

Job Growth without Unemployment Reduction: The Experience of Jordan
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Abstract

In recent years, more new jobs have been created in Jordan than the number of unemployed. However, while job creation rates have been robust, unemployment has stayed high, fluctuating around 14 percent. The bulk of new jobs created have been taken by foreign workers. This paper explores some reasons why this has been the case. We show that a combination of structural reforms and continuing distortions has generated incentives for employers to invest in sectors that are characterized by relatively low-wage jobs and, within these sectors, to prefer foreign workers to domestic workers. We also show that domestic workers have relatively high reservation wages, based on expectations of obtaining public sector or foreign jobs and of income support from families. Survey evidence suggests that more than 50 percent of the unemployed are unwilling to take available jobs at prevailing wages. Jordan's experience suggests lessons for reforms in countries that are open in terms of the ability to import and export labor. The main lesson is that while conventional economic reforms (e.g. trade and investment liberalization) may lead to growth, they may not necessarily lead to a reduction in national unemployment. The link between growth and unemployment is affected by the types of jobs that are created, by the incentives employers have to choose between foreign and local workers and by the choices that nationals make between accepting a local job and staying voluntarily unemployed in search of a better job overseas or in the public sector.

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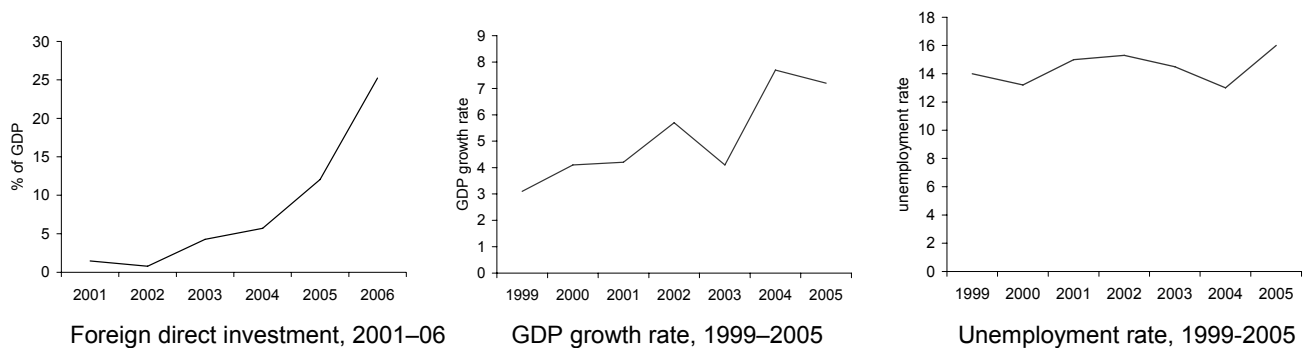
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A. Introduction

In recent years, Jordan has successfully attracted investment, achieved strong GDP growth, and created many new jobs. Private foreign investments have increased dramatically since 2001 while GDP growth averaged 6 percent during 2000- 2005. There has also been substantial job growth: from 2000 to 2005, Jordan created about 44,500 additional jobs per year on average. However, unemployment (among nationals) did not decline but fluctuated around a fairly high level of 14 percent (Figure 1).

Figure 1: Paradox: Strong investment and GDP growth, but high unemployment



Sources: Central Bank of Jordan, World Development Indicators, Employment and Unemployment Surveys.

Many of the newly created jobs were filled by foreign workers rather than by Jordanian nationals. Estimates based on official sources suggest that since 2001 around 63 percent of newly created jobs were filled by foreign workers (Table 1). By now, foreign workers in Jordan number 300,000, far more than the number of unemployed Jordanians (175,000 in 2005).

Table 1: Many new jobs but more than half have been filled by foreign workers

| | 2001 | 2002 | 2003 | 2004 | 2005 | Average |
|------------|--------|--------|--------|---------|--------|---------------|
| Jordanians | 200 | 9,900 | 6,400 | 42,900 | 23,300 | 16,500 |
| Foreigners | 26,000 | -9,400 | 21,600 | 69,900 | 31,600 | 27,900 |
| Total | 26,200 | 500 | 28,000 | 112,800 | 54,900 | 44,500 |

Why have the new jobs created been filled by foreigners instead of locals? In this paper, we show that a combination of structural reforms and continuing distortions has generated incentives for Jordanian employers to invest in sectors which feature relatively low skill low wage jobs and, in these sectors, to prefer foreign workers to local workers. We also show that domestic workers have relatively high reservation wages, based on expectations of obtaining public sector or foreign jobs and of income support from

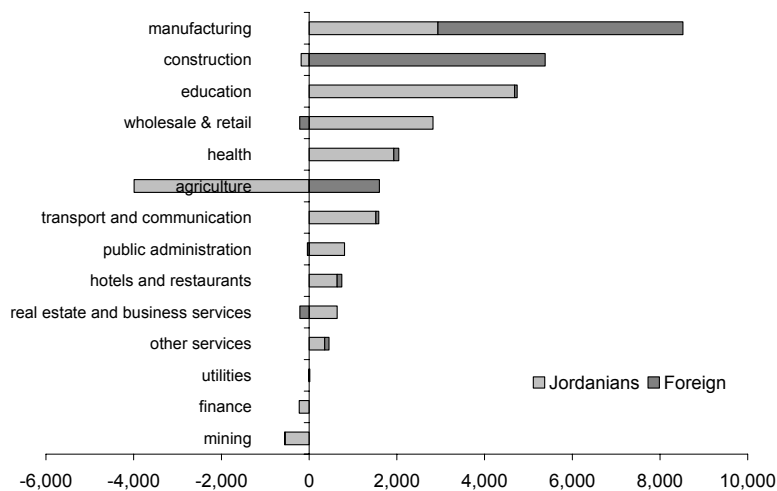
families. More than 50 percent of the unemployed indicate that they are unwilling to take available jobs at prevailing wages.

The rest of this paper is organized as follows. In Section B, we review the incentive environment for Jordanian employers. We argue that the incentive environment created by structural reforms in the 1990s and continuing distortions in labor and tax policy have led to most new jobs being created in sectors that feature relatively low wages that are not attractive to most Jordanians. We also show that the pattern of incentives in place leads to employers choosing foreign workers for these jobs. In Section C, we review some reasons why Jordanian workers prefer to remain unemployed than to accept available jobs at prevailing wages. These include high expectations of landing either domestic public sector jobs or foreign jobs (for example, in the booming Gulf region) as well as continuing income support from families. Section D provides some concluding observations.

B: The Incentive Environment for Employers

Figure 2 provides data on annual net job creation by sector in Jordan for the period 2000-05. Three observations may be made on the basis of this data: (i) the two highest growth sectors have been manufacturing and construction, both featuring relatively low paying jobs; (ii) within these two sectors, the bulk of new jobs have gone to foreign workers; (iii) in agriculture, there has been a significant decline in the jobs held by nationals but an increase in the number of jobs held by foreigners.

Figure 2: Average annual net job creation by sector, 2000–05

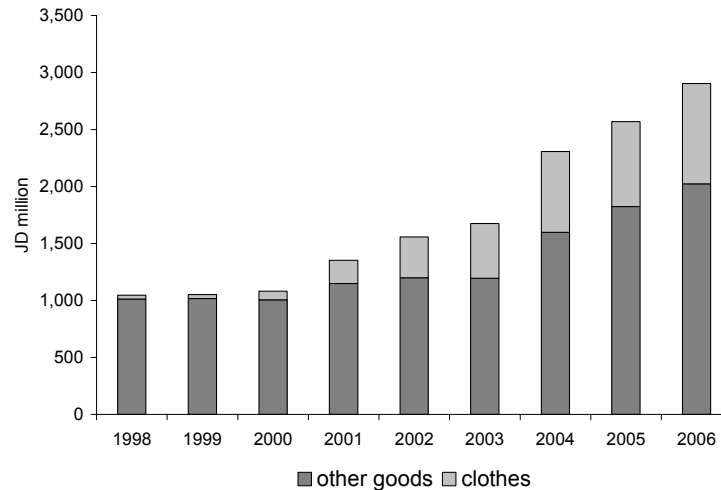


Sources: DOS (2007)

What explains this pattern of job creation? Trade and investment policy liberalization undertaken since the 1990s has played a big role. In particular, the manufacturing sector has benefited in terms of both output and job creation through these reforms. Figure 3 shows how the export of goods has soared during 1998-2006, tripling in nominal dinar value, partly due to tariff reductions (which allowed cheaper inputs to be

imported)¹ and partly to the ability to obtain privileged access to selected markets through bilateral treaties.

Figure 3: Growth and Composition of Exports 1998–2006



Source: Central Bank of Jordan 2007.

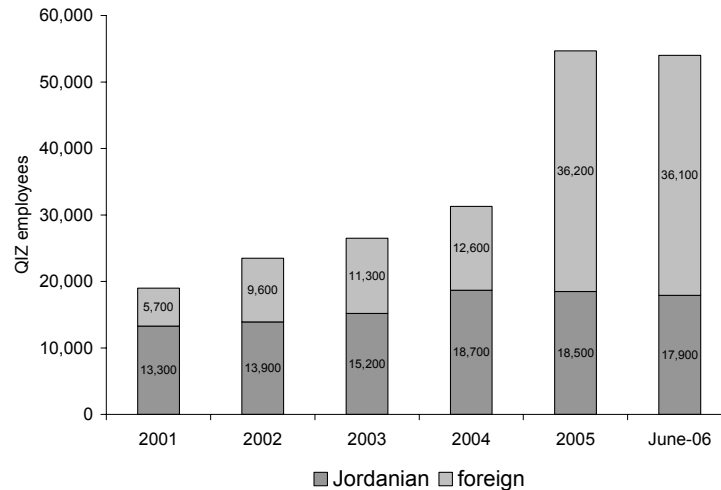
In 1997, Jordan and the United States signed the Qualified Industrial Zone (QIZ) Agreement, which extended the market access privileges of the U.S.-Israel Free Trade Agreement to approved enclaves in Jordan that produce goods in collaboration with businesses in Israel. To be eligible for free access to the U.S. market, products from the QIZs have to have at least 8 percent Israeli content, 11.7 percent Jordanian content, and a total content from Israel, Jordan, West Bank and Gaza, and the United States of at least 35 percent. The QIZs presented an important opportunity for textile and clothing manufacturers from other countries to circumvent their quota restrictions. Apparel manufacturing requires little capital investment and permits a great deal of geographic mobility, with factories picking up and moving to take advantage of opportunities. The production processes in the QIZs are primarily cutting, sewing, trimming, ironing, and packaging—all low-investment and labor-intensive processes.

QIZs have been directly responsible for a large share of the growth in exports and jobs in Jordan since 2000. The share of QIZ exports in total exports grew from 0.2 percent in 1999 to almost 28 percent in 2005 (figure 3). During this same period, the QIZs generated 54,000 new jobs, about one-third of which have been taken by Jordanian workers. Most QIZ workers are foreigners brought into Jordan under temporary labor contracts. Their number swelled after 2004, when the Government decreased work permit fees for foreign workers employed at the QIZs from the usual JD 300 per year to JD

¹ Since 1995, the share of import duties in total tax revenues has declined from more than a third to less than a fifth. Over the same time, the ratio of trade taxes to GDP fell from 7 percent to less than 4 percent.

150.² The QIZs provide few, if any, linkages to other parts of the economy and, therefore, have had little indirect job-creation effect.³

Figure 4: Employment in QIZs, 2001–06



Source: Ministry of Trade and Industry, QIZ unit and Ministry of Labor.

Three other policy areas have also been critical to the observed pattern of output and job growth: the tax system, labor regulations, and migration policy.

The tax system is designed to provide strong incentives to agriculture and industry. The multi-layered tax system that confronts entrepreneurs is the result of the overlay of three sets of laws: conventional tax laws, the investment promotion law (IPL), and the so-called Industrial Estates Law. The income tax laws differentiate tax rates by sector, the most favored sector being agriculture, which is subject to no company tax at all (Table 2). Companies operating in mining, manufacturing, hotels, hospitals, transportation, and construction pay a 15 percent rate of income tax. All other sectors pay rates of 25 percent or more. Projects supported by the IPL in a narrow set of favored sectors enjoy three major privileges: (a) reduction in the company income tax for a period of 10 years; (b) exemption from import duties; and (c) a one-stop shop that significantly reduces the time and effort required for business licensing, registration, and work permits for foreign workers. The Jordan Industrial Estates Law provides benefits to activities located in public industrial estates. The benefits include a two-year exemption from income tax and a permanent exemption from property taxes, as well as subsidized land, infrastructure, and a range of business services. Combined, these three sets of laws provide considerable incentives to agriculture, followed by industry and some categories of services, at the expense of other activities, including communications, insurance and financial services, and most other types of services.

² Average annual wages in QIZs are JD 1770, considerably lower than wages in manufacturing (JD 3070).

³ The total output of the QIZs is exported: therefore there are no forward linkages. Even in the case of transportation there is little benefit as the majority of the QIZ factories ship their products to the United States via Israel instead of Jordan.

Table 2 Income tax rates and investment incentives

| Sector | Tax rate without incentives or after incentives expire (percent) | Tax rates in incentive zones (percent) | | | |
|---|--|--|-------------------|-------------------|--------------------------------------|
| | | A | B | C | Industrial Estates |
| Agriculture | 0 | N/A | N/A | N/A | N/A |
| Industry, including mining and manufacturing | 15 | 11.25 for 10 years | 7.50 for 10 years | 3.75 for 10 years | Zero for 2 years+ |
| | | | | | A |
| Hotels and hospitals | 15 | 11.25 for 10 years | 7.50 for 10 years | 3.75 for 10 years | N/A |
| Maritime transport and railways (MTR) | 15 | N/A | N/A | 3.75 for 10 years | Zero for 2 years + 3.75 for 10 years |
| Construction, electricity and gas, transportation excluding MTR | 15 | N/A | N/A | N/A | N/A |
| Leisure and recreational compound | 25 | 18.75 for 10+ years | N/A | | N/A |
| Conventions and exhibition centers | 25 | 18.75 for 10+ years | N/A | N/A | N/A |
| Transport and distribution of water, gas, and oil | 25 | Defined case by case | | | N/A |
| Other sectors not listed elsewhere | 25 | N/A | N/A | N/A | N/A |
| Banks and financial companies, excluding Insurance | 35 | N/A | N/A | N/A | N/A |

Source: Income Tax Law of 1985 and IPL 1995 (and its amendments). Cited in AMIR (2004).

Note: Zone C includes districts strongly targeted for investment and given maximum benefits, Zone B includes districts targeted for investment and receiving moderate benefits, Zone A includes all other districts.

A complete listing of districts and zones can be found in the Investment Promotion Law at

www.jordaninvestment.com;

N/A = not applicable

Labor regulations reinforce the tax distortions by making labor less expensive for agriculture and the largely garment-based QIZs than for other sectors. Through January 2007, the garment industry was exempted from the increase in the minimum wage that took effect in other sectors in June 2006, a small but politically important concession. The wage in all sectors is now JD 110 per month. Agriculture, the garment industry, and QIZs also pay much lower fees to obtain work permits for foreign workers (Table 3).

Table 3 Work-permit fees (JD/year)

| | Non-Jordanian Arabs | Other foreigners |
|---------------------------|---------------------|------------------|
| Agriculture | 60 | 120 |
| QIZs (1st 3 years) | 150 | 150 |
| QIZs (4th year and after) | 175 | 175 |
| Other sectors | 180 | 300 |

Source: Ministry of Labor.

Foreign workers can be less expensive to employers not only because they may accept lower wages, but also because they are on temporary contracts that do not entitle them to social security or severance pay and thus employer contributions for these purposes are not required.⁴

Immigration and emigration policies in Jordan create incentives for the import of low-skill labor and the export of high-skill labor. There is nothing inherently wrong with admitting foreign workers. The impact of immigration depends critically on the extent to which migrants and natives are complements or substitutes for one another; that is, whether they are competing for the same jobs or operating in segmented markets. When foreign workers provide skills unavailable in the domestic labor market they may complement native workers to the benefit of all. Borjas (2003), studying the United States, finds that immigration harms the prospects and lowers the wage of competing native workers up to college level. A 10 percent increase in supply reduces wages by 3–4 percent. Those with the lowest skills are hardest hit. College graduates, who are often complements to foreign workers, may actually experience a wage increase as a result of immigration. In Jordan, the ability to import foreign workers and the incentives created through trade, investment and labor policy have generated economic activities that may be more suited to the characteristics of foreign workers than to the characteristics of Jordanians. Unfortunately, analysis of the benefits and costs of the current implicit migration policy is seriously undermined by the lack of data on this sizeable component of Jordan’s labor force—estimated to represent at least one in five workers.⁵

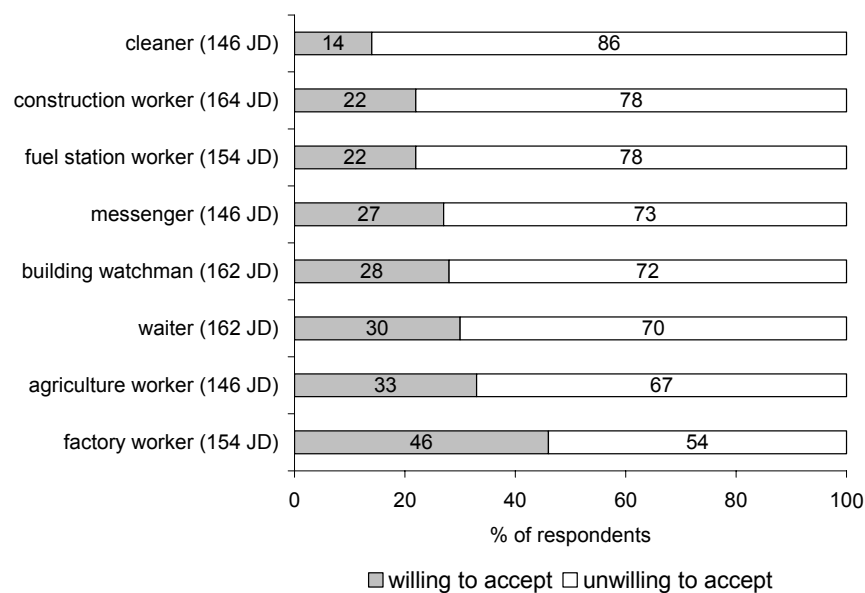
⁴ Entry of non-Arab foreign workers, who must be issued work permits before entering the country, is controlled by the Ministry of Labor. However, entry of Arabs, who do not require visas to enter Jordan, is not regulated. Although Arabs officially require permits to work, a large number are currently working without permits owing to the difficulties of enforcement once they are inside Jordan.

⁵ The EUS and census report 939,986 Jordanians employed. The Ministry of Labor reports 218,756 registered foreign workers. It is widely believed that this is an undercount and there are close to 300,000 foreign workers in Jordan.

C: Aspects of Voluntary Unemployment in Jordan

A survey conducted by the University of Jordan’s Center for Strategic Studies permits an estimate of voluntary unemployment. When unemployed Jordanian workers were asked about their willingness to accept jobs from a list of widely available jobs at prevailing wages, about 46 percent of respondents indicated a willingness to accept at least one of the jobs (figure 5).⁶ The other 54 percent of unemployed Jordanians want to work, but not at available jobs—unless the pay were significantly more than presently offered.

Figure 5 Share of unemployed Jordanians not willing to accept one of the commonly available jobs at prevailing wages, by type of job



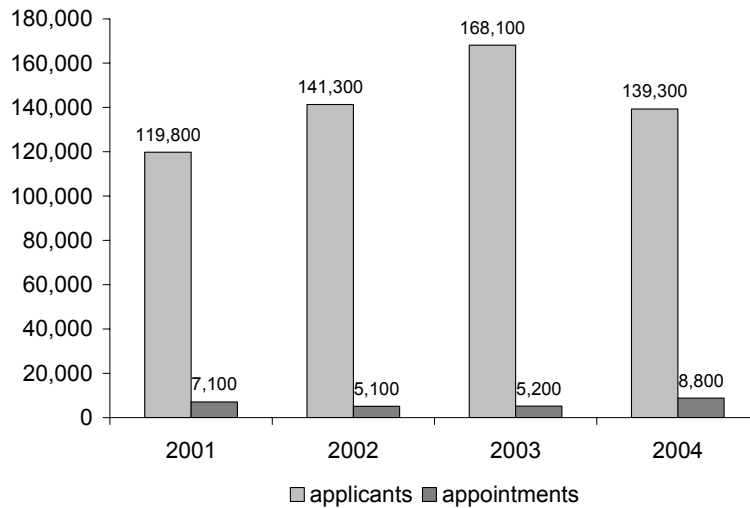
Sources: Center for Strategic Studies 2006b and Employment in Enterprises Survey 2005.

There could be several reasons why some people are willing to stay unemployed rather than work at prevailing wages. This could arise because they expect to find a higher paying job with better working conditions. This is typically the case for educated individuals who expect to find a job in the public sector or abroad. Or they can afford to wait until a more desirable job comes along because they can be supported by their families. We illustrate these possibilities in the case of Jordan by looking at the following aspects: (a) the attraction of civil service jobs; and (b) income support from family members.

⁶ For example, respondents were asked whether or not they would be willing to accept factory work – the job with the highest acceptance rate -- at various wages. 22 percent of respondents said they would accept at 115JD per month, 44 percent at 150JD, 61 percent at 180JD and 69 percent at 200JD. According to the EIE survey, the prevailing wage for factory work is 154 JD. By interpolation, we estimate that 46 percent would be willing to accept factory work at 154JD per month. All other types of jobs had lower acceptance rates.

Some evidence of the pull of public sector employment is provided in Figure 6. Although the pace of hiring has slowed, Jordan’s civil service continues to expand. New hires crept up from about 7,000 in 2001 to nearly 9,000 in 2004. Meanwhile, far greater numbers of people filed applications for employment with the Civil Service Bureau, implying that the hope of obtaining a civil service job remains very high. About 20 percent of all unemployed individuals, and 45 percent of unemployed women, apply to the civil service bureau. By continuing to accept applications that are not associated with specific job vacancies, the Civil Service Bureau perpetuates the unrealistic expectations of applicants. New efforts are needed to control the growth of the civil service and—just as importantly—to dispel illusions that civil service jobs will be available for any but the most qualified candidates.

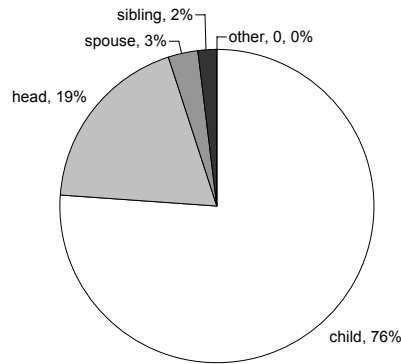
Figure 6 Civil service applications and appointments, 2001–04



Source: NCHRD (no date).

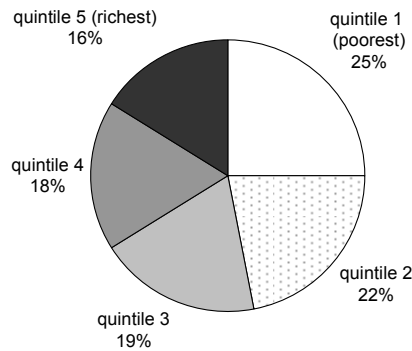
How do the unemployed afford to remain without wage income while waiting for civil service and emigration opportunities to open up? Many of the unemployed are supported by their families (with remittance income from other family members playing a crucial role). More than three in four unemployed Jordanians (76 percent) live with their parents and only one in four belongs to the lowest expenditure quintile (figure 7), and significant numbers of unemployed individuals belong to Jordan’s wealthiest families (figure 8).

Figure 7 Relationship of unemployed persons to head of household, 2004



Source: NCHRD (no date).

Figure 8 Expenditure quintile of the families of the unemployed



Source: DOS HIES, 2002–03.

Remittances sent home by Jordanians working abroad may be a disincentive for recipient households to work. They also reduce Jordan's competitiveness more generally by causing the exchange rate to appreciate. The benefits of emigration and remittances are well known. Remittances increase (and smooth) consumption in recipient households and are a stable source of foreign exchange. For a country with high unemployment, emigration reduces the size of the labor force, possibly reducing unemployment rates. And many emigrants eventually return home with savings and valuable experience. In recent years, however, economists have begun exploring the negative consequences of remittances. Most thoroughly studied to date is the potential for remittances to push up the country's real exchange rate, widen the current-account deficit, weaken monetary control, contribute to inflationary pressures, and result in sectoral misallocation of investment. Evidence from Latin America and Eastern Europe indicates that remittances create disincentives to work, cause appreciation of the real exchange rate, and often fail

to have much of an impact on poverty.⁷ In Jamaica, remittance income explains a large part of that country's simultaneously high labor demand and high unemployment—a phenomenon Jamaica shares with Jordan (Kim 2007).

Probit regressions of the determinants of labor force participation and unemployment in Jordan confirm that remittance income significantly decreases labor force participation and significantly increases unemployment. A recent study by the IMF (IMF 2006) finds that remittances have had a significant impact on Jordan's real exchange rate.⁸ This effect is likely to be partially offset by the inflow of inexpensive labor, which tends to lower the price of nontraded services. Zaqqa (2006) found that remittances to Jordan had a positive impact on construction activity and imports, but not on industry.

In Jordan, remittance income accrues primarily to middle- and upper-class families. Jordanians who emigrate tend to be well educated and from prosperous families.⁹ As a result, remittances are greater for wealthier households than for poor ones, not only in their absolute value but also as a percentage of household income. In fact, the wealthiest quintile gets 14 percent of its income from remittances (figure 9). There may be cause for concern that the entire population must bear the negative consequences of remittances, whereas primarily the wealthy receive their benefits.

Finally, the large numbers of Jordanians who live and work abroad provide a strong incentive for other family members to expect to obtain overseas jobs as well. Almost 450,000 Jordanians are believed to work abroad. This is more than 10 percent of the total population of Jordan (not counting foreign workers and Iraqi visitors).

Table 4 Estimates of Jordanians working abroad, 1975–2006

| | 1975 | 1980 | 1985 | 1995 | 2001 | 2003 | 2006 |
|-----------------|---------|---------|---------|---------|---------|---------|---------|
| Arab countries | 264,700 | 261,500 | 276,000 | 200,000 | 215,200 | 265,500 | — |
| Other countries | 39,500 | 43,900 | 52,000 | 21,700 | 26,100 | 28,500 | — |
| Total | 304,200 | 305,400 | 328,000 | 221,700 | 241,300 | 294,000 | 450,000 |

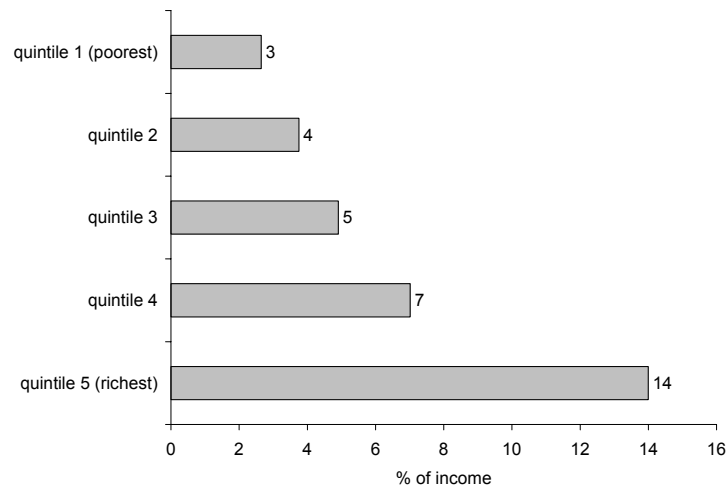
Sources: Zaqqa (2006). Data for 2006 are from Azzam in *Jordan Times*, December 11, 2006.

⁷ A study of 10 Latin American countries (World Bank 2006) found that remittances reduced labor force participation of recipient households and the number of hours worked by members of recipient households in 9 out of the 10 countries. The study controlled for a variety of factors, including education, the presence of young children, home ownership, and place of residence. In Mexico, for example, 90 percent of individuals in nonrecipient households participated in the labor force, compared with only 60 percent in recipient households. Separate studies of Jamaica found that receipt of remittances significantly raised the wage needed to induce an unemployed person to accept a job offer (i.e., their reservation wage) and, in a general equilibrium model, led to an appreciation of the real exchange rate (Kim 2007; Bussolo and Medvedev 2006).

⁸ To put the magnitude of the impact in perspective, the IMF report shows that grants have had twice as much impact on exchange rates as remittances. In recent years, the impact of remittances is likely to have decreased because remittances have decreased as a share of GDP.

⁹ According to Adams (2006), more than 55 percent of Jordanian emigrants have 13 or more years of schooling; only 16 percent have fewer than eight years. Zaqqa (2006) estimates that 44 percent have postsecondary education; 27 percent have only primary education.

Figure 9 Remittances accrue predominantly to wealthy households



In some countries, over-generous social protection programs also provide a disincentive to work and an incentive to stay unemployed (on unemployment insurance, for example) for long periods of time. In Jordan, however, the existing social protection programs do not appear to create major disincentives to work.

- *National Aid Fund (NAF)*. Some have suggested that NAF, social security, and severance pay policies may create disincentives to work. Although these programs have problems, including some related to incentives, we did not find them to be keeping the unemployed from accepting existing jobs. The categories of individuals eligible for NAF tend to be outside the labor force. Thus there are few unemployed beneficiaries, even among dependents.¹⁰ Probit regressions of the determinants of labor-force participation and unemployment find that receiving NAF benefits does not have a significant effect on labor-force participation and does not raise the likelihood of unemployment.
- *Pensions*. Many consider the social security pension system to be unsustainably generous in terms of its overall benefit level and early retirement provisions that allow beneficiaries to retire at age 45 with only minor reductions in their monthly pension. This policy clearly creates disincentives for work; indeed, a sharp decline in employment occurs at age 45. The pension system does not, however, have a large impact on unemployment: the evidence shows that unemployment rates are very low for those over 40 and increase only slightly at age 45.¹¹

¹⁰ The presence of unemployed individuals in the household negatively affects the benefit amount of even the primary beneficiary.

¹¹ The prevalence of early retirement programs, popular in the 1970s, has declined in the 1990s as the programs proved very costly without freeing up jobs for younger workers, as expected. If younger workers are complements and not substitutes for older workers, early retirement programs may even have a negative effect on the employment of younger workers. In addition, the additional financial burden of supporting pensions of early retirees may contribute to an increase in social security contribution rates, thereby raising the cost of labor and thus contributing, via a reduction in demand for labor, to a higher rate of unemployment.

- *Income support for the unemployed.* Workers who are laid off are entitled to a lump-sum severance payment.¹² Although data are not available for Jordan, severance pay policies are considered unlikely to create significant disincentives to accepting employment because the total received in severance pay is unrelated to the duration of unemployment.¹³ Severance payments do, however, reduce job creation and can encourage quitting if, as in Jordan, benefits are available for voluntary resignation (World Bank 2004).

D. Concluding Observations

This paper has shown that growth of output does not necessarily lead to unemployment reduction even in cases where it leads to substantial job creation. In the case of Jordan, we have seen that more than half the new jobs created in recent years were taken up by foreign workers. We have also shown that this was a consequence of (a) the incentive environment for investors/employers that prevails in Jordan as a result of various trade and investment liberalization actions taken in the 1990s as well as of various distortions that exist in tax, labor and migration policy; and (b) the incentive environment for job seeking Jordanian nationals, characterized by high expectations regarding public sector or foreign employment and high levels of income support from families. If unemployment reduction is a major objective of economic reforms, one lesson of the Jordanian experience is that policymakers must consider which sectors are likely to be favored by the proposed reforms, what types of jobs are likely to be generated, whether or not foreign workers are likely to be preferred, and the extent to which income support and alternative job options available to locals are likely to keep them in extended periods of search unemployment.

¹² Workers who participate in the social security system receive the lump sum through the Social Security Corporation, while workers who do not participate in the system but who work for enterprises with five or more employees, receive the lump sum directly from their employer. Although the rules vary slightly between the two systems, the basic principle is the same. Workers in enterprises with fewer than five employees are not covered.

¹³ Although severance pay does not create a moral hazard by curtailing or delaying the job search, it does affect incentives to enter unemployment and hence creates another moral hazard. Severance pay can create incentives for workers to leave employment if workers who quit are eligible for payments. Jordan's labor law does not require severance pay if the employee quits, but it is unclear the extent to which employees and employers are aware of the specifics of the law.

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