

OE D Précis



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Structural Adjustment in Jordan

The Jordanian government implemented difficult trade and industrial policy reforms in a period dominated by the 1990 Gulf crisis and its aftermath. Despite severe economic disruptions, the reforms succeeded in significantly reducing the country's macroeconomic imbalances and restoring economic growth. Jordan's experience showed that adjustment operations can succeed even in extremely adverse conditions when reforms have the right elements. In Jordan, the government fully owned the program, was persistent in carrying it out, and had the institutional capacity to implement the reforms. The program itself was well designed. It targeted fiscal deficit reduction while protecting social expenditures on health and education, and it properly timed and sequenced the reforms so they worked in support of each other and complemented the parallel stabilization measures supported by the IMF.

*Despite significant achievements, some economic and policy weaknesses remain: high import tariffs still create antiexport bias, the regulatory framework needs to be modernized, and the role of the private sector needs to be broadened through, among other things, privatization of public enterprises. These weaknesses are currently being addressed through the government's ongoing reform program supported by a sequence of economic reform and development loans from the Bank.**

During the early 1980s, Jordan's foreign savings fell sharply as the

decline in oil prices led to the slowdown in the region's economy. The Jordanian government responded by expanding public spending financed by external borrowing to stimulate the domestic economy. The result was high inflation, a worsening of the current account deficit, and a rapidly increasing foreign debt. By the late 1980s, GDP growth had turned negative.

To restore growth and reduce the economic imbalances, Jordan initiated an economic reform program in mid 1989, which the World Bank supported with a \$150 million Industrial and Trade Policy Adjustment Loan (approved in December 1989 and closed in 1992). The operation complemented a macroeconomic stabilization program supported by an IMF Stand-by Arrangement.

The main objectives of the adjustment program were to create an enabling environment for long-run sustainable growth by improving the efficiency and competitiveness of the economy. The government envisaged a three-pronged approach: (1) macroeconomic policy adjustment to reduce internal and external imbalances, mainly by reducing the fiscal deficit and maintaining a flexible and competitive exchange rate; (2) trade liberalization and industrial policy reforms to induce a strong supply response; and (3) protection of the poor through restructuring of public expenditures and provi-

sion of targeted safety nets. The policy changes were to be accompanied by reforms of the legal and regulatory regimes to stimulate investment.

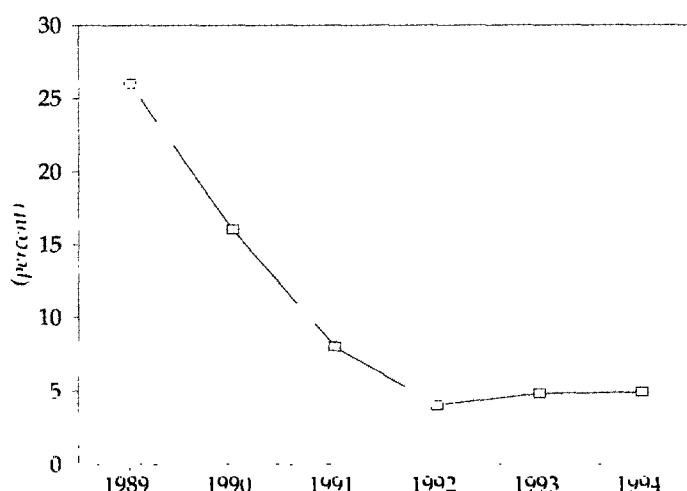
The reforms

The government started many of the reforms before the loan became effective. But the Gulf crisis, which began in late 1990, interrupted the adjustment operation, delaying the release of the loan's second tranche. The crisis not only disrupted the economy but also created severe social and political dislocation, slowing progress toward macroeconomic stabilization.

With the start of the crisis, more than 300,000 Jordanian workers returned to the country from other Arab states. The fiscal outlays needed to accommodate them severely strained the government budget. And the blockade of the

**Performance audit report: "Jordan: Industrial and Trade Policy Adjustment Loan," by Carl Jayarajah and Sanliang Yue, Report No. 14772, June 1995. Performance audit reports are available to Bank executive directors and staff. They can be ordered from the Bank's Internal Documents Unit and from regional document centers. Précis written by Farah Ebrahimi.*

Declining rate of inflation during the adjustment period, 1989-92



Port of Aqaba disrupted foreign trade, worsening the country's balance of payments problem.

Despite the crisis, the government remained committed to the reforms, and as soon as the war ended in February 1991, resumed the program. By March 1992, most of the reform measures required for the release of the second tranche had been implemented.

Macroeconomic balances

Fiscal adjustment. The central issue of macroeconomic adjustment was the fiscal deficit. While the IMF program supported reform of the tax system, the Bank-supported reforms focused on reducing public expenditures and increasing revenue. The program avoided across-the-board cuts to protect key social expenditures, focusing more on reducing capital expenditures, including military spending. Subsidies were also cut. In 1990 the government introduced a targeting mechanism to replace food subsidies. And in 1992, it increased oil prices, virtually eliminating petroleum subsidies. These efforts helped cut total expenditures by about 10 percent,

from about 49 percent of GDP in 1988 to less than 39 percent.

Total revenue also increased during the adjustment period. The program sharply increased taxes on trade and domestic transactions. Trade taxes, which at that time constituted the single largest revenue source, almost doubled during 1990-92, largely because of the conversion of quantitative restrictions into tariffs (see below) and a sharp rise in imports associated with the Jordanian returnees.

The combined effects of lower expenditures and higher revenues significantly improved the fiscal balance. The overall deficit, excluding grants, declined from almost 18 percent of the GDP to about 6 percent in 1993. With the smaller deficit, inflation went down, from about 26 percent in 1989 to 4.6 percent in 1993 (see figure).

Monetary policy and external balance. Meanwhile, the government steadily tightened monetary policy, though with a hiatus during the Gulf crisis. In parallel, it took steps to liberalize the financial sector, starting with decontrolling deposit and lending rates. The result was a steady increase in domestic inter-

est rates, which led to improvements in short-term capital inflow. This increase was supplemented by savings repatriated by Jordanian returnees: between 1988-93 Jordan's foreign exchange reserves increased tenfold, the net foreign assets of the central bank and monetary system more than doubled, and import coverage of foreign exchange reserves rose from just one week to more than four months.

The debt burden. Jordan's external debt had significant implications for macroeconomic balances. But during the adjustment period the measures taken to manage the external debt were limited to debt restructuring, which provides only temporary relief. With the recovery of private capital inflows in 1992, the government adopted a more comprehensive approach to debt management. In addition to debt restructuring, it sought to reduce the level of its debt stock through market-based operations, such as debt swaps and debt buybacks. This, coupled with the growth of GDP, brought the debt/GDP ratio down to 132 percent in 1993, from 180 percent in 1990. Despite the improvement, Jordan's debt and debt-service burden demanded a more fundamental solution: adoption of policies and measures that contribute directly to increasing domestic savings and improving export competitiveness. By 1995, the debt was reduced to 105 percent of GDP, with a net present value of 82 percent. Jordan is now entering the ranks of moderately indebted countries.

Trade and industrial policy reforms

To liberalize the trade regime, the government adopted several policy changes before the loan took effect. It replaced most of the quantitative restrictions and import bans with tariffs. It began rationalizing the tariff structure, making sure that the measures did not adversely affect revenue to avoid undermining the stabilization objective. And it lifted most price

controls, except on some essential commodities, mostly food items. Along with these measures, the government abandoned the fixed exchange rate, moving it to a managed float. This adjustment resulted in a depreciation of the Jordanian dinar by 50 percent. Recently, the Jordanian dinar has been pegged to the US dollar.

The trade reforms were accompanied by improvements in domestic regulations. Jordan's investment law was revised in 1991 to simplify licensing and to make it less discretionary. The streamlined process led to a doubling of the number of private enterprises between 1987 and 1992.

In contrast, the program had much less success in improving the export incentive scheme. For example, it attempted to make the Export Discount Facility (EDF), Jordan's primary source of export financing, more accessible to exporters, especially to exporters of nontraditional commodities. But EDF's interest margins were too low to attract commercial banks and its administrative procedures too rigid.

Protecting the poor

The program's approach to protecting the poor during adjustment was twofold: first it sought to restructure public expenditures with a view to protecting essential social services. Hence, while military spending and fiscal outlays for generalized price subsidies were cut, public spending on key social services, such as health and education, were not. In 1990 the government replaced generalized food subsidies by a rationing system for essential commodities to improve targeting of the poor. In this way, the government contained the budgetary cost of food subsidies while protecting the poor.

Second, the program attempted to improve the efficiency of the networks aiding the poor. It established the Development and Employment Fund in 1990 to coordinate the activities of government and nongovernmental organizations involved in poverty alleviation. While the fund proved useful in helping to win support for the adjustment program, its actual role in aiding the poor was limited. Over time, it became more involved in direct lending than in coordinating poverty alleviation activities.

Impact on growth, investment, and savings

The macroeconomic reforms contributed to a strong economic recovery. Following the Gulf crisis, real GDP grew at 16 percent in 1992, spurred in part by strong demand from Gulf returnees for goods and services, and then slowed in 1993 to 6 percent. Real per capita GDP also increased, after having fallen for five straight years. The manufacturing sector grew at 14 percent in 1992, indicating a strong response to the improved incentive framework in the industrial sector.

Underpinning the strong economic performance was the resurgence of domestic investment. But this increase was not matched by a corresponding rise in domestic savings, because of a sharp increase in private consumption. Domestic investment was mostly financed by foreign savings, including private remittances, official grants, and borrowing. Strong measures were needed to increase domestic resource mobilization to sustain future levels of investment and growth. Domestic savings have since increased, in 1995 to 16 percent of GDP, while national savings stand at almost 30 percent.

Improvements in the overall trade balance, which were evident following the 1989 depreciation,

slowed after 1990 for three reasons: (1) the Gulf crisis weakened regional trade, (2) the terms of trade for Jordan's traditional exports steadily deteriorated, and (3) imports rose sharply, spurred by the rapid GDP growth and increased demand for food and luxury goods associated with the influx of returnees. As a result, both the trade balance and the current account deficit deteriorated.

Some progress was made during the adjustment period in diversifying exports. Nevertheless, traditional items still account for more than 40 percent of exports, making it vulnerable to adverse terms of trade movements in the international markets. Thus, diversification remains an important objective of current trade policy reforms, as does improving the quality and productivity of the export sector. The current account deficit in terms of GDP has been halved since 1993. Finally, unemployment remains high, posing a potential obstacle to continued economic growth and highlighting the need for a focus on trade reforms in the ongoing reform agenda.

Lessons

- *Structural adjustment sets the stage for sustainable growth; it does not ensure its sustainability. For growth to continue, reforms need to be complemented by improvements in domestic savings, investment, and productivity.*
- *Appropriate sequencing of trade policy reforms can complement macroeconomic stabilization, thus strengthening the basis for the overall success of the adjustment effort. The adjustment program recognized Jordan's need for fiscal stabilization and made sure reforms did not undermine this effort. By focusing on eliminating the quantitative restrictions and rationalizing the tariff structure, the program succeeded in substan-*

tially reducing distortions in the trade regime. And by increasing tariff revenue it helped improve the internal balance.

- *In a highly indebted country (such as Jordan was at the time of loan approval) debt management should form a visible part of the adjustment program. It should seek to reduce the overall indebtedness to a level*

comparable to the country's debt servicing ability. This will improve the prospects for long-run, sustainable growth.

- *Reducing the current account deficit is a critical element of debt reduction. Jordan has thus far tried to finance the current account deficit by keeping domestic real interest rates well above world rates to attract private*

capital inflows. This, however, can only be a temporary solution. High interest rates increase the cost of private investment and encourage further external borrowing. A long-term solution would address the current account deficit directly through strong fiscal discipline, elimination of antiexport bias, and an investment-friendly and enabling business environment.

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