



منتدى الاستراتيجيات الأردني
JORDAN STRATEGY FORUM

Policy Paper

On the Challenges of the Jordanian Economy: The Need for a Fresh Look: Why and How?

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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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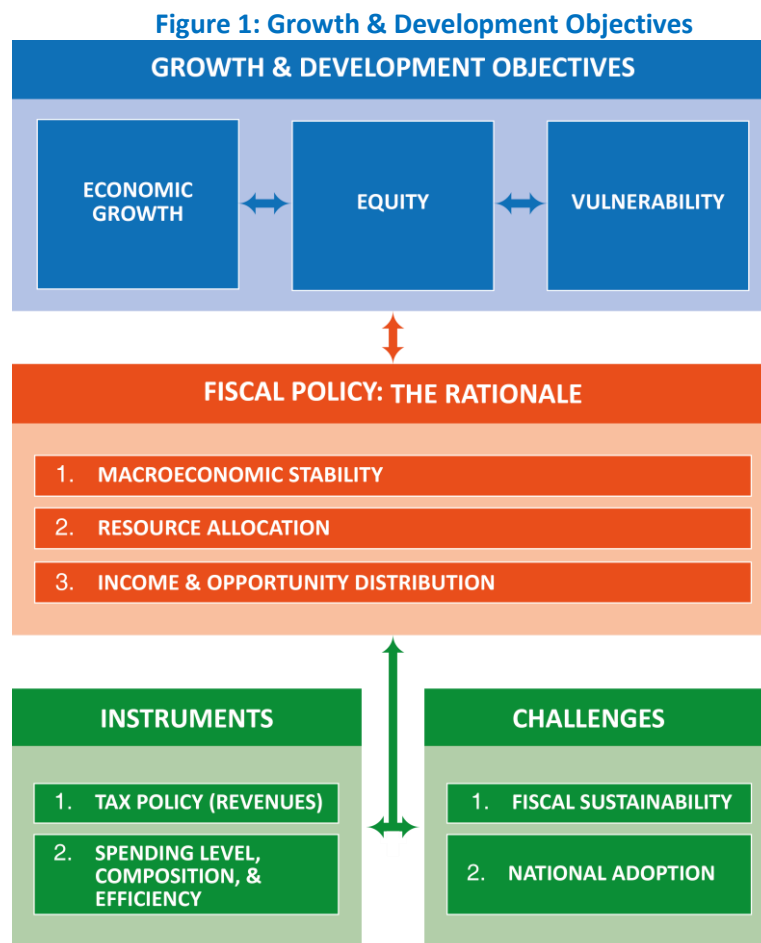
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I. BACKGROUND

Real economic growth must remain the challenge facing all Jordanians. Strong and stable growth is a powerful instrument for reducing unemployment and poverty, and improving the quality of life of the average citizen. It is also crucial to remember that the economy has always been vulnerable to external shocks (e.g. oil prices, Gulf Crisis, Syrian crisis, etc.). Such shocks raise the probability of more households falling into poverty.

Irrespective of what factors determine economic growth and development, basic economic logic asserts that **unless economic policies (e.g. fiscal) and macroeconomic stability (real GDP growth rate, inflation, budget deficit) are “right”, their impact would be limited.** Fiscal policy and macroeconomic conditions set the framework within which economic growth takes place.

1. Macroeconomic stability promotes growth because it reduces uncertainty, increases savings and investments. **(Macroeconomic Stability).**
2. Governments provide public goods and services. Such involvement benefits society, reduces inequality (income and opportunity), and promotes growth **(Resource Allocation).**
3. The tax system, as well as public investment in education, transport, housing, and health care can, not only promote growth, but also reduce poverty **(Income & Opportunity Distribution).**



Within the context of its growth and development objectives, it is important to stress that fiscal policy has short-run and long-run implications.

In the short-run, the government must be able to increase spending during weak economic performance and vice versa (**countercyclical policy**). Research shows that countries which can adopt such a policy achieve higher and more stable growth rates and lower inflation rates. In addition, recent evidence (IMF, 2017) at the micro-level indicates that fiscal stabilization fosters growth in industries.

In the long-run, the government must sufficiently and efficiently invest in physical and human infrastructure, while maintaining sustainable deficits (and public debt levels). If this is not the case, the issue of public finance itself would become the source of economic instability.

“The more countercyclical government spending is, the higher the effect of fiscal stabilization — a relatively high level of government spending when private demand is low will stabilize aggregate demand” (IMF)

“Well-developed infrastructure reduces the effect of distance between regions, integrating the national market and connecting it at low cost to markets in other countries and regions... Effective modes of transport - including quality roads, railroads, ports, and air transport - enable entrepreneurs to get their goods and services to market in a secure and timely manner and facilitate the movement of workers to the most suitable jobs” (World Economic Forum).

“Increasing output volatility by one standard deviation leads to a 1.3 percentage point reduction in growth per capita; this decline is even more sizeable (2.2 percentage points) during crises” (World Bank, 2014).

“Better infrastructure, both in quantity and quality, improves income distribution. This result, together with the proven role of infrastructure in enhancing productivity and growth, suggests that infrastructure development can have double effects on poverty reduction and inclusive growth ... Education spending to enhance human capital could increase the earning power of lower-income groups disproportionately more” (IMF).

“The government cannot provide services efficiently if it has to make high-interest payments on its past debts ... Firms cannot operate efficiently when inflation rates are out of hand” (World Economic Forum”).

Now that Jordan is well on its way towards decentralization, it is important to note, based on a recent IMF study (2017), that “a larger share of decentralized expenditure is associated with a stronger fiscal balance; however, fiscal decentralization can lead to more pro-cyclical fiscal policy”.

2. THE JORDANIAN EXPERIENCE: FISCAL POLICY / THE WHY?

If the use of fiscal policy should promote macroeconomic stability, improve the resource allocation process, reduce poverty, and promote economic growth and development, we need to ask the following question:

Where Does the Jordanian Economy Stand Relative to Macroeconomic Stability and Fiscal Policy?

A. GDP Growth: The Jordanian economy has never repeated the strong performance of the 1970s. However, since 1990, its performance has not been stable. In addition, the recent growth performance has been weak. The economy has also suffered from fluctuating inflation rates.

Figure 2: Real GDP Growth Rates

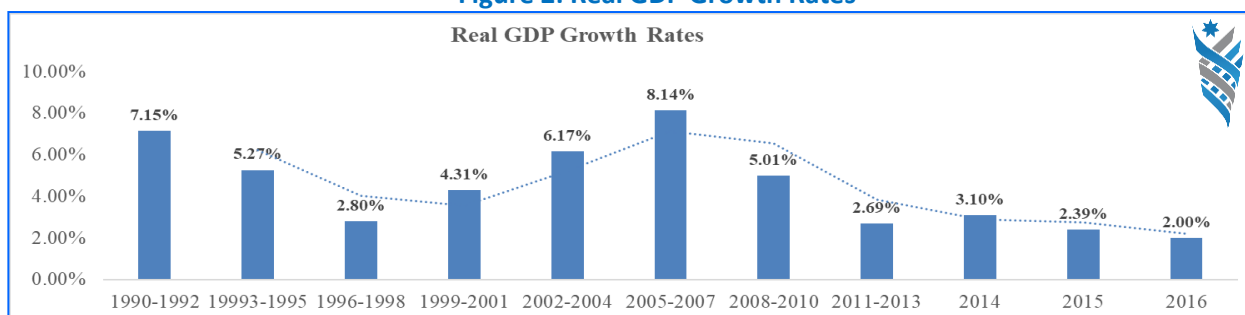
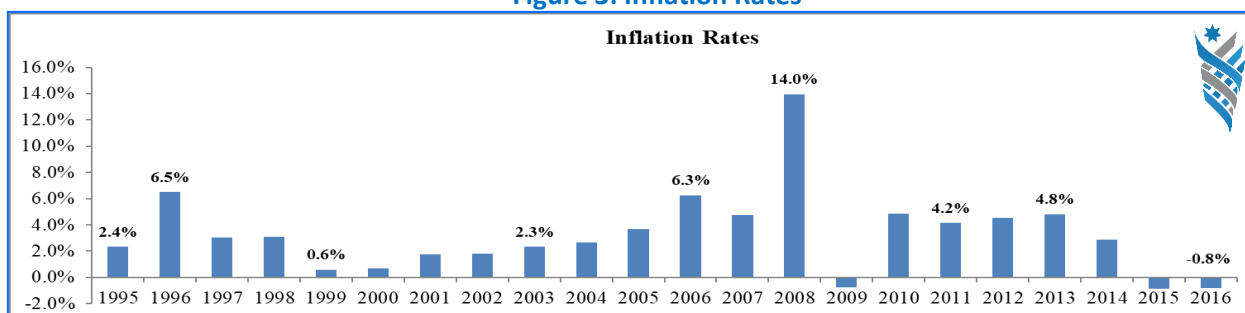


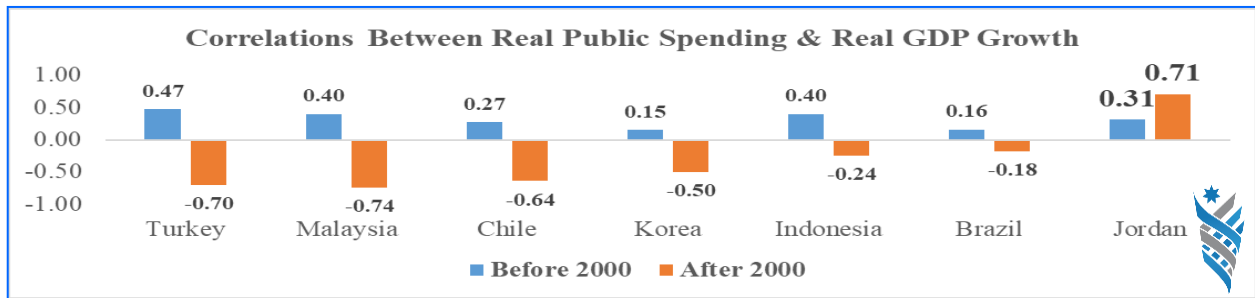
Figure 3: Inflation Rates



B. Fiscal Policy

Public Spending: Developed economies adopt counter-cyclical fiscal policy. Even some emerging economies have “**graduated**” from pro-cyclical fiscal policy. The positive (Jordanian) correlations between real public spending and GDP imply that the government could not promote macroeconomic stability.

Figure 4: Correlations between Real Public Spending & Real GDP Growth, examples of some countries of the world



Total public spending to GDP ratio has fallen from 43 percent (1970-1980) to 29.1 percent by the end of 2016. What is more important, however, is the **DECREASE in CAPITAL SPENDING**.

Figure 5: Total Public Spending to GDP Ratio in Jordan

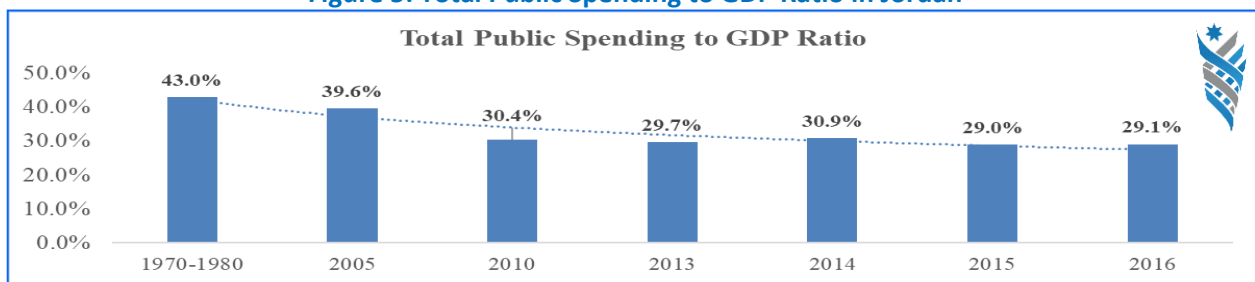
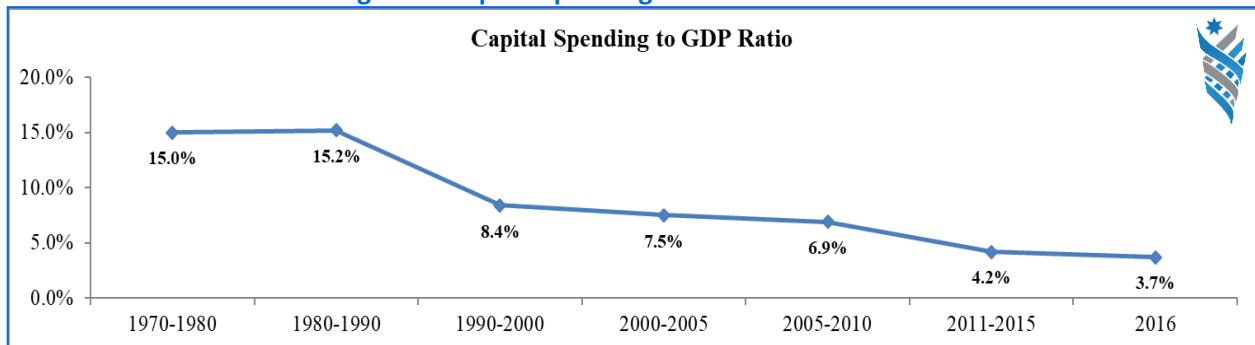
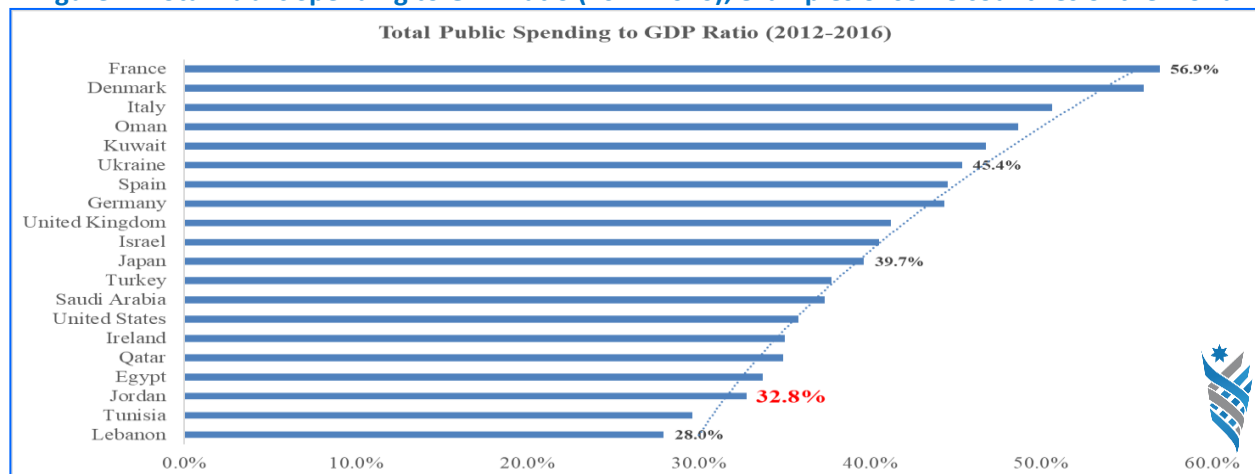


Figure 6: Capital Spending to GDP Ratio in Jordan



The government's involvement in the national economy is relatively limited. **Total public spending to GDP ratio in Jordan is relatively low.**

Figure 7: Total Public Spending to GDP Ratio (2012-2016), examples of some countries of the world



Capital Spending: The decrease in capital spending is clearly disappointing. It reflects the fact that the increase in the Jordanian population, never mind the influx of Iraq and more recently Syrian refugees, could not be met with a reciprocal increase in capital spending. **It does not take a genius to realize that this decrease in capital spending must have resulted in the deterioration of the provision of public goods in terms of both “sufficiency” and “efficiency”.**

The decline in capital spending is working against improving economic growth in Jordan for other reasons too.

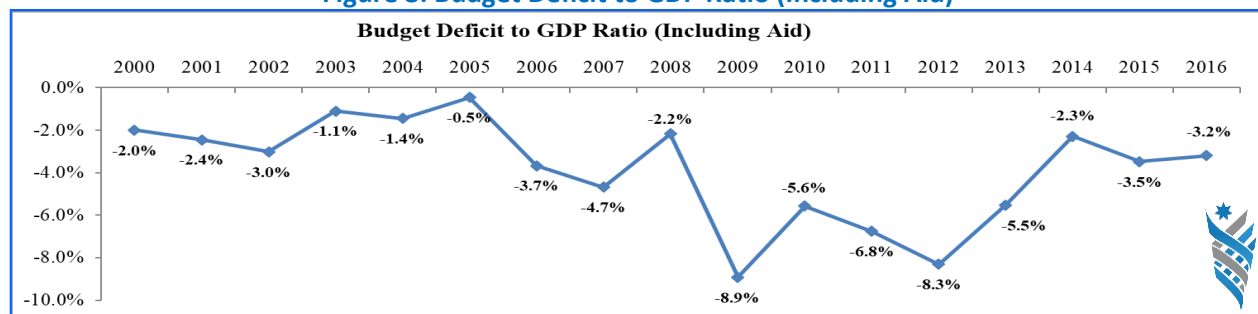
First, increasing **capital** spending by 1% increases GDP by 2.3%-2.4% in the long-run (IMF, 2013).

Second, increasing **current and capital** expenditures by 1% increase GDP by 2.4% and 5.8% respectively (ESCWA, 2015).

Third, Jordanian growth rates in total factor productivity in 2007-2012, 2012, 2013 and 2014 are equal to -0.3%, -0.6%, -0.6%, and -0.8% respectively (Conference Board).

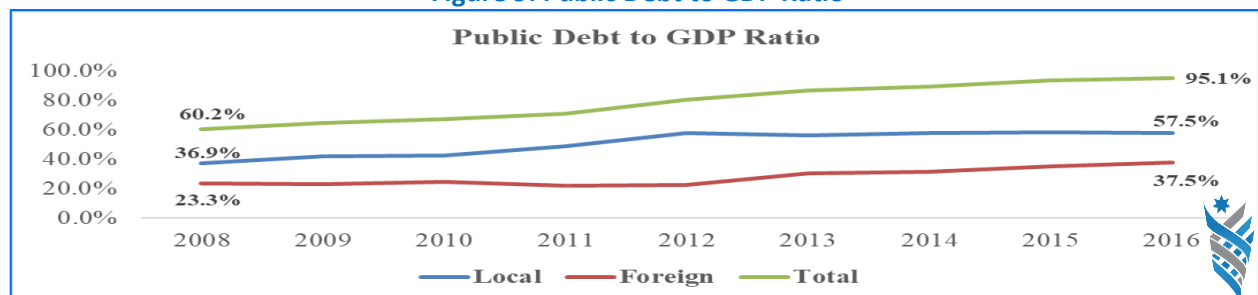
Budget Deficit: In spite of the significant aid inflows, Jordanian governments have always **suffered from consistent budget deficits.**

Figure 8: Budget Deficit to GDP Ratio (Including Aid)



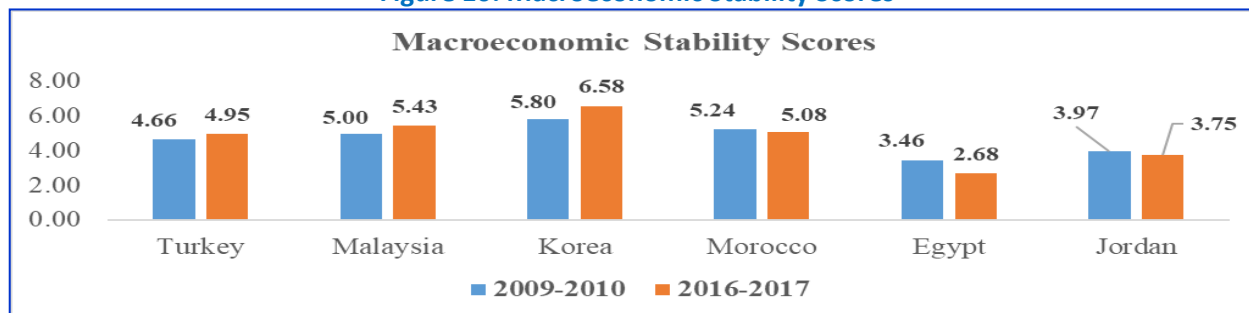
Public Debt: The decrease in total public spending and the consistent budget deficits notwithstanding, local and foreign debt levels have been rising at alarming rates.

Figure 9: Public Debt to GDP Ratio



C. Macroeconomic Stability: Based on the World Economic Forum’s (WEF) 2016-2017 report, which measures the “competitiveness index” for a total of 138 countries, Jordan ranks **63rd**. However, in terms of the “**macroeconomic stability**” dimension, Jordan comes in at **131st**. Even more disappointing, is the fact that the macroeconomic stability score has deteriorated since 2009-2010.

Figure 10: Macroeconomic Stability Scores



D. Jordan's Ranking on Global indices: Jordan's rankings in the 2016 Global Macroeconomic Stability (World Bank), Logistic Performance Index (World Bank), Global Energy Architecture Performance Index (WEF), Networked Readiness Index (WEF), Human Capital Index (WEF), Global Gender Gap (WEF), Global Enabling Trade Index (WEF), and in the Global Information Technology Index (WEF) leave a lot to be desired.

E. Tax Revenue to GDP Ratio: The tax effort in Jordan is low in comparison with other countries. For example, in 1965, while Denmark's tax effort was much higher than in Jordan, the difference has become even larger. Also, while Turkey and Greece had tax revenue to GDP ratios in 1965 close to that in Jordan, since then, the equation has changed.

Figure 11: Tax Revenue to GDP Ratio

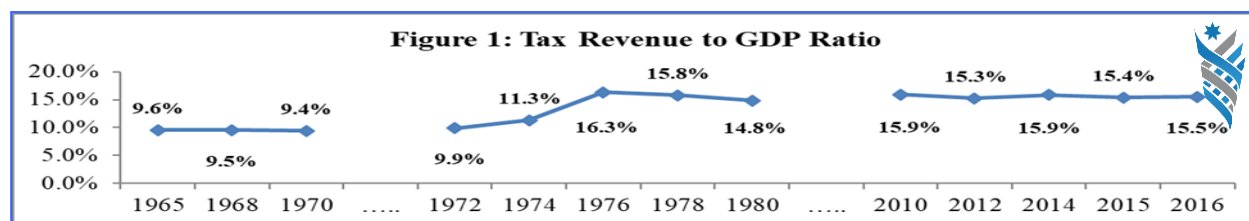
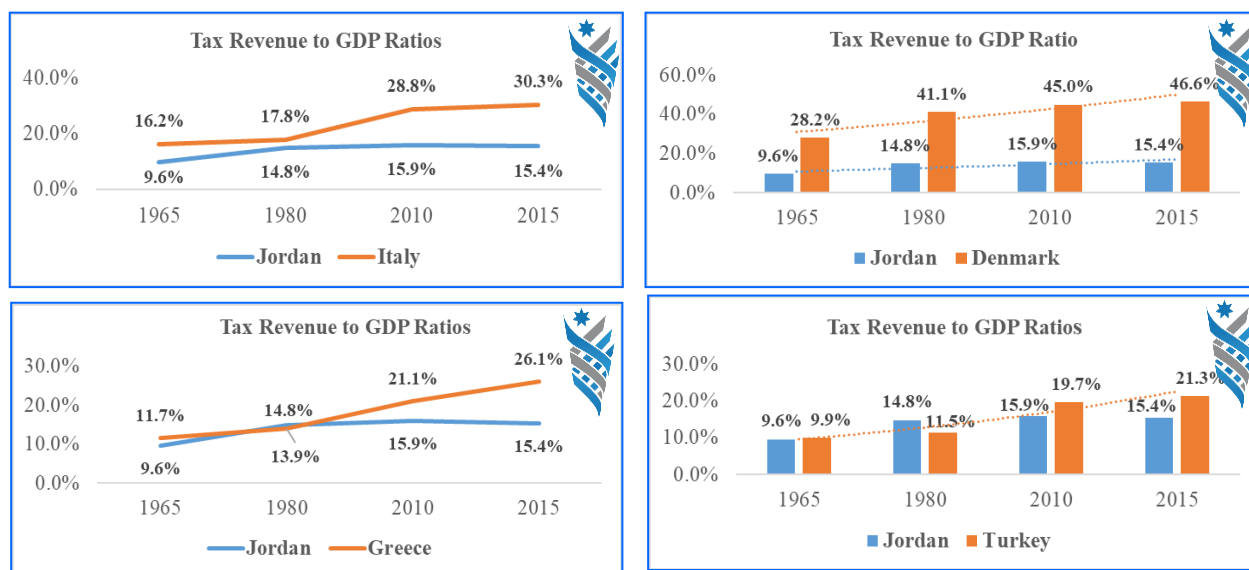
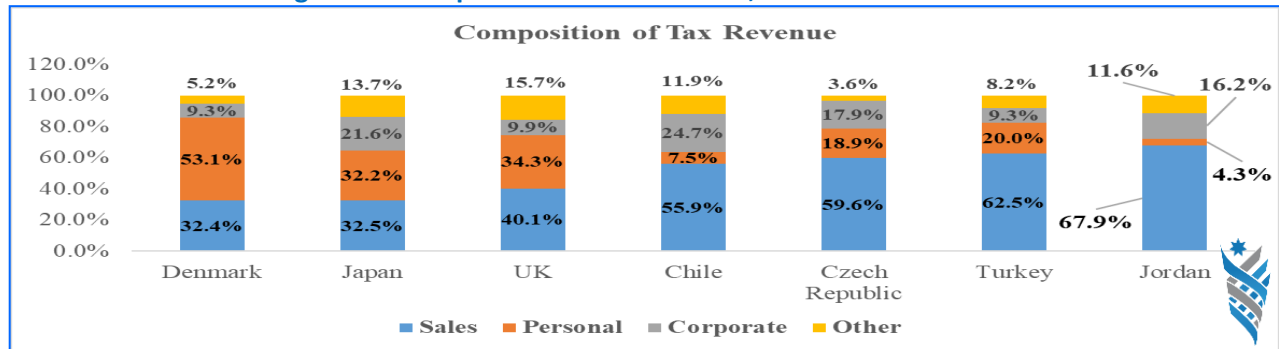


Figure 12: Tax Revenue to GDP Ratio in Jordan



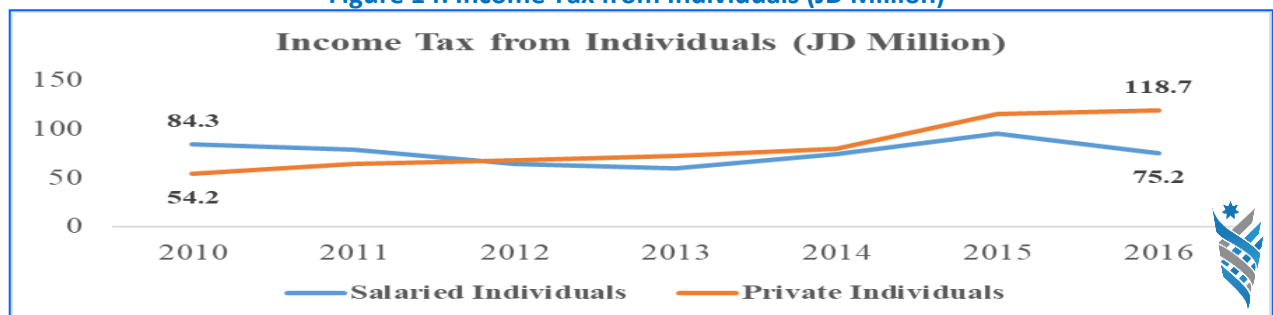
Also, the **composition of total tax revenue** provides us with useful insights. In Jordan, although a large number of goods are exempted from sales tax, this source accounts for 68 percent of total tax revenue!

Figure 13: Composition of Tax Revenue, in several countries



Finally, it is important to note that the **income tax from individuals** (salaried individuals and private individuals (SMEs)) contributes **ONLY 4.3 percent towards total tax revenue**. Even more important, is the fact that salaried individuals pay more than private individuals (SMEs)! To shed some further light on this issue, it would be interesting to note that in 2012 and 2014, the total number of private sector enterprises was equal to 147,767 and 157,852 respectively. These figures indicate that, on average, these private individuals paid JD408 (2012) and JD473 (2014) each!

Figure 14: Income Tax from Individuals (JD Million)



F. In addition, one can add many other observations:

- What explains the low knowledge and skills of 15 year olds in mathematics, reading and scientific literacy (PISA)?
- What explains the tremendous increase in the number of students attending private schools and in private hospital beds?
- **What explains the disappearance of the rail transport system in Jordan which used to transport passengers? This network carried a total of 35,056 passengers in 1966!**

The cumulative impact of macroeconomic instability, in terms of annual fluctuations in real GDP and volatile inflation rates, falling capital spending, rising debt levels, deteriorating government effectiveness, and other external factors, have weakened economic growth in Jordan during the past years. To enhance economic growth in Jordan, we must bring the national economy out of the trap it has fallen in; **low-efficiency equilibrium**.

3. WHAT TO DO? THE HOW?

The Jordanian economy must achieve stable and strong economic performance that is caused, felt, and shared by the average citizen. **The government must be able to adopt fiscal policy which enhances short-term macroeconomic stability and meet the requirements of growing human and physical infrastructure needs.** Here, we recommend three policy options:

3.1 A New National Tax Policy

The inability of the government to promote macroeconomic stability and to maintain, if not increase, capital spending, are clearly not encouraging. However, how can one expect the government to do otherwise when its' tax revenue is low (insufficient fiscal space)?

The currently existing 15 percent of GDP in the form of total tax revenue is not enough. Such a ratio makes the Jordanian government like the head of a household whose income is low, and blessed with a child every other year. Sooner or later, such a person will not be able to meet his daily expenses, never mind other (capital!!) expenses.

Based on the brief analysis of the government's tax revenues in 2-G above, and international best practices, we suggest a number of general and specific recommendations:

1. **A modern tax system that is fair, progressive enough, diversified, yields sufficient revenue to the government, and easy to administer must be discussed and adopted.**
2. **Any adopted changes in the tax regime must be openly discussed and explained to the public at large.**
3. **Frequent changes in the tax law should be avoided because they create uncertainty.**
4. **Predictability and consistency by tax administrations is important. This can be achieved through the timely issuance of rulings and any other technical interpretations. In other words, the proactive engagement of taxpayers improves understanding of the legislation and its requirements, and of the practices of the tax administration.**
5. **Effective dispute resolution mechanisms are critical in establishing certainty. Dispute resolution mechanisms should be fair and independent, accessible to taxpayers, and effective in resolving disputes in a timely manner.**
6. **There is no right or wrong in asking salaried individuals to pay more taxes. However, the fact that the mean wage in Jordan is relatively low, this option might not be viable. For example, while in Turkey such individuals pay 15 percent tax on their income which ranges between TL1-13,000, the British are exempted from the Pound 11,500.**
7. **The Ministry of Finance official figures indicate that "private individuals" contribute very little towards the government's tax revenues. This is where the "problem" lies, and something must be done about it in terms of introducing a new collection system!**

3.2 The Capital Market

The fact that Jordanian governments have been dependent on external grants and concessional loans, and local and foreign borrowing for funding deficits and capital spending, one can argue that access to alternative sources of finance is critical. This is why it is really surprising to learn that the already issued local bonds by the central government and various public entities do not trade on the secondary market and these bonds are bought mainly by local banks. The “almost zero” corporate bond market is equally surprising.

It is imperative to develop a “liquid” government bond market. The fact that infrastructure projects require long-term commitments of capital, the presence of liquid secondary markets (government bonds, corporate bonds and stocks) eases this problem by providing an asset to savers **which** they can sell. Such a prospect would not only improve successive governments’ ability in financing long-term capital investments, but also provide Jordanians who work locally, Jordanians with remitted funds, and others, with additional financial securities to invest in. The establishment of efficient government bond market involves other benefits too.

First, if Jordan borrows in foreign currency denominated debt, depreciation of the local currency would immediately worsen the balance sheet of the government and increase the debt repayment burden.

Second, with higher fiscal space (tax revenue), a well-functioning bond market enhances economic stability by enabling the government to pursue expansionary fiscal policy in recession times. Also, bond markets allow governments (together with the private sector) finance long-term infrastructure projects known to be conducive to economic growth.

Finally, vibrant local bond markets are useful for other reasons. For example, government bonds market provides the national economy with a risk-free benchmark, makes the conduct of monetary policy more effective, and contributes to budgetary discipline by exposing the government to financial discipline. These benefits can materialize especially when the tax effort improves. **Indeed, the government would be able to pay market interest rates instead of selling the issued bonds to the market, and not allowing such securities to be traded on the secondary market.**

3.3 Public-Private Partnership (PPP)

Why doesn’t the Jordanian government, under PPP agreements, specify the quality and quantity of services (public goods) it requires, while the private partner is tasked with the design, construction, operation and management of the assets (capital) and the delivery of the services to either the government or to the public at large? In return, the private partner receives either a stream of payments from the government, user charges levied directly on the end users, or a combination of both (e.g. Queen Alia International Airport).

The case for MPPP unit in Jordan cannot be overstated. Policy-makers must **“prioritize”** and **“quantify”** Jordan’s needs for public goods’ investment projects (human capital and physical infrastructure). **If such announcements are to translate into short-term confidence, medium-term jobs and long-term competitiveness, this “comprehensive” commitment must be translated into action on the ground and quickly.**



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