ICR Review

Operations Evaluation Department

Report Number: ICRR10986

1. Project Data:		**Date Posted:** 08/16/2001		
PROJ ID:	P045676		**Appraisal**	**Actual**
Project Name:	Third Economic Reform and Development Loan (ERDL III)	**Project Costs (US$M)**	120	120
Country:	Jordan	**Loan/Credit (US$M)**	120	120
Sector(s):	Board: EP - General finance sector (43%), General industry and trade sector (20%), Central government administration (17%), General transportation sector (11%), Law and justice (9%)	**Cofinancing (US$M)**		
L/C Number:	L4482			
		Board Approval (FY)		99
Partners involved:	none	**Closing Date**	06/01/2000	06/01/2000
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2. Project Objectives and Components

a. Objectives

The Third Economic Reform and Development Loan (ERDL III) was the third in a series of three one-tranche policy loans designed to assist Jordan's medium-term reform program. These loans were the pillars of the 1995 Country Assistance Strategy (CAS) to promote rapid and sustainable outward-oriented growth, led by the private sector. Under the base case scenario, GDP was projected to rise by about 6 percent annual through the end of the 1990s; per capita income would rise by an average of 3 percent; exports would grow at an average of 8.5 percent; and domestic gross domestic savings would reach 10 percent of GDP. The loans formed a continuum in trade, finance, and investment policy reform aimed at supporting Jordan in addressing constraints to rapid and sustainable outward-oriented and private sector-led growth, imposed by its small domestic market. Specifically, ERDL III focused on: (i) further trade facilitation and export development, leading to a sustained growth of exports; (ii) a comprehensive privatization program, leading to an efficient production and incentive structure; (iii) a financial sector reform, leading to efficient resource mobilization and allocation; and (iv) streamlining the regulatory framework, leading to a stable and transparent environment attractive to private businesses and enabling them to compete aggressively in the world markets.

b. Components

Trade, financial sector, regulatory reforms, and privatization are the main components of ERDL III. Trade reforms focused on facilitating trade, fostering integration with world markets, reducing administrative obstacles that raise the cost of trading activity through streamlined customs procedures for exports, and converting the Agaba area into a free port. The project supported a program of financial sector and regulatory reforms designed to: (i) enhance the efficiency of the banking system and promote the development of the capital market and long-term saving institutions; (ii) improve banking competition and supervision and increase the efficiency of financial intermediation through modernization of the institutional and legislative setup; (iii) encourage long-term savings and promote development of new financial instruments and markets; and (iv) facilitate entry and improve incentives for domestic and foreign investors. Finally, privatization measures were aimed at improving opportunities for private sector firms, increasing competition, and allowing the government to concentrate on its core functions.

c. Comments on Project Cost, Financing and Dates

EDRL III became effective on July 1, 1999 and closed on schedule on June 1, 2000. As an adjustment loan, there were no detailed project cost figures.

3. Achievement of Relevant Objectives:

Since this was a single-tranche operation, all relevant actions were taken before loan approval. Jordan's incentive regime no longer has an anti-export bias, the investment regime is friendly, and the pace of privatization has picked up. Despite the implementation of all the reform measures, the macroeconomic indicators have not improved significantly and economic growth has been slow, though the policy package supported by the loan was expected to lead to higher GDP growth supported by a robust export performance . The overall budget deficit (including grants) has doubled from 3.0 percent of GDP in 1996--when ERDL I began--to 6.3 percent in 1998, and remained high at about 3.9 percent in 1999. Economic growth slowed to an average of about 2.8 percent per annum during 1996-99, much lower than the projected 6 percent annual growth rate. The economy witnessed an impressive annual average growth rate of over 7 percent during 1991-95. Also, merchandise export growth, which remained flat for most of the 1996-99 period, started to increase in 2001. The Jordanian Dinar's appreciation between 1996 and 1999 has adversely affected exports. Investment has declined from a very high level of 31 percent of GDP in 1996, but remained at a still high level of 21 percent. Therefore, instead of investment efficiency improving in response to the changed incentive regime, it appears to have declined . Only a small proportion of investment was financed by domestic savings, which remained at about 3.6 percent of GDP. On the other hand, Jordan's economic prospects remained heavily dependent on the external environment . Exports to Iraq--Jordan's foremost export destination--has dropped by about 50 percent because of the UN sanctions. The "peace dividend" has not materialized and exports to the West Bank and Gaza and Israel have not picked up .

4. Significant Outcomes/Impacts:

Jordan's tariff structure was compressed, simplified, rationalized, and lowered to comply with the World Trade Organization (WTO). Customs administration and valuation procedures were modernized to conform to international practice. A Customs Law and Safeguard Law consistent with WTO principles were enacted and implemented . Progress in trade reform enabled Jordan 's accession to the WTO in April 2000.

5. Significant Shortcomings (including non-compliance with safeguard policies):

Bank staff underestimated the risk that private investment would not respond quickly to the new incentive regime in Jordan's and the region's current circumstances . Linking rapid growth to ERDL policy changes in a short CAS period gives rise to expectation that may not be fulfilled . The Jordanian private sector is still adjusting to the new incentive regime. Because it remains unsure that the reforms have been completed, investors continue to assess new investment prospects cautiously. The optimistic targets of 6 percent annual GDP growth from 1996 onwards needed to be substantiated by a detailed analysis of the sources of growth . The slow pace of privatization has adversely affected direct foreign investment. Even though poverty is not directly targeted, the overall impact of the reform program on poverty was expected to be favorable as higher growth in the private sector would create new jobs and expand employment. However, the weak rate of economic growth (which does not exceed the population growth rate) has resulted in declining per capita income for the past three years . Hence, poverty may have increased rather than decline. Indeed, the 1999 CAS suggests that poverty has worsened given the overall slow economic growth and negative per capita income growth since 1996. Annex B10 of the 1999 CAS indicates that the proportion of the poor has increased from 11.7 percent in 1997 to 13.6 percent in 1999.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	While a substantial package of trade, investment and financial sector reforms and privatization has been implemented, a combination of factors, some of them exogenous, has prevented a more positive outcome. Economic growth has been slow and poverty may have increased during the reform period.
Institutional Dev .:	High	Substantial	Shortcomings still remain in the full implementation of legislative and incentive changes and the realization of their intended results. Further institutional changes leading to better implementation of adopted regulations will need to be addressed by pursuing measures such as public sector reform. The Bank has recently started this process.
Sustainability :	Highly Likely	Likely	There is anxiety about the program net benefits (given the slow economic growth) and its social and political consequences . Policy reforms may no longer be socially and politically robust. Political uncertainty regarding the regional peace

			process should have cautioned against overplaying the expectations of a rapid private sector response to changes in the incentive regime and the attainment of growth of higher growth targets.
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Highly Satisfactory	Satisfactory	The government had met loan conditionality and all loan covenants were complied with. Yet progress in implementation of reforms especially privatization was slow. Political consensus evolved over a few years before the process accelerated.
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

- Changes in the incentive regime are a necessary, but not a sufficient condition for efficient and rapid economic growth. Linking rapid growth to these policy changes in a short CAS period gave rise to expectations that could not be fulfilled.
- An analysis of sources of potential growth for Jordan and advice on how to develop these prospects might have permitted reforms to be sequenced to emphasize sectors with growth potential. This would have bolstered belief in the benefits of the incentive changes, and softened the blow of job losses when uncompetitive sectors declined.

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR is clearly written and covers all relevant aspects of the loan. However, it lacks the standard table on key performance indicators and would have benefited from a detailed policy matrix of achievements prior to Board and after Board approval. The government reviewed the ICR and provided comments.