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Editors: Paul Rivlin and Joel D. Parker

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Jordan's Economy at a Crossroads: Part 2

Caleb Esrig

Last month's edition of *Iqtisadi* explored the internal tensions pressuring Jordan's economy and endangering reform plans. The Kingdom has maintained impressive economic stability through a tumultuous decade, which included the Syrian Civil War, the 'Arab Spring,' and a global financial crisis—yet riding out these storms was thanks more to external help than efficient internal management. Jordan has traditionally funded its large public sector using grants from the Gulf and the West, which (broadly) see the Hashemite Kingdom as a bastion of stability next to Syria and Iraq. While this has enabled massive government spending, such grants have served as a crutch allowing spending without commensurate revenue flows. This history of unhealthy fiscal behavior has made tax, subsidy, and spending reform difficult. It also leaves Jordan beholden to the political demands of its donors. This has trapped the country between its own political vision, its economic challenges, and the current state of the region's geopolitics.

Recently, however, the aid has begun to dry up. The United States displays an increasingly isolationist stance and may begin to cut its foreign aid. Gulf countries have grown more parsimonious for geopolitical reasons. Meanwhile, the Kingdom has exhausted several easy loan and revenue options. With lower aid, as well as internal financial problems, public debt has exploded, reaching levels, with debt-to-GDP exceeding 95 percent, that the International Monetary Fund and others believe will threaten stability and prosperity. Jordan is now facing a daunting prospect. It can acquiesce to Gulf and Western demands, which may or may not lead to additional aid; it can carry out its ambitious and somewhat-flawed reform plans; or it can continue generating massive deficits, potentially leading to economic collapse.

Between 2012-2015, aid made up almost 20 percent of total revenues for the budget.[1] Meanwhile, total foreign aid to the Kingdom, which also included some concessional loans, which were granted on generous terms, and aid for Syrian refugees, reached $3.65 billion in 2017.[2] This has allowed the Kingdom to sustain massive government spending. Even the national electric and water utilities have, in the past, received grants to offset losses.[3] In fact, the public sector, including all public entities, comprises over 50 percent of GDP and employs up to 55 percent of all the country's workers.[4] This would never survive in a normal environment, as Jordan is coming to understand.

This February, the United States signed an agreement outlining a five-year, $6.375 billion commitment through 2022, an increase of $275 million per year over the previous program. However, reliance on American aid fosters instability. President Donald Trump and an important Democratic opponent, Senator Bernie Sanders, have in the past spoken out against some components of foreign assistance. This has begun to play out: the Trump Administration has withheld large portions of its funding for the United Nations Relief and Works Agency, which may have other spillover effects in its impact on the Palestinians living in the Kingdom.[5] Jordan is dependent on American aid for around 10 percent of its government budget, so Trump's capriciousness and broader uncertainty is worrisome.[6] The danger of this reliance is particularly evident now. The Kingdom's plan to increase taxes and staple goods prices was needed partly because of a pause in aid from Saudi Arabia and its allies, which have been notoriously fickle in their aid to the Kingdom.

The Gulf Cooperation Council, a group of Gulf states with Saudi Arabia its largest member, had given Jordan a five-year, $3.6 billion aid package, but it ended in January 2017 without any renewal.[7] In fact, total Gulf aid to Jordan last year reached its lowest levels in years. This abrupt aid halt led to Jordan seeing its foreign grant receipts fall by 15 percent, helping trigger the current economic crisis.[8] Several analysts have attributed this stoppage to Jordan's refusal to follow Saudi regional policies.

Jordan has failed to fully cooperate with Saudi Arabia on several fronts. Jordan has not banned the Muslim Brotherhood, it has only partially followed the Saudis boycott of Qatar, choosing only to downgrade its diplomatic relationship, and it has not fully committed to the Saudi-led war in Yemen. Additionally, King Abdullah II has blamed financial problems in his country on Saudi anger over Jordan's continued control of Jerusalem holy sites and outspoken criticism of the United States recognizing Jerusalem as Israel's capital. Other Jordanian leaders have also tied the halting of Saudi aid to Jordan's regional policies.[9]

Saudi Arabia and its allies, did, however, step in after the recent protests, giving Jordan a $2.5 billion aid package. Yet this is a relatively small deal, as it is spread over five years, and it includes a deposit in the Jordanian central bank for an undisclosed amount, which some have speculated to approach $1 billion.[10] This deposit is critical for understanding these maneuverings, as it enables the Saudis to hold over the Jordanians the withdrawal at any time of any part of the deposit. This may prove relevant if the Trump administration unveils, as it has suggested it may, a proposal for an Israeli-Palestinian peace agreement. Jordanian leaders are forced then to either suffer fiscally for their political intransigence or risk popular backlash for following Saudi policies.

The last sizeable Saudi aid package to Jordan, in 2012, came on the heels of the Arab Spring and accompanying unrest in Jordan. Gulf allies view any democratic opening as potentially destabilizing, and Jordan was then weighing a series of political and economic reforms.[11] Indeed, some regional analysts, including Ibrahim Fraihat, a Doha professor affiliated with Georgetown, have tied this aid package to a serious attempt by Saudi Arabia to dissuade Jordan from serious political reform.[12] Political instability could trickle over, and the Saudis may view a democratic state as much more unsteady. As always in Jordan, the economic events connect to deeper geopolitics.

The growing instability of American aid, continuing global economic problems, and difficulties with the Gulf countries make it likely that Jordan will soon need to wean itself off its reliance on massive foreign aid for its budget. It faces serious challenges to doing so. According to a World Bank analysis, "When these sources of finance [foreign grants] are reduced, financial and economic stability can be compromised."[13] Yet there are great benefits to doing so. Reliance on foreign aid ties Jordanian prosperity to the fortunes and political whims of donor countries, and it undermines Jordan's fiscal health.[14]

The Jordanian population has grown accustomed to sizeable subsidies and public sector employment without significant tax collection. For example, tax evasion on sales and income taxes in the Kingdom may reach close to $1 billion annually, according to a Jordanian think tank, and other studies have given even higher levels.[15] Income tax enforcement is weak, and the tax administration is mired in inefficiency.[16] The Kingdom also lacks serious enforcement mechanisms. Additionally, the amendments to the income tax law that helped trigger the spring protests would expand the income tax base from 5 percent of the population to only 10 percent.[17] Meanwhile, the highest income tax rate paid would be 25 percent, compared to nearly double that in Israel and some European countries. It would also increase punishment for evasion.[18] The massive backlash over the tax, as well as staple subsidy cuts, illustrates the impact of the foreign aid. It has adjusted the population to poor fiscal governance.

Furthermore, it has fostered a rampant, endemic culture of corruption. It is often suspected that foreign aid can fuel a culture of corruption, and the situation in Jordan agrees. A government report called the public sector one mired in inefficiency and corruption, and aid money is often mismanaged.[19] For example, the Kingdom lost almost half of the grant it was given from the Gulf countries in 2014 because the government failed to complete enough applications for it.[20] Corruption and mismanagement were major concerns in the recent protests and remain challenges to reform efforts.

These obstacles, as well as Jordan's reliance on its sizeable public sector, make a significant narrowing of the deficit unlikely, especially with increasingly stingy international backers. However, the Kingdom is trying to take responsible steps for the short-term. In 2016, it received a $723 million loan from the IMF to restore fiscal stability and bring down debt levels. As part of this, the government proposed a series of tax increases and staple price cuts, which triggered the May and June protests. In response, the government was dismissed, and it remains to be seen how soon the Kingdom will resume its reform attempts along its IMF plan. Jordan has, in fact, asked to renegotiate or extend the agreement.[21]

Worryingly, even when the Kingdom has attempted to cut public spending, as exemplified through its cuts to subsidies, it does so in ways that do not risk the civil service or public employees. Its subsidy cuts also risk harming the most vulnerable poor. The fall in public spending to GDP that the Kingdom has seen broadly over the past few decades has largely been due to a fall in capital expenditures, spending on education, infrastructure, and health, so it is likely to have long-term negative implications.[22] Continuing with such spending cuts are certainly not ideal.

Jordan's Economic Policy Council, an advisory body to King Abdullah, has proposed a five-year growth plan through 2022 to realize Jordan's economic potential. It identifies $8.8 billion in government projects and aims to raise annual GDP growth to around 5 percent by 2022.[23] As has been discussed, key for Jordan is to unleash the private sector. With an overburdened, overemployed public sector spiraling deeper into debt, future growth, to be stable and equitable, must come from private enterprise. There is much room to grow: The World Bank placed the Kingdom 103rd in its “Doing Business” ranking, with Jordan placing particularly poorly in getting credit.[24] Yet the plan spends preciously little time on ways of supporting the private sector, but it does outline government spending projects on infrastructure, housing, and trade. It also continues to expect government control over electricity prices and energy research investment. Worryingly, it proposes, “Regulating supply of food and agricultural products to meet market demand, controlling essential commodity prices,” market-manipulation measures that would likely harm both the agricultural industry and consumers. It largely represents some continued emphasis on a government-directed economy.

However, there are positive attributes. The plan discusses, “Raising the efficiency of the public sector and its employees to provide a better level of services,” including by empowering women and raising the standards of the institutional culture. It also encourages following countercyclical fiscal policy, and it lists steps to eliminate business challenges, roadblocks, and regulation. It also suggests a number of public-private partnerships where the government can fulfill a public need by utilizing the private sector. This blueprint, as well as broader measures to foster business development and limit spending growth, would allow the Kingdom to both grow its economy and shrink its deficit. It remains to be seen, however, whether it will be followed.

A final component of Jordan’s economic challenges is its refugee population. Since the start of the Syrian Civil War in 2011, an estimated 1.3 million Syrians have taken refuge in Jordan. Of these, only 13 percent live in refugee camps, compared to 83 percent in host communities. Most left Syria while the government still controlled their regions, so it is unlikely they will be inclined to return now. There are serious problems with their management in the Kingdom. Only just over 600,000 of the refugees are registered with the United Nations High Commissioner for Refugees, and registration with the UNHCR and Jordanian Ministry of the Interior is needed to access work permits, food vouchers, and public schools and healthcare.[25] Though Jordanian leaders have bemoaned insufficient foreign aid to address the crisis, and Jordanians are concerned about refugees competing for limited employment and resources, the reality is less clear.

Analysts believe that the Kingdom has received enough aid, from international refugee agencies and increased foreign grants, to balance its refugee expenditures.[26] The challenge is developing a solution to ensure that the refugees are able to live productive and stable lives in Jordan without needing vast sums of international aid. One approach tried was the Jordan Compact, an agreement bringing billions of dollars of aid and preferential trade agreements from the European Union in exchange for work permits and education improvements for Syrians in Jordan. Yet the arrangement did not adequately consider some of the situations of the refugees, such as the labor force participation of women, so it was not extremely successful. While the government is concerned about the delicate demographic balance between East Bank Jordanians and Palestinians, bringing Syrians into the formal workforce through a similar program could provide a vital economic catalyst. Also, twenty-three percent of Syrian refugee households are led by women, so expanding employment could ultimately increase the broader portion of Jordanian women in the labor force.[27] Today, the female labor force participation rate in Jordan is 22 percent. This is a serious challenge: with over one million Syrian refugees, Jordan must develop fiscal stability and a vibrant private sector that can address an extended refugee population.

Jordan's economic challenges cannot be understated. But there is reason to be hopeful. If its leadership can competently allocate the foreign aid it receives, the Kingdom may be able to shrink its deficit without severe austerity. While it must decide whether it favors political independence or Saudi aid, some form of Western assistance is certainly likely to remain. The Kingdom already has preferable trade agreements with the United States and European Union and unleashing the private sector would go a long way to raising employment and allowing the trimming of the civil service. It must continue through fiscal and economic reform, even if difficult, by improving tax collection, cutting wasteful spending, and removing obstacles to private business. Though it faces a challenging economic future, Jordan's leaders are at a crossroads with the ability, now, to begin bringing the country to economic prosperity.

***This is part two of *Iqtisadi* articles dealing with the important element of international and regional involvement in the Kingdom. It follows our July issue on the political economy and social unrest leading to protests and instability in 2018.

Caleb Esrig is a junior studying Economics at Harvard College. He is an intern at the Moshe Dayan Center for Middle Eastern and African Studies (MDC), Tel Aviv University during the summer of 2018.

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