WORLD BANK REGIONAL REPORT
JOBS OR PRIVILEGES: UNLEASHING THE EMPLOYMENT POTENTIAL OF THE MIDDLE EAST AND NORTH AFRICA

JORDAN ISSUE BRIEF

PROBLEM

The private sector did not create enough jobs to absorb the expanding labor force into the formal economy. This has led to high unemployment, especially among young people and women, and a large number of micro firms pursuing small-scale, low productivity activities.

Question: Why was private sector job creation weak? What is needed to create more jobs in Jordan?

Answer: Open markets to provide an environment of fair competition where new firms and startups can strive and unleash faster job creation.

ANALYSIS

Small firms do not grow. Most firms in Jordan had weak employment growth; a few fast-growing firms account for a large share of job creation. Table 1 summarizes the probabilities that surviving establishments transitioned among different size categories in 2006-2011. It illustrates that among all surviving non-farm micro establishments with less than ten employees almost never enter larger size categories. For instance, of all one-person establishments in Jordan in 2006, 65 percent remained one-person establishments and 35 percent hired at least one more worker. However among all micro establishments with less than ten employees in 2006 only 2.2 percent grew and hired more than ten workers five years later. The very low probability that micro firms will transition to larger size categories is striking. This finding is consistent with those of the World Bank (2014a) which showed that most micro firms are informal, and that informal firms have a very low chance to formalize. Moreover, the probability that medium-size manufacturing establishments grow to become large establishments five years later in Jordan is only 9.8 percent in Jordan which is lower than in Turkey (13.5%), Egypt (11.9%), and Morocco (10.7%).

Table 1. Small firms do not grow

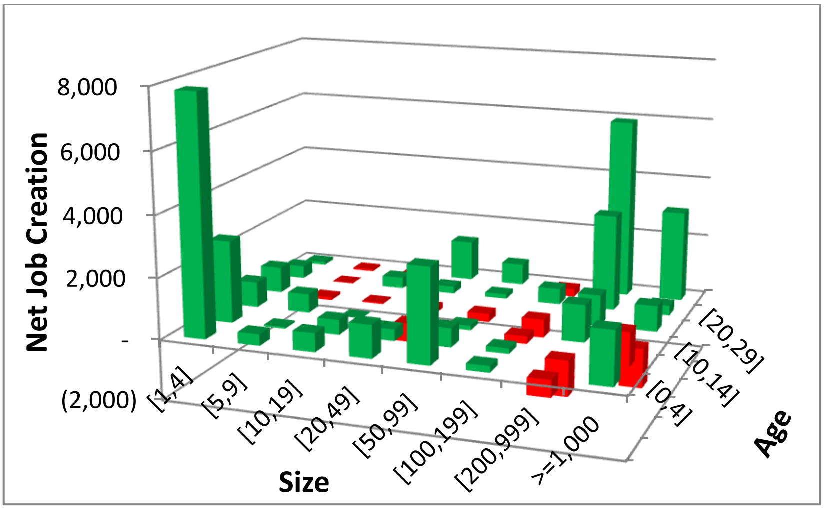
Employment Transition Matrix - Incumbent Establishments that Survived for 5 years

Status in year 2006	*Status in year 2011*			
	1-person	**Micro**	**SME**	**Large**
1-person	64.5%	35.4%	0.1%	0.0%
Micro	23.1%	74.8%	2.1%	0.0%
SME	1.7%	25.8%	67.1%	5.4%
Large	0.0%	3.9%	9.8%	86.2%

Source: Jordan establishment census. Note: Total number of incumbent establishments observed is 14,142, where an incumbent is an establishment that is at least one year old.
Micro = 2-9 employees, SME = 10-99 employees, Large>=100 employees.

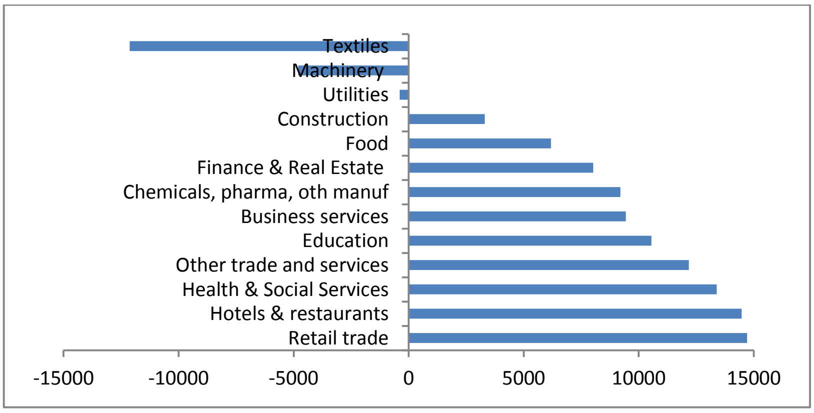
Startups, young firms and a few large and old firms, often foreign owned, are the engines of job creation in Jordan. In Jordan - as in most countries in the region as well as in high-growth economies – it is primarily young firms and startups that create most jobs. Figure 1 below illustrates this finding for surviving firms in Jordan.[1] It shows that young firms create – establishments between 0 to 4 years of activity – accounted for 40 percent of aggregate net job creation between 2006 and 2011. Among, young firms, micro startups – establishments between 0 to 4 years of activity and with less than five employees – accounted for more than half of these new jobs. Moreover, the oldest category of firms – establishments created more than 30 years ago – accounted for 28 percent of aggregate net job creation. Many of these large old firms, however, are foreign owned. That is, 19 percent of all large establishments in Jordan are foreign owned; they account for 30 percent of employment generated by large establishment. Thus, they reflect the high inward foreign direct investments rather than organic growth of large domestic firms.

Figure 1. Among surviving firms, startups and a few large and old firms created most in Jordan between 2006 and 2011



Notes: From World Bank (2014). The graph shows net job creation among surviving firms in Jordan from 2006-2011. The job destruction by exiting firms is not included since exiting firms are not observed. Size-age categories that created jobs are in *green* while categories that shed jobs are in *red*.

Figure 2. Net job creation by surviving firms across economic activities in Jordan between 2006 and 2011



The aggregate performance mirrors the sectoral patterns of job creation in Jordan. Figure 2 shows that job creation was driven by retail trade, hotels & restaurants, and health &

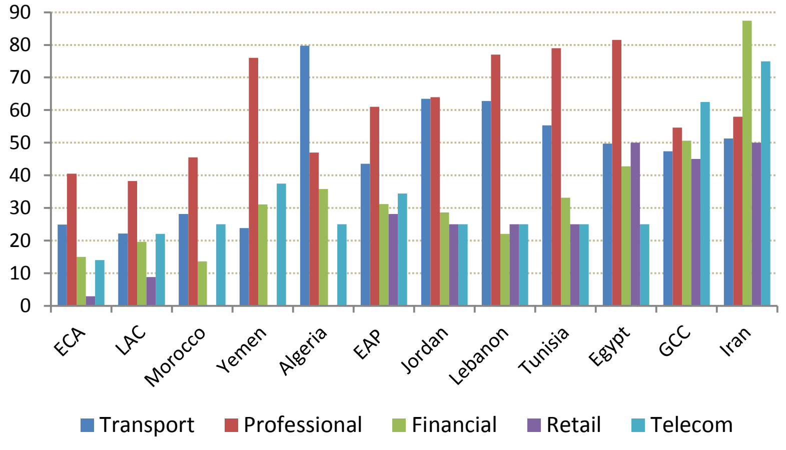
[1] The job destruction by exiting firms is not included since exiting firms are not observed.

social services. The average firm size in these three sectors is below 4 wage workers in Jordan. In fact, World Bank (2011a) shows that job creation in micro-firms in these sectors is often part of the informal economy, which is less productive in Jordan than in other developing regions. Certain higher productivity activities such as chemicals & pharmaceuticals, the food sector, and finance & real estate real also contributed to job creation; these sectors accounted for 28 percent of total net job creation between 2006 and 2011, counterbalancing somewhat the trend towards jobs in the informal sector.

However, startup creation is low pointing to many barriers to starting or closing a business and competition. For instance, for every 10,000 working age persons, only 7 new limited liability firms are created annually in Jordan compared to an average of 26 new firms among all developing countries worldwide. The entry densities in many fast-growing developing countries such as Serbia, Brazil, Croatia, Chile, and Bulgaria are between three and ten times higher than in Jordan.

Moreover, most firms in Jordan do not improve their productivity significantly over time due in particular to low competition and poor performance in backbone services. Restrictions on foreign firms entering service sectors in Jordan are high for some service sectors such as transport and legal services and to a lesser extent also in mobile telecommunication and banking (Figure 3). This partial protection from foreign competition in domestic service sectors has led to lower productivity growth of services firms in Jordan. In particular, Foreign Direct Investment (FDI) inflow in Jordan leads to a partial crowding-out of old and small domestic firms operating in the same sector, but has positive employment spillovers among domestic service providers and young firms. Domestic manufacturing firms (suppliers) did not benefit from FDI spillovers, possibly reflecting a combination of weak competition in the sector and the absence of well-designed and effective technical supplier support programs. Removing restrictions to FDI into services in Jordan is expected to create jobs among domestic firms.

Figure 3. Service trade restrictions in transportation services in MENA, 2008



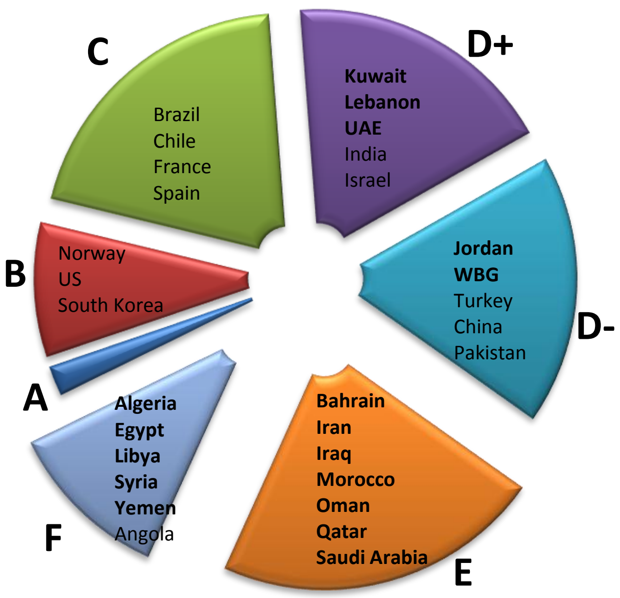
Source: Authors calculation based on World Bank Service Trade Restriction Database (Mattoo et al., 2011). Note: The higher the index, the more restrictions are imposed on foreign firm entry: zero implies no restrictions on foreign owners, 100 implies foreigners are not allowed to operate in the sector at all.

In addition, discriminatory policy implementation creates an uneven playing field in Jordan. Many firms in Jordan identify “policy uncertainty” as a “severe” or “major” obstacle to growth. This reflects firms’ perception of “policy implementation uncertainty” resulting from discriminatory practices. The variations in policy implementation observed in the data are substantial, and firms spend a significant amount of time and effort to influence policy implementation. Uncertainty in rule enforcement reduces competition and innovation in Jordan, suggesting its potential negative impact on productivity growth and private sector dynamism, especially the entry and growth of new firms.

Given that these policies cost jobs, why are they still in place? The report "Jobs or Privileges" shows that policies in the Middle Eastern and North African region have often been captured by a handful of politically connected firms which created privileges rather than jobs. Direct evidence on the adverse impact of politically connected firms on growth and job creation is only documented for the Mubarak and Ben Ali regimes in Egypt and Tunisia. The available qualitative evidence, however, points to similar mechanisms of policy privileges in other MENA countries including Jordan.

Patronage networks between the military and business are common features in most MENA countries including Jordan. For instance, the Transparency International (TI) Government Defense Anti-Corruption Index analyzes corruption risk in defense establishments worldwide. This index assesses and compares levels of corruption risk and vulnerability across countries. TI assessed 82 countries in 2012 and classified each country in a category from A to F, with A being the lowest corruption risk and F the highest. TI's evidence suggests that the relatively poor ranking in Jordan internationally is associated with patronage networks. The report found that networks based on close family ties between the military and businesses and restrictions on public debate and civil society freedom are features of most MENA countries including Jordan (even though to a lesser extent). Figure 4 shows that Jordan was placed in category D-: along with countries like China, Pakistan, Russia, and Turkey. TI reports for Jordan that in recent years the line between business and the military has become blurred with the government's efforts to focus more on profit-generating activities.

Figure 4. Transparency International: Defence Anti-Corruption Index



Source: Transparency International: Government Defence Anti-Corruption Index.

SOLUTION

Reform the policies that undermine open markets and competition for the advantage of a few privileged firms. Policies that need to be reformed include administrative barriers to firm entry, cumbersome bankruptcy laws, exclusive license requirements to operate in specific sectors, legal barriers to Foreign Direct Investment in services, trade barriers, or barriers to access to the judiciary, land, or industrial zones.

Policymakers should reduce the space for discretionary policy implementation and ensure that laws and regulations are enforced equally across firms and that policy is designed and implemented by a strong, capable, and accountable administration. The latter can be supported by linking entry into and promotions within the administration to merit, judged on the basis of potential or actual contributions to the legitimate goals of public policy.

One critical aspect of this reform agenda is to create institutions that promote and safeguard competition and equal opportunities for all entrepreneurs. These include a strong competition law and an independent competition authority; appropriate procurement laws and implementation; an independent judiciary, and so forth.

Citizens should also have access to information on proposed and ratified laws and regulations; citizen input into policy design and evaluation; citizen knowledge of politicians' stakes in firms that benefit from government policies; and citizen awareness of the beneficiaries of subsidies, procurement tenders, public land transactions, privatizations, etc. Ultimately a process of consultation, inputs and debate between policymakers and citizens will need to be established.

For references and detailed analysis and policy recommendations, refer to the complete 2014 World Bank Regional Report: "Jobs or Privilege: Unleashing the Employment Potential of the Middle East and North Africa".