Opportunities to Attract Foreign Direct Investment: Investment Environment, Governance, & Ease of Doing Business

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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.

For more information about the Jordan Strategy Forum, please visit our website at www.jsf.org or contact us via email at info@jsf.org. Please visit our Facebook page at Facebook.com/JordanStrategyForumJSF or our Twitter account @JSFJordan for continuous updates aboutJordan Strategy Forum.

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1. Background:

Recently, the world has witnessed the 2008 global financial crisis and the emergence of COVID-19. However, the COVID-19 shock is different. The virus has not spared the largest and richest economies, hit the supply demand sides of economies, and has led to policy shocks.

While the impact of COVID-19 is still evolving, the signs are becoming clear. For example, the outbreak has led to a dramatic decrease in the global flow of Foreign Direct Investment (FDI). In its' April 2021 Report (FDI in Figures), the Organization for Economic Co-Operation and Development (OECD), states that "global FDI flows decreased by 38% in 2020 to USD 846 billion, their lowest level since 2005".

The flow of FDI has long been recognized as an engine of growth and development. The flow of FDI is an important source of financing development, especially in developing countries. Therefore, the decline in FDI will have some negative consequences for countries, such as Jordan, that seek to attract this capital inflow.

This Policy Paper, issued by the Jordan Strategy Forum (JSF), makes a case for the Jordanian economy's need for FDI. In addition, the paper outlines the recent experience of Jordan in attracting FDI. Finally, the paper recommends some policy measures whose objective is to increase the inflows of FDI in the Jordanian economy.

2. The Case for Attracting FDI Inflows

For so long, it has been known that the Jordanian economy suffers from a multitude of socio-economic challenges. These challenges include modest growth rates, and high, and rising unemployment rates. Naturally, COVID-19 would make these challenges even more serious, and perhaps for years to come.

The Jordanian economy must realize strong, consistent, and stable real economic growth rates to overcome its challenges. This is the only way to make a significant dent in the hitherto existing double-digit unemployment rates.

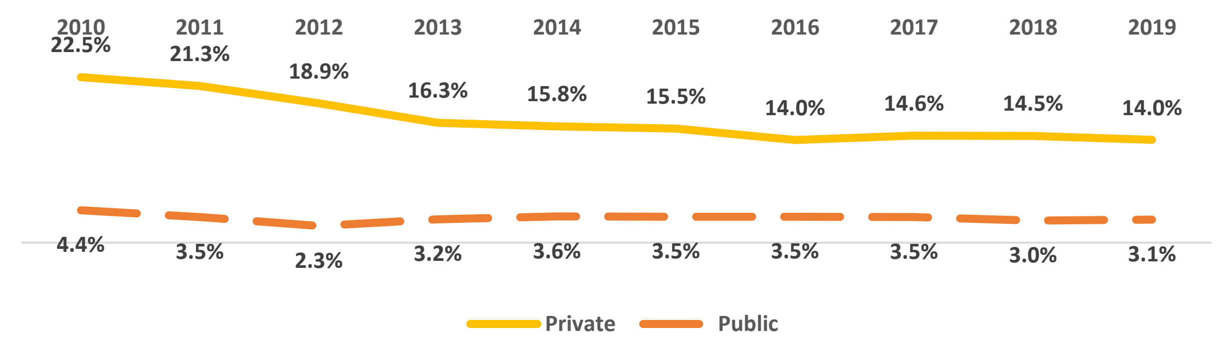
For centuries, economists have tried to examine why and how countries achieve strong growth. The still on-going research effort places emphasis on a myriad of factors including macroeconomic policies (fiscal and monetary), human capital, international trade, economic complexity, competition, institutional framework, demography, and others. In addition, the economics literature looks at FDI as a factor, which can be instrumental in the promotion of economic growth and development.

The inflows of FDI bring-in a multitude of benefits. FDI can create jobs and promote national exports. In addition, the knowledge and technology that multinationals possess can benefit local companies. Domestic firms, for example, can imitate the multinationals in terms of products, production, and even management techniques.

Within the context of the growth and unemployment challenges that face the Jordanian economy, and the above-mentioned benefits of attracting FDI, it is important to stress that Jordan needs FDI inflows. Below, we outline few observations that reflect this.

First, based on the World Bank's published data, private and public Gross Fixed Capital Formation (GFCF) in Jordan have been on a downward trend (Figure 1).

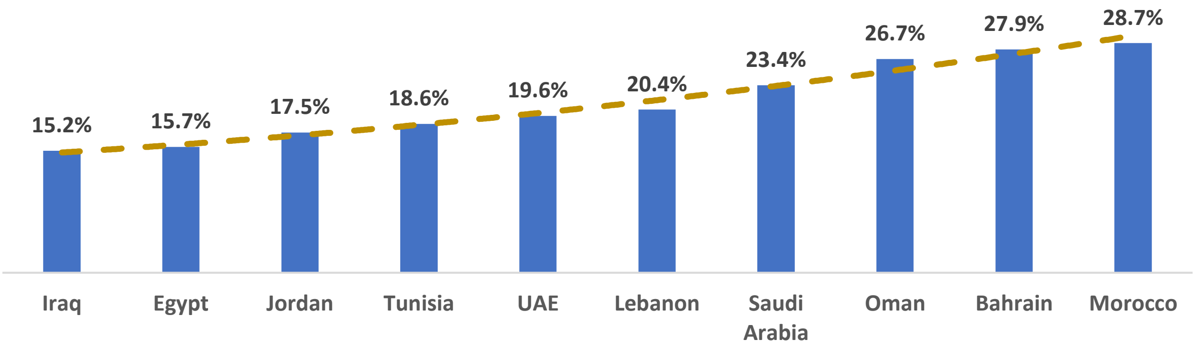
Figure 1: Gross Fixed Capital Formation to GDP Ratio



Source: The World Bank – Open Data

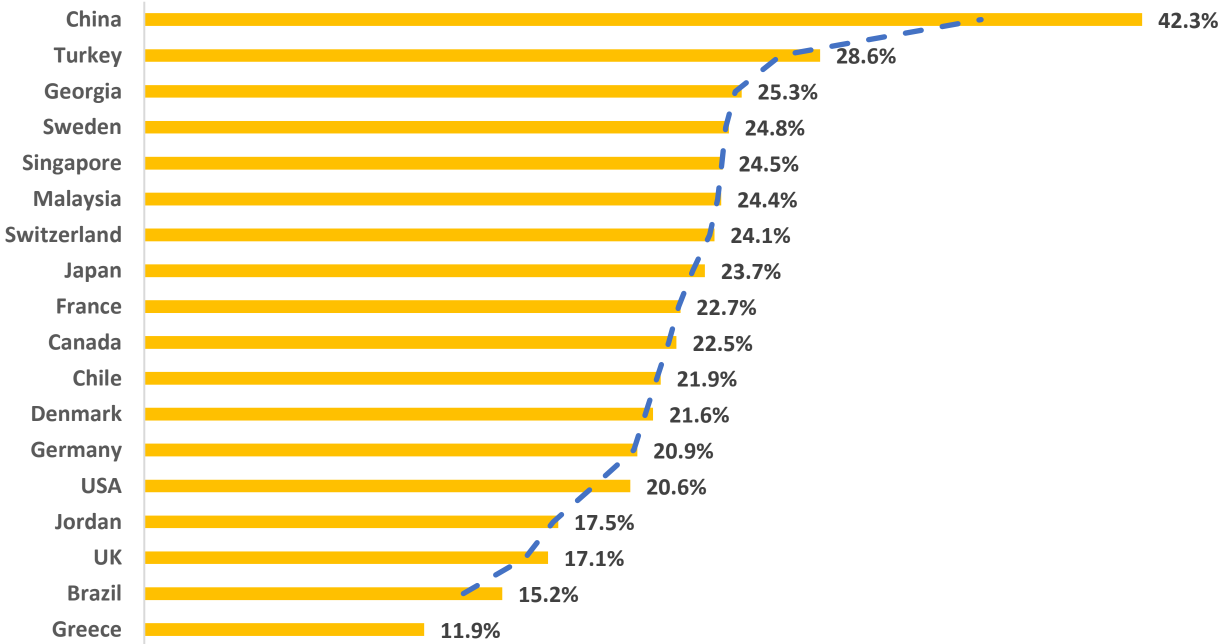
Second, at the regional level, one can state that GFCF in Jordan is relatively low (Figure 2). At the international level, GFCF in Jordan is also low (Figure 3).

Figure 2: Regional Gross Fixed Capital Formation to GDP Ratio (2016 - 2019)



Source: The World Bank – Open Data

Figure 3: International Gross Fixed Capital Formation to GDP Ratio (2016 - 2019)



Source: The World Bank – Open Data

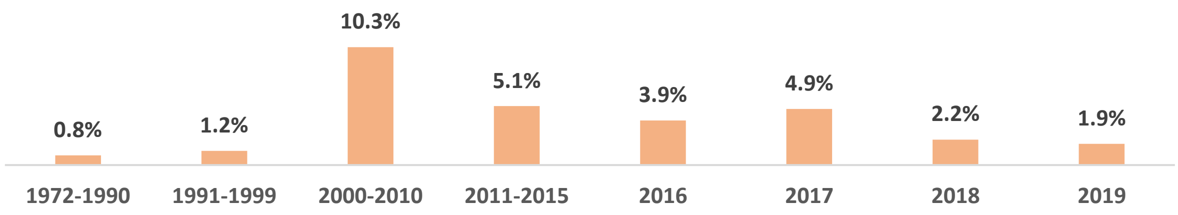
In a Nutshell, based on the above-mentioned observations about GFCF (private and public), it is in the interest of the Jordanian economy to expand the productive base of the economy, and facilitate the inflows of FDI. There is an urgent need to increase investment rates, without which development will be difficult to achieve. In addition, sufficient job opportunities, instrumental in easing tensions, especially among the youth, will not be created.

3. Foreign Direct Investment: The Jordanian Experience

The experience of Jordan in attracting FDI reflects some significant observations.

A. During the period 2000-2010, the mean annual ratio of this capital inflow to GDP was equal to 10.3%. While this high ratio was the result of the privatization program, since 2010, however, this inflow has been on a decreasing trend (Figure 4).

Figure 4: Jordan: Net Inflows of FDI To GDP Ratio



Source: The World Bank – Open Data

B. The record of Jordan in attracting FDI is encouraging. During the period 2010-2019, it is only countries like Georgia, Chile, Lebanon, and Switzerland that have attracted higher ratios (Figure 5A). However, it is also useful to note that the variability (standard deviation) in this inflow to Jordan is lower than in these countries (Figure 5B).

Figure 5A: Mean Annual Net Inflows of FDI to GDP Ratio (2010-2019)

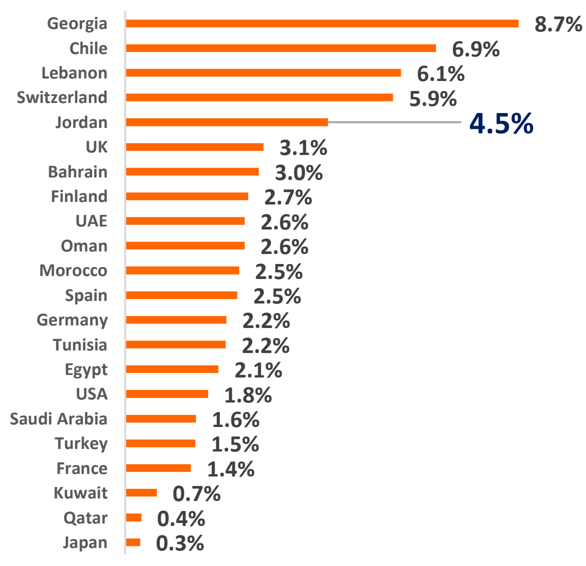
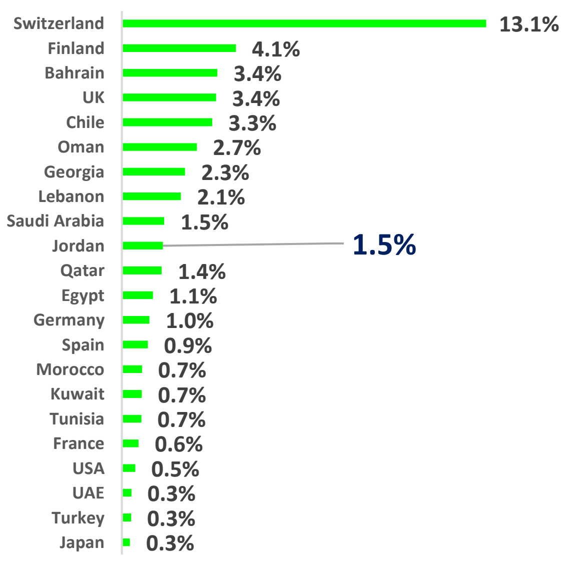


Figure 5B: Standard Deviation of Net Inflows of FDI to GDP Ratio (2010-2019)



Source: The World Bank – Open Data

In a Nutshell, the recent inflows of FDI are encouraging. However, Jordan needs to explore the reasons behind the variability and volatility in attracting more FDI inflows. In normal circumstances, it is challenging to maintain a constant stream of FDI because such inflows are related to the business environment, and existing business opportunities.

4. The Promotion of FDI: What to Do?

In 2020, the global FDI flows decreased by 38% (OECD). With the pandemic still unfolding, FDI is projected to decrease by 5% to 10% in 2021 (World Investment Report / United Nations Conference of Trade and Development / UNCTAD). The outlook for 2022, and beyond, is highly uncertain, and difficult to predict. Any recovery in FDI depends on the duration of the pandemic, effectiveness of policy interventions to accelerate investment, and on the on-going geopolitical and trade tensions. Within this context, three observations are worth raising.

First, the road to FDI recovery will be uncertain, hard, and slow.

Second, FDI will be a critical resource, especially in countries whose public financing, because of COVID-19, become tighter than ever before.

Third, lower levels of FDI will lead to heightened competition for investment among governments.

The Jordanian government must recognize these three observations. It is true that the pandemic has hit investment. However, COVID-19 should provide the government with a "window of opportunity" to re-examine its approach to the inflows of FDI.

Responding to the pandemic would not be easy. To attract, retain, and facilitate investment in general and FDI in particular, the government must take into consideration a multitude of factors. Indeed, a large set of FDI determinants have been used in the economics literature. Naturally, the objective of this effort is to understand the FDI decisions of multinational enterprises.

Within the context of what really affects where the flows of FDI go, it is informative to note the OECD has recently published a paper (The Determinants of Foreign Direct Investment: Do Statutory Restrictions Matter? / 2019) that examines the determinants of FDI in 60 advanced and emerging countries during the period 1997–2016. In this paper, two factors stand out, and these are "Good Governance" and "Foreign Direct Investment Restrictions". Within this context, one should not forget the instrumental role of the World Bank Doing Business indicators in affecting FDI.

Good Governance: No one can argue that the quality of the host country institutions does not affect FDI. First, good governance is supposedly associated with higher per capita income levels and higher productivity levels. Second, poor governance, such as corruption, represents costs to investors. Third, FDIs usually involve significant fixed costs, and this renders them particularly vulnerable to uncertainty, such as poor government capacity, poor policy implementation, policy reversals, weak enforcement of property rights, and others.

Foreign Direct Investment Restrictions: No one can argue that statutory barriers to FDI, and other operational restrictions, are not expected to discourage FDI. Indeed, "barriers may limit market reach or raise transaction costs relative to competing locations for foreign firms both in particularly restrictive sectors as well as for foreign firms operating in FDI-related supporting sectors".

Doing Business: No one can argue that business regulations for local firms are not expected to affect FDIs. "By gathering and analyzing comprehensive quantitative data to compare business regulation environments across economies and over time, Doing Business encourages economies to compete towards more efficient regulation, offers measurable benchmarks for reform, and serves as a resource for academics, journalists, private sector researchers and others interested in the business climate of each economy" (World Bank).

Relative to the above-mentioned three factors (good governance, FDI restrictiveness, and doing business), it is also informative to note that the World Bank publishes **"The Worldwide Governance Indicators"** for over 200 countries and territories (including Jordan), the OECD publishes the **"Foreign Direct Investment Restrictiveness Index"** for a total of 84 economies (including Jordan), and the World Bank publishes the Doing Business for a total of 190 economies.

Below, we use these three indices to report the scores of Jordan, and where Jordan ranks on them. Naturally, the objective of this exercise is to determine what the Jordanian government needs to do to improve governance and FDI restrictiveness, and hence to promote the inflows of FDIs.

A. Governance: World Bank Framework and Benefits

The question of how to measure the quality of governance is important. After all, if a country wishes to improve its governance, stakeholders need to know how to improve what. Within this context, the World Bank, since 1996, has been the leading institution in measuring governance.

The Worldwide Governance Indicators report on six dimensions of governance for over 200 countries and territories. The six dimensions are:

1. **Voice and Accountability:** This dimension captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

2. **Political Stability and Absence of Violence:** This dimension captures perceptions of the likelihood that the government will be de-stabilized or overthrown by un-constitutional or violent means including politically-motivated violence and terrorism.

3. **Government Effectiveness:** This dimension captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

4. **Regulatory Quality:** This dimension captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

5. **Rule of Law:** This dimension captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

6. **Control of Corruption:** This dimension captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests.

Good governance is important for several reasons.

First, it reduces uncertainty. In other words, when the rules of the game are clear, life becomes more predictable. Certainty encourages investment and promotes long-term growth.

Second, good governance creates a level-playing field. It does not give certain advantages to firms or individuals. Good governance promotes equality of outcome, equality of opportunity, and a more efficient allocation of economic resources.

Third, governments with better governance are able to raise more fiscal revenues relative to the size of their economies (IMF / 2019). Such governments are in a better position to provide for public goods and services.

Where Does Jordan Stand on the Worldwide Governance Indicators?

A. On a scale of -2.5 to +2.5, the voice and accountability, and political stability and absence of violence dimensions remain negative.

Figure 6A: Voice & Accountability

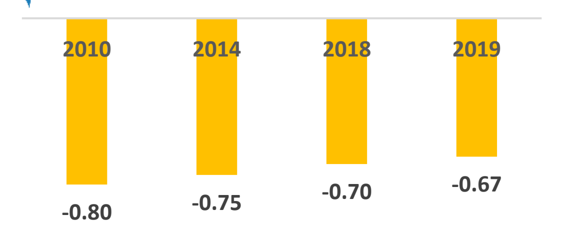
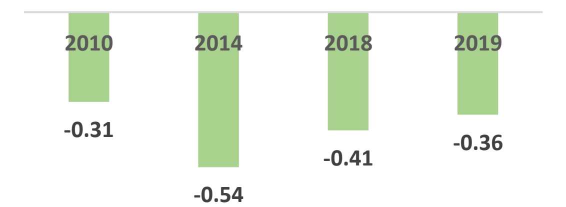


Figure 6B: Political Stability & Absence of Violence



Source: The World Bank - Worldwide Governance Indicators

B. On a scale of -2.5 to +2.5, the control of corruption remain low. However, the score of the rule of law dimension has deteriorated.

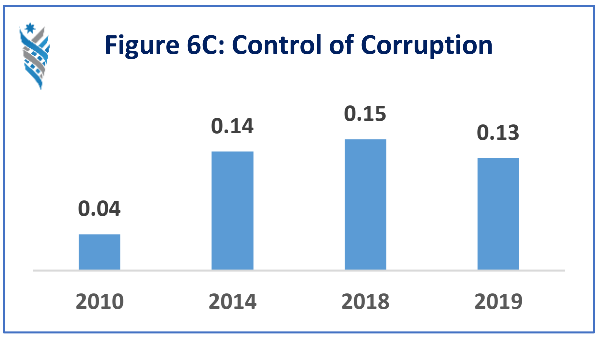


Figure 6C: Control of Corruption

Source: The World Bank - Worldwide Governance Indicators

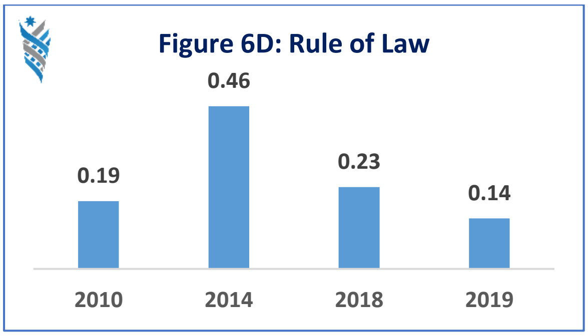


Figure 6D: Rule of Law

Source: The World Bank - Worldwide Governance Indicators

C. On a scale of -2.5 to +2.5, it is unfortunate to note that the score of government effectiveness remains low. What is unfortunate, however, is the low and deteriorating score of the regulatory quality dimension.

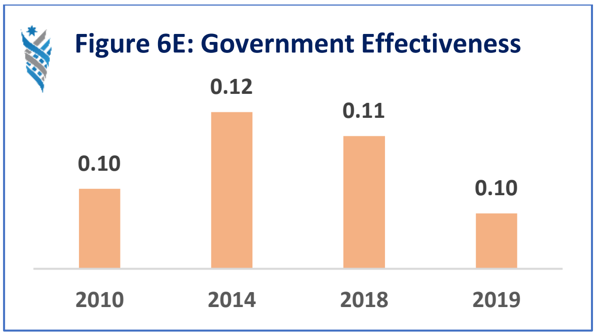


Figure 6E: Government Effectiveness

Source: The World Bank - Worldwide Governance Indicators

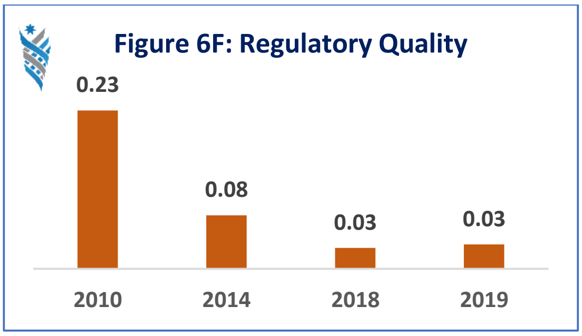


Figure 6F: Regulatory Quality

Source: The World Bank - Worldwide Governance Indicators

D. Sweden scores high in the voice and accountability dimension. Singapore ranks high in the political stability dimension. Relative to Arab countries, Jordan's scores are fine.

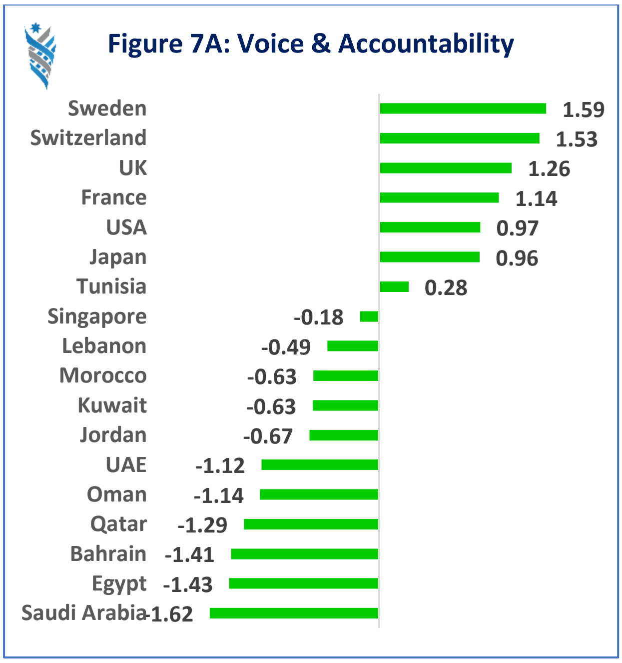


Figure 7A: Voice & Accountability

The World Bank - Worldwide Governance Indicators

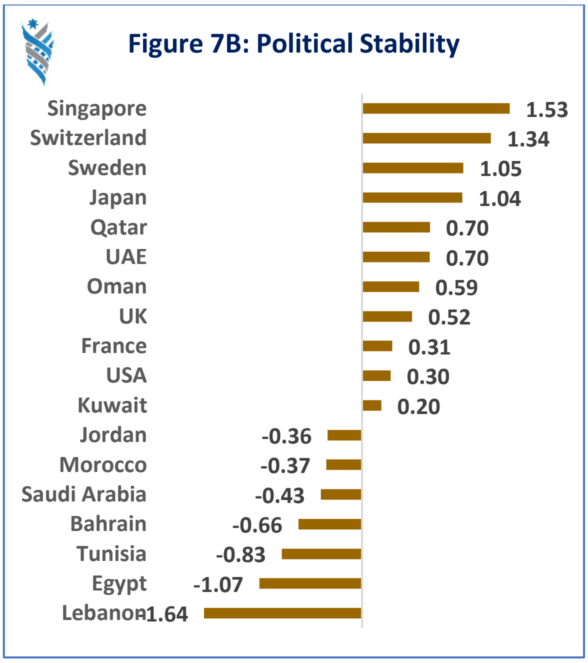
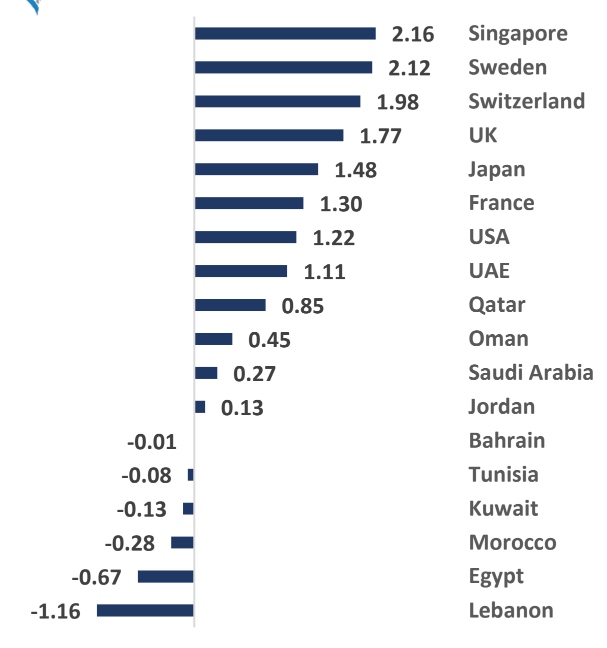


Figure 7B: Political Stability

The World Bank - Worldwide Governance Indicators

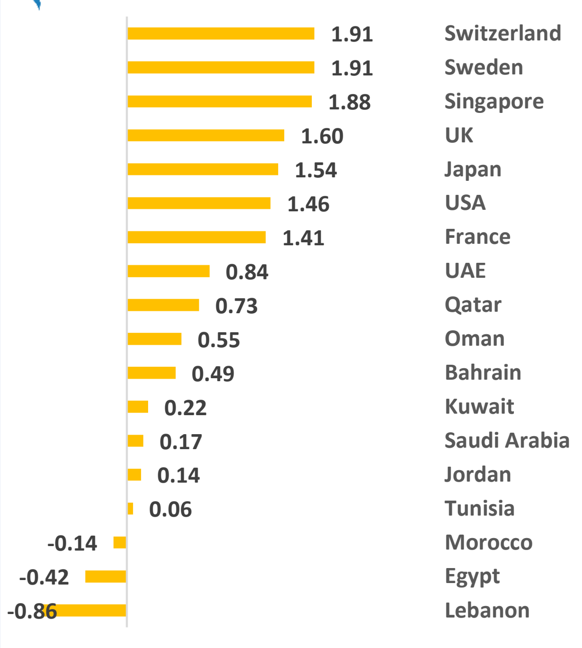
E. Singapore scores high in the control of corruption dimension. Switzerland is top in the rule of law dimension. Relative to Arab countries, Jordan's score are somewhere in the middle.

Figure 7C: Control of Corruption



Source: The World Bank - Worldwide Governance Indicators

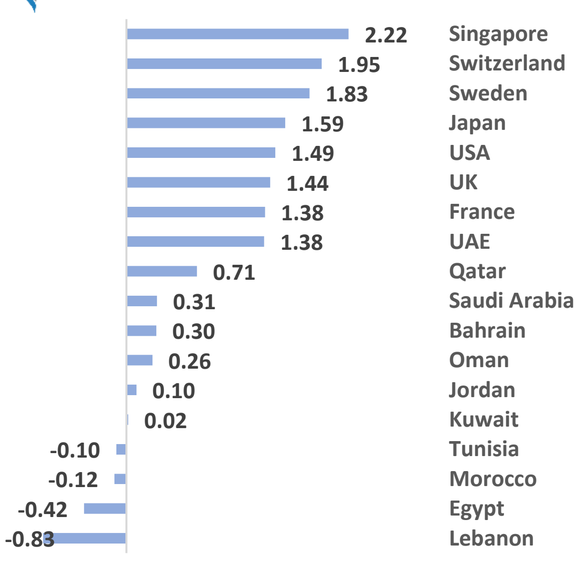
Figure 7D: Rule of Law



Source: The World Bank - Worldwide Governance Indicators

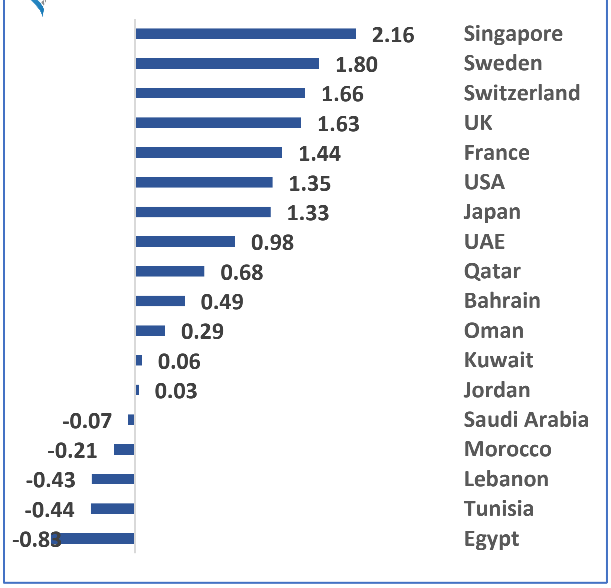
f. Singapore scores high in the government effectiveness and regulatory dimensions. Relative to Arab countries, Jordan's scores are somewhere in the middle.

Figure 7E: Government Effectiveness



Source: The World Bank - Worldwide Governance Indicators

Figure 7F: Regulatory Quality



Source: The World Bank - Worldwide Governance Indicators

B. FDI Restrictiveness: OECD Framework

The OECD has been publishing what is called the "Foreign Direct Investment Regulatory Restrictiveness Index". This index gauges the restrictiveness of a country's FDI rules by looking at four types of restrictions. The value of the index ranges between zero (open) and one (closed).

1. Foreign Equity Restrictions.

If no foreign equity is permitted, the score is one. If majority foreign control is not allowed, the score is 0.5 and if there is, a requirement of a domestic minority holding the score is 0.25.

Foreign Equity Limits:	Score
	Start-Ups & Acquisitions
No foreign equity allowed.	1
Foreign equity < 50% of total equity.	0.5
Foreign equity > 50% but < 100% of total equity.	0.25
	Acquisitions
No foreign equity allowed.	0.5
Foreign equity < 50% of total equity.	0.25
Foreign equity < 50% of total equity but < 100% of total equity.	0.125

2. Screening & Prior Approval Requirements.

Screening mechanisms applicable only to foreign investors fulfil many functions and vary widely in their scope. At their most restrictive, they may apply economic needs, net economic benefit or national interest tests to both start-ups and acquisitions. But in some cases, they are automatic and amount to little more than a pre-notification requirement for investors.

Screening & Approval	Score
Approval required for new FDI / acquisitions of < USD 100mn or if corresponding to < 50% of total equity.	0.2
Approval required for new FDI / acquisitions above USD100mn or if corresponding to > 50% of total equity	0.1
Notification with discretionary element.	0.025

3. Rules for Key Personnel.

Measures regarding key personnel (directors, managers and other key personnel) are recorded. Such measures include economic needs tests for the employing foreign managers, time limits on employing foreign managers, and nationality requirements for members of the board of directors.

Restrictions on Key Foreign Personnel / Directors	Score
Foreign key personnel not permitted.	0.1
Economic needs test for employment of foreign key personnel.	0.05
Time bound limit on employment of foreign key personnel.	0.025
Nationality/residence requirements for board of directors:	
Majority must be nationals.	0.075
At least one must be national.	0.02

4. Other Restrictions on the Operation of Foreign Enterprises.

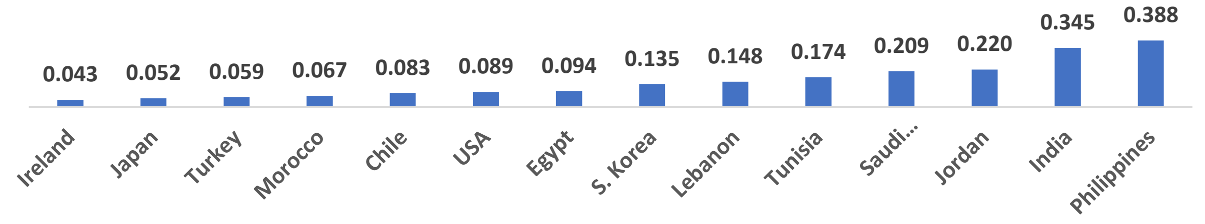
These measures include restrictions on the establishment of branches, acquisition of land for business purposes, including cases where foreigners may not own property but may sign leases, reciprocity clauses in particular sectors, and restrictions on profit or capital repatriation.

Other Restrictions	Score
Establishment of branches not allowed / local incorporation required.	0.05
Reciprocity requirement.	0.1
Restrictions on profit / capital repatriation.	1 - 0.1
Access to local finance.	0.05
Acquisition of land for business purposes.	0.1
Land ownership not permitted but leases possible.	0.05 - 0.01

Where Does Jordan Stand on the Foreign Direct Investment Regulatory Restrictiveness Index?

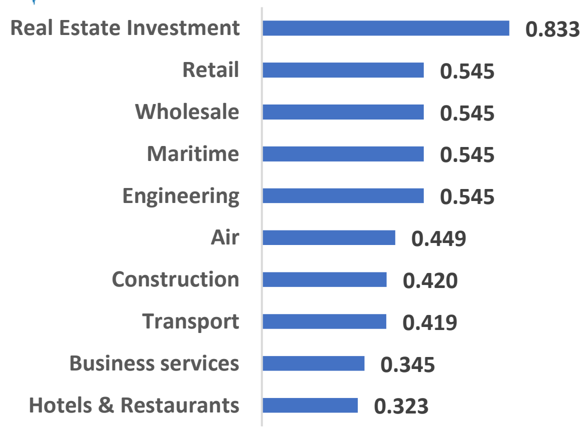
A. The Jordanian economy is relatively restrictive (Figure 8). The index's scores in Morocco, Egypt Lebanon, Tunisia, and Saudi Arabia are lower (closer to zero). In addition, it is useful to note that some sectors, like real estate investment, are more restrictive (Figure 9A), than others (Figure 9B).

Figure 8: FDI Restrictiveness Index 2019 l OECD



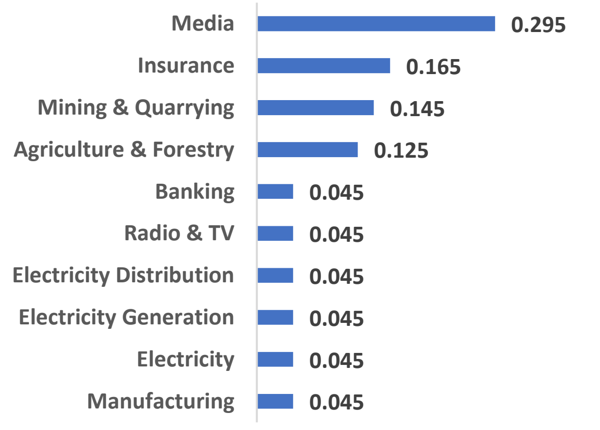
Source: OECD

Figure 9A: FDI Restrictiveness Index



Source: OECD

Figure 9B: FDI Restrictiveness Index



Source: OECD

B. Jordan looks more restrictive if one looks at the index's scores in different sectors. For example, the restrictiveness score in real estate investment is equal to 0.833, and this score is way higher than in Chile (0.0), Georgia (0.056), Morocco (0.0), and Ireland (0.250).

Table 1: FDI Restrictiveness Index by Sector: International Comparison

Sector	Jordan	Chile	Georgia	Morocco	Egypt	Turkey	Ireland
Real Estate Investment	0.833	0.000	0.056	0.000	0.338	0.550	0.250
Engineering	0.545	0.000	0.000	0.000	0.100	0.000	0.000
Maritime	0.545	0.600	0.025	0.300	0.443	0.575	0.150
Wholesale	0.545	0.000	0.000	0.000	0.255	0.000	0.000
Retail	0.545	0.000	0.000	0.000	0.255	0.000	0.000
Air	0.449	0.575	0.375	0.500	0.380	0.575	0.225
Construction	0.420	0.000	0.000	0.000	0.555	0.000	0.000
Transport	0.419	0.413	0.133	0.267	0.276	0.383	0.125
Business services	0.345	0.013	0.000	0.400	0.100	0.125	0.000
Hotels & Restaurants	0.323	0.000	0.000	0.000	0.015	0.000	0.000
Media	0.295	0.188	0.025	0.025	0.005	0.200	0.000
Insurance	0.165	0.000	0.000	0.100	0.055	0.000	0.023
Mining & Quarrying	0.145	0.000	0.000	0.000	0.005	0.050	0.000
Agriculture & Forestry	0.125	0.000	0.075	0.050	0.080	0.000	0.045
Manufacturing	0.045	0.000	0.000	0.000	0.005	0.000	0.000
Electricity	0.045	0.000	0.000	0.000	0.005	0.000	0.000
Electricity Generation	0.045	0.000	0.000	0.000	0.005	0.000	0.000
Electricity Distribution	0.045	0.000	0.000	0.000	0.005	0.000	0.000
Radio & TV	0.045	0.350	0.050	0.050	0.005	0.400	0.000
Banking	0.045	0.000	0.000	0.000	0.005	0.000	0.000

Relative to the above-mentioned observations, it is informative to note that the OECD, in its paper (The determinants of Foreign Direct Investment: Do statutory restrictions matter? / 2019), examines the FDI flows in 60 advanced and emerging countries over the period 1997–2016. Based on the results, it is stated that reforms liberalizing FDI restrictions by about 10%, as measured by the Index, could increase bilateral FDI in stocks by 2.1% on average. Effects are even greater for FDI in the services sector. But we propose here few measures that Jordan can adopt to improve its ranking and accordingly attract FDI … we may even quantify and rounded certain numbers

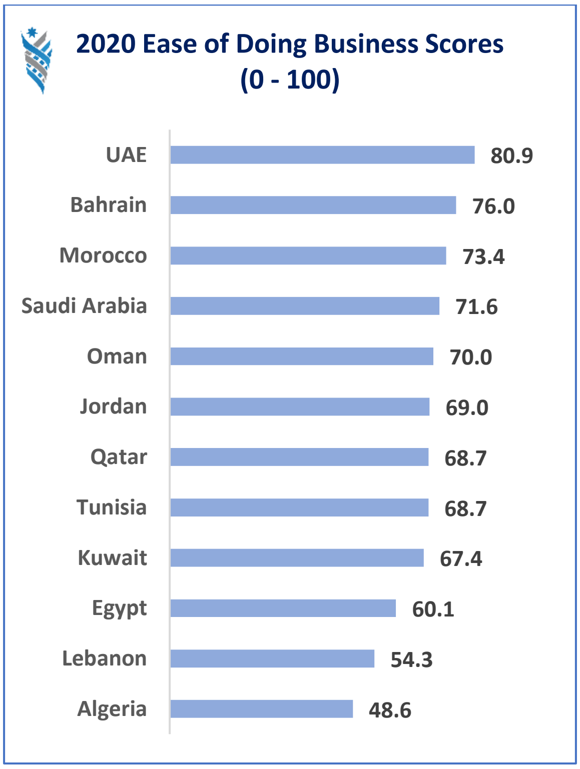
C. Doing Business: The Framework

The World Bank publishes "Doing Business" which provides objective measures of business regulations for local firms. The 2020 Doing Business report covers 11 indicator sets to measure various aspects of business regulation and their enforcements across 190 economies. The Doing Business measures the processes for starting a business, getting a business location, accessing credit, dealing with day-to-day operations, and operating in a secure environment. Naturally, each of these activities has its own quantitative indicators and measures (Table 2).

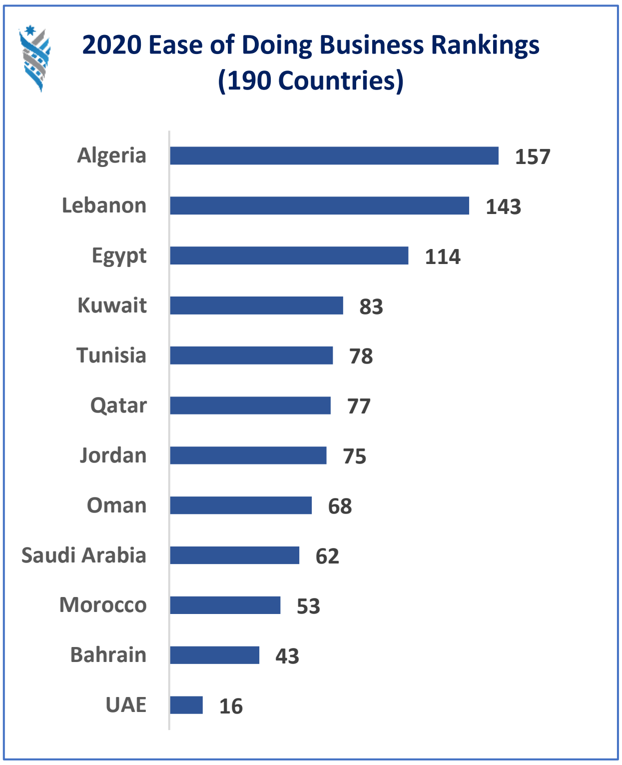
TABLE 2: What Doing Business Measures	
Indicator Set	**What is Measured**
Starting a business	Procedures, time, cost and paid-in minimum capital to start a limited liability company.
Dealing with construction permits	Procedures, time and cost to complete all formalities to build a warehouse and the quality control and safety mechanisms in the construction permitting system.
Getting electricity	Procedures, time and cost to get connected to the electrical grid, the reliability of the electricity supply and the transparency of tariffs.
Registering property	Procedures, time and cost to transfer a property and the quality of the land administration system.
Getting credit	Movable collateral laws and credit information systems.
Protecting minority investors	Minority shareholders' rights in related-party transactions and in corporate governance.
Paying taxes	Payments, time and total tax and contribution rate for a firm to comply with all tax regulations as well as post-filing processes.
Trading across borders	Time and cost to export the product of comparative advantage and import auto parts.
Enforcing contracts	Time and cost to resolve a commercial dispute and the quality of judicial processes.
Resolving insolvency	Time, cost, outcome and recovery rate for a commercial insolvency and the strength of the legal framework for insolvency.

Where Does Jordan Stand on the Doing Business?

First, Jordan ranks 75th out of 190 countries and 6th among Arab countries.



Source: The World Bank – Ease of Doing Business

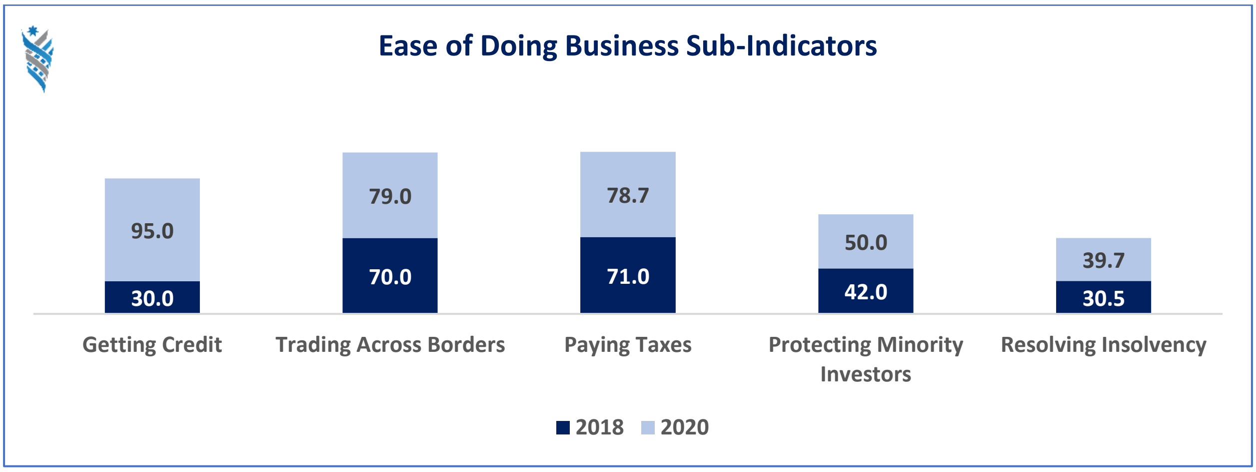


Source: The World Bank – Ease of Doing Business

Second, Jordan's score on the Ease of Doing Business has increased from 59.9 in 2018 to 69.0 in 2020.

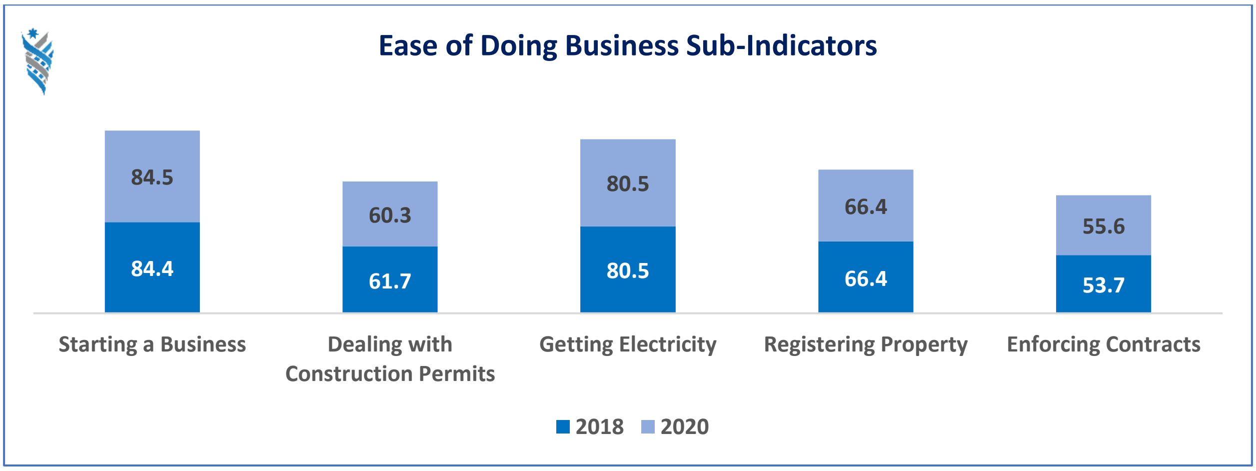
Source: The World Bank – Ease of Doing Business

Third, Jordan's scores in getting credit, trading across borders, paying taxes, protecting minority investors and resolving insolvency have improved.



Source: The World Bank – Ease of Doing Business

Fourth, Jordan's cores in the other sub-indicators of the ease of doing business have not changed by much.



Source: The World Bank – Ease of Doing Business

5. IN a Nutshell

Based on the above-mentioned observations, and to increase the inflows of FDI, stakeholders in Jordan need to examine the country's scores on the Worldwide Governance Indicators, FDI Regulatory Restrictiveness Index, and on the Ease of Doing Business.

Stakeholders should adopt the necessary remedial measures because it is the only way to promote the inflows of FDI. Indeed, doing business depends on a whole set of factors that interact with each other. In addition, it is not possible to reform the business climate while ignoring the political framework, within which businesses operate. It is also clear that the business environment is integrated, as it is not possible to reform certain aspects and ignore others. What is required is a holistic view of what is known as "the investor's journey".

The post-COVID-19 era points-out to more intense competition for FDIs. This fact makes it all the more important to quickly review the indicators that attract investments. Indeed, these indicators are what foreign investors look at before making their foreign investment decisions.

Within the context of attracting FDI, whilst production costs such as taxes, energy, transportation and labor are important; one should not underestimate the importance of making the business environment more attractive. After all, all businesses operate within this environment.

Finally, it is clear that gross fixed capital formation in Jordan is relatively low. It is necessary to look at the root causes of this problem, including the investment climate, clarity in the future vision, and the decline in savings which can be mobilized to generate more investments.

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