# REVIEW OF FREE ZONE AND INDUSTRIAL ESTATE POLICY AND PRACTICE IN JORDAN

IMPLICATIONS FOR LOCAL ECONOMIC DEVELOPMENT

DRAFT REPORT

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# REVIEW OF FREE ZONE AND INDUSTRIAL ESTATE POLICY AND PRACTICE IN JORDAN

IMPLICATIONS FOR LOCAL ECONOMIC DEVELOPMENT

DRAFT REPORT

SUSTAINABLE ACHIEVEMENT OF BUSINESS EXPANSION AND QUALITY (SABEQ)

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# EXECUTIVE SUMMARY

## INTRODUCTION

This paper reviews free zone and industrial estate policy and performance in Jordan against international experience. The paper also looks briefly at the appropriateness of using zones to address local poverty and unemployment in Jordan, with implications for the proposed Mafraq Special Economic Development Zone.

## CONCLUSION

The general conclusion of this report is that duty-free free zones have demonstrated their effectiveness as a useful vehicle for enterprises engaged in international transit trade and storage. Jordan appears to fulfill a natural entrepot role trading with its neighboring countries. The current momentum inducing manufacturers to adopt free zone status should be resisted. One reason is that the European Union, and GAFTA for the time being, does not provide duty-exemption privileges to imports from Jordanian free zones. More importantly, providing income tax exemptions for manufacturing within free zones and easing the restrictions on selling into the domestic territory will artificially encourage manufacturing to relocate to zoned enclaves away from areas of natural comparative advantage in Jordan. Relying on zone enclaves as the primary instrument to streamline the investment environment risks slowing improvements in public service delivery throughout the country.

As Jordanian import duties on production inputs, including capital equipment and raw materials, are eliminated the need for special measures to help manufacturers avoid the anti-export bias from paying duties and sales tax on their inputs disappears. Pressure should be brought to bear on customs and sales tax administration to eliminate customs duties on production inputs, to improve their facilitation of the movement of goods and refund excess sales tax credits as quickly and costlessly as possible.

Whether or not WTO members permit current income tax exemptions on export earnings to continue, from a national economic welfare perspective manufacturing, together with all other economic activity, should be subject to a modest flat rate of income tax. Tax relief can be provided to Gulf investors through bilateral double taxation agreements, rather than trying to target tax exemptions to specific sectors, regions of the country or categories of investor.

The ineffectiveness of income tax incentives, the growing redundancy of duty-exemptions for manufacturers, and their potential to create disputes with trading partners, means that industrial estates, free zones and special economic zones today merely fulfill a good governance role. They provide efficient infrastructure and deliver effective services, thereby creating a suitable climate for investment. This is the role of local government. Jordan should not replace local government with artificial zone structures. Moreover, zone management does not have the ability to create clusters and increase linkages with the rest of the economy. If local government does not have the legal or financial ability to perform these roles then central government should provide them with that ability. Development of autonomous economic zones with special powers and privileges should not be used as an excuse to delay or forego necessary national economic reform.

The Aqaba Special Economic has been a very special success story in Jordan. It has demonstrated that local economic development is possible with the appropriate governance structure. It is arguable that the investment in tourism infrastructure and property development and increase in heavy industry output would have taken place without the duty-free and low-tax policies being in place. However, by replacing three local government authorities with one sufficiently empowered, motivated and funded organization an environment was created to attract and facilitate new investment.

It is not necessary to replicate the Aqaba SEZ model by enacting special legislation for each underdeveloped region of Jordan. Effective local governance and certain and efficient national taxation are sufficient to facilitate local economic development. Creation of special economic zones involves significant political capital, distracts and confuses investors, and distracts central government from necessary national structural and administrative reform. The experience of the Aqaba industrial estate demonstrates a) the difficulty of attracting light manufacturing investment in a labor-short environment; and b) the potential usefulness of a single estate regulatory agency to establish and monitor contractual guidelines for developers and operators.

The Government and donors need to work more closely with local communities to strengthen their capacity to guide and support local economic development. Zones and tax incentives will not overcome the inherent weaknesses in each region. The most commonly cited problem is the quality and quantity of labor in the regions. Local government must improve vocational training immediately. Central government needs to address labor market impediments – is the same minimum wage necessary throughout the country? Workers need to be able to relocate flexibly from their towns and villages to growth points in the country. This entails lowering the cost of long-term housing finance, improving public transport and reducing the cultural concerns of children living away from home.

Based on the experience of Aqaba, Karak and Ma'an, government funding of manufacturing infrastructure in Mafraq will be unlikely to increase in manufacturing output and employment in the region. Mafraq appears to have a comparative advantage in the facilitation of transport logistical services. Only the private sector has the ability to fully recognize such market opportunities and bear the investment risk. Central and local government has two roles in Mafraq: 1) to efficiently allocate public land to the private sector to take advantage of investment opportunities, and 2) to facilitate this investment in as transparent and as efficient a manner as possible without artificially distorting investment decisions. Neither of these roles require the creation of a special economic zone.

Careful *national* planning is required to efficiently allocate resources to develop an infrastructure network. Public investment in competing transport infrastructure hubs can lead to duplication and redundancy, rather than higher volumes of trade and output. Users of the transport network should compete transparently but not the network itself. Therefore, the Government needs to coordinate the Amman inland port, and airport, road and railway use in a national plan. Creating competing economic zones around key transport infrastructure will not necessarily maximize national economic welfare. Artificially dividing land freight and sea freight shares between different "transport hubs", i.e. Amman, Aqaba and Mafraq to satisfy perceived private sector investor demand may reduce welfare.

The second set of conclusions from this report is that private providers of zones and estates should be provided the same rights and obligations as public providers. This includes the same fiscal treatment, as well as business licensing and urban planning authorities. The Government needs to urgently create an independent regulator of estates and free zones. Given its custodial role over public land, central and local government needs to ensure optimal management of that public land. The private sector should be able to bid for the use of public land on equal terms with the JIEC and FZC. The regulator would approve applications for new zones and estates against national guidelines and monitor compliance by both private and public sectors operators with legislation and concession agreements. The national guidelines can build upon the 2006 Industrial Map that matched potential sites for industrial and commercial zones with projected industrial demand.

The Government needs to reassess the role of the JIEC and FZC – in particular, the onus placed on the JIEC and FZC to develop estates and zones in remote parts of the country and their low financial returns compared to private sector competitors. The Government could consider privatizing both the JIEC and FZC and concentrate on the terms and conditions under which the private sector would manage public land. Through an efficient income tax regime on private developers and operators, the government could earn a greater return on public land, while minimizing its own commercial risk. With current high land values privatization proceeds could repay a significant share of public debt. However, before any sale takes place, an effective zone and estate regulatory agency needs to be fully functioning and a strategy in place for national industrial land-use.

## RECOMMENDATIONS

The Government should undertake the following activities:

- Establish an industrial estate and free zone regulatory body to ensure equal rights and obligations between private sector developers and operators and the JEIC and FZC. The regulatory body would also review the feasibility and financial capacity of applicants for new estates and zones against land-use guidelines, allocate public land among competing bidders, monitor the compliance of developers and operators with national guidelines and monitor the administration of other public services including customs, labor and environment regulation.
- Replace the current selective fiscal incentives with a universal flat rate of income tax applicable to most, if not all, manufacturing and service sectors. Investigate the potential for double taxation agreements with countries that do not tax their residents on foreign investment income.
- Continue to eliminate customs duties on inputs used in production by all economic sectors in Jordan, including capital goods, intermediate goods and raw materials.
- Streamline customs procedures, business licensing procedures and ensure the prompt refund of excess sales tax input credits.
- Develop a national industrial land-use plan to guide the use of private and public land among competing uses, set out a methodology for allocating public land, set out an appropriate property taxation system to promote productive use of land, and involve the economic and social interests of the local community.
- Create institutional mechanisms to facilitate local economic development by empowering local representatives to coordinate with counterparts to plan and achieve development goals.

The Government should NOT undertake the following activities:

- Create any new special economic zones with special selective fiscal incentive packages;
- Invest further public funds in manufacturing industrial estates in remote locations until sufficient investor demand is demonstrated and unless sufficient qualified labor is locally available
- Enable manufacturers serving the domestic market to adopt free zones status or establish production facilities within free zones

USAID-funded SABEQ is supporting the Government to implement a number of these recommendations and is ready to support the other recommendations. In particular, SABEQ is working with the Ministry of Industry and Trade to identify remaining customs duties on production inputs and schedule their removal; streamline business licensing procedures; and create and support local development councils in Irbid and Karak. SABEQ is ready to support the creation of an estate and free zone regulatory agency

The USAID-funded AMIR Program reviewed current investment incentives and recommended their replacement with universal income tax and duty measures. The USAID-funded Fiscal Reform Project is working with the Ministry of Finance to convince parliamentarians and the public of the need for tax policy reform. SABEQ will support this reform work through its activities with the Ministry of Industry and Trade.



## BACKGROUND – ZONES AND ESTATES

Commercial zones represent commonly managed, geographically delimited areas of land that are leased or sold for profit to individual businesses locating within the zone. There are about 3,000 zones scattered throughout the world. Jordan has a very large number of commercial zones, 46 are operating and 19 are planned – in the form of industrial estates, free zones and the Aqaba Special Economic Zone.

Jordan has industrial estates, free zones and a special economic zone. **Industrial estates** provide the necessary infrastructure and services for manufacturing located within delimited parcels of land. **Free zones** essentially provide a duty and tax free environment for the storage of goods in fenced compounds regarded as being outside the customs territory of Jordan. Manufacturing and services are also permitted to locate within free zones.

The private sector competes with the public sector to develop and operate both free zones and industrial estates. Public industrial estates are developed and managed by the Jordan Industrial Estates Corporation (JIEC) while public free zones are developed and managed by the Free Zone Corporation (FZC). Free zones offer an income tax exemption on all activities except sales to the domestic territory. Tenants in industrial estates may apply to the Jordan Investment Board (JIB) for industry investment incentives. In addition, the JIEC provides a two-year income tax holiday to its tenants not available in private industrial estates.

The five public estates with the five operational private estates employ 75,000 workers – at least 40 percent of the 2004 manufacturing workforce – and exported $1.7 billion in total exports in 2006.

### PURPOSE OF ZONES AND ESTATES

Commercial zones are developed for two main purposes:

1. Local economic development – provide appropriate soft infrastructure (policies and procedures) and hard infrastructure in order to attract investment and increase local income and employment.
2. A model for national economic reform – to demonstrate best practice and test the impact of economic reforms before introducing them nationally.

The Aqaba Special Economic Zone is a duty-free, low-tax zone covering an area of 350 sq km administered by the Aqaba Special Economic Zone Authority (ASEZA). The Aqaba Special Economic Zone fulfills both of the purposes for establishing commercial zones described above, in particular providing lessons on local governance, simplified municipal processes and public-private sector partnerships.

The World Bank cautions that export processing zones may be used by developing countries to 'muddle along without reforms,' and therefore concludes that countrywide trade liberalization must be given priority over the establishment of isolated free market enclaves.[1] Jordan need not continue relying on zones to test and demonstrate the effectiveness of new economic policies for eventual application to the whole country. At least three arguments point to a smaller role for zones in Jordan:

1. Firstly, there are fewer potential policy advantages that can be provided to investors by a special economic zone today in Jordan that are not currently available nation wide. For example, customs duties are being eliminated on all production.

2. Secondly, maintaining unique policies within special economic zones in Jordan has the danger of distracting central and local government from the essential work of reforming national policy.

3. Thirdly, Jordan is too small geographically and economically to be distracting investors by offering a range of incentive packages tied to different zones and regions.

## EVOLVING ROLE OF GOVERNMENT

Government has a role to ensure that all land is used appropriately – maximizing social returns with the least social and environmental impact. With respect to zones, governments have evolved from being the sole developer and operator to being the land owner and regulator of private sector development and operation of zones. Conflicts of interest persist when public zone agencies guide and monitor private sector performance in competition with their own public operations.

## REGULATION OF ESTATES AND ZONES

Private investors began developing industrial estates in the late 1990s prompted by the activation of the QIZ program. The FZC has extended their traditional transit trade function by registering private firms to develop their own single factory and multipurpose free zones. However the JIEC and FZC enjoy greater benefits than their private sector competitors. They enjoy access to public funds and public land, are exempt from income and sales taxes, and exercise municipal powers to classify land and license enterprises. Private developers enjoy none of these rights.

[1] *Export Processing Zones*, World Bank, Policy and Research Series Paper 20, Industry Development Division, 1992

It is necessary to place public developers and operators on a level playing field with private developers and operators. An independent regulatory body needs to be empowered to set and implement national industrial land-use guidelines and to monitor the operations of private estates and zones. Conversely, the JIEC and FZC should not be restricted in how they set rental rates and sale prices for land.

# PERFORMANCE OF ESTATES AND ZONES IN JORDAN

## INDUSTRIAL ESTATES

The JIEC was established as a financially and administratively autonomous corporate entity in 1985. The GoJ owns 67% of JIEC's shares, semi-public entities own the remaining shares. Sixty four percent of available space in the five public estates is occupied, concentrated at the Abdullah II estate in Sahab. Altogether, the JIEC has the potential to develop a further 1,700 hectares of industrial land – six times its current occupied space.

Of the nine private estates open for business over the past five years, only five have attracted many tenants. And only two estates enjoy anywhere near close to full occupancy – Al Tajamouat and Ad-Dulayl – which were able to attract the early Asian garment investors into Jordan's QIZs. In total, only 17% of developed land at operational private estates is occupied.

Following its local economic development function, the JIEC has opened estates in remote areas in excess of projected demand for industrial land. The Karak estate has remained half occupied since opening and the Ma'an and Aqaba Industrial Estates have remained virtually empty. The Aqaba industrial estate is particularly disappointing; after a US$17.3 million grant to develop the estate it remains virtually empty four years after opening. Despite better port and airport access, more attractive long-term investment incentives and effective local governance, Aqaba likely suffers the same labor shortages as Ma'an and Karak. Until the JIEC fully understands the reasons for lack of demand in its southern industrial estates – the Government should be very weary about developing new industrial estates or zones.



## FREE ZONES

The FZC is a fully publicly-owned entity reporting to the Minister of Finance with no private shareholding. The role of the FZC is to establish, develop, manage, and promote free zones in Jordan. There are six public free zones in Jordan with 85% occupancy – dominated by the Zarqa Free Zone. The FZC has licensed 26 operational private free zones, most of which are single-factory free zones. A further ten private free zones are under construction, including three large multipurpose zones at Karama on the Iraqi border.
Three trends are emerging:

1) Multi-purpose free zones, and not industrial estates, have become the preferred format for new multi-purpose commercial zone developments, likely for the assured long-term tax and duty-free status they bestow on tenants, and easier customs arrangements;

2) There appears to be a willingness now at the FZC and within the rest of government to permit large-scale manufacturing at free zones. The FZC is lobbying government to permit goods made within free zones duty-free entry into the rest of Jordan if such

goods meet the 40% local content. Furthermore, the Government is seeking for the GAFTA to permit exports manufactured in free zones, and meeting the 40% local content rule, to receive preferential duty-treatment in importing countries. This is blurring the distinction between industrial estates and free zones, and risks relocating manufacturing currently taking place outside of free zones.

3) The need for a public free zone developer is called into question when three private developers are ready to develop free zones at the border with Iraq. The government can still benefit from private free zone development through an appropriate tax regime.

### PUBLIC VERSUS PRIVATE PERFORMANCE

Activity at public industrial estates has generally stagnated over the past seven years. The total number of enterprises and total capital has remained relatively constant over the past seven years. However, both garment and non-garment exports have continued to increase from all public estates. Opening new estates without accompanying growth in the number of new enterprises, has limited JIEC's profitability over the past six years. In 2005 operating profit net of total expenses was 33 percent less than in 2001.

Although employment and investment levels in both public and private free zones are more modest than found in industrial estates, they have been steadily increasing over the past decade. The number of lessees has doubled and employment tripled across all public zones over the past eight years, including in manufacturing. Transit trade today involving public free zones is about five times its level in 2000. Private free zone activity has been even greater: capital investment increased from about JD 150 million in 1998 to over JD 1 billion last year and employment increased from 500 in to 8,000. Traders increasingly perceive free zones to be an efficient place to keep inventory – simpler customs procedures and an ability to delay payment of sales tax and remaining customs duties until time of consumption in Jordan.

The FZC has been very profitable – over the past six years operational income has increased by 121%. The FZC has developed a lucrative business model from the leasing and sub-leasing of land and warehouses. In addition, the FZC levies regulatory-like fees on private free zone tenants. These regulatory fees have been increasing at an annual average rate of 25% in the past five years reaching JD 8.1 millions in 2005 – 44 percent of total revenue. The FZC could continue collecting 'regulatory fees', but these fees should be separately accounted for on behalf of the GOJ. There should be no risk of regulatory income subsidizing operational income.

The two public developer/operators earn the lowest estimated returns from their land holdings. Just comparing operating returns to occupied space, the two private sector operators surveyed are at least twice as profitable as the FZC and four times as profitable as the JIEC. The JIEC owns a large area of non-operational land which results in an even lower return on total land value. Although much of this non-operational land has a low opportunity cost and is being held in reserve for the development of future estates, it could be crowding out more efficient private sector investment either in estate development or individual activities.

Another simplistic way to compare performance using available data is to look at the value of exports per unit of land occupied. Again the three privately owned and operated industrial estates for which data is readily available appear to manage land more productively. They earn on average $24.2 million per hectare in garment export revenue compared to the average $6.3 million per hectare earned by the Al-Hassan and Al-Hussein estates on their garment exports. Abdullah II estate is the largest concentration of non-garment export manufacturers in the country. Its relatively low export earnings of $2.3 million per hectare indicates the valuable contribution of garment exports to land use in Jordan.

### THE AQABA SEZ EXPERIENCE

The Aqaba SEZ has stimulated the local economy – growing 25 percent faster than its pre-zone trend and creating 10,000 new jobs. The SEZ has become a tourism and transport hub focused on Jordan's coastline. The creation of the SEZ has also achieved another of its goals – improving efficiency of public administration. In 2005, local government is able to regulate an economy that is 1.8 times its 2000 size with the same level of public sector output. Compare this to the country as a whole with a national economy that is only 1.3 times its 2000 size but is regulated by public service output that has grown by 24% since 2000.

Tourism and temporary construction are expected to contribute significantly to the total estimated employment increase of between 70,000 to 100,000 new jobs by 2015. This will put tremendous pressure on the small Aqaba labor market. Only 29 percent of the labor force has any training beyond secondary school.

Hoped for manufacturing investment in the Aqaba QIZ has not taken place despite private sector management of the estate. This lack of new light manufacturing investment in the QIZ is all the more surprising given the increase in heavy industry value-added. Institutional factors may have contributed to the poor performance of the industrial estate, in particular the sharing of promotional and monitoring functions between ASEZA and the JIEC rather than under the responsibility of one organization. This again demonstrates the need for a single regulatory agency to set guidelines and contracting requirements in such situations.

The Aqaba Special Economic has been a very special success story in Jordan. It has demonstrated that local economic development is possible with the appropriate governance structure. It is arguable that the investment in tourism infrastructure and property development and increase in heavy industry output would have taken place without the duty-free and low-tax policies being in place. However, by replacing three local government authorities with one sufficiently empowered, motivated and funded organization an environment was created to attract and facilitate new investment.

## THE POLICY ENVIRONMENT

### CUSTOMS DUTIES

In addition to customs duty reductions on imports from Jordan's free-trade partners, the GoJ is steadily eliminating remaining customs duties on imports from other countries, particularly on capital goods and goods used in production. The GoJ has provided a range of measures to counteract the anti-export bias of historically high duties on production inputs, including temporary admission schemes, duty and sales tax exemptions on capital equipment under the Investment Promotion Law, free zones and bonded warehouses.

Two changes in the policy environment restrict the use of these measures:

- From 1 May 2006, the EU Association Agreement no longer permits preferential entry into the EU of goods manufactured in Jordan from inputs imported into Jordan that were in any way exempt from customs duties, including goods manufactured in free zones.

- GAFTA members currently do not permit preferential entry of any products from other member countries that were manufactured in free zones.[2]

GoJ should remove all remaining duties on these imports as quickly as possible. This would immediately help exporters and eliminate the need to rely on the above duty-relief schemes. Long-term tariff protection for producers in a small market is of limited economic benefit anyway. In conclusion, as the final duties on production inputs are removed, efficient production of goods and services can take place at any location in Jordan without the need for any duty deferral or temporary admission scheme. Industrial estates can still attract investment by offering efficient infrastructure and support services. As this report has shown, free zones remain popular for the storage of high-value goods destined for both the local market and transit trade.

### SALES TAX

Producers today are more concerned about the cost of paying 16% General Sales Tax (GST) on the value of their purchase including capital equipment. Firms either have to carry forward excess input tax credits for some time or wait for a refund. This is a tax administration issue common to all countries. Some countries legislate to refund exporters within fixed time periods, e.g. three weeks. The solution is not to expand the number of exempt or zero-rated industries – this reduces the efficiency and fairness of the tax base and risks significant tax evasion.

### INCOME TAX

The current income tax law applies a 15% corporate income tax rate to manufacturers; this is due to increase to 17% if the new income tax law is approved. The income tax rate on most other services remains at 25%. The long term objective of the Ministry of Finance is understood to apply a flat 20% rate of income tax on all economic activities except financial services and insurance. If the higher rate remains then the differential tax treatment will likely remain the most significant impediment to new investment in services in Jordan.

The new income tax law is also intended to eliminate the current investment incentives offered under the Investment Promotion Law (16) for the Year 1995, and the current exemption on export earnings under the Income Tax Law. This exemption has enabled industrial estates and QIZs to attract export investment without offering special export tax incentives of their own. Jordan is required to eliminate its export earnings exemption by the end of 2009 according to the the Subsidies and Countervailing Measures (SCM) Agreement applied by all members of the World Trade Organization (WTO). However, WTO members are soon expected to extend prohibited export subsidies of thirty countries including Jordan. If the WTO does continue to permit Jordan to exempt export earnings, then the Ministry of Finance will need to continue its struggle to introduce a flat rate of income tax on all activities – as exemplified in the debate surrounding the current income tax bill.

Free Zones enjoy their own set of investment incentives independently of those provided by the Investment Promotion Law or the Income Tax Law. If Jordan loses its right to exempt export earnings from income tax, then a simple amendment to the law to exempt income derived from any activity occurring within a free zone could be sufficient to exclude such an

[2] GAFTA members are currently renegotiating rules of origin and are likely to recognize free zone exports if local content meets the standard GAFTA minimum of 40%.

exemption from being treated as a prohibited export subsidy under the SCM Agreement.[3] Therefore, if the Investment Promotion Law is repealed, free zones and the Aqaba SEZ would remain the only locations offering fiscal incentives to investors in Jordan.

These potential policy changes raise two important considerations for manufacturing in Jordan:

> Firstly, currently only the US permits duty free entry of goods manufactured in Jordan's free zones under the Jordan-US Free Trade Agreement (JUSFTA). However, GAFTA members may soon permit duty free entry of imports from free zones. Therefore, exporters are likely to relocate to free zones given the more advantageous duty-free and sales tax-free environment and the continuing uncertainty over taxation of export earnings.
>
> Secondly, exempting all activities within free zones from income tax will encourage significant numbers of existing domestic manufacturers and service providers to relocate to free zones. The Free Zone Corporation wants to encourage this relocation by exempting products manufactured in free zones with 40% local content from customs duties upon sale into the domestic territory. Therefore, manufacturers serving the domestic market could operate in free zones free of customs duties, sales tax and income tax.

Raising and enforcing income taxes throughout the country but allowing domestic firms to relocate or register as free zones will lead to significant tax-induced investment distortions and revenue loss for the country. The Government needs to resist applying policy fixes to institutional problems. Income tax should be applied at a low flat rate to all firms in Jordan – with appropriate relief for investors from tax-free jurisdictions. Rather than build more free zones to ease customs procedures in an otherwise low tariff environment, customs should continue to streamline its procedures nationally and eliminate tariffs on all production inputs. Rather than zero-rate or exempt certain industries from sales tax, the Sales Tax Department should administratively ease the cash-flow problems of its clients.

## INEFFECTIVENESS OF INVESTMENT INCENTIVES

The package of fiscal incentives offered by zones is increasingly the same around the world. The fact that virtually the same package of incentives is offered by successful zones and failed zones suggests that they are not a key success factor.

Because of the importance of getting the system of taxation right in any country it is worth repeating extracts from the executive summary of a 2004 study on the economic distortions caused by Jordan's current investment incentive regime:[4]

> *As for promoting regional development, no tax incentive in the world has ever attracted investors to areas where no fundamental conditions for profitability exist, such as the*

[3] Even though free zone income tax exemptions are not regarded as prohibited export subsidies, another WTO member could try to argue that such exemptions are a specific actionable subsidy causing injury to their domestic (garment) industry.
[4] Duanjie Chen, Jack Mintz, Gabi Afram, Reem Goussous; *Reformulating the Tax Incentive Program in Jordan: Analysis and Recommendations*, AMIR Program, July 2004, extracts from pages 1 to 6.

*availability of natural resources, skilled workers, adequate infrastructure, or even population density to support markets. As such, tax incentives that were targeted to regional development have generally failed.*

*The most important factors that motivate a profit-driven investment decision, as broadly recognized around the world, are the size of the market, economic stability, market-friendly institutional settings, adequate infrastructure, the availability of a trained labor force and natural resources. In contrast, tax factors are placed within the bottom 10 among 20 critical location factors evaluated by the multinational firms. Furthermore, tax incentives may not be an effective factor at all in attracting foreign investors from countries that tax repatriated profits, such as most OECD member countries., while providing credit for foreign taxes paid – resulting in a pure revenue transfer from Jordan to that of the investors' home country.*[5]

*Jordan's current investment incentive program is too complicated and inefficient. It is overly selective in the sectors and regions it favors, the conditions for exemption it offers, and the periods to qualify for tax incentives that it requires. The following five points summarize the main weaknesses of Jordan's current incentive program.*

- *The income tax reductions for selective sectors categorized by development zones significantly worsen the tax distortion arising from the existing income tax rates.*
- *The program's use of tax holidays is not necessarily an effective means of attracting large-scale, long-term capital investment.*
- *The current conditions required to obtain import duty exemption for fixed assets are too restrictive and obsolete.*
- *The narrowly defined sectoral coverage of the program encourages interest groups to seek even more selective incentives, so that government has to increase taxation on the economy as a whole to meet revenue targets.*
- *All of the current incentives require bureaucratic pre-approval. This administrative discretion is unnecessary and undesirable.*

The situation in Jordan is complicated by the level of Foreign Direct Investment (FDI) from Gulf countries where residents are not subject to income tax on their earnings and so have no interest to pay income tax on their Jordanian investments. The Government of Jordan could explore the possibility of renegotiating income tax treaties with these countries to relieve Gulf investors of any significant income tax burden without having to provide tax relief to all potential foreign investors in Jordan.

## RECENT FDI TRENDS IN JORDAN

Jordan has attracted significant levels of foreign direct investment in the last three years. Over JD 2.2 billion was registered by the Central Bank of Jordan in 2006, up from just JD 53 million in 2002. Investment incentives have remained unchanged for the last 12 years and so are unlikely to have had much influence on additional investment decisions. The major driving force of the recent surge in FDI appears to be the growth in regional FDI – due to the increase in regional investment by oil exporting countries. There is an almost perfect correlation between FDI into the region and FDI into Jordan.

[5] A meeting between Chen and et al and a potential investor from the United States provides a fresh example. When told about the difference in tax benefit between paying the regular income tax and enjoying the income tax reduction, he immediately expressed preference for paying the regular income tax rather than going through the application for the tax holiday provided under the current incentive program, since the latter would not bring him any effective tax benefit.

Have investment incentives played any role in allocating FDI within Jordan, once the investor has decided to locate in Jordan? Industrial estates and free zones are evenly distributed throughout the three investment zones under the Investment Promotion Law. The total value of approved investment in Zones A and C are about equal despite the income tax rate in Zone C being one third of the applicable rate in Zone A, and despite Zone C representing 80 percent of the total land area of Jordan.

A survey of investors from a number of public and private industrial estates emphasized the poor work ethic of the local workforce as an impediment to fully capitalize on the tax exemptions granted. There was a general consensus that a tax exemption would rank inferior to other key success factors such as quality of infrastructure and industrial estate management support.

## IMPLICATIONS FOR MAFRAQ

In November, the Government announced plans to establish a special economic zone in Mafraq to help alleviate rural poverty and unemployment. The Government established the Mafraq Development Company (MDC) with JD 100 million initial capital to develop and manage a free trade zone in Mafraq. The Social Securities Corporation has contributed 80 percent of the capital and is temporarily managing the project. Stage One of the development plan comprises the JD 250 million infrastructural development of 900 hectares between 2007 and 2015 on formerly military land adjacent to the King Hussein Airbase in Mafraq. The zone is intended to act primarily as a transport and logistics hub for local trade – particularly linking Gulf and Mediterranean trade – and host to related manufacturing and housing and community services.

A feasibility study of the proposed Mafraq transport and logistics hub projects a positive rate of return for the MDC over the next 20 years. The zone is forecast to expand to 2,000 hectares and employ 29,000 workers. These results depend upon the successful activation of a number of activities, including an "Arabian Landbridge" via railway and road to compete with sea freight between Dubai and Europe, and the ability of the Mafraq zone to handle a share of Jordan's imports and exports including air freight. These projects will be adversely affected by a proposed inland port to be based near Amman and a proposed concession agreement with the new Queen Alia Airport operator to handle Jordan's air freight.

It is not the role of this report to review the feasibility study. This report has reviewed on current zone and industrial estate policy in Jordan. However, based on the findings in this report a number of comments can be offered about the Mafraq project:

Firstly, the manufacturing projections appear very ambitious. About 24,000 workers are projected by 2025. This is a third of the current workforce in all public and private free zones throughout the whole country. Given the experience of Karak, Ma'an and Aqaba over the past five years it seems unrealistic to expect such manufacturing growth in Mafraq. Unfortunately, logistics is not a significant employer; only 1,200 jobs are projected to be created in this sector in Mafraq by 2025. Therefore, potential returns may be somewhat lower than expected in the feasibility study.

Secondly, Mafraq appears to have a comparative advantage in the facilitation of transport and logistical services. Only the private sector has the ability to fully recognize such market opportunities and bear the investment risk. Central and local government, or in this case the

MDC, has two roles in Mafraq: 1) to efficiently allocate public land to the private sector to take advantage of investment opportunities, and 2) to facilitate this investment in as transparent and as efficient a manner as possible without artificially distorting investment decisions. Neither of these roles requires the creation of a special economic zone.

The Government needs to coordinate the Amman inland port, and airport, road and railway use in a national plan. Creating competing economic zones around key transport infrastructure will not necessarily maximize national economic welfare. Artificially dividing land freight and sea freight shares between different "transport hubs", i.e. Amman, Aqaba and Mafraq to satisfy perceived private sector investor demand may reduce welfare.

Thirdly, the Mafraq zone has been established, perhaps temporarily, as a private free zone under the Free Zones Corporation. A duty-free area in which a transport and logistics hub can operate makes sense. However, extending income tax exemptions to transport and logistics operators and to manufacturers does not make sense. As Jordanian import duties on production inputs are eliminated the need for special measures to help manufacturers avoid the anti-export bias from paying duties and sales tax on their inputs disappears. Pressure should be brought to bear on customs and sales tax administration to improve their efficiency.

Fourthly, the ineffectiveness or redundancy of income tax incentives means that industrial estates, free zones and special economic zones today merely fulfill a good governance role. They provide efficient infrastructure and deliver effective services, thereby creating a suitable climate for investment. This is the role of local government. Jordan should not replace local government with artificial zone structures.

The Government and donors need to work more closely with local communities to strengthen their capacity to guide and support local economic development. Zones and tax incentives will not overcome the inherent weaknesses in each region. The most commonly cited problem is the quality and quantity of labor in the regions. Local government must improve vocational training immediately. Central government needs to address labor market impediments – is the same minimum wage necessary throughout the country? Workers need to be able to relocate flexibly from their towns and villages to growth points in the country. This entails lowering the cost of long-term housing finance, improving public transport and reducing the cultural concerns of children living away from home.

# INTRODUCTION

This paper reviews free zone and industrial estate policy and performance in Jordan against international experience. The paper also looks at the appropriateness of using zones to address local poverty and unemployment in Jordan, with special emphasis on Mafraq.

Every country in the world has regions of low growth and high unemployment due to changing productivity and market trends. As local barriers to the free movement of products, labor and capital decline, locations that were once competitive locally can become uncompetitive. Over the past fifty years, labor intensive industries such as shipbuilding and garment manufacturing have continually moved to ever lower cost sources of labor. From remote mill towns in Scotland and Massachusetts to port cities in Japan in the 1950s, to South Korea and Taiwan in the 1960s and 1970s, South East Asia in the 1980s and now to India and China. The situation is little different in Jordan. A combination of low agricultural productivity and a growing population have encouraged the Government to admit lower-cost imported food. Tribal affiliations are under great stress as unemployment increases and local incomes fall.

The Government should resist the temptation for quick-fix panaceas such as local investment incentives or major infrastructural projects in remote regions. Build it and they may not come! The role of government is to facilitate economic activity by regulating fair and efficient access to resources. This means effectively regulating markets and the rule of law with the minimum of distortion, administrative and compliance costs. It is for the private sector to respond to market signals, manage risks and use available resources in the most efficient manner.

As the International Finance Corporation's annual *Doing Business in Jordan* survey shows, the Government is still struggling to facilitate efficient and effective regulation of markets in Jordan. In particular, the rule of law is weak – discouraging risk taking across the economic spectrum. Jordanians who can rely on family connections to settle disputes have better access to capital and a larger appetite for risk than most foreign and individual investors. Regulation generally imposes very high compliance costs on business, e.g. business start-up costs are unnecessarily high. The administrative and compliance costs of raising Government revenue are high and distorting. Poor tax policy and administration has encouraged Jordanians to invest overseas, to speculate in financial and real asset trading, and evade income tax[6]. In short the dead hand of a Government that controls 60 percent of national income is crowding-out the private sector.

[6] The Government collected income tax receipts equivalent to just 3.1% of gross domestic product in 2005. Compare this to the 10.4% average for all OECD member countries, including 7.4% for Turkey, 11.9% in Ireland and 21.1% in New Zealand – the country with the highest income tax as a share of GDP. Income tax is an important fiscal instrument when used in coordination with regressive consumption taxes.

# CHAPTER 1 – INTERNATIONAL ZONE EXPERIENCE REVIEW

## 1.1 BACKGROUND ON ZONES

Commercial zones represent commonly managed, geographically delimited areas of land that are leased or sold for profit to individual businesses locating within the zone. Usually commercial zones offer a special package of incentives to locating businesses, particularly relating to exemption from customs duties and income tax. There are about 3,000 zones scattered throughout the world. Jordan alone has 46 operating commercial zones, with 19 zones in the planning stage.

The most well known historic examples are free ports, where traders could unload, trade and load goods without being subject to duties or taxes. The ports profited from the additional economic activity generated by the new trade. The island of Delos was an ancient Greek free port. More recently the Venetians established Trieste as a free port in the 15th century and the English established Gibraltar free port in the 18th century.

If the zone exempts goods entering the zone from customs duties and sales tax then it is regarded as a "free zone" and its administration is guided by the principles described in the International Convention on the Harmonization and Simplification of Customs (the revised customs Kyoto convention) and Annex D to the Convention. Annex D defines a free zone as being outside the customs territory of the country in which it is located, with respect to customs duties and sales taxes. The Convention also lays down the principle of minimal documentation for the entry and exit of goods.

Six broad categories of commercial zone can be differentiated, sharing the common features of single administration, geographical cohesion and incentive package – regardless of whether the zone offers duty free benefits or not:[7]

> **Free Trade Zones**, also known as commercial free zones and free commercial zones, are small, fenced-in, duty-free areas, offering warehousing, storage and distribution facilities for trade, transshipment and re-export operations, located in most ports of entry around the world. The main benefit for investors locating in or using free trade zones is the cash flow advantage from delaying payment of sales taxes and customs duties until goods that have been imported and stored in the zones are released into the customs territory outside the zone. Users of foreign trade zones in the United States

[7] This zone classification and the references to international practice in this report are discussed more fully in *Free Zones: Performance, Lessons Learned and Implications for Zone Development*, BearingPoint, Inc., unpublished paper prepared for Foreign Investment Advisory Service, November 2004

enjoy lower operating costs as a result of reduced insurance, security and overhead costs. The Free Zone Corporation operates six free trade zones in Jordan.

**Export Processing Zones,** industrial estates offering special incentives and facilities for manufacturing and related activities aimed mostly at export markets. Export processing zones today are typically subdivided into a general zone open to all industries regardless of export orientation and a separate export processing zone area reserved for export-oriented, zone-registered enterprises. Although not a duty-free area, Qualifying Industrial Zones are a close example of an export processing zone in Jordan. QIZs are specially designated zones for manufacturers to access the US market without being subject to US duties. See Box 1.

**Enterprise Zones** are intended to revitalize distressed urban or rural areas through the provision of regulatory incentives and financial grants. Most zones are in developed countries like the USA, France and UK, although South Africa is developing a similar mechanism. Enterprise zones in the United Kingdom have a limited ten-year life span and try to attract clusters of businesses by providing capital allowances and simplified regulatory procedures.

**Single Factory export processing zone** scheme is where incentives are provided to individual enterprises regardless of location; factories do not have to locate within a designated zone to receive incentives and privileges. Some countries rely exclusively on a single factory scheme, e.g. Mauritius, Madagascar and Mexico. Jordan, Costa Rica and Sri Lanka allow both industrial estate-style zones and single factory designations. Twenty single factory private free zones currently operate in Jordan. One of the largest and oldest is the JD 120 million Jordan-Indo Chemicals Company, an Indian-Jordanian-Saudi joint-venture.

**Special-Purpose Zones** have been developed for specific economic activities, seeking to promote agglomeration benefits between locators. Table 1 gives examples of special-purpose zones to promote technology or science-based industries; petrochemical and heavy industry zones; financial services zones; software and ICT zones; airport-based zones; logistics parks, cargo cities, providing facilities and support services to facilitate trade, supply chain management and logistics and tourism zones. In Jordan, the King Abdullah Design and Development Center, Jordan Media City, and Aviation City at the Al-Mushatta Qualified Industrial Complex are arguably special-purpose zones – albeit under single ownership.

**Freeports/Special Economic Zones** (SEZs) are generally a much broader concept—typically encompassing much larger areas; accommodating all types of activities including tourism, retail sales; permitting people to reside on site; and providing a much broader set of incentives and benefits. China has developed large-scale SEZs and the Aqaba Special Economic Zone is a recent example. SEZs can have significant economic impact, particularly in terms of exports and foreign investment. The Subic Bay and Clark Freeports in the Philippines, for example, together account for almost 10 percent of national merchandise exports. The Shenzhen SEZ in China has attracted almost US$30 billion in FDI and generates 14 percent of Chinese exports. SEZs can also be very effective in promoting the diffusion of new policies, procedures and governance structures.

Table 1. Examples of Special-Purpose Economic Zones

| Type of Zone | Development Objective | Size | Typical Location | Activities | Markets | Example |
|---|---|---|---|---|---|---|
| Technology or Science Parks | Promote High-tech and Science-based Industries | < 50 hectares | Adjacent to universities institutes | High technology activates | Domestic and Export | Singapore Science park, Singapore |
| Petrochemical Zones | Promote energy industries | 100-300 hectares | Petrochemicals hubs: efficient energy sources | Petrochemicals and other heavy industry | Domestic and Export | Laem chabang Industrial Estate, Thailand |
| Financial Services | Development of offshore financial svcs. | < 50 hectares | None | Offshore financial & non-financial services | Export | Labuan Offshore Financial Centre, Malaysia |
| Software and Internet | Development of software and IT services | < 20 hectares | Adjacent to universities, urban areas | Software and other IT services | Export | Dubai Internet City, UAE |
| Airport-based | Air cargo trade and trans | < 20 hectares | Airports | Warehousing, transshipment, sub-dividing | Re-export and domestic | Kuala Lumpur Airport Free Zone, Malaysia |
| Tourism | Integrated tourism development | 200-1,000 hectares | Tourism areas | Resorts and other tourism | Export and domestic | Baru Island, Colombia |
| Logistics Parks or Cargo Villages | Support logistics | < 50 hectares | Airports, ports, transport hubs | Warehousing, transshipment | Re-export | D1 Logistics Park, Czech Republic |

Source: *Free Zones: Performance, Lessons Learned and Implications for Zone Development*, BearingPoint, Inc., unpublished paper prepared for Foreign Investment Advisory Service, November 2004



> However, the high public regulatory, administrative and infrastructural demands of SEZs mean that minimal preconditions must exist before countries should attempt to create such zones. In order to create ASEZ, the two local government bodies were merged into a new administrative authority; special customs and tax regimes were designed and administered through new agencies. Significant training and new systems were required to administer relations with investors and private sector operators of zone infrastructure. In the final analysis, SEZ development efforts should be undertaken only rarely, and only by those countries that have the requisite institutional capabilities, expertise and commitment to make them succeed.

One of the critical issues that need to be addressed in the configuration of a free zone development program is the types of zones to be promoted. International experience suggests that the recommended approach is to adopt a flexible free zone model with the following features:

- Permit industrial estates to host export processing zone enterprises as well as those licensed under other regimes. The preferred approach is to allow all enterprises to co-locate within the same area, although the development of separately fenced-off areas solely for export processing zone enterprises (as in Philippine and Thai zones) is an acceptable approach.
- Ensure that the export processing zone regime is flexible, allowing a range of commercial as well as manufacturing activities. If properly supervised, a separate commercial free zone regime, as in Malaysia and Thailand, is not required.

All types of zones should be permitted, offering customized infrastructure, facilities and services tailored to the specific needs of target industries. But as far as possible, all zones should have a common set of incentives and privileges, rather than duplicating and overlapping regimes which can result in revenue loss. China and Viet Nam provide particularly egregious examples where numerous zone regimes exist each with slightly different incentive packages. This complicates effective tax regulation and can promote income tax avoidance.

## 1.2 ESTATES AND ZONES IN JORDAN

Jordan has industrial estates, free zones and a special economic zone. **Industrial estates** provide the necessary infrastructure and services for manufacturing located within delimited parcels of land. **Free zones** essentially provide a duty and tax free environment for the storage of goods in fenced compounds regarded as being outside the customs territory of Jordan. Manufacturing and services are also permitted to locate within free zones. The attributes and benefits of industrial estates, free zones and bonded warehouses are summarized in a table in Annex One of this report.

The private sector competes with the public sector to develop and operate both free zones and industrial estates. Public industrial estates are developed and managed by the Jordan Industrial Estates Corporation (JIEC) while public free zones are developed and managed by the Free Zone Corporation (FZC). Jordan's zone experience is described in Section 2 of this report.



### Box 1. Qualifying Industrial Zones (QIZs)

Qualifying Industrial Zones (QIZs) are specially designated industrial estates in Jordan. Approved products manufactured in QIZs may enter the United States free of any import duties and quotas. This special access was approved by the U.S. Congress in 1996 as an incentive for economic cooperation between Jordan and Israel following the 1994 Peace Agreement. Each new product must be approved by a committee jointly chaired by Jordan and Israel with a U.S. observer. Although, the agreement provides for one of three qualifying methods to calculate rules of origin, garment producers, in practice, have adopted the following method – the product must be "substantially transformed" with 35 percent of its value added in Israel, a QIZ, or the West Bank/Gaza. Of this 35 percent, a minimum of 11.7 percent must be added in a QIZ, 8 percent in Israel (7 percent for high tech goods), and the remaining 15.3 percent from Israel, West Bank/Gaza, Jordan or the US.

The quota-free advantage of QIZs attracted garment producers from countries subject to binding quota constraints on their own exports to the United States, including China, Hong Kong, India, Pakistan, South Korea, Sri Lanka, Taiwan and the UAE. After the elimination of garment quotas on 1 January 2005, QIZ producers are specializing in garments subject to high duties in the US market, e.g. garments containing synthetic fibres.

Twelve industrial estates have been designated as QIZ's in Jordan. However, only the two publicly-owned estates and the four private estates designated as QIZs before 2002 have attracted sufficient garment firms in order to continue operating today. The removal of quotas, labor and water constraints, and the opening of a QIZ program in Egypt appears to have slowed the entry of new garment producers into Jordanian QIZs over the past few years.

Free zones offer an income tax exemption on all activities except sales to the domestic territory. Tenants in industrial estates may apply to the Jordan Investment Board (JIB) for industry investment incentives. In addition, the JIEC provides a two-year income tax holiday to its tenants not available in private industrial estates. Investment incentives are discussed in Chapter 4 of this report.

The Aqaba Special Economic Zone is a duty-free zone covering an area of 350 sq km in and around the port of Aqaba. The Zone was established in February 2001 and is regulated by its special law. The zone is administered by the Aqaba Special Economic Zone Authority (ASEZA.) The law transfers regulatory authority from a range of central and local government entities to ASEZA. These include authority over customs, taxation and all municipal services including business licensing subject to a continuing role for certain specialized central government licensing agencies. Most importantly ASEZA replaced the Aqaba Regional Authority and the Aqaba Municipality and subsumed the authority of the Free Zones Corporation with the zone. The law provides for the zone to be a duty-free area with a seven percent sales tax on a very limited number of products, and provides for a flat five percent income tax rate on the profits of registered enterprises.

**Table 2. Summary of Industrial Estate and Free Zone Land-Use in Jordan (Hectares)**

| | Number of Operating Zones and Estates | Occupied Space as % of Developed Land | Developed Land | Planned Development |
|---|---|---|---|---|
| Public Free Zones | 6 | 85% | 557 | 370 |
| Private Factory Free Zones | 24 (6) | 100% | 225 | 230 |
| Private Multi-purpose Zones | 2 (4) | <20% | 503 | 1,289 |
| Public Industrial Estates | 5 (9) | 64% | 417 | 1,422 |
| Private Industrial Estates | 9 | 17% | 397 | 962 |
| **Total** | **46 (19)** | | **2,099** | **4,273** |

Notes: 1. Number of planned zones are listed in parentheses;
2. Three of the private industrial estates also have private free zone status.

## 1.3 WHY CREATE ZONES?

Commercial zones are developed for two main purposes:

1. Local economic development – provide appropriate soft infrastructure (policies and procedures) and hard infrastructure in order to attract investment and increase local income and employment. Hard infrastructure – fully serviced sites with purpose-built facilities for sale or lease – is aimed at enhancing the competitiveness of manufacturers and service providers, and realizing agglomeration benefits from concentrating industries in one geographical area. These include efficiencies in government supervision of enterprises; provision of off-site infrastructure; improved environmental controls; increased supply and sub-contracting relationships among industries; among others. This 'infrastructure rationale' is one of the most important driving forces behind zone development in infrastructure-poor countries.

2. A model for national economic reform – some zones are purposefully maintained by their host governments as enclaves independent from the rest of the high-tariff, high-tax and highly regulated economy. This is characteristic of the Tunisian and Dominican Republic zones. However, other transition economies have used zones to demonstrate best practice and to test the impact of economic reforms before introducing them nationally. Chinese SEZs, for example, experimented with market-oriented FDI, land and tax policies before extending them to all enterprises. Costa Rica used free zones as efficient mechanisms to attract foreign investment prior to extending these approaches to enterprises more broadly.

In Jordan, the Aqaba Special Economic Zone is an example of a zone serving both of these purposes. The ASEZ has introduced a number of simplified systems that could be extended or provide lessons to the rest of Jordan. These systems include simplified policies and administration relating to: income and sales tax, business licensing, land-use management, customs entry including imported food inspection, and public-private partnerships in infrastructure management.

## 1.4 KEY REASONS FOR ZONE FAILURE

The economic failure of zones is due to a number of factors. Often poor site location, design and development practices can be the main cause. Most government-developed zones, for example, were located in remote areas to act as growth poles. The location of many others reflected political rather than economic and technical factors. For example, the San Bartolo Free Zone in El Salvador had to be subsidized to offset high development costs due to poor site conditions. The ZOLIC free zone in Guatemala constructed over 24,000 sq.m. of factory space in first two years of operations that sat empty without adequate marketing support.

The weak performance of some programs can be traced to weak government bodies established to develop and operate zones, and regulate free zone activity. In many countries, free zone authorities lack necessary powers and autonomy, are under funded or poorly managed. Decision-making in older free zone authorities in Jordan, Syria and Egypt, for example, is excessively centralized—alteration of a land lease rate usually requires approval of the country's Cabinet. Many others are subject to political influences and are chronically over staffed. At one point in Egypt, for example, the GAIFZ had over 4,000 employees. Many others lack control over their budgets and have restrictive civil service limitations on remuneration and employment conditions.

Another contributing factor is inadequate coordination and the lack of effective partnerships between private zone developers and governments in terms of external infrastructure provisions. Most private export processing zones and industrial zones in Viet Nam, for example, sat vacant because local and national authorities could not provide road and other infrastructure connections to the site.

One of the most significant factors accounting for the financial and economic failure of zones is the once common practice of subsidizing land and building lease and sale rates. Many government zones do not operate on a cost recovery basis leading to losses for national treasuries. This is exacerbated if water, power and other utility services are also subsidized. The lack of adequate funding has meant that many public zones are inadequately maintained, as exemplified by zones in the Dominican Republic, and/or do not have robust promotional efforts.

In summary, the main reasons contributing to the failure of free zones are:

- Poor zone development practices—poorly designed or over-designed facilities, poor maintenance and promotion practices
- Subsidized rent and other services
- Cumbersome procedures and controls (For example, until recently, the investment application for free zone status in Egypt was 40 pages long, and investment approvals took anywhere from 12 to 24 months).
- Inadequate administrative structures or too many bodies involved in zone administration
- Inadequate coordination between private developers and governments in infrastructure provision

Annex Three summarizes the key zone development guidelines from the 2004 BearingPoint review of international experience.[8]

## 1.5 EVOLVING ZONE POLICY AND PRACTICE

This section of the report examines the evolution of key principles and practices relating to zone planning, development and operation – in particular the relative roles of the public and private sectors. International zone experience is compared to Jordanian experience.

### 1.5.1 THE ROLE OF GOVERNMENT

Government has a role to ensure that all land is used appropriately – maximizing social returns with the least social and environmental impact. In many cases the government is seeking the best social and economic return for publicly owned land, whether it is used as a national park, school or industrial zone.

Initially zones were developed and operated only by government agencies. The public sector usually owned the land and saw zones as an extension of its municipal role. Industry policy and the creation of jobs was something to be led and implemented by the public sector. However, it has been increasingly recognized to be better able to identify and manage risk; access labor, capital and technology efficiently; and respond to market opportunities. Therefore, the role of government has evolved from being the sole developer and operator of zones to being the land owner and regulator of private sector development and operation of zones. This is a difficult transition taking place with varying degrees of success throughout the world.

The transition for governments from being the monopoly provider and regulator of zones to only regulating private sector provision usually starts with the establishment of specialized public sector zone development and management agencies, such as the JIEC and FZC. These agencies hold a range of development, management and regulatory powers. Private sector zones are increasingly able to compete with these public agencies, including receiving contracts to manage public zones. However, conflicts of interest persist when the public agencies guide and monitor private sector performance in competition with their own public operations.

[8] *Free Zones: Performance, Lessons Learned and Implications for Zone Development*, BearingPoint, Inc., unpublished paper prepared for Foreign Investment Advisory Service, November 2004

There are few, if any, market failures that require the government to intervene in the market for the provision of commercial land in Jordan. The private sector is likely better able to bear and manage the risks associated with these functions than the Government in all situations – even when the land is publicly owned. Historically, the Government has been too ready to risk taxpayer funds operating commercial activities without being subject to the discipline of capital markets. As capital markets develop there is increasingly less sense in the government competing with efficient private interests. Governments have traditionally tried to establish commercial zones in underdeveloped regions in order to generate employment. Private operators can still establish and operate such zones if the government provides an explicit subsidy in a competitive and transparent manner to the operator.

### 1.5.2 REGULATION OF ESTATES AND ZONES IN JORDAN

Private investors began developing industrial estates in the late 1990s prompted by the activation of the QIZ program. In the 1990s, the FZC began permitting large industrial plants, e.g. the phosphoric acid, bromine and fertilizer factories, to operate as private free zone factories. Such export-oriented industries were already income tax exempt, however, free zone status permitted simpler customs control over entry and exit of goods. The government moved further from the traditional commercial transit trade function of public free zones in Jordan by permitting manufacturing in both public and private multi-purpose free zones.

Public estates and zones compete with private estates and zones. The JIEC and FZC have access to public funds and public land. [9] The JIEC and FZC have municipal powers to classify land and license enterprises. The FZC can issue certificates of origin and register special free zone companies. Most importantly, the JIEC and FZC are exempt from income tax and sales tax. Private developers do not enjoy any of these rights.

The government has been slow to regulate private estate and zone developers. Private free zones are regulated by the Free Zone Corporation, which continues to develop and operate its own public free zones. A substantial share of FZC revenue is derived from regulatory fees and revenue sharing measures imposed on private free zones. The JIEC develops and manages public industrial estates, but private industrial estates are not regulated by any central government entity.

In February 2004, the AMIR Program produced a report on Regulation of Private Industrial Estates in Jordan to address the weakness in the Jordanian legislation governing private industrial estates at the time. The report recommended that the application requirement for licensing industrial estate developers/operators be simple, succinct, and publicly available and that the evaluation criteria for accepting/rejecting applications be included in the Regulation, with effective penalties on developers/operators violating their obligations. Both recommendations were not implemented. Regulation No. 117 of 2004 is the implementing

[9] Despite their many benefits over private competitors, the JIEC and FZC as public entities are subject to a number of operational constraints:

a. Investors in public free zones are unable to own land, hold title to leasehold improvements, or dispose of real assets after the expiration of their lease. As a result, firms cannot use real assets for collateral financing and must hand over such property to the Free Zones Corporation after lease expiration.
b. The FZC can only increase land charges once every three years and at no more than the rate of inflation (Article 16 FZC Law). The Council of Ministers has to approve new service fees (Article 7-E) and approve loans to the FZC (Article 7-F) and the FZC budget (Article 7-G). Approval of the Council of Ministers is also necessary for the categories of industries that may be established in free zones (Article 13-C).

regulation that gives the Ministry of Industry and Trade (MIT) the authority to license and monitor private Ies. The regulation does not articulate these elements clearly and comprehensively. Nor does any legislation appropriately regulate the development and operation of private free zones.

Table 3. Allocation of Zone and Estate Regulatory Functions

| Regulatory Function | Responsible Entity | | | |
|---|---|---|---|---|
| | MIT | MOF | JCD | Operator |
| Designate an area as an industrial estate or a free zone in line with a national land-use plan | ✓ | | | |
| Set policy and evaluation criteria, rights and obligations, fees and penalties to license IE or FZ developers and operators | ✓ | | | |
| Monitor compliance of IE developers and operators | ✓ | | | |
| Monitor compliance of FZ developers and operators | ✓ | ✓ | | |
| Control customs-related functions | | | ✓ | |
| Register companies to operate in free zones or industrial estates | ✓ | | | |
| Administer and monitor any fiscal incentives | ✓ | ✓ | | |
| Establish the basis for licensing companies to operate in industrial estates or free zones (approving projects) | ✓ | | | |
| Prevent anti-competitive practices | ✓ | | | |
| Municipalities delegate land-use planning and vocational licensing to MIT. Operator will exercise these powers on behalf of MIT under their operator license agreement with MIT | | | | ✓ |
| Issuing certificates of origin – on behalf of MIT | | | | ✓ |

Source: Clarify Regulatory Issues for JIEC-FZC Merger Law (Confidential – Not for Distribution), Reem Aloul and Geoff Wright /The Services Group Inc. (TSG), Souad Abdelhamid / Chemonics International Inc. AMIR Program, July 2006

It is necessary to place the public developers on a level playing field with private developers. An independent regulatory body needs to be empowered to set and implement national industrial land-use guidelines. The regulatory body should also review the feasibility and financial capacity of applicants for new estates and zones against those land-use guidelines, allocate public land among competing bidders, monitor the compliance of developers and operators with national guidelines and monitor the administration of other public services including customs, labor and environment regulation. Enforcing compliance with national customs, labor and environment regulations remains within the authority of their respective ministries.

TSG prepared a report for the AMIR Program recommending that the regulatory role of MIT, authorized in Regulation (No. 117) for the year 2004, be strengthened to accommodate the additional zone and estate regulatory functions outlined in the report. Table 2 summarizes the allocation of these functions.

Land-use rules are not just a way for local municipalities to administer their rate-paying populations, they should guide land-use that reflects the economic and social interests of the local community. Development of appropriate land-use rules can build upon the 2006 Industrial Map. The map was prepared for the Ministry of Industry and Trade to match projected demand for industrial estates and free zones over the period 2005-2030 with a detailed inventory of the supply of land and associated industrial infrastructure. The results indicate locations where land is available and where existing zones could be expanded or new zones constructed. The study reveals that current industrial estate and free zone space is sufficient to meet demand until 2017. The results from the industrial map, clearly emphasize the need for an efficient regulatory environment to be in place where government can approve land use for appropriate economic activities and the private sector can develop and manage that land.

## 1.6 NEW ZONES VERSUS NATIONAL ECONOMIC REFORM

Economic theory suggests that free zones are a 'second best solution' to compensate for the anti-export bias of trade policies and other policy distortions typical of many developing countries. The World Bank cautions that export processing zones may be used by developing countries to 'muddle along without reforms,' and therefore concludes that countrywide trade liberalization must be given priority over the establishment of isolated free market enclaves.[10]

In a study of nation-wide benefits of a duty-free export processing zone in Rwanda, Abt Associates developed a trade simulation model to compare the economic impact of:

1) Eliminating all customs duties and establishing Rwanda as an economy-wide free trade zone like Singapore or Hong Kong, versus
2) Retaining existing duties and establishing discrete manufacturing duty-free export processing zones.

The quantitative simulation model demonstrates the clear superiority of eliminating all tariffs over export processing zones.

> *"Whereas manufacturing export processing zones might be counted upon to expand exports of textile and apparel products (and possible other manufactures, with accompanying foreign direct investment), only the economy-wide FTZ is likely to have a substantial impact on not only export performance but also employment and the general economy, led notably by agriculture and the rural economy where the population of Rwanda is overwhelmingly centered and where the country's most immediate comparative advantage lies. Also, only the economy-wide FTZ provides appreciable improvement to the economic welfare of both producers and consumers, albeit at some financial cost from lost import tariff revenues."*[11]

Jordan need not continue relying on zones to test and demonstrate the effectiveness of new economic policies for eventual application to the whole country. At least three arguments point to a smaller role for zones in Jordan:

Firstly, there are fewer potential policy advantages that can be provided to investors by a special economic zone today in Jordan that are not currently available nation wide. Customs duties are being eliminated on all imported capital and intermediate inputs into the production of goods and services.[12] The duty-free benefits of GAFTA, JUSFTA and EUAA are available

[10] *Export Processing Zones*, World Bank, Policy and Research Series Paper 20, Industry Development Division, 1992

[11] *Rwanda as a Free Trade Zone: An Inquiry into the Economic Impacts*, Dean DeRosa and Vernon Roningen, July 2002, USAID, page iii

[12] SABEQ is working with the Ministry of Industry and Trade to determine the speed of tariff elimination through the development of a national trade strategy. Tariffs on high-dutiable consumer products imports such as motor vehicles and consumer electronics could be replaced with an excise or special GST, depending on administration and compliance costs. This will remove many policy biases and distortions that currently adversely affect Jordan's export potential. Policing tariff barriers is administratively very costly, for a declining amount of revenue each year. Already, more than 70% of imports come from duty-free trade partners. The

to producers located anywhere in Jordan – unlike the QIZ arrangement which will cease to be of any advantage to exporters by 1 January 2010. Jordan's commitments to the General Agreement on Trade in Services permit foreign investment in almost all service sectors.[13] Presumably the market for industrial land is more liquid and secure today than 25 years ago when the JIEC started parceling land for industry. Migrant workers can be employed anywhere in the country.

Secondly, maintaining unique policies within special economic zones in Jordan has the danger of distracting central and local government from the essential work of reforming national policy. Rather than substitute complex and costly municipal bureaucracy with a lean commercial zone management, central and local government must continue to reform delivery of their services, especially land-use management and regulatory compliance. The Municipality of Madaba has performed what many would regard as the miraculous – reducing the number of days to license a new business from 50 to 2 days. Rather than provide a complex range of income tax rates across different sectors and zones, the Ministry of Finance should continue to convince policy makers that a low, flat rate of tax on corporate profits makes sense, with no exemptions for exporters. Rather than maintain the special free zone company regime for investors in free zones, the Ministry of Industry and Trade needs to persevere with is review of bankruptcy and minimum capital requirements for all companies. Perhaps most importantly, rather than replace the authorities of a range of regulatory agencies with one special economic zone authority, Government should work to improve the coordination and simplification of regulation in Jordan.

Thirdly, Jordan is too small geographically and economically to be distracting investors by offering a range of incentive packages tied to different zones and regions. Long term sustainable economic growth derives from the dynamic interplay of comparative advantage and market opportunities. Artificial stimulants to create either of these through government subsidies generally fail. Governments cannot pick "winners" – the role of government is to facilitate market forces to pick winners by regulating markets as efficiently as possible, and to provide public goods as efficiently as possible. Furthermore, the fiscal and political capital required to create a series of special zones throughout Jordan would likely be more than that needed to undertake the underlying national reforms discussed in the previous paragraph.

Minister of Industry and Trade established a committee in August 2006 that began recommending the sequence of tariff elimination on inputs into production.

[13] Sectors that Jordan has not committed to liberalize have remained less productive and have depressed average employee costs compared to liberalized sectors. See Impact of Trade Liberalization, 1994-2003, AMIR Program 2005

# CHAPTER II – JORDANIAN ZONE AND ESTATE EXPERIENCE

## 2.1 JORDAN INDUSTRIAL ESTATES CORPORATION (JIEC)

The JIEC was established as a financially and administratively autonomous corporate entity —a non-official public institution— in accordance with Law No. 59 of 1985. The GoJ owns 67% of JIEC's shares, the Housing Bank owns 12%, and the remaining shares are owned by the Industrial Development Bank and the Social Security Corporation. As a non-official public entity, the JIEC can issue its own board instructions covering personnel matters, fees and lease rates, planning and establishment of new estates. However, annual increases in lease rates for land and buildings may not exceed five percent. The JIEC has a 14 member Board of Directors that includes five private sector representatives appointed by the Council of Ministers. The Council also approves the JIEC's annual budget and the designation of new public industrial estates.

Its objectives are to study, plan, establish, and manage industrial estates in Jordan and to encourage industrial projects to locate within industrial estates. JIEC offers a number of investment incentives to investors locating in its estates – see Chapter 4 of this report.[14] Industrial estates are defined as areas designated to accommodate manufacturing industries and related services. To meet its objectives the JIEC may perform the following activities:

- Purchasing and acquiring industrial land[15];
- Selling and renting industrial land to private-sector investors;
- Managing industrial estates;
- Acting as a municipality within its industrial estates;
- Acting as the local and regional planning committees within its industrial estates;
- Providing infrastructure, ancillary services and investment incentives to estate tenants;
- Determining property selling and renting rates; and
- Protect the environment by enforcing national environmental legislation.

The JIEC is considered as a municipality and it exercises the authorities of the Local and the Regional Planning Committees within industrial estates. Hence, it is entitled to issue vocational licenses and construction and building permits to industrial estate tenants.

The JIEC has developed and operates the following five industrial estates, three of which are QIZs:

**Abdullah II Ibn Al-Hussein Industrial Estate, Sahab, Amman**

The Abdullah estate is not a QIZ – it is the oldest and largest estate in Jordan and remains Jordan's manufacturing hub with almost JD 500 million in annual total sales. Established in

[14] .

[15] The JIEC is the legal owner of land transferred to it through a Council of Ministers decision — land is accounted for as an asset in JIEC's balance sheet

1984 in Sahab, 12 km southeast of Amman, Abdullah II estate has a total area of 2,530 dunums and is fully occupied. It currently accommodates 348 enterprises, with a total investment of JD 847 million and 14,000 workers. Firms are evenly distributed across food, engineering (metal and electronic), plastic and rubber, pharmaceuticals, chemical industries, cotton and weaving, wooden and metallic furniture, printing and packaging.

**Al-Hassan Industrial Estate - QIZ, Irbid**
Al Hassan was established in 1991 near Irbid, 72 km north of Amman and received the first QIZ status of any zone in Jordan. The estate was developed in three phases, with a total area of 1,178 dunums. The estate has continued to attract new investors over the past five years and now has 99 firms, 35 of which are garment firms employing 20,000 garment workers. Other major industries represented include engineering, plastic and rubber and pharmaceuticals.

**Al-Hussein bin Abdullah II Industrial Estate - QIZ, Al Karak**
Al Hussein was established by the JIEC in 2000 near Karak. The estate has a total area of 1,856 dunums. The estate has slowly developed in terms of attracting investors – three garment firms occupied the zone by 2001 with total approved JIB investment of JD 40 million, employing 2,000 workers. Three smaller garment firms entered in 2004. However, one of the large garment firms left in 2005. Total JIB approved investment remains relatively unchanged at JD 40.6 million

**Aqaba International Industrial Estate – QIZ, Aqaba**
JIEC developed the Aqaba International Industrial Estate, with $17 million in grant funding from USAID. AIIE is the only industrial estate in the Aqaba Special Economic Zone, and has a total area of 2,750 dunums. In 2003 JIEC awarded the operation and marketing of AIIE to Parsons Brinkerhoff International Inc., US, in association with Suta Insaat ve Mehundislik, Turkey. Progress has been disappointing; only five firms investing JD 3.5 million have located in the estate - engineering, plastics & rubbers, furniture and printing & packaging. A JD 70 million ceramics factory is due to commence constructing its premises this year once its investment requirements have been finalized.

Table. 4 Summary of Land Occupancy at the JIEC Public Industrial Estates

| Industrial Estate | Total Area (Dunums) | Net Area Available for Investment (Dunums) | Occupied Area (Dunums) | Free/Unused Area (Dunums) | Area Available for expansion (Dumuns) | Occupied Area % of Net Area Available for Investment |
|---|---|---|---|---|---|---|
| Abdullah II Ibn Al-Hussein / Sahab | 2,530 | 1,874 | 1,874 | 0 | 0 | 100% |
| Al-Hassan Bin Abdullah / Irbid | 1,178 | 776 | 537 | 239 | 173 | 69% |
| Al-Hussein II Bin Abdullah / Karak | 1,856 | 544 | 237 | 307 | 1,070 | 44% |
| Aqaba International Industrial Estate | 2,750 | 490 | 8 | 482 | 2,180 | 2% |
| Ma'an Industrial Estate / Ma'an | 2,500 | 488 | 2 | 486 | 1,800 | 0% |
| **Total** | 10,814 | 4,172 | 2,658 | 1,514 | 5,223 | 64% |

Source: Table 8, Industrial Map Project (2006),

**Ma’an Industrial Estate / Ma’an**
JIEC has developed the 70 hectare (700 dunums) phase one of the Ma’an Industrial Estate with the support of a $9 million soft loan from the Chinese Government. Total developable area is 1800 dunums. QIZ status was provided in May 2005, although the estate was operating by

2004 when two firms invested JD 500,000. In 2006 the zone attracted two more investors with a total capital of JD 10 million. Employment, sales and exports are negligible at present.

The land area of the above estates comprises about 1,000 hectares, of which 417 is developed for sale or lease to industrial enterprises – see Table 4. Sixty four percent of this available space is occupied. However, as the individual estate descriptions above show, only the Abdullah II estate is full. Al-Hassan in Irbid is two thirds occupied, Al-Hussein in Karak is less than half full and Ma'an and Aqaba are almost empty. This is a problem also faced by the private industrial estates and is discussed further below.

The JIEC owns another 1,177 hectares of land at nine sites around the country on which it is planning to develop industrial estates. Estate designs have been completed for sites at Al-Mafraq, Al-Salt and Queen Alia Airport– see Table 5. Adding to this the 522 hectares of space available for expansion at the five existing public industrial estates (ignoring the 151 hectares of currently unoccupied developed space), JIEC has the potential to develop a further 1,700 hectares of industrial land. This is six times its current occupied space.

Table 5. Future JIEC Public Industrial Estates

| **Land Owned and Estates Designed** | |
|---|---|
| **Location** | **Total Area (hectares)** |
| Al-Mafraq | 225.0 (phase I is 73.5) |
| Al-Salt | 26.4 |
| Queen Alia Airport | 25.0 |
| **Land Owned but Estates not Designed** | |
| Al-Hasa | 406.4 |
| Al-Muwaqer | 300.0 |
| Al-Tafila | 100.0 |
| Madaba | 50.0 |
| Al-Zarqa | 25.0 |
| Ajloun | 19.1 |
| **TOTAL** | **1,176.9** |

Source: JIEC 2005 Annual Report p.34

## 2.2 PRIVATE INDUSTRIAL ESTATES

The QIZ program was the major stimulus for private sector development of industrial estates in Jordan. The QIZ program provided an obvious industry to attract investment – the garment sector – and an obvious window of investment opportunity (from QIZ agreement approval in 1998 until 2005 when garment quotas were eliminated). Garment firms are mobile and have quick start-up times enabling private estates to become profitable relatively quickly.

Table 6. gives a snapshot of current indicators of the main operating industrial estates in Jordan. Five public industrial estates are operated by the JIEC, three of which are QIZs, and four private industrial estates are operational, all of which are QIZs. Together they employ 75,000 workers – at least 40 percent of the 2004 manufacturing workforce – and exported \$1.7 billion in total exports in 2006.[16]

Al Tajamouat (private) and Al-Hassan (JIEC) estates are a similar size in terms of the number of garment firms, capital invested by tenants and garment exports. Both estates export over 60% of the nation's total garments exported to the US. As noted above the largest and oldest

[16] The 2004 Census result for the size of the manufacturing workforce is 159,948. Assuming the Census did not record the approximately 30,000 foreign garment workers in 2004, industrial estate workers still make up about 40 percent of the total manufacturing workforce.

estate is the Abdullah II estate operated by the JIEC at Sahab near Amman. Almost 350 firms in a range of manufacturing sub-sectors are located in the estate, exporting $438 million in 2006. The estate is not a QIZ and so houses no major garment exporters.

Table 6. Operating Industrial Estates

| Zone | Status | Year Established | Number of Firms | Invested Capital (JD million) | Number of Garment Firms | Number of Workers | Garment Exports -2006 (US$ million) |
|---|---|---|---|---|---|---|---|
| **Public Estates** | | | | | | | |
| **Abdullah II IE** | Non-QIZ | 1984 | 348 | 847 | 0 | 13,991 | 438* |
| **Al-Hassan IE** | QIZ | 1991 | 99 | 239 | 35 | 22,434 | 417 |
| **AL-Hussein IE** | QIZ + FZ | 2000 | 7 | 41 | 2 | 4,331 | 115 |
| **Aqaba IE** | QIZ | 2003 | 5 | 4 | 0 | 250 | 12* |
| **Ma'an IE** | Non-QIZ | 2005 | 4 | 10 | 0 | 10 | 0 |
| **Private Estates** | | | | | | | |
| **Al-Tajamouat** | QIZ | 1999 | 140 | 253 | 38 | 17,000 | 392 |
| **Ad-Dulayl** | QIZ + FZ | 2001 | 28 | 164 | 17 | 13,200 | 192 |
| **Cybercity** | QIZ + FZ | 2000 | 5 | 27 | 4 | 2,672 | 97 |
| **Al-Zay Century** | QIZ | 2000 | 2 | 18 | 2 | 1,353 | 8 |
| **Total** | | | **638** | **1,603** | **98** | **75,241** | **1,671** |

Source: JIEC, MIT, MOL, Industrial Map, Kardoosh, TIIS, websites
* total exports

### OPERATIONAL PRIVATE ESTATES

**Al-Tajamouat Industrial City** is located in Sahab, 20km from Amman and 26 km from Queen Alia International Airport with a total area of 30 hectares. It is the first private park to be established in Jordan, receiving QIZ status in October 1999, and has grown into the largest private industrial estate. The major shareholders include six banks. Thirty eight garment firms employ over 14,000 workers out of the total workforce of 17,000 in the zone. Al-Tajamouat has applied for free zone status.

**Ad-Dulayl Industrial Park** is located 45 km northeast of the capital Amman and 15 km from the city of Zarqa with a total area of 72 hectares. Ad-Dulayl was established in 2001 as a QIZ and was recently given the status of a free zone. Garments also dominate its sectoral distribution of investors, employing 13,200 workers in 17 garment firms. [CHECK GARMENT FIRM AND WORKER NUMBERS IN THESE TWO QIZS]

**Cyber City Park** is located near Irbid, next to Jordan University of Science and Technology, with a total area of 400 hectares. The Park is designed to attract information technology and light industrial tenants. It is both a QIZ and free zone. The Park has attracted few tenants since opening for business in 2000. Four of its five tenants produce garments and employ almost 3,000 workers.

**El Zay Sub-zone** is part of El Zay Ready Wear Manufacturing Company; a Jordanian public shareholding company specialized in the manufacture of high quality men's suits. The company is located in Russaifeh and is the only existing garment factory in Jordan that applied for QIZ status.

#### PARTLY-OPERATIONAL PRIVATE ESTATES

**Al Qastal Industrial Park** is a privately owned industrial park, located 3 km from Queen Alia International Airport, 20 km south of Amman with a total area of 400 hectares. It has only one remaining garment firm operating.

**Gateway Industrial Park**: The 50 hectare Phase I of the Jordan Gateway Project is being developed by a $35 million consortium led by led by the SAFRA banking and investment group, intending to connect Jordanian and Israeli business. The group has received a $10 million loan from the IFC. The Park is located on the River Jordan, 8 km south of Sheik Hussein Bridge about 90 km northwest of the capital Amman and 40 km west of Irbid. Gateway Park is both a QIZ and free zone. Kardoosh reports that the park has one factory, Micron Jordan, for jewelry manufacturing, which started operating in March 2003. There are 40 employees currently working at the park. Gateway's management plan to attract medical equipment, air conditioning systems, and textile manufacturing.

**Hashemite University** in a joint venture with **Hillwood**, a US property development firm, is locating an industrial park located near Zarqa. It is situated 30 km east of Amman with a total area of 150 hectares.

**Al Hallabat Industrial Park** is located 15 km from Zarqa on 440 dunums (44 hectares). The Park was established in 2002, received QIZ status in 2003.

**Al Mawared Industrial Estate** in Muwaquar east of Amman

**Al-Mushatta Qualified Industrial Complex** is located in Quneitra east of Queen Alia International Airport. A consortium of local and foreign investors was established with capital of $42 million in 2002 to develop the zone for manufacturing in Jordan. Jordan Aviation Industry (JAI) representing several aircraft manufacturers has agreed to establish repair and maintenance centers and flight schools in Phase I of the zone – a potential investment of $100 million. Phase One comprising 130 hectares of serviced land has just been completed and has received QIZ status. JOFCO International has announced a $7 million investment in the manufacturing of safety equipment. The Canadian International Development Agency (CIDA) gave Al Mushatta a grant of JD 407,675 to help them with the technical studies and consultancy work done by Canadian firms. The Fortress Company for Investment and Commerce is promoting the zone to foreign investors.

Of the nine private estates open for business over the past five years, only five have attracted many tenants. And only two estates enjoy anywhere near close to full occupancy – Al Tajamouat and Ad-Dulayl. These are the two oldest estates that managed to attract the early Asian garment investors into Jordan's QIZs. The main garment factory at the Al-Qastal estate closed in 2006. The four garment factories operating at CyberCity estate occupy only 3% of its total available area. The innovative Gateway estate built on the border with Israel is still relatively empty after opening in 2002. Table 7. shows that less than 20% of available space at private estates is occupied – almost all in Al-Tajamouat and Al-Dulayl. This is a tremendous loss of potential economic output and employment for Jordan.

The reasons for the low private estate occupation rate are more obscure than for the low rate at the Karak and Ma'an public estates. The private estates are located in attractive locations close to labor and transport hubs. Presumably their owners invested sufficiently in infrastructure and marketing. It appears to be a situation of excess industrial space supply.

Table 7. Operational Private Industrial Estates 2006

| Industrial Estate | Total Area (Dunums) | Net Area Available for Investment (Dunums) | Occupied Area (Dunums) | Free/Unused Area (Dunums) | Area Available for expansion (Dumuns) | Occupied Area % of Net Area Available for Investment |
|---|---|---|---|---|---|---|
| Al-Tajammouat Industrial City* | 450 | 270 | 202 | 68 | 88 | 75% |
| Al-Dulayl Industrial Park* | 800 | 480 | 171 | 309 | 188 | 36% |
| Cyber City Park* | 3,000 | 750 | 23 | 727 | 2,050 | 3% |
| Gateway Park* | 700 | 480 | N/A | 480 | N/A | 0% |
| Al Mushatta Qualified Industrial Complex | 3,600 | 450 | 130 | 320 | 3,040 | 29% |
| Al Halabat | 441 | 339 | 4 | 335 | N/A | 1% |
| Al Mawared for Investment | 325 | 245 | N/A | 245 | N/A | 0% |
| Hashemiya University / Hillwood | 1,500 | 560 | N/A | 560 | 750 | 0% |
| Al Qastal Industrial Park | 4,000 | 400 | 40** | 300 | 3,500 | 10% |
| Total | 14,816 | 3,974 | 930 | 3,044 | 9,616 | 17% |

Source: Table 9, Industrial Map Project (2006), Al-Mushatta website
Note: * Awarded or applied for free zone status, ** assumed land occupied by three garment factories – one remains in operation.

An AMIR Program Industrial Land Demand Study in 2002 forecast a base case scenario of 105 hectares of new developed sites being demanded between 2002 and 2007 in both public and private industrial estates. The worst case demand scenario was 35 hectares and best case demand scenario was 205 hectares. This was a very accurate forecast. The 2006 Industrial Map study shows this was achieved – 108.5 hectares of developed land was occupied between 2002 and 2006. The 2002 study concluded that with the 334 hectares of developed private and public industrial estate space available, the JIEC should not develop any new land but focus on marketing its existing industrial space.

Since then the JIEC has opened the Ma'an Industrial Estate with 49 hectares available for industrial users. The Ma'an and Aqaba Industrial Estates have remained virtually empty. This suggests that estates in remote areas do not attract investor interest. The Sahab estate is full and so new tenants replace former tenants. Table 5. above shows that less than two thirds of JIEC's current public estate capacity is occupied. The Irbid estate has attracted about 20 new tenants since 2001 – about 30% of its total tenants in 2001. Ad Dulayl and Al-Tajamouat have attracted some new tenants, but as the discussion above shows, most private industrial estates remain relatively empty.[17] AIIE is particularly disappointing. After a US$ 17.3 million grant support to develop the estate it remains virtually empty four years after opening. AIIE is less remote than Ma'an and Karak, has immediate access to port and airport facilities, and enjoys ASEZA's efficient regulatory and incentive regime. Until the JIEC fully understands the reasons for lack of demand in its southern industrial estates, and the private industrial estates in the north are attracting more investment – the Government should be very weary about developing new estates or zones.



[17] Ad-Dulayl management stated that the only non-garment manufacturer they have attracted to the estate over the past three years is an Egyptian maker of building insulation.

## 2.3 FREE ZONES CORPORATION (FZC)

The FZC was established in accordance with the provisions of Law No. 32 of 1984 (FZC Law) as a fully publicly-owned entity reporting to the Minister of Finance. Unlike the JIEC, the FZC has no private shareholding and requires Council of Minister approval for regulations governing administrative and operational matters, including fees and the annual budget. The FZC does not sell land but instead leases land. Although there appears to be no legal prohibition on the FZC to sell land, it has based its financial model on leasing and sub-leasing of land and buildings.

The role of the FZC is to establish, develop, manage, and promote free zones in Jordan. A free zone is a designated and fenced area in which goods are stored or manufactured in a customs duty-free environment— as though the area is regarded as being outside the customs territory of Jordan. Goods transiting Jordan may only be stored in a free zone. Free zones are established and cancelled by the FZC, through a Board decision. Like the JIEC, the FZC enjoys the exemptions from customs duties, fees, and taxes, which are granted to all Ministries and Government Departments in Jordan.

The tasks and functions of the FZC include the following:

- Establishing, developing, managing, and cancelling free zones and warehouses in Jordan including joint free zones[18];
- Providing investor facilitation services to free zone tenants (company registration and licensing, vocational licenses, construction permits, and certificates of origin);
- Encouraging private sector service providers to locate in free zones;
- Implementing customs control conditions and provisions[19]; and
- Exercising the power of the Ministry of Environment to enforce the Protection of Environment Law No. 19 of 2004 within the free zones in Jordan.

The FZC has established six public free zones. Zarqa Free Zone dominates all free zone activity in the country. It was established in 1982 and comprises some 245 enterprises occupying 400 hectares mainly engaged in commercial transit-trade activities. The public free zone at Karama on the Iraqi border started operating at the beginning of 2005 and is already the second most active public free zone – the completion of phase two will bring 120 hectares into operation.

Starting in 1990, the private sector has been able to develop free zones under the supervision of the FZC. There are currently 26 operational private free zones, over half of which are individual factory free zones – these are existing factories that have adopted free zone status to simplify customs arrangements and, if not an exporter, avoid paying income. Eleven further private free zones have been designated by the FZC and are under construction.

#### LIST OF PUBLIC FREE ZONES:

**Zarqa Free Zone:** Located in Zarqa Governorate, 35 km northeast of Amman, the zone was established in 1982 and comprises a total area of 520 hectares of which 400 hectares is developed. The zone houses more than 70 licensed industrial companies in manufacturing, repacking, and mixing, in addition to 175 warehouses. The zone is currently 95% full. The FZC plans to add 170 hectares.

[18] A Joint Free Zone is established jointly between Jordan and other countries, or between public and private sector actors

[19] Customs control at free zone gates is executed by the Customs Department. The FZC maintains control of commodities within its free zones and coordinates activities with the Customs Department

**Sahab Free Zone**: Located in Sahab City/ King Abdullah II Industrial Estate, east of Amman, this zone was established in 1997, and covers 6.6 hectares at the Sahab Industrial Estate. It is 100% occupied.

**Queen Alia International Airport Free Zone**: Located near Queen Alia International Airport, east of Amman, this zone was established in 1998 on 3.5 hectares of land. This zone is allocated for the purpose of serving transit trade and establishing high-tech, pollution free industries. The ZF is 100% occupied.

**Al-Karak Free Zone**: Located at the Al - Hussein Bin Abdullah II Industrial Estate, this zone was established in 2001 on an area of 15 hectares. This zone benefits from QIZ status, therefore manufacturing companies benefit from duty-free treatment for goods exported to the US. Land is available. The FZC started renting property in 2006.

**Al-Karameh Free Zone**: Established in 2004 on a total developable area of 1,500 hectares of land, this zone is located adjacent to the new Jordan-Iraq border center at Al-Karameh. The zone is intended to host industrial, commercial, and service industries catering to the Jordanian and Iraqi markets. The FZC has a 200 hectare allocation, and is currently developing the 70-hectare phase one of Al Karamah free zone after the completion of the 50-hectare phase two. Phase one opened at the beginning of 2005. Land is available. Three private firms are developing up to 1,100 hectares of land in the Al-Karameh area.

**Al- Muaqar Free Zone** is a branch of Sahab free zone: Located near Sahab City, east of Amman, this zone was established in 2004 on 12.2hectares of land, and will accommodate industrial, commercial, and services projects.

A new trend is emerging in private free zone development. In addition to the traditional single industrial complexes being designated as factory free zones, five of the current ten new private free zones being developed are multi-purpose zones similar to the Zarqa free zone or the Sahab Industrial Estate. Three of the multi-purpose zones are adjacent to the public free zone at Al-Karama on the Iraqi border. The Treasury Saving and Investment Company is developing a 500 hectare site; the Economic Global Investment Company is developing a 400 hectare site; and the Tabouk Holding Group is developing a 200 hectare site. Two new private free zones are being developed at South Shuna - the International Group for Development is developing a 145 hectare site and the Jordan International Industries Company is developing 44 hectares at South Shuna.

In addition, The International Committee of the Red Cross is developing a free zone to store equipment and materials at Al-Qastal. Hikma Company is developing a plant also at Al-Qastal on 20 hectares, Middle East Regional Development Company is developing a silica sand plant at Al-Hamina, and a JD 16 million chlorine and caustic soda plant is being developed as a free zone at Al-Halabat.

These developments raise three immediate findings:

4) Multi-purpose free zones, and not industrial estates, have become the preferred format for new multi-purpose commercial zone developments, likely for the assured long-term tax and duty-free status they bestow on tenants, and the easier customs arrangements;
5) There appears to be a willingness now at the FZC and within the rest of government to permit large-scale manufacturing at free zones. The FZC is lobbying government to permit goods made within free zones duty-free entry into the rest of Jordan if such goods meet the 40% local content. Furthermore, the Government is seeking for the GAFTA to permit exports manufactured in free zones, and meeting the 40% local content rule, to receive preferential duty-treatment in importing countries. This is blurring the distinction between industrial estates and free zones, and risks dislocating

manufacturing currently taking place outside of free zones. See Chapter 5 of this report for further discussion of the estate and zone policy environment.

6) The need for a public free zone developer is called into question when three private developers are ready to develop free zones at the border with Iraq. The government can still benefit from private free zone development through an appropriate tax regime.

Table 8. List of Operational Private Free Zones

| Free Zone | Partners | Activity | Workers | Actual Capital (JD million) | Location | Land Area donum | Service Fee |
|---|---|---|---|---|---|---|---|
| Jordan-Indo Chemicals Co. | Joint Venture between Indian Jordanian and Saudi Arabia | Phosphoric Acid | 401 | 119 | Ma'an | 900 | Only fixed fees |
| Jordan Bromine Company | Joint venture between Jordan Dead Sea Production Co and American Albermarle Holding | Production of Bromine and its derivatives | 212 | 105 | Karak | 150 | Salaries of civil servants working in the free zone |
| Jordan Magnesia Company | Joint Company with Arab Potash Company | Oxide of Magnesium % Derivatives | 175 | 72 | Karak | 148 | Salaries of civil servants working in the free zone |
| Hejazi & Gousheh Sheep Co | A company specialized in the field of livestock and sheep | Livestock | 171 | 22 | Qweirah-Aqaba | 222 | Fixed Fees |
| Trans-Jordan Livestock Company | A company specialized in the field of livestock and sheep | Livestock | 11 | 2.6 | Qweirah-Aqaba | 159 | Fixed Fees |
| King Abdullah Design & Dev Center | Muti-purpose activity/Civil and military projects | | 200 | 1.39 | Zarqa | 5,000 | NA |
| International Diamonds Investment Co. | | Manufacturing, Fruit/ vege grading/storage | 100 | 10 | Al-Shouna | 83 | Annual fee of JD 5,000 per factory |
| Jordan Media City Company | Owned by Dallah information Production Company | TV / cinema production and-leasing | 40 | 20 | Amman | 34 | Salaries of public servants working in the zone |
| Jordan-Japan Fertilizer Company | 1999 Joint-venture between Jordan Phosphate Mines, Arab Potash& Japan Co.s | Chemical fertilizer production | 103 | 17 | Aqaba | 52 | |
| Slovochem Holland B.V. | Dutch FDI in 1990 | Storing, trading chemicals and Oil products | 30 | 7 | Aqaba | 27 | |
| Masbookat Al-Shar'a Production Co | 2003 | Art production company | | 3 | Al-Qweirah Aqaba | | |
| Jordan Duty Free Shops | | Operates land border shops | | 14 | | | |
| Kamira Arab Potash Co. | 2000 Joint Venture between Arab Potash & Finnish Co. | | 120 | 150 | Aqaba | 500 | |
| Red Cross | Commenced operating in 2005 | Storage | 10 | | Amman | 2,000 | 10,0000 |
| Al-Baha Soda & Chorine Production Co. | Commenced operating in 2006 | Chlorine and Caustic Soda production | | 16 | Al-Halabat | 67 | |
| Hikma Pharmaceuticals | Commenced operating in 2006 | | | | Al-Qastal | 200 | |
| Jordan International Investment Co. | Commenced operating in 2006 | Garment manufacturing | | | | | |
| TOTAL | | | >1,573 | >560 | | >9,542 | |

Source: Various FZC Annual Reports

Notes: Excludes Cyber City, Ad-Dulayl and Gateway industrial estates that have both free zone and QIZ status.

Table 9. Private Free Zones at Airport

| Free Zone | No of Employees | Paid in Capital (JD million) | Location | Land Area (donum) | Annual Service Fee |
|---|---|---|---|---|---|
| **Jordan Aeronautical System Company** | 54 | 5 | Marka Airport | 10 | JD 10,000 |
| **Jordan Flight Training and Simulation Company** | 61 | 29 | Alia Airport | Warehouse | JD 75,000 |
| **Jordan Maintenance of Aircraft Company** | 430 | 8.5 | Alia Airport | Warehouse | JD 125,000 |
| **Seabird Aviation** | 25 | 0.1 | Alia Airport | 2 | 3% of the company annual sales (reduced from 8%) |
| **Jordan Manufacturing & Developing of Aircraft Company** | 40 | 30 | Alia Airport | 6 | 3% of the company annual sales (reduced from 8%) |
| **Jordanian Company for maintenance of aircraft engines** | 430 | 10 | Alia Airport | Warehouse | JD 125,000 |
| **Duty Free Shops for the Jordanian Airports Company** | 165 | 66 | Sea and Land ports | NA | 8% of annual sales |
| **Jordan Flight Catering Company Ltd** | 214 | 15 | Alia Airport | NA | 8% of the company's total sales |
| **Jordan International Air Cargo Co.** | NA | 5.7 | Marka Airport | 20 | JD 200,000 |
| **TOTAL** | 1,419 | 169.3 | | 38 | |

# CHAPTER III – JORDANIAN ESTATE AND ZONE PERFORMANCE

## 3.1 ARE PRIVATE ZONES BETTER PERFORMERS?

In South-East Asia, the majority of zone activity takes place in private zones. Private zones account for over 70 percent of total exports in the Philippines and the majority of FDI and exports in Thailand and Viet Nam. This rises to over 90 percent of exports and employment in El Salvador and Honduras. Are privately owned and operated zones better economic performers than public ones? The limited data available suggests that—from the perspective of a host country—private zones are both less expensive to develop and operate and yield better economic results. Private zones usually require less public funding to establish and operate for a number of reasons including:

1. Private developers finance onsite infrastructure and facilities; governments are required only to provide offsite infrastructure and facilities which are usually a maximum of 25 percent of onsite costs.
2. Many countries require private developers to provide offices and other facilities for government authorities to be based onsite, e.g. Dominican Republic and the Philippines.
3. Most private free zones in Latin America and the Philippines, for example, pay overtime and other special benefits for customs officers and other officials to remain onsite 24-hours per day.
4. Governments also delegate a number of regulatory functions such as inventory counts on behalf of Customs authorities, for example in Kuwait, Costa Rica, Uruguay, Colombia.

Government has an important role to regulate private zones, including ensuring they are located sufficiently close to existing public infrastructure and facilities, thereby reducing government outlays. Early private zones in Mexico and Central America were largely uncontrolled developments, without guidance of specific zoning controls and land use plans. As a result, rapid growth of private zones strained public infrastructure, facilities and services, and leading to demands to ban new private zones in the Dominican Republic.

The natural profit motive of private zones encourages them to be more responsive to client needs and provide better facilities and amenities, command higher prices from locators and thus attract locators with higher value-added activities who are more likely to be committed to long-term performance. For example, standard factory building lease rates in the private industrial free zones in the Dominican Republic are up to three times higher than in government-run ones. Due to physical, funding, and operational constraints most public sector zones have crowded, poorly designed and inadequately maintained facilities.

## 3.2 PERFORMANCE OF PUBLIC SECTOR IN JORDAN

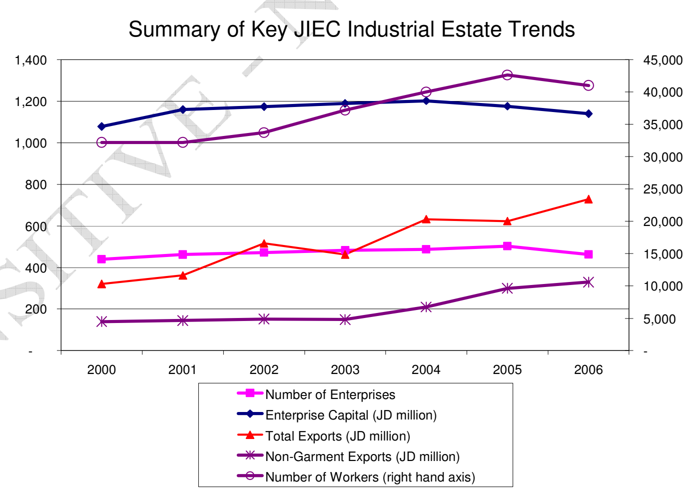
Public estates and free zones in Jordan are well funded and well managed. Competition with private estates has encouraged quality service and competitive market rates for land. Whether or not the JIEC and FZC rely on their public status to subsidize land prices requires further research. Until now the FZC has had no private sector competition facilitating transit trade. With its ability to raise regulatory revenue from private free zones, the FZC is in a position to charge non-market rents on its land.

### 3.2.1 PUBLIC INDUSTRIAL ESTATES

The JIEC and its public industrial estates dominate manufacturing in Jordan. The JIEC produces more statistics than private estate operators, therefore the following discussion focuses more on JIEC performance.

Figure 1. below depicts changes in key non-financial JIEC indicators. Even though the number of enterprises and total capital invested by these enterprises has remained relatively constant over the past seven years, exports and employment have steadily increased. Employment, investment and the number of enterprises declined last year at the Abdullah II estate – likely due to overcrowding and the increase in land prices at the estate in the beginning of 2006. However, non-garment exports continued to increase from the estate. Garment exports from Al-Hassan and Al-Hussein estates picked up again in 2006 after declining in 2005, likely due to buyer uncertainty over the end of quotas and export surges from India and China in early 2005.

Figure 1.




Source: *Jordan Industrial Estates Corporation – Historic Trends*, Jordan Fiscal Reform Project, March 2007, unpublished note

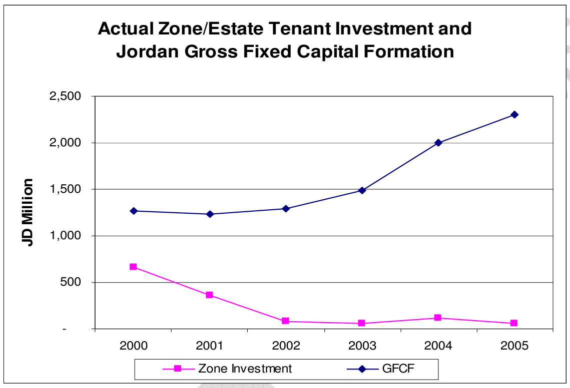
Looking more closely at investment trends at JIEC estates, Table 10. shows the decline in enterprise investment capital in the last two years. Fifty enterprises, fifty million dinar and 2,170 manufacturing workers left the Abdullah II estate in 2006. They did not move to Al-Hassan estate in Irbid. According to the 2006 FZC Annual Report, employment at both public and private free zones increased by only 700 in 2006. Given the general shortage of garment workers, the workers could have been absorbed at garment factories in the operating private industrial estates. However, the enterprises departing Abdullah II estate were not garment firms.

Table 10. Capital Investment in Public Industrial Estates (2000-2006)

| | Total Actual Investment in Public industrial estates (JOD) | | | | | | |
|---|---|---|---|---|---|---|---|
| **Industrial Estate** | **2000** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** |
| Abdallah II Ibn Al-Hussein Industrial Estate | 895,600,000 | 919,200,000 | 916,400,000 | 932,100,000 | 927,570,000 | 893,300,000 | 846,847,223 |
| Al-Hassan Industrial Estate | 168,010,000 | 200,600,000 | 209,790,000 | 218,370,000 | 228,370,000 | 237,810,000 | 241,180,000 |
| Al-Hussein Bin Abdallah II Industrial Estate | 15,000,000 | 40,000,000 | 40,000,000 | 40,000,000 | 43,000,000 | 40,630,000 | 40,730,000 |
| TOTAL | 1,078,610,000 | 1,159,800,000 | 1,166,190,000 | 1,190,470,000 | 1,198,940,000 | 1,171,740,000 | 1,128,757,223 |
| Annual Change | | 81,190,000 | 6,390,000 | 24,280,000 | 8,470,000 | -27,200,000 | -42,982,777 |

Source: JIEC and Trade and Investment Information System

Figure 2.




Source: Department of Statistics, Table 6, 8, 9 and 10 above.

Figure 2. tracks estimated industrial and commercial investment by locators in new estates and zones against gross fixed capital formation for the entire economy. While GFCF almost doubled between 2002 and 2005 to JD 2.35 billion, investment by locators in zones and estates has remained relatively flat over this period. Although, the biggest driver of GFCF growth was the category "finance, insurance, *real estate* and business services" – growing from JD 251 million in 2000 to JD 892 million in 2004 (latest year available from the CBJ), national GFCF in manufacturing grew from JD 129 million to JD 164 million over this period. This may suggest that growth in manufacturing investment has taken place outside of zones and estates – although given the very rough estimates of the zone and estate investment figures further research is required to confirm this hypothesis.

### 3.2.2 PUBLIC FREE ZONES

Table 11. shows key indicators of public and private free zone activity over the past ten years. Although employment and investment levels are more modest than found in industrial estates, they have been steadily increasing. Apart from the small public free zones developed to serve the Abdullah II and Al-Hassan industrial estates, land-use was dominated by the Zarqa Free Zone until the development of the Karameh Free Zone on the Iraqi border. Manufacturing employment increased three times after 1999 as the number of new enterprises located in Zarqa increased from 64 manufacturing lessees in 2000 to 149 lessees in 2006.

Private free zone activity has steadily increased at a faster rate than public free zone activity over the past ten years. Capital investment increased from about JD 150 million to over JD 1 billion last year and employment increased from 500 in to 8,000. As discussed above new private free zones are becoming an accepted business form for manufacturing.

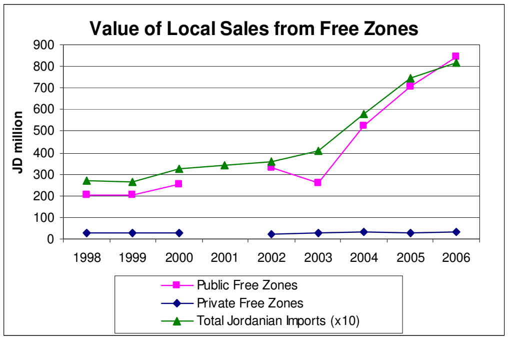
Table 11. Selected Public and Private Free Zone Activity 1997-2006 (Cumulative)

| | 1990-1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Free Zones – Private** | | | | | | | | | | |
| Operational Area - Hectare | 169 | 131 | 136 | 216 | 231 | 240 | 240 | 240 | 240 | 273 |
| Number Operational Zones | 6 | 6 | 7 | 15 | 20 | 23 | 23 | 24 | 24 | 26 |
| Capital Investment (JD million) | 156 | 151 | 168 | 703 | 938 | 972 | na | 976 | 976 | >1,000 |
| Employment | na | 511 | 976 | 1,000 | na | na | na | 4,213 | 7,688 | 7,988 |
| **Free Zones - Public** | | | | | | | | | | |
| Operational Area - Hectare | 406 | 410 | 410 | 410 | 425 | 425 | 425 | 437 | 487 | 557 |
| Number Operational Zones | 2 | 3 | 3 | 3 | 4 | 4 | 4 | 6 | 6 | 6 |
| Capital Investment (JD million) | na | na | na | na | na | 495 | 526 | 581 | na | na |
| Zarqa Commercial | na | na | na | na | na | 378 | 406 | 435 | na | na |
| Zarqa Manufacturing | na | na | na | na | na | 85 | 88 | 107 | na | na |
| Number Leasing Contracts | na | 1,076 | 1,066 | 1,109 | 1,215 | 1,322 | 1,412 | 1,630 | 1,920 | 1,959 |
| Zarqa Commercial | na | na | na | 882 | na | 969 | 1,004 | 1,106 | 1,221 | 1,270 |
| Zarqa Manufacturing | na | na | na | 64 | na | 85 | 88 | 119 | 137 | 149 |
| Total Employment | na | na | 3,964 | 5,553 | na | na | na | 10,200 | 11,662 | 12,118 |
| Zarqa Commercial | na | na | 1,272 | 2,355 | na | na | na | na | 4,919 | 5,009 |
| Zarqa Manufacturing | na | na | 1,153 | 1,640 | na | na | na | na | 3,387 | 3,594 |

**Notes:** Private Free Zones exclude the Ad-Dulayl, Cyber-City and Gateway industrial estates, which have free zone status. Actual capital represents total 2005 capital investment by each project recorded at year of start-up.

Public free zones temporarily store goods for eventual sale into the domestic market or to be re-exported as transit trade to neighboring countries – in particular Iraq. Local sales have increased significantly in the last three years, rising with total Jordanian imports – see Figure 3., below. However, the share of total imports being stored in public free zones before entering Jordanian customs territory appears to be increasing from 7.5% in 1998 to 10.5% in 2006. This suggests that traders increasingly perceive free zones to be an efficient place to keep inventory – simpler customs procedures and an ability to delay payment of sales tax and remaining customs duties until time of consumption in Jordan.

The increase in sales to the domestic territory does not appear to include an increase in goods manufactured within free zones and sold into the domestic territory. The value of such manufactured products has varied between JD 3 million and JD 9 million since 1999, according to DOS imports from a free zone as country of origin.



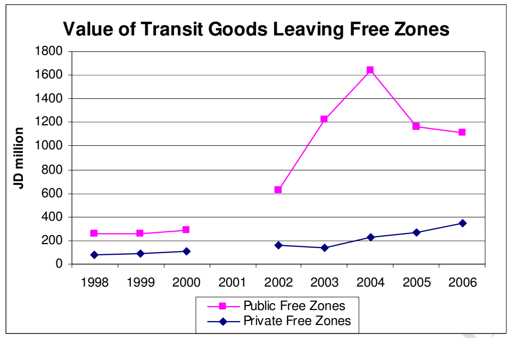




Figure 3 and 4. Source: Various FZC Annual Reports, Department of Statistics

Table 11. shows the number of public free zone tenants has almost doubled since 2000 – particularly since the 2003 overthrow of Saddam Hussein in Iraq. Commercial tenants temporarily import goods into free zones and export them to neighboring countries. Today transit trade involving public free zones is about five times its level in 2000 – see Figure 4. Transit trade peaked in 2004 before Iraq imposed age limits on vehicle imports in 2005. The number of private free zones starting operation recently has led to a significant increase in transit trade involving such zones. Today private zones manage more international exports and transit trade than the FZC managed before 2001. These results indicate a growing demand for transit trade facilitated by free zones.

## 3.3 REVENUE AND EXPENDITURE

### 3.3.1 JIEC

Opening new estates without accompanying growth in the number of new enterprises, has limited JIEC's profitability over the past six years. Operating revenue declined while total expenses increased between 2000 and 2003. Operating revenue is now increasing helped by internal reorganization in 2003 and an increase in land prices at the beginning of 2005. However, total expenses continue to increase with new zone development. In 2005 operating profit net of total expenses was 33 percent less than in 2001. The JIEC has managed to supplement its operational revenue by JD 2 million each year as an annual tranche of a $17.3 million USAID grant to develop the Aqaba QIZ.

Table 12. JIEC Income 2000-2005 (JD million)

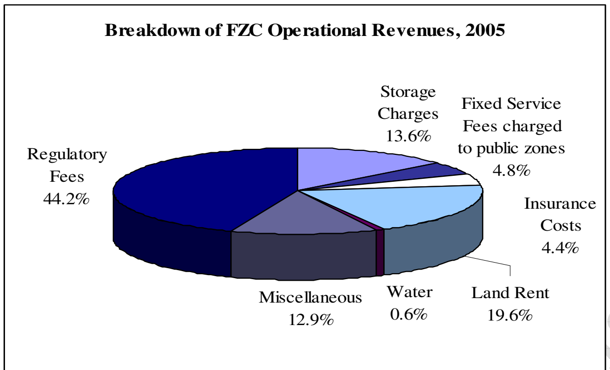
| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | % Change |
|---|---|---|---|---|---|---|---|
| Grant Income | | | 2.022 | 2.022 | 2.022 | 2.022 | |
| Operational Revenue | 4.094 | 4.525 | 3.634 | 3.643 | 4.327 | 4.985 | 22% |
| General & Administration | 1.300 | 1.013 | | | 1.904 | 2.133 | 64% |
| Total Expenses | 2.091 | 1.758 | 2.178 | 2.861 | 2.799 | 3.143 | 50% |
| Operational Income | 2.794 | 3.511 | | | 2.423 | 2.852 | 2% |
| Net Operational Income | 2.002 | 2.766 | 1.456 | 0.782 | 1.528 | 1.842 | -8% |

Source: Various JIEC Annual Reports

### 3.3.2 FZC

The FZC has been very profitable – net profit has doubled over the past five years to JD 15 million in 2005, representing 81% of total operating revenue. The FZC does not sell land and acts as a custodian of government land. It has developed a lucrative business model from the leasing and sub-leasing of land and warehouses. However, a large share of operating revenue is generated from regulatory-like fees imposed by the FZC on private free zone tenants – these regulatory fees represented 44 percent of total revenue in 2005. These fees are not related to the delivery on any service – they are essentially a regulatory tax on the value of goods shipped through the private zones or as a percentage of total turnover. These regulatory fees have been increasing at an average rate of 25% in the past five years reaching JD 8.1 millions in 2005.

Figure 5.




This revenue, generated from regulatory functions, may be subsidizing FZC operational income putting the private sector operators at a disadvantage, i.e. negatively affecting their ability to compete fairly in operating free zones. Adjusting revenue and net profit by removing regulatory fee income from FZC operating revenue reduces 2005 net profit from JD 15.0 million to JD 6.9 million (see Table 13). This still represents a very high 67% of adjusted revenue. Over the past six years operational revenue has increased 77% while general and administration expenses have increased only 25%, resulting in a 121% increase in operating income.

Table 13. FZC Income and Expenditure

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | % Change |
|---|---|---|---|---|---|---|---|
| Regulatory Revenue | 1.852 | 3.511 | 3.913 | 6.278 | 7.789 | 8.096 | 337% |
| Operating Revenue | 5.800 | 5.913 | 4.697 | 6.011 | 8.581 | 10.239 | 77% |
| General & Administration | 2.693 | 2.389 | 2.292 | 2.666 | 3.494 | 3.369 | 25% |
| **Operating Income** | **3.107** | **3.524** | **2.405** | **3.345** | **5.087** | **6.870** | **121%** |

Source: 2000 and 2003 Annual Reports, AMIR (2006)

The FZC could continue collecting 'regulatory fees', but these fees should be separately accounted for on behalf of the GOJ. There should be no risk of regulatory income subsidizing operational income. The level of regulatory fees should be set to cover the cost of all public services otherwise unfunded, and some return for the privilege of operating in a duty and tax free environment. Many zone authorities around the world charge a standard annual fee and a variable fee proportional to the workload of public services provided to the zone.

Furthermore, both the JIEC and FZC need to apply the most appropriate pricing plan that maximizes return on equity subject to competitive conditions. This necessitates accurately costing each element of their investment package, separately charging for each service provided to investors, and covering the total cost of land.

## 3.4 COMPARISON OF PUBLIC AND PRIVATE RETURNS

A crude way to compare the performance of private and public operation of zones in Jordan is to compare their return on equity and return on land ownership. Whether the operator owns the land or is a trustee of public land is irrelevant. The operator should be maximizing their economic return from the asset under their control. Each estate and zone developer accounts for their land holdings at original cost. The JIEC published the value of their developed land in 2005 as JD 21.251 million, and undeveloped land as JD 6.108 million. With 1,081 hectares of developed land, this is a value of JD 1.966 per square meter, and undeveloped land at JD 0.519 per square meter. In contrast, according to their 2005 annual report, Ad-Dulayl values their land and buildings at JD 19.349 million representing JD 24.187 per square meter. This is likely well below current land values. The JIEC and FZC are undertaking a joint financial valuation exercise which will provide a current market valuation of assets and operations. For the purposes of this report, in order to compare performance of both public and private developers, land values have been standardized using listed land prices where available at the locations of each zone.

Table 14. below, values all the land held by the FZC and JIEC in addition to land at individual estates and zones, i.e. Al Tajamouat and Ad-Dulayl private industrial estates. Available results for JIEC's Abdullah II Estate at Sahab and the FZC's Zarqa free zone are also compared. FZC income excludes regulatory revenue. Since the JIEC and FZC do not pay income tax, all income stated is before provision for income tax. Financial results for Al-Tajamouat are from 2003 because more recent results include earnings from non-estate management activities.

Returns for the publicly owned estates and zones are low – net profit represents about two percent of land value for both Zarqa and Sahab and for the entire land holdings of the FZC. Net-profit as a share of total land owned by the JIEC is a very low 0.7 percent. Al-Tajamouat is the most profitable with net profit representing 16.5% of total land value. Only half of the large area of land owned by the JIEC comprises functioning industrial estates. Therefore, ignoring non-operational estates in the performance comparisons doubles the returns earned by the JIEC to 1.2%.

Calculations of net profit mask significant non-operational income and expenditure. For example, the JIEC currently earns JD 2.022 million as an annual payment under a $17.3 million grant from USAID for the development of the Aqaba International Industrial Estate. Also the different levels of debt financing of each entity mean provision for interest varies considerably. Accounting only for operational income, i.e. income from renting and selling developed land, buildings and associated services, leaves the results for the FZC relatively unchanged. However, removing non-estate income sources halves the operational return to land earned by the JIEC, Ad-Dulayl and Al-Tajamouat compared to returns from pre-tax profit.

A further refinement is to compare performance using only the land that is occupied by tenants or investors rather than total land, and therefore matching assets used against revenue derived from those assets. The FZC and JIEC increase their operational returns to 4.7 percent and 1.9 percent respectively. Al-Tajamouat, which is 75% occupied, reach a 17 percent return. Ad-Dulayl improves its operational return significantly to more than nine percent because it is only 36% occupied.

Return on equity is more similar across each entity – ranging from 8% for the JIEC to 12% for Al-Tajamouat. However, the FZC and JIEC do not include the value of their land in their fixed assets. Therefore, without knowing the exact composition of equity for each entity the stated returns on equity provide little indication of comparative performance.

In summary, the two public developer/operators earn the lowest estimated returns from their land holdings, less than half the return earned by competing private sector estates. In addition, the JIEC owns a large area of non-operational land which results in a very low total return on land value. Although much of this non-operational land has a low opportunity cost and is being held in reserve for the development of future estates, it is likely crowding out more efficient private sector investment either in estate development or individual activities.

Table 14. Comparison of Returns to Land and Equity

| | Total Land Area (hectare) | Assumed Average Land Value (JD/sq.m) | Land Value (JD million) | Average 2004-5 Pre-Tax Profit (JD million) | Average 2004-5 Pre-tax Return on Land | Average 2004-5 Operational Income | Average 2004-5 Operational Return on Land | Average 2004-5 Owner's Equity (JD million) | Average 2004-5 Pre-tax Return on Equity |
|---|---|---|---|---|---|---|---|---|---|
| **Total FZC** | 927 | 35 | 324 | 6.061 | 1.9% | 5.979 | 1.8% | 58.794 | 10.3% |
| Total Zarqa | 520 | 40 | 208 | 3.818 | 1.8% | | | | |
| Occupied Space | 363 | 35 | 127 | 6.061 | 4.8% | 5.979 | 4.7% | | |
| **Total JIEC** | 2,258 | 25 | 565 | 3.788 | 0.7% | 1.866 | 0.3% | 48.924 | 7.7% |
| Total Abdullah II | 253 | 50 | 127 | 2.616 | 2.1% | | | | |
| Operational Land | 1,081 | 30 | 324 | 3.788 | 1.2% | 1.866 | 0.6% | 48.924 | 7.7% |
| Occupied Space | 266 | 37 | 98 | 3.788 | 3.8% | 1.866 | 1.9% | | |
| **Al Tajamouat** (2003) | 45 | 50 | 23 | 3.713 | 16.5% | 1.702 | 7.6% | 12.541 | 29.6% |
| Occupied Space | 20 | 50 | 10 | 3.713 | 37.1% | 1.702 | 17.0% | | |
| **Ad-Dulayl** | 80 | 30 | 24 | 1.052 | 4.4% | 0.473 | 2.0% | 13.324 | 7.9% |
| Occupied Space | 17 | 30 | 5 | 1.052 | 20.6% | 0.473 | 9.3% | | |

Source: Relevant annual reports. Notes: The Zarqa Free Zone pre-tax profit is an estimate based on the zone's share of total FZC revenue and average 2004-5 net income excluding regulatory income. Pre-tax profit of the JIEC Sahab estate is based on total JIEC net income and the Sahab estate's share of total JIEC active land area. FZC pre-tax profit excludes regulatory revenue. Shareholder equity for the FZC is for 2004 only. Price of land at Ad-Dulayl is listed as $42 per square meter on their website. JIEC land valued at listed prices for operating zones; the more remote non-operating JIEC zones assumed to be JD 20 per square meter. Al-Tajamouat land price assumed equal to JIEC Sahab estate land price. Zarqa free zone land price assumed average of Ad-Dulayl and Sahab land prices; remaining FZC land valued at 30 JD per sq. meter. Total and occupied land from tables 8, 9 and 11 of Industrial Map (2006), FZC occupied land includes 50 hectares at Karameh free zone

Table 15. Industrial Export Exports Produced Per Hectare

| | Active Area (hectares) | Exports 2006 US$ million | Exports per hectare US$ million |
|---|---|---|---|
| Abdullah II Ibn Al-Hussein / Sahab | 187.4 | 438 | 2.34 |
| Al-Hassan Bin Abdullah / Irbid | 53.7 | 417 | 7.77 |
| Al-Hussein II Bin Abdullah / Karak | 23.7 | 115 | 4.85 |
| Al-Tajammouat Industrial City | 20.2 | 392 | 19.41 |
| Al-Dulayl Industrial Park | 17.1 | 192 | 11.23 |
| Cyber City Park | 2.3 | 97 | 42.17 |

Another simplistic way to compare performance using available data is to look at the value of exports per unit of land occupied. Data is available to compare garment exports from each operating QIZ and also total exports from the Abdullah industrial estate in Sahab. Again the three privately owned and operated industrial estates appear to manage land more productively. They earn on average $24.2 million per hectare in garment export revenue compared to the average $6.3 million per hectare earned by the Al-Hassan and Al-Hussein estates on their garment exports. The Abdullah II estate in Sahab is not a QIZ and does not export garments. However, Abdullah II estate is the largest concentration of non-garment export manufacturers in the country. Its relatively low earnings of $2.3 million per hectare indicates the valuable contribution of garment exports to land use in Jordan.

## 3.5 PRIVATIZATION

With an effective and independent agency to regulate the use of public land, and the activities of free zones and industrial estates in Jordan, the Government could privatize the JIEC and FZC. The discussion above demonstrates the relative efficiency of the private sector in developing and managing zones and estates. Public ownership of JIEC and FZC perpetuates the risk persist for hidden costs and subsidies to disguise the real rate of return and distort investment decisions. Furthermore, the JIEC is hampered by a statutory role to develop zones in remote parts of Jordan thus reducing its financial rate of return. Instead, the Government could provide a transparent subsidy to the private sector to develop a zone or estate in remote regions. Meanwhile the FZC has a monopoly power to raise regulatory revenue from the movement of goods and property leases within private free zones.

Through an efficient income tax regime on private developers and operators, the government could earn a greater return on public land, while minimizing its own commercial risk. With current high land values privatization proceeds could repay a significant share of public debt. However, before any sale takes place, an effective regulatory agency needs to be fully functioning and a strategy in place for national industrial land-use.

## 3.6 IMPACT OF ASEZA

The Aqaba SEZ has become a tourism and transport hub focused on Jordan's coastline. FDI is concentrated in hotel and property development, and the public-private partnerships in infrastructure investment being facilitated by the Aqaba Development Corporation.

USAID has funded a number of initiatives to support the Aqaba region and the Aqaba Special Economic Zone (ASEZ) in particular. USAID reported in April 2004 total support of US $86.85 million – of which approximately half supported water management and treatment and half supported ASEZA, the Aqaba Industrial Estate and the Aqaba Development Corporation.[20] One of the USAID-funded projects supporting ASEZA, the Aqaba Zone Economic Mobilization (AZEM) project, prepared a series of social and economic studies on the Zone. In July 2006, AZEM published a paper estimating past and projected rates of economic growth for the Zone.[21] The paper estimates that gross regional product (GRP) of the Aqaba Governorate grew by 13 percent per year in the period 2000-2005. This growth is almost three percentage points above the estimated underlying trend prior to the creation of the Zone. This growth generated JD 180 million in additional output by 2005 throughout the entire country – equivalent to a cumulative 2.3 percent of 2005 national GDP, and 0.82 percent of national GDP in 2005 alone. This additional output was distributed as approximately JD 100 million to Aqaba and JD 80 million to the rest of Jordan. Measured in

[20] USAID, *United States Support for the City of Aqaba,* April 2004 http://jordan.usaid.gov/upload/keydocs/Aqaba%20Assistance.pdf

[21] Nicolas O. Rockler for Nathans Associates*, Impact of Aqaba Special Economic Zone Growth on the Jordanian Economic, Volume IV*, ASEZ Project

employment terms, the economy as a whole gained a total of 10,000 jobs which were about evenly split between Aqaba and the rest of the country.

Two sectors stand out as contributing to this growth. The largest contributor is manufacturing – 18 percent of the total additional output was produced in Aqaba and 21 percent in the rest of Jordan. The second largest contributing sector was transport and communication – 16 percent of total additional output was produced in Aqaba and 4 percent in the rest of Jordan. The additional manufacturing output is concentrated in the southern industrial area behind the port – heavy industry relating to processing of phosphate and other minerals. Surprisingly, construction, hotels and restaurants only contributed 8.7 percent of total additional output – almost all produced in Aqaba. The lower measured additional contribution from these latter sectors is mainly due to their already high rates of value-added growth before the SEZ opened in early 2001. In particular, construction activity increased significantly in 1999 and 2000 from a relatively low base, possibly in anticipation of SEZ status being approved.

The available data on past trends and prospective major projects suggest that the regional economy could grow at an average real rate of 15.2 percent per year over the five years from 2005 to 2010, and by 13.6 percent per year over the ten-year horizon from 2005 to 2015 (compared to the national average real rate of 6.5% over the period 2001 to 2005).

Tourism and temporary construction are expected to contribute significantly to the total estimated employment increase of between 36,000 to 57,000 new jobs by 2010, and more than double this range by 2015.[22] This will put tremendous pressure on the Aqaba labor market. AZEM reports the Jordanian labor force at only 22,768 with a relatively low unemployment rate of 11.9 percent, in a survey from 2003.[23] Only 29 percent of the labor force has any training beyond secondary school.[24] The labor force was complemented by about 9,000 foreign workers – mainly Egyptians. As in the rest of the economy the almost infinite supply of unskilled foreign labor, means that unskilled Jordanian wages will always be depressed – protected only by the minimum wage. Unless Jordanians improve their levels of education, only skilled workers will benefit from growth in Aqaba, income inequality will rise and a dual labor market will persist.

> *"In order for Aqaba to become the growth center envisioned by national plans, the Aqaba labor market must be both dynamic and flexible. Such a market would provide substantial benefits both by encouraging investment and by generating higher incomes. Alternatively, a segmented and rigid labor market would inhibit such beneficial developments. Analysis of the labor market in Aqaba indicates that it is segmented and rigid in many ways. Indeed, one cannot expect the market in its present condition to be either an enabler of development or a mechanism for income enhancement across the board. Neither the market nor the various labor market institutions are working well."*[25]

Hoped for manufacturing investment in the Aqaba QIZ has not taken place despite private sector management of the estate. After being formally open since 2003, the only significant investment is a proposed $100 million ceramics factory. This lack of new light manufacturing investment in the estate is all the more surprising given the increase in heavy industry, and

[22] Bruce Bolnick for Nathans Associates, *Aqaba Special Economic Zone Regional Economic Development Plan, Macroeconomic Projections for the ASEZ, 2005-16, Technical Notes, Volume II*, July 2006
[23] infra Table 4, page 15.
[24] Robert Fearn, Nathans Associates Inc., *The Labor Market in Aqaba, Jordan*, USAID-funded AZEM, May 2005, Table 5, page 16.
[25] infra page i.

given the availability of the most preferential income tax regime in Jordan – a flat rate of 5% and no value-added tax. A number of factors can explain the lack of manufacturing investment, including the shortage of skilled labor and tighter environmental controls. However, there may also be institutional factors that have contributed to the poor performance of the industrial estate, in particular the sharing of promotional and monitoring functions between ASEZA and the JIEC rather than under the responsibility of one organization. This again demonstrates the need for a single regulatory agency to set guidelines and contracting requirements in such situations.

In summary, the Aqaba SEZ has stimulated the local economy – growing 25 percent faster than its pre-zone trend and creating 10,000 new jobs. Forty percent of this additional output was generated by heavy industrial manufacturing in Aqaba and its linkages with the rest of the country. The creation of the SEZ has also achieved another of its goals – improving efficiency of public administration. The contribution of public administration to total gross regional output has almost halved from 8.5% in 2000 to 4.7% in 2005. This is a tremendous achievement. In 2005, local government is able to regulate an economy that is 1.8 times its 2000 size with the same level of public sector output. Compare this to the national economy regulating an economy that is 1.3 times its 2000 size with 24% more public service output.

ASEZA has to be careful to ensure that its current revenue streams cover current expenditure. Given the temptation for SEZs to offer significant income tax exemptions to potential investors, administrators tend to rely on service fees as a source of revenue. Fee income is relatively inelastic, i.e. it does not increase proportionately with economic activity within the SEZ.

# CHAPTER IV – POLICY ENVIRONMENT

This section of the report looks more closely at the current fiscal policy environment of industrial estates and free zones and discusses the impact on industry of likely changes to the policy environment either being considered by the Government or being imposed by Jordan's international treaty obligations. For reference, the attributes and benefits of industrial estates, free zones and bonded warehouses are summarized in a table in Annex One of this report.

## 4.1 CUSTOMS DUTIES

In general, imports are subject to custom duties and sales tax, and corporate earnings are taxed in Jordan. However, the GoJ is steadily eliminating duties, particularly on capital goods and goods used in production. Duties will remain on high value consumer goods, including tobacco, alcohol and vehicles. The simple average tariff has been reduced from 29% in 1994 to 11.7% in 2005. Because the majority of imports now enter Jordan duty-free from its free trade partners, the trade-weighted average tariff is today likely between five and ten percent.

GoJ has provided a range of measures to counteract the anti-export bias of historically high duties on production inputs. These measures are still in use today:

2. Temporary Admission - In accordance with the Customs Law, all exporters - no matter where they are located in Jordan - may apply for exemption from duties and sales taxes on imported raw materials as temporary admissions into the production of exports. Exporters provide a bank guarantee covering suspended duties and taxes.[26]

3. Duty and sales tax exemption on capital equipment approved by the Investment Promotion Committee and imported within three years of such approval, and spare parts imported within ten years of approval by projects belonging to one of eight economic sectors.[27]

4. Free Zones – storage and manufacturing estates permitting entry of any imported products free of customs duties and sales tax, unless destined for the domestic Jordanian customs territory, pursuant to the Free Zones Corporation Law (32) for 1984 and its amendments.



[26] Parliament rejected draft legislation last year that would have significantly reduced the costs for traders and manufacturers of deferring payment of duties. Currently, traders wanting to defer payment of duties have to give the Customs Department a bank guarantee for an amount ranging in value up to the total value of the goods (in order to account for potential duties, taxes and penalties). The Department proposed establishing the use of customs bonds which permit the importer to buy an insurance bond for the amount of the duties payable. The typical international cost of such bonds are less than 0.5% of the value covered. Compare this to the costs currently borne by Jordanian importers to obtain a bank guarantee – 8% of the value covered. The value of current guarantees currently is in excess of JD 250 million.

[27] Industry, agriculture, hotels, hospitals, maritime transport and railways, leisure and recreational compounds, convention and exhibition centers, pipelines for distributing water and petroleum products. Article 3 of Law (16) of 1995 and its amendments The Investment Promotion Law

5. Bonded Warehouses – subject to the payment of a guarantee, goods can be stored in bonded warehouses for up to two years without payment of customs duties or sales taxes. Manufacturing is not permitted.

Three changes in the policy environment bring into question the purposes of these measures:

- The general elimination of duties on imported manufacturing and service inputs.
- From 1 May 2006, the EU Association Agreement no longer permits preferential entry into the EU of goods manufactured in Jordan from inputs imported into Jordan that were in any way exempt from customs duties, including goods manufactured in free zones.
- GAFTA members currently do not permit preferential entry of any products from other member countries that were manufactured in free zones. Only Saudi Arabia, under a bilateral agreement, permits Jordan's free zone manufacturers duty-free entry provided they meet GAFTA rules of origin.[28]

**Box 2. Investment Incentives in Jordan**

The JIEC Law 59/1985 offers: (a) 100 percent exemption for two years on income and social services tax; (b) total exemption from tax on buildings and land; and (c) exemption or reduction on most municipality fees.

The Investment Promotion Law 16/1995 offers (a) 100 percent exemption on customs duties, sales taxes and fees applicable to imported fixed assets, fixed assets needed for expansion, and spare parts; (b) a 10-year exemption from income and social services taxes for projects approved by the Investment Committee at the following rates depending on sector and the area in which the project is located, as follows: Zone (A) – 25 percent, Zone (B) – 50 percent, Zone (C) – 75 percent. Eligible sectors are: all zones – agriculture, mining, manufacturing, hotels and hospitals; Zone A only – leisure and convention centers and distribution of water, gas and electricity; Zone C only – maritime transport and railways.

The FZC Law 32/1984 offers: (a) no income tax on export and transit trade earnings, and earnings derived from transferring goods within free zones; (b) foreign workers exempt from income and social services tax; (c) no customs duties, sales taxes and fees on all imports; (c) exemption from fees and taxes on buildings and construction; (d) special 8% tourism sales taxes on goods and services consumed within the zones, and other special sales taxes to be defined on services exported outside the Kingdom; (e) sales to domestic territory subject to normal sales tax, and customs duties on imported inputs.

The above conditions suggest that as far as customs duties are concerned, Jordanian manufacturers need no longer be concerned with paying customs duties on imported capital equipment, intermediate inputs and raw materials. GoJ should remove all remaining duties on these imports as quickly as possible. Different duty rates on inputs and outputs lead to unintended effective rates of protection, favoring one sector over another. See Jim Robertson's report for a discussion of this phenomenon referred to as cascading. Eliminating duties on production inputs will also enable Jordanian producers to source inputs at the lowest cost world price, rather than from one of Jordan's free trade partners. Free trade agreements can divert trade away from least cost producers in countries subject to Jordanian customs duties. US and GAFTA producers can price their duty-free exports to Jordan up to the value of the duty-inclusive cost of exports from competing least cost producers in the rest of the world. The attraction of any duty-free entrepot such as Hong Kong or Singapore is that producers based there can source the world's lowest cost inputs.

[28] GAFTA members are currently renegotiating rules of origin and are likely to recognize free zone exports if local content meets the standard GAFTA minimum of 40%.

*The removal of duties from production inputs – both services and manufacturing – is a major competitive advantage for Jordan and should be highlighted by the Jordan Investment Board. By continuing to promote customs duty exemption schemes to potential investors, Jordan implies that it has high duties requiring some counteracting measures in order to attract investment.*

The Ministry of Finance can continue to maintain duties on high-value consumer products in order to raise revenue. These duties also protect any local producers, although long-term tariff protection in a small market is of limited economic benefit given the disincentive not to reach minimum efficient export scale. The Minister of Industry and Trade established a tariff reduction committee in August 2006 to identify remaining duties on production inputs that should be eliminated. The work of this committee is very important and the GoJ should make best efforts to support the committee and implement its recommendations.

In conclusion, as the final duties on production inputs are removed, efficient production of goods and services can take place at any location in Jordan without the need for any duty deferral or temporary admission schemes. Industrial estates can still attract investment by offering efficient infrastructure and support services. What does this imply for the future role of free zones and bonded warehouses? As table 2 highlights, free zones in Jordan are generally used to store high-value goods destined for other countries— transit trade. Their simple duty-free procedures, minimal quarantine restrictions and long-term storage facilities attract warehousing of goods destined for Iraq and Syria. Private and public warehouses are used to store goods destined for the local market. Private warehouses are restricted to storage of vehicles and tobacco products and require bank guarantees against suspended duties and taxes.

## 4.2 GOODS AND SALES TAX

Producers are today more concerned about the General Sales Tax (GST) in Jordan than customs duties. Sales tax is levied on all imports and domestic goods and services at the rate of 16%. As a value added tax producers pass the tax on to the final consumer. If the final consumer lives outside Jordan, i.e. the product is exported, the exporter receives a refund of the GST paid on their costs of production. However, GST causes two major cash flow problems, which have encouraged firms in Jordan to seek zero-rating or exemption for their industries. GST paid on purchases of capital equipment can be a significant additional cost of doing business. The firm may have to carry forward excess input tax credits for some time. Secondly, the tax administration may be slow to refund input tax paid by exporters. This is a tax administration issue common to all countries. Mechanisms exist to address these issues. For example, some countries legislate refunds to exporters within fixed time periods, e.g. three weeks. The solution is not to expand the number of exempt or zero-rated industries – this reduces the efficiency and fairness of the tax base and risks significant tax evasion.

## 4.3 INCOME TAX

The current income tax law applies a 15% corporate income tax rate to manufacturers, this is due to increase to 17% if the new income tax law is approved, along with hotels, hospitals and transport). The income tax rate on most other services remains at 25%. Unless, in practice, assessable income is calculated differently for services then the differential tax treatment will likely remain the most significant impediment to new investment in services in Jordan.

The current Income Tax Law exempts firms from income tax on earnings derived from exports. This exemption has enabled industrial estates and QIZs to attract export-oriented investment without offering special export tax incentives of their own. Non-exporters could avail of the Investment Promotion Law or a two-year income tax holiday offered by the JIEC, and later by private industrial estate operators.

The new income tax law is intended to eliminate the exemption on export earnings, as well as the JIEC and Investment Promotion Law investment incentives. The elimination of incentives under the Investment Promotion Law reflect the ineffectiveness of these incentives in attracting additional investment into Jordan – particularly to underdeveloped regions of the country.

After 2009, Jordan has to comply with the prohibition on any export-linked subsidies, in particular Jordan's income tax exemptions, under the Subsidies and Countervailing Measures (SCM) Agreement applied by all members of the World Trade Organization (WTO). Article 27.4 of the SCM Agreement permits Jordan two years to "phase out" its income tax exemption after the last year of authorized waiver extension, i.e. two years after 2007. The Doha Round established a set of procedures for developing countries to submit requests to extend the original eight-year deadline in the SCM Agreement.[29] To date, most of the thirty eligible countries, including Jordan, have submitted requests to the WTO for extension of the deadline.

WTO members are expected to agree within the next few months to an extension for eligible countries. However, the length of extension and associated conditions of any potential agreement remain uncertain. If the WTO does continue to permit Jordan to exempt export earnings, then the Ministry of Finance will need to continue its struggle to introduce a flat rate of income tax on all activities – as exemplified in the debate surrounding the current income tax bill. In this uncertain environment, the private sector is lobbying GoJ to retain the Investment Promotion Law income tax incentives. On its website, Ad-Dulayl QIZ is promoting itself as a Zone C QIZ so that investors are eligible for a 75% reduction in income tax under the Investment Promotion Law when the tax exemption for export earnings expires.[30]

Free Zones enjoy their own set of investment incentives independently of those provided by the Investment Promotion Law or the Income Tax Law. The private sector is arguing that free zones are outside of the customs territory of Jordan and therefore should remain outside of its income tax regime. If Jordan loses its right to exempt export earnings from income tax, then a simple amendment to the law to exempt income derived from any activity occurring within a free zone could be sufficient to exclude such an exemption from being treated as a prohibited export subsidy under the SCM Agreement.[31] Therefore, if the Investment Promotion Law is repealed and export earnings become taxable, free zones and the Aqaba SEZ would remain the only locations offering fiscal incentives to investors in Jordan.

[29] Eligible countries are those whose share of total world exports was below 0.10 percent in 1998-2000, and whose gross national income was below US$20 billion in 2000. Some countries, e.g. Thailand, have amended their zone legislations to comply with the SCM.
[30] http://www.ad-dulayl.com/5.htm 22 Feb 2007
[31] Even though free zone income tax exemptions are not regarded as prohibited export subsidies, another WTO member could try to argue that such exemptions are a specific actionable subsidy causing injury to their domestic (garment) industry.

The Free Zone Corporation is expecting existing exporters to migrate to free zones or for existing QIZs and industrial estates to adopt free zone status. Ad Dulayl has recently adopted free zone status. Assuming land costs and other charges are equal, garment firms are expected to either migrate from QIZs (industrial estates) to free zones or seek private free zone classification. This is because by 1 January 2010 all garment exports will be able to enter the US duty free under the FTA. Unlike GAFTA members and the EU, the US extends free trade privileges to exports from Jordanian free zones. Therefore, garment producers will no longer have to export under the QIZ agreement and can enjoy the more advantageous duty-free and sales tax-free environment within an free zone compared to the temporary exemption status if operating outside free zones.

Two policy issues have to addressed before all productive capacity in the country adopts free zone status:

> Firstly, as discussed above, exports from free zones are excluded from preferential treatment under GAFTA and the Jordan-EU Association Agreement. Only the US permits duty free entry of goods manufactured in Jordan's free zones under the Jordan-US Free Trade Agreement (JUSFTA).
>
> Secondly, exempting all activities operating within free zones from income tax will encourage significant numbers of existing domestic manufacturers and service providers to relocate to free zones. The Free Zone Corporation wants to encourage this relocation by treating products manufactured in free zones with 40% local content as Jordanian origin products. Once classified as Jordanian origin the products would not be subject to duties and taxes, as they currently are, upon sale into the domestic territory. Therefore, manufacturers serving the domestic market could operate in free zones free of customs duties, sales tax and income tax.

Raising and enforcing income taxes throughout the country but allowing domestic firms to relocate or register as free zones will lead to significant tax-induced investment distortions:

- Loss of fiscal revenue as existing and potential tax-paying firms adopt free zone status.
- Significant administrative costs on free zone regulatory and operational staff to handle the influx of new free zone designations and enterprise start-ups
- Significant administrative costs on tax officials to audit free zone enterprise income tax returns to ensure income and expenses are being appropriately sourced.
- Many firms would no longer be locating at their natural least cost location in Jordan, therefore, their production costs and output value will be distorted upwards.
- Unless GAFTA members agree to permit exports from free zones meeting the 40% local content rule, manufacturers in free zones will not be able to export to the EU or GAFTA members – Jordan's two largest markets. This will artificially induce them to remain small and focused on the domestic Jordanian market.

For these reasons it is almost inconceivable that GoJ would permit established domestic manufacturers and service providers to adopt free zone status. However, as this report has shown the number of private free zones is accelerating as export-oriented manufacturers seek to overcome customs bureaucracy and likely uncertainty over income-tax exemption as an exporter under the Income Tax Law.

The conclusion is that the GoJ is too ready to apply policy fixes to institutional problems. Income tax should be applied at a low flat rate to all firms in Jordan – with appropriate foregiveness for investors from tax-free jurisdictions. Rather than build more free zones to ease customs procedures in an otherwise low tariff environment, customs should continue to streamline its procedures nationally and eliminate tariffs on all production inputs. Rather than zero-rate or exempt certain industries from sales tax, the Sales Tax Department should administratively ease the cash-flow problems of its clients.

## 4.2 INVESTMENT INCENTIVE EFFECTIVENESS

The package of fiscal incentives offered by zones is increasingly the same around the world. Over the years, this has expanded from simple import duty exemptions to a combination of corporate income tax reductions or holidays; exemptions from most indirect and local taxes; unrestricted repatriation of capital and profits; unrestricted management of foreign exchange earnings, etc. Most MENA zones go further, offering personal income tax exemptions for expatriate workers and zero corporate income taxation in perpetuity. The fact that virtually the same package of incentives is offered by successful zones and failed zones suggests that they are not a key success factor. Even worse, the reliance of zone programs on incentives with limited effectiveness such as income tax holidays impose significant costs on government budgets with little benefit.

**Box 3. Problems with Tax Holiday**



- A tax exemption is of little benefit if the company is not making profits, which is usually the case in the initial years of operation. Firms that are profitable from the outset might not have needed incentives in the first place.
- Tax holidays can facilitate income shifting from non tax exempt enterprises to tax-exempt companies through transfer pricing of inter-company transactions.
- Tax holidays reduce the appeal of debt financing of capital investment by removing the benefits of interest deductibility. This equity funding bias is accentuated if dividends of tax-exempt firms are also exempt from personal income tax.
- Tax exemptions tend to benefit investments with a short-term time horizon. Longer-term projects that generate profits beyond the tax holiday period do not benefit, unless firms are permitted to accrue and defer asset depreciation deductions beyond the tax holiday period.
- Tax exemptions do not benefit investors from many OECD countries that tax income on a global basis, unless a “tax sparing” agreement is in place.

### 4.2.1 EFFECTIVENESS OF INCENTIVES IN JORDAN

The discussion of the Aqaba SEZ above suggests an inability of income tax incentives to overcome specific weaknesses of an investment climate for any particular economic sector. Arguably, investors are already attracted to invest in hotels in Aqaba, and so enjoy a windfall gain from the low income tax rate. Outside manufacturers likely face unprofitable employment constraints and so the low tax rate is quite ineffective.

A major review of current investment incentives was undertaken in 2004 by Dr. Duanjie Chen for the USAID-funded AMIR Program. It is worth repeating part of the background and main findings of her report:[32]

[32] Duanjie Chen, Jack Mintz, Gabi Afram, Reem Goussous; *Reformulating the Tax Incentive Program in Jordan: Analysis and Recommendations*, AMIR Program, July 2004

*A traditional rationale for investment incentives is to encourage capital investment that is inadequately provided by markets. The designers of tax incentives around the world have believed they can induce investors to follow directions favored by the government, which in turn are assumed to ensure "wider benefits" for the overall economy.*

*Unfortunately, the directions favored by government have often been arbitrarily defined in terms of capital allocation by industry, or by type of investor, or by location, or by size of investment, or some combination of these criteria. For example, in many economies, tax incentives have been used to implement industrial policy, and were given first to the mining industry, then to manufacturing, then tourism, and then information technology, and so on.*

*Since governments rarely foresee economic structural change and are not able to pick the "winners" that will be chosen by the market ahead of time, existing industry-specific incentives often become an obstacle to fostering infant industries.*

*As for promoting regional development, no tax incentive in the world has ever attracted investors to areas where no fundamental conditions for profitability exist, such as the availability of natural resources, skilled workers, adequate infrastructure, or even population density to support markets. As such, tax incentives that were targeted to regional development have generally failed.*[33]

*Furthermore, regardless of how carefully these tax incentives are targeted, their immediate fiscal impact has always been to reduce tax revenue directly or indirectly by narrowing the tax base. When this revenue loss cannot be offset by the trickle-down or spillover effect expected from an "induced" capital investment, government must raise revenue elsewhere or cut expenditures, both of which can harm the economy without any beneficial offset. Failing tax incentives therefore need to be abandoned or redesigned.*

*As indicated, profit is the ultimate driving force for any investment decision in a market economy. Taxation is only one of the many factors that affect such capital allocation. The most important factors that motivate a profit-driven investment decision, as broadly recognized around the world, are the size of the market, economic stability, market-friendly institutional settings, adequate infrastructure, the availability of a trained labor force and natural resources. In contrast, tax factors are placed within the bottom 10 among 20 critical location factors evaluated by the multinational firms*[34]*.*

*When the overall investment environment is unattractive to investors, tax compensation through incentives cannot effectively attract unwilling investors. Furthermore, tax incentives may not be an effective factor at all in attracting foreign investors from countries that tax repatriated profits, such as the U.S. and the U.K., while providing credit for foreign taxes paid. In such cases, the tax incentives given to foreign investors result in a lower tax credit for the investors at home, and therefore a pure revenue transfer from the government of the investors' host country to that of the investors' home country.*[35]

*Finally, the design of tax incentives has progressively changed over the past several decades. Tax holidays were originally popular as an incentive but are losing favor*

[33] As stated in Shankar, Raja, and Anwar Shah (2003), "Bridging the Economic Divide Within Countries: A Scorecard on the Performance of Regional Policies in Reducing Regional Income Disparities," in World Development, Vol. 31, Issue 8, August 2003, pp. 1421-1441, "regional development policies have failed in almost all countries–federal and unitary alike–to reduce regional inequalities."

[34] World Bank Multinational Investment Guarantee Agency, "Foreign Direct Investment Survey," January 2002.

[35] Our recent meeting with a potential investor from the United States provides a fresh example. When told about the difference in tax benefit between paying the regular income tax and enjoying the income tax reduction, he immediately expressed preference for paying the regular income tax rather than going through the application for the tax holiday provided under the current incentive program, since the latter would not bring him any effective tax benefit.

*compared to more efficient forms of incentives that are directly linked to the actual amount of investment*[36]*. In fact, "a low tax rate accompanied by loss carry forwards for tax purposes and accelerated depreciation is considered to be a major element in an effective tax system and one that is highly attractive to foreign investors."*[37]

*Hong Kong (China) and Ireland both illustrate the benefits of a simple and transparent tax structure. Both economies are small and poor in natural resources, and both have adopted low flat company tax rates, of 17.5 percent in Hong Kong and 12.5 percent in Ireland, for all business sectors with no discretionary tax incentives. Both countries have excelled in attracting FDI. As measured by the ratio of FDI inflow to GDP from 1997 to 2001, Hong Kong at 20 percent and Ireland with 14 percent stand out as the second and fourth most successful countries in the world.*[38]

*Jordan's current investment incentive program is too complicated and inefficient. It is overly selective in the sectors and regions it favors, the conditions for exemption it offers, and the periods to qualify for tax incentives that it requires. The following five points summarize the main weaknesses of Jordan's current incentive program.*

- *The income tax reductions for selective sectors categorized by development zones significantly worsen the tax distortion arising from the existing multi-leveled income tax rates.*
- *The program's use of tax holidays is not necessarily an effective means of attracting large-scale, long-term capital investment.*
- *The current conditions required to obtain import duty exemption for fixed assets are too restrictive and obsolete.*
- *The narrowly defined sectoral coverage of the program creates an environment that encourages interest groups to seek even more selective incentives, so that government has to increase taxation on the economy as a whole to meet revenue targets.*
- *All of the current incentives require bureaucratic pre-approval. This administrative discretion is unnecessary and undesirable.*

*In order to quantify the distorting effect of the current investment incentive program, we apply the tool of marginal effective tax rate (METR) analysis. METR measures the overall cumulative tax burden incurred by a marginal or new investment project under a given tax regime, including tax incentives. METR analysis is a powerful tool for evaluating the total impact of taxes on investment, as it accurately measures the extent to which taxes paid on an investment project affect the profitability, and therefore the desirability, of the venture.*

*Our analysis demonstrates that the current investment incentive program causes an inter-sectoral tax distortion of more than twice the amount that would occur in the absence of such investment incentives. The inter-sectoral tax distortion is measured by the dispersion of marginal effective tax rates across 13 business sectors and sub-sectors of the Jordanian economy.*

*Of course, without any investment incentives, the overall cost of capital to investors would be higher, due to the loss of the tax benefits that the current program offers to selective sectors of the economy. However, by providing alternative tax incentives that are less selective and directly linked to capital investment, such as an import duty exemption and a 20-percent initial allowance for investment in machinery and equipment (M&E) that*



[36] Drawbacks of tax holidays have been extensively documented. Recent references include UNCTAD (2000, pp.17-20), FIAS (2003, p.5), and Mintz (2004, pp.10-11).
[37] See UNCTAD (2000).
[38] See Mintz (forthcoming).

*would be available to all businesses, the inter-sectoral tax distortion be drastically reduced.*

*Jordan's wide gap in METR on foreign capital investment between the manufacturing and service sectors (17 percentage points) is second only to UAE/Dubai (26 percentage points) in the region and indicates a significant sectoral tax distortion, which discourages foreign investment. As a result, with all else being equal and considering only taxation, foreign investors would have much less interest in Jordan's service sector, including high-technology, than in its manufacturing industry, which undermines efforts to modernize the economy.*

*By way of further comparison, Jordan's METR gap between manufacturing and service sectors (17 percentage points) is more than four times the gap in Ireland (4 percentage points), which has demonstrated exceptional success in attracting foreign investment and promoting rapid economic growth with a flat tax rate (currently 12.5 percent) and no selective tax incentives. Again, it is clear that the introduction of more even-handed tax incentives that are directly linked to capital investment would enable Jordan not only to retain its current tax advantage in manufacturing, but also to become the lowest-taxed country in services among its key regional competitors for foreign direct investment (FDI). Furthermore, its METR gap between manufacturing and service sectors would drop to a level close to that of Ireland.*

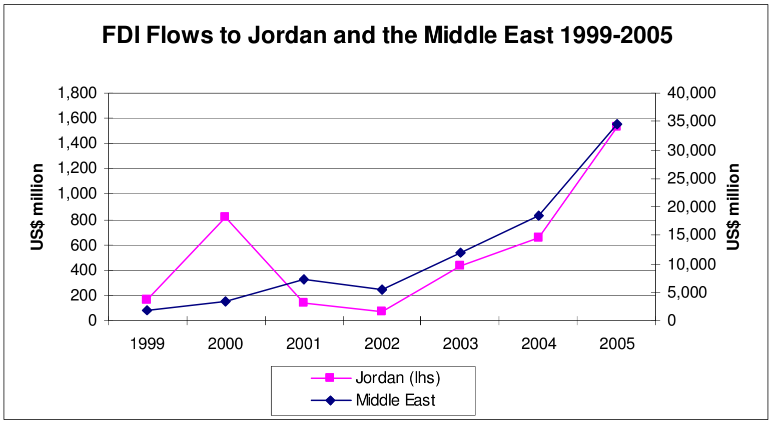
### 5.2.2 RECENT FDI TRENDS IN JORDAN

Jordan has attracted significant levels of foreign direct investment in the last three years. See Annex Two for a summary table of JIB approvals by sector and investment zone. Over JD 2.2 billion was registered by the Central Bank of Jordan in 2006, up from just JD 53 million in 2002. The peak in 2000 was due to privatization of Jordan Telecom and the national cement company. Has Jordan changed its investment environment in any way to attract this extra FDI? Investment incentives have remained unchanged for the last 12 years and so are unlikely to have had much influence on additional investment decisions. Macroeconomic stability and continuing microeconomic reform has enabled sustained GDP growth each year over five percent since 2003.

The major driving force of the recent surge in FDI appears to be the growth in regional FDI – due to the increase in regional investment by oil exporting countries. Figure 6. shows the almost perfect correlation between FDI into the region and FDI into Jordan. In addition to the surge in FDI into the MENA region, a further reason for the increase in JIB approvals is the likelihood that the Ministry of Finance will prevail in eliminating investment incentives. Therefore, investors are possibly accelerating their incentive applications in advance of the elimination of incentives.

Have investment incentives played any role in allocating FDI within Jordan, once the investor has decided to locate in Jordan? The following Figure 7. shows the distribution of JIB approvals over the past eleven years by zone. Industrial estates and free zones are evenly distributed throughout the zones. Al-Tajamouat and Abdullah II estates and Zarqa Free Zone are in Zone A. Al-Hassan estate is in Zone B. Karak, Ma'an and Ad-Dulayl are in Zone C.

Figure 6.

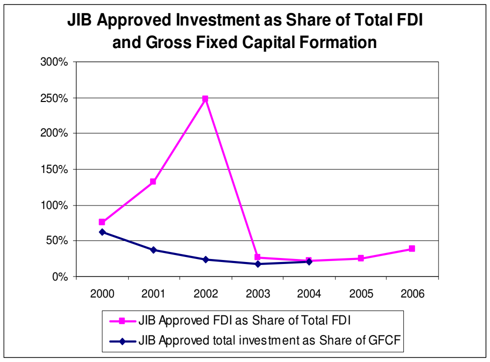


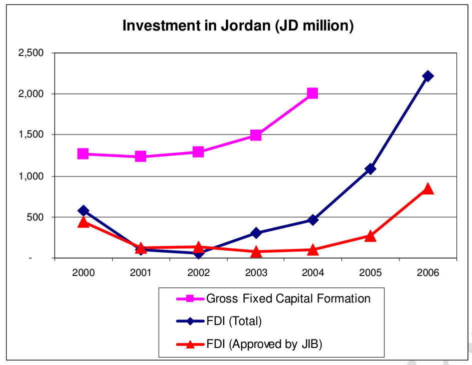

Source: Central Bank of Jordan, International Monetary Fund

Figure 7. shows the distribution by value of projects approved to receive investment incentives between 1996 and 2006. The figure excludes JD 700 million of investment in four proposed cement factories in Zone C approved by the JIB in 2006. It is very unlikely that the four cement factories will be built at the same time, if at all. The total value of approved investment in Zones A and C are about equal despite the income tax rate in Zone C being one third of the applicable rate in Zone A, and despite Zone C representing 80 percent of the total land area of Jordan. It is also interesting to note that new investment projects obtaining only the import duty exemption without income tax reduction or exemption accounted for 24 percent of total new investment in the same period.

Figure 7.

Finally, Figures 8. and 9. compare JIB approved FDI to total FDI and also to total investment represented by Gross Fixed Capital Formation (GFCF) – a measure of total investment in fixed assets in the economy. Unfortunately, GFCF is not available yet from the Department of Statistics for 2005 and 2006, and the Central Bank did not report comparable FDI figures before the year 2000. At least until 2003, JIB approvals were a declining share of total investment in Jordan, but have likely increased since 2003. JIB FDI approvals have been an erratic share of total FDI, but also appear to have been stable and increasing since 2003. Clearly, most of the approvals between 2000 and 2003 did not eventuate. JIB FDI approvals have been maintaining their share of total FDI – around 25% since 2003. However, removing the JD 700 million cement factory approvals reduces this share to 7% in 2006. It is fair to say in summary, that FDI investment incentive approvals continue to comprise a relatively stable share of total FDI and total investment in Jordan. However, the surge in liquidity due to high oil prices and the threat of incentive elimination has likely driven approvals in 2005 and 2006.




Figures 8 and 9. Source: Jordan Investment Board, Central Bank of Jordan

### 4.2.3 CASE STUDY: SURVEY OF INVESTORS

In preparation for the AMIR report on non-fiscal measures to attract investment, Al Jidara consultants conducted a survey of investors from a number of public and private industrial estates regarding their motivation to invest in different locations around the country including Al Hussein QIZ in Karak.[39] As Table 9. above shows new investment effectively stopped in Al Hussein after three large garment factories began operating there in 2001. Al Hussein is the third industrial estate to be established and managed by JIEC and Jordan's second industrial estate to be designated as a Qualifying Industrial Zone (QIZ) after Al Hassan Industrial Estate in 1999. It is located in Zone C, thereby qualifying for the maximum allowable tax reduction over the greatest length of time, receives extra JIEC incentives, has a developed infrastructure, and is the only industrial estate in southern Jordan to be located near a university. Despite these impressive statistics and characteristics, it has strikingly underperformed in terms of attracting investments compared to other public and private industrial estates.

Although the investors interviewed stated Zone C tax exemptions were important in their decision to invest in Al Hussein, they placed greater weight on a number of issues related mainly to the quality of the local workforce and estate management. More specifically, they viewed the poor work ethic of the local workforce as an impediment to fully capitalize on the tax exemptions granted. There was a general consensus that a tax exemption would rank inferior to other key success factors such as quality of infrastructure, industrial estate management support and professionalism, and industrial work ethic by the locals that was reported to be of higher significance than technical competence.

In contrast, there was a general consensus amongst investors in other industrial estates that, if they ever considered investing in less developed areas such as Al Karak and Ma'an, fiscal incentives would be considered insufficient if not coupled with quality physical infrastructure in terms of road networks, transportation facilities, and other utilities. Investors also stressed the importance of an adequate business support infrastructure in terms of availability of governmental representatives (from Ministry of Industry & Trade, Ministry of Labor, and Jordan Customs Department). Additionally, investors voiced significant concerns about labor and discussed this issue at great length. Moreover, investors stated that they fear the tribal spirit of the local population at Al Karak, and that "they have an agrarian way of living and do not appreciate, nor they have the minimum requirements, to be engaged in an industrial lifestyle that is required at the industrial estates." A common phrase encountered was: "We

[39] Gabi Afram, Amal Nashef, Rana Dababneh, Eugene O'Reilly, Duanjie Chen. *Non-Fiscal Measures to Attract Investment*, AMIR Program, April 2005, pp 53-55

are already suffering from laborers and their bad work behavior from absenteeism to passiveness in Amman. Imagine how it would be in Al Karak!"

Investors that are located close to Amman reported that their main motivation to invest in their current location was the proximity to services and facilities (banks, governmental organizations, and customs office). Furthermore, investors favored Amman because it is an economic hub and logistics are not a problem. Investors also complained about the bureaucracy and red tape of the government procedures and administrative practices. One investor said: "The problem is not in the law as much as it is in the execution of that law; procedural and administrative issues are tiring us."

# CHAPTER 5 – LOCAL ECONOMIC DEVELOPMENT

The general conclusion from this report is that duty-free status for free zones is useful for enterprises engaged in transit trade and storage. However, the ineffectiveness of most investment incentives and their potential to create disputes with trading partners, in particular the European Union, means that industrial estates, free zones and special economic zones merely fulfill a good governance role. They provide efficient infrastructure, effective services and create a space for industrial clusters to form. This is the role of local government. Jordan should not replace local government with artificial zone structures. If local government does not have the legal or financial ability to perform the services required then central government should provide them with that ability.

As further background to enhancing the capacity of local government to facilitate economic development, this chapter of the report repeats text and findings of a report completed two years for USAID in Jordan that explored international experience in local economic development.[40] The intention of the report was to explain measures, other than fiscal incentives, that could be used to develop low-income, high-unemployment areas of Jordan. SABEQ is developing local economic development pilot projects in Irbid and Karak. A report will be distributed soon outlining the methodology and recommendations.

Local economic development in this context is defined as the enhancement of the business environment and industrial investment climate needed to make long-term improvements in living conditions and provide jobs and income opportunities to the less-developed areas of the country by attracting investments and creating business activity.[41] Local economic development is thus accomplished through the coordinated effort of private businesses in partnership with national and local entities in promoting initiatives to improve the conditions for citizens of the less-developed areas.

## 5.1 EXPERIENCE WITH LOCAL ECONOMIC DEVELOPMENT

After more than half a century's experiments around the world, a fundamental change is occurring in thinking concerning government policies towards local economic development. (OECD, 2003). With the strong motivation coming from alleviating regional disparities, helping the poor, and integrating a nation's economy, governments in many countries, developed or under developed, have tried various policy instruments to reduce such regional disparities. However, a blunt assessment of these experiments, based on an empirical study of eight industrial and 18 non-industrial countries, is that "local economic development policies

[40] Overview of Non-fiscal Measures to Attract Investment, Gabi Afram, Amal Al-Nashef, Rana Dababneh (Al-Jidara), Duanjie Chen, Eugene Reilly (The Services Group), AMIR Program, April 2005, pages 5-15

[41] Roughly speaking, this broad definition covers most of the country's areas which are far from the population and economic activity centers of Amman and Zarqa, which together account for more than two-thirds of the country's population and approximately 80 percent of its gross domestic product.

have failed in almost all countries – federal and unitary alike – to reduce regional inequalities."[42]

What went wrong? The problem lay in thinking about what government can and cannot do.

First, regional disparity in most cases is a combined result of historical evolution (e.g., the uneven process of industrialization), inequality in natural resources, differences in institutional settings (e.g. East and West Germany after reunification), and cultural and mental differences (e.g., urban vs. rural sectors). These sources of regional disparity often cannot be changed at the rapid pace desired by governments.

Second, local economic integration seldom took the route desired by the government – a flow of resources from richer regions to poorer ones. The trend is often the opposite – a flow of resources from poorer regions to the richer ones, which is not necessarily bad, but does seem to some to constitute a waste of government funds and endeavors on the redistribution front.

**Box 4. New Zealand's New Policy Focus and Local Partnerships Program**

Local economic development polices and programs have been a feature of New Zealand's central government public policy environment since 1999, with a strong policy focus on partnership between central government and regions and on locally-driven, broad-based economic development. This policy focus steers away from inter-regional transfer policies or large-scale investment incentives to focus instead on identifying local specialization, fostering local innovation, developing local capability, and strengthening local institutions, including co-ordination between stakeholders.

In the New Zealand context, policies that encourage agglomeration of economic activity and greater specialization may be particularly important, given the country's size and distance from major markets, the large number of very small firms and local government units, and the associated difficulties with sustaining critical mass in industries and institutions. It will often be necessary for groups of firms, supported by public sector institutions, to work together to access export markets.

Similarly, neighboring regions and districts may benefit from collaboration, joint initiatives, and resource sharing. The primary concern of policy makers, therefore, has been with levels of institutional support and inter-firm collaboration, the strength of a consensus on a common purpose, and with structures that encourage innovation, skills, and knowledge transfer.

To enhance local initiatives and build local capability and institutions for economic development, economic development partnership groups have been formed in 26 New Zealand regions. In addition, capability building and the development of major local initiatives aligned with a region's area of specialization are under way.

Source: See footnote 40, Overview of Non-Fiscal Incentives, AMIR 2005, Box 2.2 page 9

Finally, past local economic development policies have proven incompatible with the emerging trend of globalization, which is characterized by the "increased movements of goods, capital, labor and ideas, in the context of rapid shift of tastes and demographic changes." (OECD, 2003) This unprecedented mobility of almost all products and services and their inputs augmented "both opportunities and risks of regions by allowing them – and their competitors – to reach out to external resources and markets." (OECD, 2003) As a result, a strategy of local economic development by promoting the integration of regions into the

[42] Shankar, Raja, and Anwar Shah (2003), "Bridging the Economic Divide Within Countries: A Scorecard on the Performance of Regional Policies in Reducing Regional Income Disparities," in World Development, Vol. 31, Issue 8, August 2003, pp. 1421-1441.

global economy has become more appropriate than the outdated strategy of bringing all regions into an integrated national economy.

As a result of such rethinking, policy makers in many countries are now taking a different approach, by talking more about “agglomeration economies” instead of “integrated economies,” and more about local competitiveness instead of local equalization.[43] “Agglomeration economies” refers to a situation where enterprises or activities derive cost-saving benefits by locating near each other as clusters, while “integrated economies” refers to a situation where different sectors of an economy (e.g., agricultural and industrial sectors) work together efficiently and are interdependent.

In today’s global economy, most competitive economies are often characterized by their greater level of agglomeration, such as India’s emergence as an outsourcing destination for major international software producers and financial services providers (e.g., large banks). By contrast, countries that are still pursuing inward, national economic integration are often left behind. Of course, this rethinking does not mean a conflict between “agglomeration economies” and “integrated economies,” between “local competitiveness” and “local equalization.” It simply suggests that a broader stage of economic integration (i.e., from a national to a global stage) through agglomeration economies is a more efficient way of promoting local economic development within a country.

**Box 5. Local Innovation, Industry Clusters, and Rural Development**

Research indicates that one major difference in local economic performance lies in their capacity to innovate – to transfer new ideas and knowledge into high-quality products or services. Innovation is a driver of competitiveness, and *vice versa.* It is vitally important to understand that innovative activity is not limited to “high-tech” sectors.

The capacity for local innovation is often driven by industry “clusters” – broad networks of companies, suppliers, service firms, academic institutions, and organizations in related industries that together bring new products or services to market with a great advantage of cost-saving through minimized distance between each other.

Furthermore, clusters regularly cross over traditional rural-urban boundaries. Therefore, developing strategies for rural areas need to be designed around “local hubs” and “rural spokes.” Every rural region needs a local hub to connect to, and the connections to the hub are critical. As a result, policy makers need to move away from thinking about purely “rural strategies” and focus on the economic regions in which entire competitive clusters are found and rural activities are linked to urban centers of economic activity.

Source: see footnote 40, Overview of Non-Fiscal Incentives, AMIR 2005, Box 2.3 page 9

An outcome is that, in replacing the various, conventional, locally-targeted fiscal incentives or financial infusion, a popular approach is to bring together all the stakeholders – government and private – to exploit agglomerations by making full use of local immobile resources, accelerating innovation, and encouraging local competitiveness on a global stage.

[43] According to the *MIT Dictionary of Modern Economics,* the definition of “agglomeration economies” is the following: “Cost savings in an economic activity which result from enterprises or activities locating near one another. Examples of such savings include the clustering of retail establishments which permits consumers to make price comparisons without multiple journeys, the efficient use of information where contact between buyers and sellers is facilitated, the spreading of costs of public services and the development of specialized input suppliers serving a number of consumers in the surrounding area. In the last case, cost reductions arise through economies of scale and specialization in the supplying firms, thus they are said to be internal to these firms. Agglomeration economies are an example of external economies where one firm’s activities confer benefits on other firms.”

The implication of this policy switch is that local economic-development policy should encourage agglomeration by aiming at areas with high growth potential rather than those with little unused resources. This is not to say that the policy direction in helping the poor is wrong, but the question is what kind of policy actually works. Facing the intensified challenge of this question, policy makers are increasingly linking together local innovation, industry clusters, and rural development.

What does a government need to do to accommodate agglomeration economies, related urbanization, and rural development? There is no doubt that provision of infrastructure is crucial as labor migration requires housing, transportation, public utilities, medical services, education system, and more. Above all, perhaps, institutional support and strategic planning are important for cultivating economic dynamics, which are keys for sustainable growth and development.

What, then, are the main elements of institutional support? And what level of strategic planning should a government have in mind?

Besides a pro-business government leadership that provides stable social and political environment including a sound legal system, the main elements of institutional support for a business-friendly environment may include the following: a close cooperation between government and business sector, an effective coordination within the government, and a sound tax system.

## 5.2 PRELIMINARY THOUGHTS FOR JORDAN

Based on the above analysis, we present suggestions as to what Jordanian policymakers may consider doing to attract increased capital investment and promote local economic development in Jordan.

#### DIRECT GOVERNMENT INVESTMENT IN INFRASTRUCTURE

> Ranging from basic infrastructure (e.g., roads, public utilities, and communication systems) to more sophisticated public goods (e.g., education, training, medical services, research and development facilities)

In cases where basic infrastructure is already in place, available funds for future government investment might be planned with an eye to catalyzing agglomeration economies. Geographic areas for such investment should be chosen based on their resources and hence growth potential. These resources include closeness to ports, universities, tourism destinations, and potential markets.

#### DIRECT GOVERNMENT FUNDING

> Including both grants and loans

We have no strong preference for this instrument out of concerns for the cons presented in the previous section. However, if funding is readily available, priority might be given to helping start-up businesses with strong entrepreneurship and innovative ideas.

#### INDIRECT GOVERNMENT FUNDING

> Including funding through commercial banks with government-subsidized, low interest and government loan guarantees

Government should initiate a partnership with the banking system to make such funding a norm in the country. Enterprises seeking such loans are often those with a high probability to succeed based on a solid feasibility study and hence deserve the government's support. The choice between government-guaranteed loans and government-subsidized, low-interest loans should be based on minimizing the risk to government.

#### INSTITUTIONAL SUPPORT

> Consisting principally of pro-business government leadership that provides stable social and political environment, including a sound legal system

In a fast-paced business world, the agenda for government to provide adequate institutional support will be always full. Our list of potential support measures below is neither exhaustive nor prioritized. It is simply meant to illustrate those measures that policymakers may consider.

Government might build close partnerships with the business sector for strategic planning and problem-solving. "Jordan Vision 2020" is an example of such a partnership. Critical to such efforts is the regular appraisal of what has been accomplished and what needs to be pursued further. Only solid implementation of a shared vision will strengthen such partnerships.

Government might take steps to plan strategically and to promote agglomeration economies with innovative ideas and within Jordan's unique local context. Thus, ideas contributed by various parties in the past envisaging Jordan as a center in the region that provides high value-added services, ranging from educational, medical, training, high-tech, and professional (e.g., legal, accounting, urban planning), might be further explored through feasibility studies. Some of these ideas might be implemented, if they are proven feasible.

Government might make staff training a part of its regular business, with the objectives of "skill upgrading" and "mental modernization." The content of this regular training includes how to coordinate within government both horizontally and vertically, as well as how to deal with the enterprise sector on specific issues. This type of regular training is crucial to ensure the efficiency and effectiveness of a pro-business government.

# CHAPTER 6 – COMMENT ON PROPOSED MAFRAQ DEVELOPMENT ZONE

In November, the Government announced plans to establish a special economic zone in Mafraq to help alleviate rural poverty and unemployment. The Government established the Mafraq Development Company (MDC) with JD 100 million initial capital to develop and manage a free trade zone in Mafraq. The Social Securities Corporation has contributed 80 percent of the capital and is temporarily managing the project. Stage One of the development plan comprises the JD 250 million infrastructural development of 900 hectares between 2007 and 2015 on formerly military land adjacent to the King Hussein Airbase in Mafraq. The zone is intended to act primarily as a transport and logistics hub for local trade – particularly linking Gulf and Mediterranean trade – and host to related manufacturing and housing and community services.

A feasibility study of the proposed Mafraq transport and logistics hub projects a positive rate of return for the MDC over the next 20 years. The zone is forecast to expand to 2,000 hectares and employ 29,000 workers. These results depend upon the successful activation of a number of activities, including an “Arabian Landbridge” via railway and road to compete with sea freight between Dubai and Europe, and the ability of the Mafraq zone to handle a share of Jordan’s imports and exports including air freight. These projects will be adversely affected by a proposed inland port to be based near Amman and a proposed concession agreement with the new Queen Alia Airport operator to handle Jordan’s air freight.

It is not the role of this report to review the feasibility study. This report has reviewed on current zone and industrial estate policy in Jordan. However, based on the findings in this report a number of comments can be offered about the Mafraq project:

Firstly, the manufacturing projections appear very ambitious. About 24,000 workers are projected by 2025. This is a third of the current workforce in all public and private free zones throughout the whole country. Given the experience of Karak, Ma’an and Aqaba over the past five years it seems unrealistic to expect such manufacturing growth in Mafraq. Unfortunately, logistics is not a significant employer; only 1,200 jobs are projected to be created in this sector in Mafraq by 2025. Therefore, potential returns may be somewhat lower than expected in the feasibility study.

Secondly, Mafraq appears to have a comparative advantage in the facilitation of transport and logistical services. Only the private sector has the ability to fully recognize such market opportunities and bear the investment risk. Central and local government, or in this case the MDC, has two roles in Mafraq: 1) to efficiently allocate public land to the private sector to take advantage of investment opportunities, and 2) to facilitate this investment in as transparent and as efficient a manner as possible without artificially distorting investment decisions. Neither of these roles requires the creation of a special economic zone.

Careful *national* planning is required to efficiently allocate resources to develop an infrastructure network. Public investment in competing transport infrastructure hubs can lead to duplication and redundancy, rather than higher volumes of trade and output. Users of the transport network should compete transparently but not the network itself. Therefore, the Government needs to coordinate the Amman inland port, and airport, road and railway use in a national plan. Creating competing economic zones around key transport infrastructure will not necessarily maximize national economic welfare. Artificially dividing land freight and sea freight shares between different "transport hubs", i.e. Amman, Aqaba and Mafraq to satisfy perceived private sector investor demand may reduce welfare.

Thirdly, the Mafraq zone has been established, perhaps temporarily, as a private free zone under the Free Zones Corporation. A duty-free area in which a transport and logistics hub can operate makes sense. However, extending income tax exemptions to transport and logistics operators and to manufacturers does not make sense. Providing income tax exemptions for manufacturing within free zones and easing the restrictions on selling into the domestic territory will artificially encourage manufacturing to relocate to zoned enclaves away from areas of natural comparative advantage in Jordan. Relying on zone enclaves as the primary instrument to streamline the investment environment risks slowing improvements in public service delivery throughout the country.

As Jordanian import duties on production inputs, including capital equipment and raw materials, are eliminated the need for special measures to help manufacturers avoid the anti-export bias from paying duties and sales tax on their inputs disappears. Pressure should be brought to bear on customs and sales tax administration to eliminate customs duties on production inputs, to improve their facilitation of the movement of goods and refund excess sales tax credits as quickly and costlessly as possible.

Fourthly, the ineffectiveness of income tax incentives, the growing redundancy of duty-exemptions for manufacturers, and their potential to create disputes with trading partners, means that industrial estates, free zones and special economic zones today merely fulfill a good governance role. They provide efficient infrastructure and deliver effective services, thereby creating a suitable climate for investment. This is the role of local government. Jordan should not replace local government with artificial zone structures. Moreover, zone management does not have the ability to create clusters and increase linkages with the rest of the economy. If local government does not have the legal or financial ability to perform these roles then central government should provide them with that ability. Development of autonomous economic zones with special powers and privileges should not be used as an excuse to delay or forego necessary national economic reform.

The Government and donors need to work more closely with local communities to strengthen their capacity to guide and support local economic development. Zones and tax incentives will not overcome the inherent weaknesses in each region. The most commonly cited problem is the quality and quantity of labor in the regions. Local government must improve vocational training immediately. Central government needs to address labor market impediments – is the same minimum wage necessary throughout the country? Workers need to be able to relocate flexibly from their towns and villages to growth points in the country. This entails lowering the cost of long-term housing finance, improving public transport and reducing the cultural concerns of children living away from home.

# CHAPTER 7 - RECOMMENDATIONS

The Government should undertake the following activities:

- Establish an industrial estate and free zone regulatory body to ensure equal rights and obligations between private sector developers and operators and the JEIC and FZC. The regulatory body would also review the feasibility and financial capacity of applicants for new estates and zones against land-use guidelines, allocate public land among competing bidders, monitor the compliance of developers and operators with national guidelines and monitor the administration of other public services including customs, labor and environment regulation.
- Replace the current selective fiscal incentives with a universal flat rate of income tax applicable to most, if not all, manufacturing and service sectors. This would help to minimize distortions favoring investment in manufacturing over services. Investigate the potential to exempt tax-sensitive investors by negotiating double taxation agreements with countries that do not tax their residents on foreign investment income, e.g. Kuwait and the United Arab Emirates.
- Continue to eliminate customs duties on inputs used in production by all economic sectors in Jordan, including capital goods, intermediate goods and raw materials. An elimination schedule should be prepared and followed as soon as possible to provide certainty to the private sector and potential investors. SABEQ is
- Streamline customs procedures, business licensing procedures and ensure the prompt refund of excess sales tax input credits. In order to relieve pressure for new special economic zones, the Government should accelerate the process of reform of the national investment climate. As policies improve, efficient administration of policy becomes the predominant concern of business. The World Bank and International Finance Corporation *Doing Business in Jordan* survey sites numerous customs, business start-up and operational problems in Jordan.
- Develop a national industrial land-use plan to guide the use of private and public land among competing uses, set out a methodology for allocating public land, set out an appropriate property taxation system to promote productive use of land, and involve the economic and social interests of the local community. This work would build on the 2006 Industrial Map that matched potential sites for industrial and commercial land with projected demand based on the National Agenda forecast of industrial output.
- Create institutional mechanisms to facilitate local economic development by empowering local representatives to coordinate with counterparts to plan and achieve development goals. International experience and ASEZA have demonstrated that effective local government organization can accelerate local economic development compared to relying on uncoordinated central government planning or fiscal investment incentives on their own.

The Government should NOT:

- Create new special economic zones with special selective fiscal incentive packages;

- Invest further public funds in manufacturing in industrial estates in remote locations until sufficient investor demand is demonstrated and unless sufficient qualified labor is locally available
- Enable manufacturers serving the domestic market to adopt free zones status or establish production facilities within free zones. By adopting free zone status domestic manufacturers would merely be avoiding income tax without associated economic gains.

USAID-funded SABEQ is supporting the Government to implement a number of these recommendations and is ready to support the other recommendations. In particular, SABEQ is working with the Ministry of Industry and Trade to develop a national trade strategy which will set out policy and trade facilitation actions to be implemented at the national and sectoral level by Government and the private sector. One strategic activity will be to identify remaining customs duties on production inputs and schedule their removal. This work was started in 2006 by an inter-department committee under the Ministry of Industry and Trade. SABEQ is also working with local municipalities to streamline business licensing procedures and to create and support local development councils in Irbid and Karak. SABEQ is ready to support the creation of an estate and free zone regulatory agency

The USAID-funded AMIR Program reviewed current investment incentives and recommended their replacement with universal income tax and duty measures. The USAID-funded Fiscal Reform Project is working with the Ministry of Finance to convince parliamentarians and the public of the need for tax policy reform. SABEQ will support this reform work through its activities with the Ministry of Industry and Trade.

## ANNEX ONE – TABLE 1. COMPARISON OF ESTATES, ZONES, AND BONDED WAREHOUSES

| | Industrial Estates | Free Zones | Bonded Warehouses |
|---|---|---|---|
| **Number of Zones in Jordan** | ▪ 9 Private industrial estates<br>▪ 5 Public industrial estates | ▪ 26 Private free zones<br>▪ 10 Private free zones under construction<br>▪ 5 Public free zones | ▪ 11 public warehouses<br>▪ 80 private warehouses |
| **Objective** | ▪ Provide needed infrastructure for the development of industrial projects within Customs Territory | ▪ Allow for manufacturing and storage of goods outside Customs Territory | ▪ Provide storage facility for goods primarily destined to local market<br>▪ Defer payment of sales tax and duties until goods enter the Customs Territory |
| **Manufacturing of Goods** | ▪ Mainly allows for the manufacturing of goods. Storage of raw materials has to abide to very tight inspection and control (application of the 'production formula') | ▪ Storage and manufacturing | ▪ Manufacturing is prohibited - only cleaning, repacking and sorting may take place and under Customs supervision |
| **Regulator** | ▪ JIEC and MIT for private estates | ▪ FZC | ▪ JCD |
| **Management** | ▪ Public industrial estates managed by JIEC<br>▪ Private industrial estates are managed by private investors | ▪ Public free zones are managed by FZC<br>▪ Private free zones are managed by private investors | ▪ Minister of Finance can license private companies to manage a public warehouse<br>▪ Private warehouses owned and managed privately |
| **Ownership** | ▪ Investors can purchase or lease land from JIEC | ▪ Investors can only lease land from FZC. All improvements are transferred to FZC after lease terminates – this discourages long-term investment. | ▪ Private investor cannot own public warehouses – land is owned by JCD<br>▪ Private warehouses can be owned by private investors |
| **Treatment under Trade Agreements** | ▪ Products manufactured in industrial estates enjoy preferential access under all trade agreements (including the EU if duties on imported inputs are not exempted) | ▪ Goods produced in free zones do not enjoy free access under the GAFTA and the EUAA. The Arab League is likely to agree to permit GAFTA recognition of free zone products if they meet 40% local value-added test. | ▪ Not applicable |
| **Customs Bond** | ▪ A bank guarantee is required so that goods can enter on temporary admission or drawback system | ▪ Bank guarantees or customs bonds are not required in free zones | ▪ Investors storing their goods in public bonded warehouses do not to pay a bank guarantee<br>▪ Investors managing public warehouse have to pay a bank guarantee of JD 50,000<br>▪ Investor managing private warehouse have to pay a bank guarantee of JD 150,000 and a service fee of JD 0.5 per square meter or JD 60 whichever is higher |

| | Industrial Estates | Free Zones | Bonded Warehouses |
|---|---|---|---|
| **Fiscal Incentives** | ▪ Exemption from income tax and social services tax for two years<br>▪ Exemption from buildings and land tax<br>▪ Exemption from or reduction on most municipalities' fees<br>▪ Investors can benefit from fiscal incentives in accordance with the Investment Promotion Law No 16 of 1995 which includes:<br>o 100% exemption from custom duties and fees on imported fixed assets for starting or expanding a business<br>o Reduction on income and social services tax for 10 years at rates ranging from 25% to 75% based on sector/location | ▪ No company income tax on exports, transit<br>▪ Total exemption from personal income tax and social services tax for non-Jordanians working in free zones<br>▪ Total exemptions from custom duties, sales tax, import fees and all taxes except for goods destined to the domestic market<br>▪ Total exemption from construction licensing fees and building and land taxes for all construction activities within free zones<br>▪ Allows for profit repatriation<br>▪ No duties are imposed when goods are exported from one free zone to another (but subject to bank guarantee) | ▪ Goods stored in public warehouses are exempted from income and sales tax when exported against a bank guarantee |
| **Regulatory fee paid to JIEC, FZC or JCD (service fee)** | ▪ Investors do not pay any service fees | ▪ Tenant storing their goods in public free zones, have to pay a service fee and an 'ownership' transfer fee when selling goods<br>▪ Tenant in private zone pay two types of service fees: a fixed and a 'negotiated' fee in addition to an ownership transfer fee | ▪ Tenants storing goods in public bonded warehouses do not pay any service fee<br>▪ Investor managing public warehouse have to pay an annual service fee of JD 0.5 per square meter or JD 10,000 whichever is higher<br>▪ Investor managing private warehouse pay service fee of max of JD 0.5 /sq m or JD 60 |
| **Appraisal and classification** | ▪ Custom duties are determined based on the value of imported inputs. No new duties on sale to local market if duties paid on inputs. | ▪ No duties on imports. Customs duties on sales to local market are assessed by committee on foreign content of final good | ▪ No duties on imports goods. Duties paid when same goods released into local market |
| **Customs Entry** | ▪ JIEC is within the Customs Territory, a customs entry must be filed for all goods imported by investors, subject to temporary admission privileges | ▪ free zones are not considered within Customs Territory. Simplified free zone entry requirements for Customs | ▪ A bonded warehouse is within the Customs Territory. Customs entry required when goods enter and leave the warehouse |
| **Storage Period** | ▪ Temporary admission or drawback system should not exceed two years | ▪ Unlimited | ▪ Limited to two years |
| **Inspection** | ▪ Goods entered to industrial estates under the duty drawback system or temporary admission subject to inspection and bureaucratic procedures. This includes application of the production formula on goods manufactured in | ▪ Inside free zones there are no restrictions on utilization of raw material (production factor is not applied) - inspections on the stock of raw materials are moderate | ▪ Customs declaration are reviewed against stock of raw materials |

| | | | |
|---|---|---|---|
| | the industrial estates | | |

## TABLE 2 ADVANTAGES AND DISADVANTAGES OF FREE ZONES/PUBLIC BONDED WAREHOUSES — *STORAGE OF GOODS*

| Free Zones | | Public Bonded Warehouses | |
|---|---|---|---|
| **Disadvantages** | **Advantages** | **Disadvantages** | **Advantages** |
| ▪ Political decision regarding non-Jordanian products affect Free zone tenants (e.g. quotas, border closure)<br>▪ Higher lead time to enter the local market as products having a 'free zone' status need to file for customs entry<br>▪ Potentially high regulatory fees | ▪ Transit goods can only be stored in free zones<br>▪ Storage period is unlimited<br>▪ Simplified Customs regulations apply to free zones. For example, agricultural quarantine regulations permit mangoes to be stored in free zones but not in the rest of Jordan. Export declarations not required | ▪ Normal customs rules on prohibited and restricted goods apply<br>▪ Normal agricultural quarantine rules apply<br>▪ Fees are due when goods are released<br>▪ Storage is limited to two years<br>▪ Any goods exported subject to normal customs procedures | ▪ No regulatory service fees charged by public bonded warehouse<br>▪ Public bonded warehouses are located close to consumer market<br>▪ Better lead time to supply local consumer with goods. Customs entries are filed before goods enter the warehouse, thus expediting their removal |
| Free zones are more attractive for the storage of goods bearing high duties and taxes destined to be re-exported | | Public bonded warehouses are more attractive for the storage of goods bearing high duties and taxes destined for the local market<br>Private bonded warehouses only permitted to store cars, tobacco for local consumption | |

## ANNEX TWO – SUMMARY OF PROJECTS APPROVED BY THE JORDAN INVESTMENT BOARD 2001-2006

| All Sectors | Number of Approved Projects by JIB | | | | | | Volume of Invesments by JIB (JOD) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sector (JIB) | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
| Zone A | 165 | 123 | 93 | 152 | 207 | 216 | 165,007,618 | 68,595,494 | 94,423,191 | 99,742,711 | 160,072,974 | 507,384,213 |
| Zone B | 37 | 68 | 46 | 66 | 89 | 101 | 36,626,431 | 154,936,444 | 66,146,632 | 119,537,533 | 166,472,857 | 212,538,045 |
| Zone C | 59 | 44 | 39 | 58 | 84 | 90 | 175,335,000 | 22,132,065 | 25,815,500 | 55,154,300 | 317,208,550 | 916,824,711 |
| Non-Zone | 77 | 74 | 110 | 145 | 177 | 172 | 502,359,098 | 52,731,447 | 73,642,285 | 143,952,305 | 106,228,753 | 196,924,451 |
| **TOTAL** | **338** | **309** | **288** | **421** | **557** | **579** | **879,328,147** | **298,395,450** | **260,027,608** | **418,386,849** | **749,983,134** | **1,833,671,420** |
| **ZONE C** | **Number of Approved Projects by JIB** | | | | | | **Volume of Invesments by JIB (JOD)** | | | | | |
| **Sector (JIB)** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** |
| Agriculture | 18 | 10 | 12 | 16 | 40 | 19 | 20,079,000 | 4,438,000 | 4,780,000 | 12,843,300 | 19,969,000 | 48,872,990 |
| Hospitals | 1 | . | 1 | . | 1 | 1 | 800,000 | . | 33,500 | . | 780,000 | 3,000,000 |
| Hotels | 4 | 1 | 1 | 2 | 1 | 3 | 42,220,000 | 100,000 | 1,200,000 | 2,700,000 | 50,000,000 | 923,666 |
| Industry | 36 | 33 | 25 | 40 | 41 | 67 | 112,236,000 | 17,594,065 | 19,802,000 | 39,611,000 | 36,459,550 | 864,028,055 |
| pipeline transport | . | . | . | . | 1 | . | . | . | . | . | 210,000,000 | . |
| | **59** | **44** | **39** | **58** | **84** | **90** | **175,335,000** | **22,132,065** | **25,815,500** | **55,154,300** | **317,208,550** | **916,824,711** |
| **ZONE B** | **Number of Approved Projects by JIB** | | | | | | **Volume of Invesments by JIB (JOD)** | | | | | |
| **Sector (JIB)** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** |
| Hotels | . | . | 2 | . | 1 | . | . | . | 1,350,000 | . | 266,000 | . |
| Industry | 37 | 68 | 44 | 66 | 88 | 101 | 36,626,431 | 154,936,444 | 64,796,632 | 119,537,533 | 166,206,857 | 212,538,045 |
| | **37** | **68** | **46** | **66** | **89** | **101** | **36,626,431** | **154,936,444** | **66,146,632** | **119,537,533** | **166,472,857** | **212,538,045** |
| **ZONE A** | **Number of Approved Projects by JIB** | | | | | | **Volume of Invesments by JIB (JOD)** | | | | | |
| **Sector (JIB)** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** |
| Agriculture | . | . | . | . | . | 1 | . | . | . | . | . | 1,350,000 |
| Convention centers | . | 1 | . | . | 3 | . | . | 6,300,000 | . | . | 15,530,000 | . |
| Hospitals | 2 | . | 2 | 3 | 2 | 2 | 22,334,360 | . | 3,244,840 | 13,278,000 | 6,155,050 | 12,313,000 |
| Hotels | 4 | 2 | 2 | 8 | 8 | 15 | 17,790,000 | 1,241,400 | 7,661,500 | 10,192,570 | 8,849,083 | 236,516,473 |
| Industry | 157 | 119 | 88 | 140 | 191 | 198 | 121,833,258 | 58,054,094 | 83,426,851 | 70,342,141 | 117,813,841 | 257,204,740 |
| Leisure | 2 | 1 | 1 | 1 | 3 | . | 3,050,000 | 3,000,000 | 90,000 | 5,930,000 | 11,725,000 | . |
| | **165** | **123** | **93** | **152** | **207** | **216** | **165,007,618** | **68,595,494** | **94,423,191** | **99,742,711** | **160,072,974** | **507,384,213** |

## ANNEX THREE – BEST PRACTICE GUIDELINES FOR ZONE DEVELOPMENT

The following best practice guidelines are copied from the BearingPoint Inc. review of international free zone practice.[44]

Best practice guidelines for the development of an effective institutional framework are the following:

- Ensure adequate autonomy of the zone authority particularly over staffing, budgets, spending and policy-making.
- Ensure adequate authority by constituting an independent Board comprised of key government ministers and private sector representatives reporting to the highest level of government. Ideally, allow private sector representatives to constitute the majority of Board membership to ensure flexibility, results-orientation and customer-focus.
- Ensure that the zone authority serves as a one-stop shop by promulgating legislation that provides the body with single-point authority over other government bodies in core areas.
- Ensure that the body delegates, outsources and privatizes as many non-core functions and
- services as possible to focus on core activities.

Best practice guidelines for zone physical development are the following:

- Implement land use planning and zoning efforts in defined areas for industrial and commercial development to guide the actions of private developers.
- Develop zone designation criteria in the free zone law and implementing regulations to ensure that private free zones are well located (near population centers and transportation hubs) and minimize offsite infrastructure development expenditures of government.
- Establish a land use planning and infrastructure development unit in the government to ensure adequate planning and support of offsite infrastructure provision.

Best practice guidelines for design of a free zone incentive framework are the following:

- Introduction or reform of free zones regimes should be leveraged as an opportunity to rationalize income tax incentives. Ideally, this would result in harmonization of free zone corporate income taxation policies with national policies, or at least that zone enterprise taxation is the same as that provide to 'promoted industries.' Best practice approach for income tax incentives is to have performance-based incentives within a country's tax code rather than through special legislation such as export processing zone regimes.

[44] *Free Zones: Performance, Lessons Learned and Implications for Zone Development*, BearingPoint, Inc., unpublished paper prepared for Foreign Investment Advisory Service, November 2004, Chapter Five, Lessons Learned and Implications for Zone Development, pages 42-52

- Zone regimes should be used to advance demonopolization and deregulation of telecommunications and other utilities where applicable. Jamaica and other countries have used their free zone regime to accomplish this.

- Incentive framework should be WTO compliant. This is best done by removing any export obligation and allowing zone enterprises full access to the domestic market on a duty-paid basis.

Best practice guidelines for the development of a best practice zone regulatory framework are the following:

- Install streamlined procedures for business registration embodying a simple declarative investment registration system, rather than any sort of investment approval regime. Key elements would include: application to a single government office to provide the license; promulgation of a negative list of ineligible activities and other explicit criteria for approval or denial; default clause authorizing automatic approval of the application if no ruling has been issued within the review period.

- Facilitate provision of secondary permits and authorizations. Additional permits—land, buildings, labor, health and safety, etc—can be facilitated by vesting all such authorizations within the zone authority rather than other ministries and agencies. The zone authority should have offices within each zone to perform these services.

- Develop a special customs rules and regulations drawing upon WCO and WTO provisions, and fast-track implementation of automated customs systems, with proper inventory controls and audit systems, within the free zones.

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