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# Socio-Economic Challenges and Jordan's Foreign Policy: Employment, Trade, and International Cooperation - Perspectives from the Region and Europe

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## *Employment*

## From Survival Strategy to Innovation: Creating an Enabling Business Environment for Micro, Small and Medium Enterprises in Jordan

Sophie Schmid

### *Summary*

Despite the fact that Micro, Small, and Medium Enterprises (MSMEs) make up 99 percent of all registered enterprises in Jordan and employ 77 percent of the private sector workforce, their contribution to the GDP is still comparably low. Moreover, MSMEs make up the vast majority of all unregistered and unlicensed enterprises within Jordan's constantly growing unofficial sector. This means that the Kingdom's large number of MSMEs not only represents untapped tax revenues for the state, but also holds potential for significant economic growth. It is vital for policymakers to facilitate processes and adapt regulations in the fields of administration, financing, taxation, and compliance in order to reduce everyday hurdles for entrepreneurs in both setting up a business and expanding it. An enabling, rather than a stagnant business environment will not only reduce incentives for remaining in the informal sector, but also galvanize entrepreneurship as a source of economic growth and innovation in the Kingdom, instead of being a mere survival strategy.

## From Survival Strategy to Innovation: Creating an Enabling Business Environment for Micro, Small and Medium Enterprises in Jordan

Sophie Schmid

Although Jordan's MSMEs<sup>i</sup> could be the backbone of the country's economy and a vital source for job creation, they do not live up to their potential. Despite the fact that MSMEs make up 99 percent of all registered enterprises in Jordan and employ 77 percent of the private sector workforce, their contribution to overall production lies at only 30 percent,<sup>ii</sup> while they account for a mere fraction of total company revenues. This imbalance represents a risk and opens up prospects at the same time: as 55 percent of all MSMEs are concentrated outside of Amman, they are able to reach pockets of poverty in rural areas, contribute significantly to local development, and promote economic decentralization.<sup>iii</sup>

Another vital opportunity for the Jordanian government to tackle economic stagnation lies in the country's informal sector. The fact that unregistered and unlicensed MSMEs make up the vast majority of the unofficial sector – which represents about 26 percent<sup>iv</sup> of the Jordanian economy – means that the government fails to benefit from substantial tax revenue each year. By creating incentives for enterprises to transition from the informal to the formal sector, the Jordanian government would not only set a model example for the way states handle illegal employment, but also pave the way for much-needed additional fiscal revenues.

Jordan's economy has been troubled by numerous challenges and setbacks over the past years: government debt at 94.3 percent of GDP in 2018, an unemployment rate of 18.7 percent in Q1-2019, a stagnating GDP growth of around 2.4-2.5 percent, rising energy costs, and a bloated public sector.<sup>v</sup> With close to 70 percent of the country's population below the age of thirty, the Kingdom is a very youthful country. Nevertheless, close to one-third of young people in Jordan is neither in employment nor in education. In 2017, labor force participation stood only at 39.7 percent.<sup>vi</sup>

Moreover, Jordan has come to rely heavily on foreign financial aid, loans, and assistance funds. The government has committed to various IMF and World Bank programs targeting different economic areas and demanding a set of free-market policies in return. Despite partial success in certain sectors, the austerity measures announced by the government as a result

of the financial aid programs have led to severe dissatisfaction among citizens as well as rising inflation. The high influx of refugees from Iraq, and especially Syria, poses an additional burden on the country's public services and resources.

In a country like Jordan, where economic and political stability are particularly intertwined, and the latter is directly related to its dependence on foreign financial aid, it is of the utmost importance to strengthen the private sector and focus on job creation. By creating an enabling business environment for the vast amount of MSMEs in Jordan, the government has the opportunity to draw on and unleash an already existing economic potential. Through the implementation of a set of legal, administrative, and economic reforms targeting the simplification of setting up and expanding a business, both the state and Jordanian entrepreneurs would benefit from the MSME contribution to economic growth.

### Restrictive Regulations and Unfavorable Laws

Regarding the regulatory and administrative framework, the conditions and requirements imposed in Jordan often constitute avoidable obstacles for entrepreneurs: Jordan ranked only 104 out of 190 in the World Bank Doing Business Index 2019 and reached 61 points in the distance to frontier score of the World Bank in 2017.<sup>vii</sup> Restrictive regulations not only lead to high dissatisfaction among entrepreneurs, but also to an increase in unregistered and unlicensed MSMEs. The incentives for MSMEs to remain informal seem to be higher than to transition to the formal sector.

Thanks to the new e-government system however, the registration process for limited liability companies in Jordan has been simplified in recent years and usually only takes several days. Since late 2018, the registration of an LLC can be carried out online, registration fees can be paid electronically, and each year's financial report can be submitted at the e-tax department. At any point though, this process can be delayed in order to obtain a "special approval" for security reasons, carried out by the Ministry of Interior and the Intelligence Department. This security check has neither a legal basis nor transparent criteria or a clear time frame, and opens the door for arbitrariness and corruption.

According to startup-founder Sadeq Rasheed, remaining obstacles in the registration process also include signing up for the company's trade mark (taking approximately nine months) or buying the ".jo" domain, which costs JD 100 the first time and an additional JD 50 for each annual renewal. On top of a great deal of expensive paperwork and the minimum capital requirements, the costs of registration and licensing a business are often too high for MSME founders.

In addition to the regulatory structure, the legislative framework for economic growth does not provide legal incentives for founding a business or investing in the private sector: Although anticipated in the Jordan Vision 2025,<sup>viii</sup> there are still no accessible, transparent, and predictable laws regulating MSMEs or startups in Jordan. The movable assets law<sup>ix</sup> was passed in May 2018, but has not yet been implemented. According to a recent survey,<sup>x</sup> laws governing investment in startups are very unfavorable (38 percent), the social security law for entrepreneurs is somewhat to very unfavorable (26 percent), and the customs law and regulations are very unfavorable (35 percent).

### Deficiencies in Funding and Financing

Since access to finance has been described as the main obstacle for firms in Jordan according to the World Bank “Enterprise Surveys,”<sup>xi</sup> this must be facilitated and alternative financing options should be provided. Jordanian entrepreneurs usually belong to the low-income category and only have a startup capital of JD 5,000 or less.<sup>xii</sup> However, 96 percent of all firms in Jordan are said to be “micro” firms, with fewer than ten employees, while accounting for just 8 percent of total company revenues.<sup>xiii</sup> For these businesses, there are usually a number of institutions providing access to capital – the most prominent in Jordan being private Microfinance Institutions (MFI) and commercial banks. In recent years, the Jordanian government has introduced several strategies aimed at stimulating the private sector and promoting private investment opportunities, the most prominent being the Jordan Economic Growth Plan (JEGP) 2018-22. Since 2004, non-profit micro-finance companies as well as NGOs have been exempted from all taxes, and Jordan established a Credit Bureau in 2015.

Despite these efforts, Jordanian MSMEs are still struggling to access credit and finance: there is no specific micro-lending regulation, no effective regulations protecting minority investors, and no efficient bankruptcy and insolvency system. One of the main problems concerning access to finance lies in the fact that many entrepreneurs in Jordan lack a formal financial history or have incomplete credit data, and are primarily dependent on cash transactions. Only 25 percent of Jordanians aged over fifteen report having an account at a financial institution, which makes them ineligible for most bank loans.<sup>xiv</sup>

Another key issue for MSMEs’ access to funding is described as the “missing middle” financing gap: Jordanian entrepreneurs seeking between USD 50,000 and 2 million are often too big for micro-finance loans and too small and risky for commercial banks.<sup>xv</sup> Although banks’ interest rates tend to be lower than those of MFIs, SME loans account for only 13 percent of the total commercial loans in Jordan and usually result from collateral rather than creditworthiness.<sup>xvi</sup>

When it comes to alternative funding sources such as incubators, accelerators, or funds, there is a significant gap in Jordan. According to Sadeq Rasheed, existing Jordanian early-stage seed investment companies, business accelerators, and other institutions such as OASIS500, ZINC, or the King Hussein Business Park are not only already fully occupied for the coming years, but simply do not provide a sufficient amount of funding. Furthermore, in order to qualify for many of these institution's programs, entrepreneurs must not only present an innovative business idea, but should also have a certain academic or vocational background.

Another major issue mentioned by MSME owners in Jordan is the lack of foreign investment and insufficient access to foreign markets. Despite the government introducing various measures to improve the business environment for foreign investment, such as easing visa procedures or establishing the Jordan Investment Commission (JIC), many foreign investors are still dependent on a Jordanian partner holding 50 percent of the shares, while several economic sectors are not accessible for foreign investors at all.

### Promoting Stagnation through Taxes

According to 51 percent of Jordanian startup founders in the abovementioned survey,<sup>xvii</sup> government policy perceptions on taxes are "very unfavorable," while 73 percent of all participants identified Jordanian tax law as the least favorable of all government policy perceptions. Entrepreneurs criticize irrelevant tax laws, high indirect taxes, as well as a lack of training and knowledge among entrepreneurs for comprehending the highly complex taxation system.

At the same time, the Jordanian state loses significant amounts of tax revenue due to widespread tax evasion, especially among MSMEs. According to the Ministry of Finance's Income and Sales Tax Department, the total tax losses in 2016 stood at USD 4.2 billion.<sup>xviii</sup> Even though MSMEs are exempted from sales tax up until JD 70,000 annual revenue, this most likely hinders entrepreneurs' motivation to expand their annual income. Furthermore, irrelevant tax laws create additional admin compliance costs. In this regard, Jordan is a good example of how tax policies can negatively impact productivity.

### Recommendations

In order for Jordan's already existing vast network of MSMEs to expand and become a vital source of job creation and income, the Jordanian government needs to introduce a set of easily implementable reforms within the areas of administration, funding, and taxation to improve both the quality and the quantity of entrepreneurship in the country. It is equally important to create incentives for unregistered MSMEs to transition into the formal sector. All measures should focus on the great potential of MSMEs to support economic decentralization in rural areas.

### *Ministry of Industry, Trade, and Supply*

- *Simplify business registrations and fee structures*

Business registrations and fee structures should be simplified by developing standard application procedures, lowering the minimum capital requirements, and passing a set of laws regulating MSMEs and startups. These goals can be met by a set of tools, among them a flat fee for business registration and the “ex-post” method. The fees for registering and licensing a business should not be a tool for collecting money for the state, especially in a country like Jordan where small or even micro enterprises are the majority. Instead, a flat fee for MSME registration, licensing, trademarks, and domains should be introduced, regardless of capital amount, and based on a threshold capital amounting to 1 percent of GNP per capita.<sup>xix</sup>

When applying the “ex-post” method when evaluating the security of a business, the business can start operating immediately after being registered without interrupting the registration process through arbitrary “special approvals.” Although this measure does not mean these security checks will not be carried out at a later point in time, it will at least allow the business to start operating.

Jordan has to adopt accessible, transparent, and predictable laws regulating MSMEs or startups and implement the movable assets law to obtain credit from financial institutions.

### *Ministry of Finance, Ministry of Planning and International Cooperation, The Bank of Jordan, World Bank Group*

- *Facilitate access to finance by promoting various financing options while ensuring the regulatory protection of lenders and creating incentives for foreign investment*

By imposing specific micro-lending regulations, the Jordanian government would not only ensure a legal framework that guarantees stability, competition, and efficiency in the financial market, but also protect minority investors. Micro-finance regulations broaden the range of criteria for credit-worthiness and separate by risk type. They differentiate between the various pledges of loan applicants – by collateral, reputation, or attitude – and provide an alternative to bank loans by strengthening credit information. Funding programs should be directed towards and tailored to entrepreneurs’ needs (according to sector, stage, size, and so on), with the introduction of provisions for various financing avenues to service differing needs among the population.



In addition, regulations need to address the “missing middle” gap: lending capital should be available to support each stage of development. In order to safeguard regulatory protection of lending institutions and thereby increase their willingness to lend, Jordan should assess and seek to improve an efficient bankruptcy and insolvency system.

Beyond financing, MSME owners need non-financial services as well. Therefore, the Jordanian government should invest significantly in incubators and accelerators, which offer loans, work spaces, as well as mentoring, financial education, and business training. This way, entrepreneurs receive essential start-up support, build up a sustainable network, and benefit from best-practice examples.

In order to create incentives for foreign investment and provide MSME owners better access to foreign markets, the Jordanian government needs to reduce tariffs significantly on both exports and imports. Trade facilitation measures such as the elimination of trade-related transaction costs will enable entrepreneurs to grow, diversify, and ultimately contribute to Jordan’s economic expansion.

#### *Ministry of Finance, Prime Ministry*

- *Ensure a balanced tax system that creates incentives rather than merely cracking down on tax evasion*

As administrative, legal, and financing procedures in Jordan hinder the establishment of MSMEs, current tax regulations actively discourage them from growing or expanding. Therefore, regulations should be remodeled in such a way that they support productivity, rather than punishing companies through the use of disproportionately high and partially arbitrary taxes. A tax system composed of several stage tariffs differentiating between an enterprise’s annual revenues, rather than increasing in a linear way, would relieve MSME founders of certain tax payments, especially at early development stages. Instead of cracking down on tax evasion, the tax system should motivate citizens to pay taxes by being affordable and – ideally - offer high quality services in return.

Another tool draws from the Tunisian Finance Act 2018, which determines that profits from direct investment in local development areas are fully deducted from taxable income up to the end of a five-year period. Hereby, the tax system would actively support entrepreneurship as well as decentralization in Jordan.



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## Notes

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<sup>i</sup> Like many other countries, Jordan does not have an official definition of MSME. According to the policy recommendations of the Small and Medium Enterprises Conference held under the umbrella of the Economic & Social Council and the Jordan Chamber of Industry in December 2018, micro enterprises comprise 1-4 employees, small enterprises 5-19, medium enterprises 20-99, and large enterprises employ more than 100.

<sup>ii</sup> “Small and Medium Enterprises Coalition Jordan, “Towards a New Economic Model: Enhancing the role of SMEs as Motives of Economic and Social Development,” Economic & Social Council, Jordan Chamber of Industry, 2018.

<sup>iii</sup> Ibid.

<sup>iv</sup> Ibid.

<sup>v</sup> “The World Bank in Jordan,” World Bank  
<<https://www.worldbank.org/en/country/jordan/overview#1>>  
(accessed July 8, 2019).

<sup>vi</sup> “Jordan Economic Monitor, Fall 2017: Towards Stronger External Trade Performance,” World Bank, 2017  
<<https://openknowledge.worldbank.org/handle/10986/29098>>  
(accessed July 8, 2019).

<sup>vii</sup> This score measures a country’s business environment over time from a scale from zero to 100, 100 being the maximum.

<sup>viii</sup> The Jordan Vision 2025 is an extensive strategic plan for the country’s near future and determines the integrated economic and social framework that will govern the economic and social policies of the coming years. It was launched by the Jordanian government in May 2015.

<sup>ix</sup> A moveable assets law provides lenders with the ability to register effective security over moveable assets. The law legalizes and regulates the registration of movable assets as collaterals for obtaining credit from financial institutions. Such a law makes it easier for small businesses to obtain credit using other forms of assets such as cars, machinery, and so on.

<sup>x</sup> A survey conducted in January 2019 by the Ministry of Information and Communications Technology together with the World Bank Group and GIZ interviewed 230 Jordanian startup founders from over ten sectors, the majority being from the ICT sector. Its results were published in a PowerPoint presentation, “Jordan Startup Ecosystem Survey Results,” January 16, 2019.

<sup>xi</sup> “Jordan 2013,” World Bank Group Enterprise Surveys  
<<http://www.enterprisesurveys.org/data/exploreeconomies/2013/jordan#corruption>> (accessed July 8, 2019).

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<sup>xii</sup> Ghassan Omet et al., “Entrepreneurship in Jordan: Regional Analysis and Envisaged Role,” *Research Journal of Business and Management* 2 (September 2015), p. 323.

<sup>xiii</sup> “Jordan 2025: A National Vision and Strategy.”

<sup>xiv</sup> Adam Schiff et al., “Entrepreneurship Environment Assessment in Jordan,” Silatech Research and Policy Report, University of Minnesota, Humphrey School of Public Affairs, May 2015  
<<https://conservancy.umn.edu/bitstream/handle/11299/172490/Schiff%2C%20Schmidt%2C%20Troncoso-%20Entrepreneurship%20Assessment%20in%20Jordan%20May.pdf?sequence=1>> (accessed July 8, 2019).

<sup>xv</sup> Ibid.

<sup>xvi</sup> Ibid.

<sup>xvii</sup> See endnote x.

<sup>xviii</sup> “Challenges of Starting a Small Business in Jordan.” Jordan Strategy Forum (JSF), May 2013 <[http://jsf.org/sites/default/files/Challenges%20of%20Starting%20a%20Small%20Business%20in%20Jordan\\_1.pdf](http://jsf.org/sites/default/files/Challenges%20of%20Starting%20a%20Small%20Business%20in%20Jordan_1.pdf)> (accessed July 8, 2019).

<sup>xix</sup> According to “Challenges of Starting a Small Business in Jordan” by JSF, the World Bank found that the cost of starting up a business for the top ten countries in terms of cost does not exceed 1 percent.