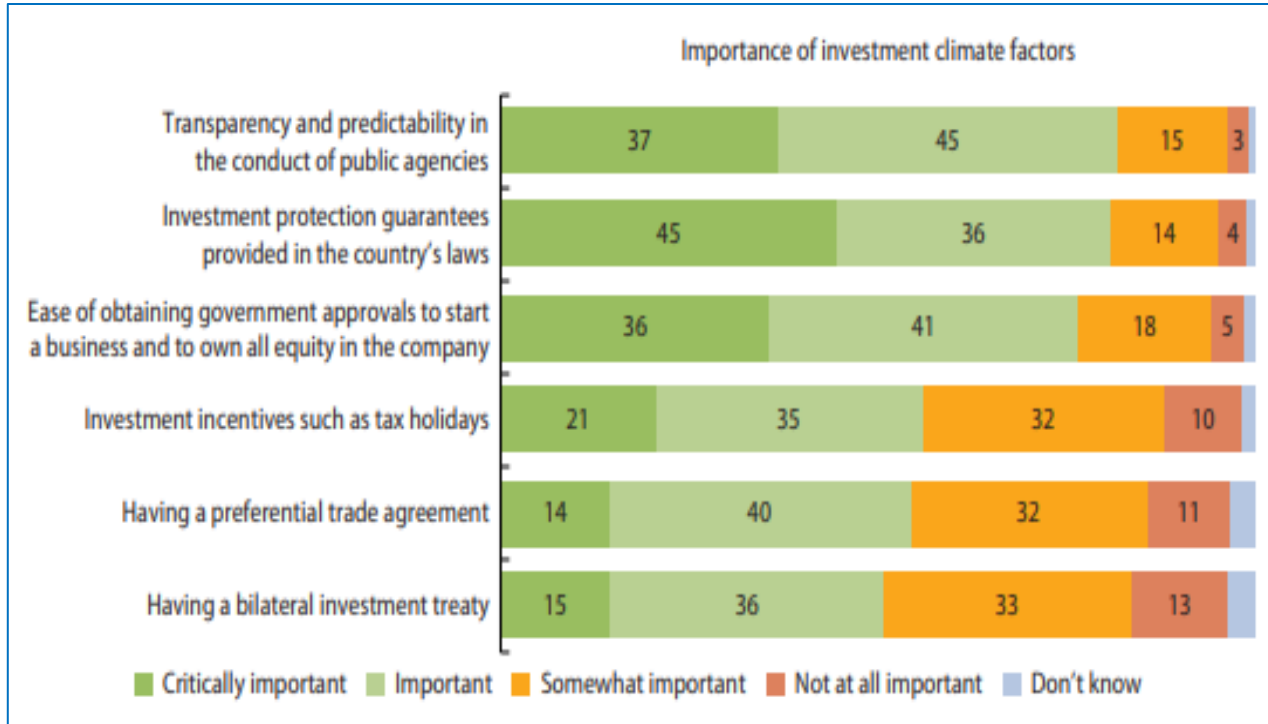
1. “Political stability and a business-friendly regulatory environment are most important in investors’ decision making” (World Bank, 2018). Indeed, 87% of the respondents find that political stability and security important or critically important in their investment (foreign) decisions. Similarly, 86% of the respondents find the legal and regulatory environment important or critically important in investors’ decisions. These observations do not imply that other factors are not important. For example, 44% of the respondents find financing in the domestic market important or critically important. However, if we add those who responded with “somewhat important”, this proportion becomes equal to 75% (Figure 9).

Figure 9: Factors Affecting Investment Decisions



2. Investors seek strong legal protections. They also seek predictability and efficiency in implementing laws and regulations (Figure 10). 82% of the respondents find transparency and predictability in the conduct of public agencies important and critically important. Also, they find many other factors as important and critically important!

Figure 10: Investors Seek Predictable, Transparent, and Efficient Conduct of Public Agencies



4. Summary and Recommendations

The subject matter of FDI has caught the imagination of several stakeholders including the governments of developing countries. Within this context, Jordan is not an exception. Indeed, attracting FDI has been, for so long, the concern of not only His Majesty King Abdullah II, but also successive Jordanian government, as well as the private sector.

The recent experience of Jordan in attracting FDI has been relatively successful. This argument is based on the fact that the inflow of FDI to GDP in Jordan is relatively (to the region) is high. Moreover, the fact that FDI has positive implications (growth), Jordan must maintain, and increase, the inflow of this capital.

Based on the JSF analysis, it can be argued that the impact of the inflows of FDI to Jordan is positive. Indeed, the results indicate that when real FDI increase by 1%, real GDP increases by 0.34%.

We can argue that developing countries, like Jordan, face serious challenges in attracting FDI. Based on the World Bank's survey results, no one factor impacts the flow of global FDI. Jordan must compete in a multitude of issues to succeed in maintaining, if not increasing, the inflows of FDI. This is why, it is critical that all relevant stakeholders, including the Ministry for Investment Affairs, must have at their disposal what is happening to Jordan's (and other competitive countries) rankings in many global indices. These include:

The Market Potential Index; The Global Innovation Index; A.M. Best Country Risk Ratings; The Foreign Direct Investment Confidence (FDI) Index; The

Global Cities Index; The Annual Global Services Location Index; The A.T. Kearney Global Retail Development Index; AON Crisis Management Web Analytics; The Economic Freedom of the World; The Commitment to Development Index; Coface's Country Risk Assessments; The; Emerging Market Global Players; DuCroire: Country Risks; The Global Connectedness Index; The Doing Business: Economy Rankings; Fitch: Sovereign Ratings; Forbes: Best Countries for Business; Heritage Foundation: Index of Economic Freedom; World Bank Worldwide Governance Indicators; Global Competitiveness Report; Logistics Performance Index; Global Enabling Trade Report; Global Information Technology Report; Global Adaptation Index; Human Development Reports; The U.S. News & World Report Best Countries to Invest In; Corruption Perceptions Index; The KOF Index of Globalization; The Country Sustainability Ranking; Ease of Paying Taxes; OECD Country Risk Classification; Economic Complexity Ranking; Happy Planet Index; Global Opportunity Index; Cost of Living City Rankings.

The JSF stresses the importance of regulation stability in attracting foreign investments. Within this context, it is critical for the government to be transparent and predictable in the conduct of its various public agencies- institutions.

Finally, the JSF stresses the importance of following-up the ranking of Jordan on the FDI restrictiveness index. All relevant stakeholders must work on improving and maintain the position of Jordan on this index.

Appendix A

The Model:

The basic model specifying the role of FDI is expressed by:

$$RGDP_t = \alpha_0 + \beta_1 RFDI_t + \varepsilon_t$$

Both variables are in their natural logarithm form. The focus of the analysis is on the parameter β . If there is an impact of FDI on economic growth, the term β will have a positive sign ($\beta > 0$).

In such an exercise, the usual techniques are applied and these include, stationarity test, co-integration, Vector Error Correction Model (VECM), and variance decomposition analysis.

The Results:

TABLE 1
Augmented Dickey-Fuller Unit Root Test

	Level	First-Difference	Level	First-Difference	Level	First-Difference
	None		Constant		Constant & Trend	
RGDP	2.514	-0.830	-0.741	-2.896*	-2.002	-2.636*
RFDI	0.771	-1.992*	-2.515	-2.154*	-1.601	-5.042*

TABLE 2
Johansen Multivariate Co-Integration Test

Hypothesized No. of CE(s)	Trace Statistic	P-Value	Max-Eigen Statistic	P-Value
None*	22.977	0.003	21.528	0.003
At most 1	1.448	0.228	1.449	0.229

TABLE 3
Long Run Relationship

Variable	Coefficient
RFDI	0.344*

TABLE 4
Estimates of VEC Model

Variable	Coefficient	t-statistic
λe_{t-1}	-0.066	-1.703*

Δ RGDP(-1)	-0.526	-1.640*
Δ RGDP(-2)	-0.172	-0.574
Δ RFDI(-1)	0.019	0.654
Δ RFDI(-2)	0.009	0.569

TABLE 5
Variance Decomposition of Tax

Period	RGDP	RFDI
1	100.000	0.000
2	98.221	1.778
3	97.667	2.332
4	97.088	2.911
5	96.643	3.356
6	96.337	3.663
7	96.041	3.959
8	95.825	4.175
9	95.646	4.353
10	95.480	4.520

Table 6
Pairwise Granger Causality Tests

Null Hypothesis:	F-Statistic	Probability
RFDI does not Granger Cause RGDP	0.407	0.673
RGDP does not Granger Cause RFDI	0.614	0.554



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