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**Ex-ante evaluation statement on EU macro-financial assistance
to the Hashemite Kingdom of Jordan**

Accompanying the document

Proposal for a

DECISION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

providing macro-financial assistance to the Hashemite Kingdom of Jordan

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1.1. Introduction

Since early 2011, Jordan's economy has been significantly affected by the domestic events related to the Arab Spring and the ongoing regional unrest, notably in neighbouring Egypt and Syria. Combined with a weaker global environment, the political transition of Jordan has taken a heavy toll on external receipts and has strained public finances. Lower tourism and foreign direct investment (FDI) inflows, higher international energy prices and the repeated disruptions to the flow of natural gas from Egypt, which forced Jordan to replace gas imports from Egypt with more expensive fuels for electricity generation, have put a drag on growth and have resulted in a marked deterioration in the balance of payments and fiscal position. Jordan has also been affected by the intensification of the Syria crisis, notably through the inflow of refugees and its fiscal implications. While Jordan has so far managed to date to maintain macroeconomic stability, including through substantial fiscal consolidation efforts and financial support from foreign donors, there are significant balance of payments and financing needs.

Under the pressure of a sharp drop of international reserves in the first half of 2012, the Jordanian authorities have agreed on a USD 2 bn (800% of quota), 36-month Stand-By Arrangement (SBA) with the IMF, approved on August 2012. The aim of the SBA is to support the government's economic reform programme, eliminate economic vulnerabilities and foster sustainable and inclusive growth.

In this context, the Jordanian government requested Macro-Financial Assistance (MFA) from the EU in the amount of EUR 200 mn in December 2012. The Commission intends to submit to the European Parliament and the Council a proposal for MFA to the benefit of the Hashemite Kingdom of Jordan amounting to a maximum of EUR 180 mn in the form of loans. The proposed legal base is Article 212 of the TFEU. The EU's MFA would contribute towards covering Jordan's residual external financing needs in 2013 and 2014, in the context of the IMF programme.

The proposed MFA would help Jordan address the lingering economic consequences of the Arab Spring and the external shocks of its energy sector. It would reduce the economy's short-term balance of payments and fiscal vulnerabilities, while supporting the adjustment and reform programmes agreed with the IMF and the World Bank, as well as the reforms agreed under the EU's budgetary support operations (including the Good Governance and Development Contract operation of EUR 40 mn financed by the *Support for Partnership Reform and Inclusive Growth* (SPRING) programme).

The proposed assistance would promote policy measures to improve public financial management and tax reform while strengthening the social safety net (including through a better targeting of the cash transfers system put in place last November to compensate households for the reform of the energy subsidy system); measures to improve the regulatory framework and climate for investment; and reforms to reduce unemployment and encourage participation in the labour market, notably among women.

The proposed MFA is consistent with the political and financial pledges made by the EU to the Jordanian authorities at the EU-Jordan Task Force meeting in February 2012. It is also in line with the aims of the new partnership for the South Mediterranean region proposed at the G8 Deauville summit and the orientations of the new European Neighbourhood Policy.

1.2. Jordan's macroeconomic situation and structural reform challenges

Jordan has faced worsening economic conditions since 2011 due to the regional and political turmoil associated with the Arab Spring and the weaker regional and global economic environment. These circumstances negatively affected two of the main external drivers of economic growth, namely tourism receipts and FDI. In addition, the frequent interruption of gas supplies from Egypt has forced the government to replace gas with more expensive oil imports, which has increased the import bill significantly.[1] These adverse external shocks have contributed to create large fiscal and external imbalances.

In this context, and following a period of robust economic growth averaging 6.5% during 2000-2009, partly reflecting a propitious external environment, **GDP growth** dropped sharply to 2.6% in 2011. GDP growth picked up moderately to 2.9% in the first half of 2012, following a recovery of tourism receipts and despite the weak performance of the mining and construction sectors. In 2013, GDP growth is projected to be supported by increased FDI in the energy and banking sectors but remain relatively low (at about 3%).

Consumer price inflation increased moderately in the course of 2012, reaching an average of 4.8%, compared to 4.5% in 2011, as the impact of domestic fuel and electricity tariff increases was partially offset by that of weaker domestic demand. Inflation is expected to rise further to 6.1% on average in 2013, partly as a result of the foreseen energy price adjustments. Since mid-2011, **monetary policy** has been tightened in order to preserve the attractiveness of JOD-denominated assets. In July 2011, the central bank raised its policy interest rates by 25 basis points, followed by another 50 basis points rise in February 2012. In December 2012, the Overnight Window Deposit Rate was increased by another 75 basis points, while the interest rates on the Overnight Repurchase Agreement rate and the Re-discount rate remained unchanged. The current fixed **exchange rate policy** (peg to the USD) has helped anchor inflation expectations.

The **external position** has worsened markedly since the beginning of 2011 due to the aforementioned shocks. The **current account deficit** (including grants) reached 12% of GDP in 2011 (19% of GDP excluding grants), up from 7.1% of GDP in 2010 (11.3% of GDP excluding grants), partly due to a 16.6% increase in the import bill. By the end of 2012, it had widened further to 17% of GDP (20.6% of GDP excluding grants), despite a 15.3% increase in tourism receipts (broadly attributed to tourist flows from Arab countries) and a 3.5% increase of remittances. The projection is, however, that the current account deficit excluding grants will narrow down to 12.1% in 2013 in view of stronger export growth and a gradual normalisation of gas supplies from Egypt. The shortfall in FDI in 2011-2012 further deteriorated the external position. Financing needs for 2011-12 were largely met through foreign assistance, in particular form the Gulf Cooperation Council (GCC) countries and the Bretton Woods institutions, and the mobilisation of **international reserves,** which fell by 14% (to USD 10.7 billion) in 2011 and more dramatically throughout 2012, to reach USD 5.2 billion (just above the standard minimum benchmark of 3.5 months of imports) by the end of the year.

[1]Although in mid-January Jordan's Egyptian gas supplies temporarily returned to normal levels after nearly two years of reduced supply (240 million cubic feet per day compared to an average of 40 mcf for most of 2012), they have recently dropped again to one-third of their normal levels, prompting fresh concerns over the security of the country's primary energy source. Moreover, the renegotiation of the gas supply contract with Egypt has approximately tripled its price.

Table 1: Jordan – Selected macroeconomic indicators, 2009-2013

	2009	2010	2011	2012 Prel.	2013 Proj.
	(Annual percentage change, unless otherwise indicated)				
National Accounts					
Real GDP growth	5.5	2.3	2.6	3.0	3.0
Population (million)	5.98	6.11	6.25	6.40	6.54
Consumer price index, period average	-0.7	5.0	4.4	4.8	6.1
GDP per capita (USD)	3,987	4,323	4,618	4,883	5,213
Unemployment rate (in percent)	12.9	12.5	12.9	13.1*	…
	(In percent of GDP, unless otherwise indicated)				
Consolidated government operations					
Government and government-guaranteed gross debt	64.8	67.1	70.7	79.4	83.5
o/w external debt	22.9	24.6	21.9	20.0	22.4
Revenue and grants	26.5	24.9	26.4	24.4	25.7
Expenses	35.4	30.4	33.2	31.6	31.2
Overall fiscal balance	-8.9	-5.6	-5.7	-7.2	-5.5
Overall fiscal balance excluding grants	-10.9	-7.7	-11.7	-10.7	-9.3
External sector					
Current account balance	-4.9	-7.1	-12.0	-17.0	12.1
Current account balance excluding grants	-9.0	-11.3	-19.0	-20.6	-16.3
Gross international reserves, end of period (USD bn)	11.0	12.4	10.7	5.2	7.7
- In months of next year's imports of goods/services	7.7	7.4	5.9	2.9	4.1
Foreign direct investment, net	9.9	6.3	5.0	4.2	4.6
Nominal exchange rate (peg to the USD)	1.41	1.41	1.41	1.41	1.41

Sources: Jordanian authorities and IMF staff estimates * Third quarter

Public finances have been under strain due to the social expenditure packages adopted in 2011, the budgetary impact of the increase in energy import prices and the economic slowdown. The budget deficit excluding grants increased from 7.7% of GDP in 2010 to 11.7% in 2011, while public debt had risen to 70.7% of GDP by end-2011 (from 67.1% of GDP at end-2010). Although the 2012 budget adopted in February envisaged a large fiscal adjustment compared to 2011, by mid-year it had become clear that this could no longer be possible, reflecting much higher than assumed fuel subsidies, a higher wage bill due to the reform of the civil service, higher pension and health outlays, and spending on housing and medical assistance for Syrian refugees.[2] To mitigate debt sustainability risks and possible shortfalls in external flows, the government decided in May 2012 to take additional fiscal measures, amounting to 3.4% of GDP. The aim was to lower the overall deficit in 2012 by approximately 1.5 percentage points of GDP (to 10.7% of GDP, excluding grants).

On the **expenditure side**, fiscal consolidation measures (amounting to 2.9% of GDP) included: the removal of subsidies on gasoline octane 95, jet fuel and heavy fuel oil; a 13%

[2]Jordan is being seriously affected by the on-going Syrian refugee crisis. With the biggest influx of Syrian refugees (about 180,000 by January 2013) and the fastest growing refugee camp (about 1,000 Syrians crossing Jordanian borders every day), Jordan has been the most affected country in the region at a time the economy is already grappling with severe shortages of water and electricity. Since the outbreak of the Syrian conflict, the budgetary cost of hosting Syrian refugees is estimated to have exceeded EUR 600 mn (about 3% of the Kingdom's GDP).

decrease in the subsidy for gasoline octane 90; a 6% increase in the price of diesel; as well cuts in capital spending and current expenditure (including ministries' operational spending and military expenditure and the freezing of hiring in all government ministries with the exception of the Ministries of Health, Education, and Social Development).

On the **revenue side**, the consolidation effort amounted to 0.4% of GDP and was reflected in: the introduction of a sales tax on cellular phones and air conditions; the increase in the taxes on cars, air tickets and alcoholic and tobacco products; an increase in visa resident fees; a rise in money transfer fees; and the removal of certain exemptions. At the same time, efforts to improve tax administration are being stepped up.

In early September 2012, the government took the decision to introduce a 6% tax on diesel and to remove subsidies from gasoline octane 90. However, this decision, which is a structural benchmark of the IMF programme, was initially suspended by the King. The liberalization of gasoline octane 90 finally took place in mid-November (together with the lifting of subsidies on diesel, kerosene, and household gas prices), in full alignment with the price adjustment structural benchmark set by the IMF program. Although these measures led to serious social protests in mid-November, the government maintained the fuel price adjustments.

Under the programme agreed with the IMF, substantial additional fiscal adjustment measures are planned for 2013, including increases in diesel and kerosene prices, reductions in tax exemptions and, possibly, increases in excise taxes, with the aim of cutting the fiscal deficit excluding grants to 9.3% of GDP for that year (5.5% including grants).

1.3. IMF and other donor support

On 3 August 2012, the IMF Board approved, as noted, a USD 2 bn (800% of quota) 36-month Stand-By Arrangement (SBA) for Jordan. In their talks with the IMF, the Jordanian authorities were originally interested in a programme under the Precautionary and Liquidity Line. However, the IMF considered that Jordan did not qualify for this facility; in particular, the IMF judged that the country's vulnerabilities were too high ("low" and, exceptionally, "moderate" vulnerabilities is one of the eligibility criteria for the PLL). They, therefore, finally agreed on a standard SBA. The negotiations were completed very quickly, allowing a first disbursement in the fourth quarter of 2012. The programme is relatively frontloaded, with 300% of quota (out of the total of 800%) paid out in the first two tranches (the second tranche is to be disbursed upon completion of the first programme review).

The program envisages a package of measures aimed at strengthening growth while reducing vulnerability to exogenous shocks, notably by reforming the energy subsidies system, bringing NEPCO back to cost recovery and promoting energy supply diversification. The program further foresees consolidating the fiscal sector through an effective rationalization of the tax system, improved tax administration and cuts in expenditure (not only through the reform of energy subsidies but also by restraining other current as well as capital expenditure). Finally, the program aims at strengthening the business environment, fostering private sector-led innovation and promoting trade and foreign investment.

Under the IMF programme's macroeconomic framework, economic activity is projected to gradually gain momentum during the program period, with real GDP growth accelerating to 3% in 2012 and to 4.5% over the subsequent years of the programme. Starting from 2014, inflation is expected to slow down to 2.7% in 2015 (6.1% in 2013) on the back of sustained fiscal consolidation combined with a moderation in international food and fuel prices. Further easing of international fuel and food prices and stronger export growth combined with the emergence of alternative energy sources by mid-2015 and the implementation of structural reforms for enhancing competitiveness are expected to gradually reduce the current account deficit (excluding grants) to about 9% of GDP by the end of the program, down from nearly 21% of GDP in 2012.

The first review of the IMF program was scheduled to be completed by last December. However, delays in the adjustment of energy prices and in the adoption of other measures, including a medium-term strategy to bring the state-owned electricity company back to cost recovery, has delayed the completion of the review. The proximity of the January elections also complicated matters, including the discussion on the 2013 budget. However, most of the macroeconomic performance criteria for end-September, as well as other structural benchmarks, were met. An IMF mission arrived to Amman in mid-February (aiming also to collect end-December figures) to finalise discussions, including on the second review of the programme. Progress is being made, with support from USAID and the World Bank on the finalisation of the medium-term strategy for NEPCO and, provided that the IMF and the authorities agree on some additional measures to keep the fiscal programme on track, the first and second review of the programme are expected to be completed by the IMF Board in early April.

Regarding **other official lenders**, the **World Bank** made available USD 250 mn in the form of a Development Policy Loan (DPL2) in early 2012, to strengthen transparency and accountability, budget and debt management, efficiency of public spending and services, and private sector development. A second DPL (DPL3) in the amount of USD 100 mn is under discussion.

France has extended a low-interest, medium-term budget support loan to Jordan worth USD 192 mn, with the first payment already made in the fourth quarter of 2012 and the second payment expected to follow in the first half of 2013. Official financing in the form of budget support loans has been also made available from **Japan**, with USD 175 mn to be disbursed over 2012-14.

Concerning official assistance in the form of **grants**, a USD 5 billion grant package, to be disbursed over 5 years starting in 2012, was approved by the **GCC** in 2011 (equally distributed among Saudi Arabia, Kuwait, UAE, and Qatar and linked to development projects).[3] **US** grant disbursements to the budget over the period 2012-15 are estimated at nearly USD 900 mn with a third of it already disbursed in 2012.

The EU has made available EUR 293 mn in grants for the period 2011-13 under its regular cooperation, in support of Jordan's political and economic reform agenda. In addition, EUR 70 mn has been allocated to Jordan in 2012 under the SPRING programme, and EUR 10 mn from Humanitarian Aid to support Syrian refugees. The first part of the SPRING allocation (EUR 30 mn) has already been released. It will be used for programs in the areas of education, electoral system reform, justice sector reform and SMEs, covering a multi-year period. Following the implementation of a series of political and economic reform benchmarks, the second tranche of the SPRING allocation (EUR 40 mn) was allocated to the GGDC operation, the financial agreement of which was signed during President Barroso's visit to Jordan on 7

[3]Out of the entire grants of USD 5 billion from the GCC countries, 24% will be directed towards local development, 18% towards roads development, 14% for the energy sector, 12% for the health sector and 10% for the water sector. Kuwait, Saudi Arabia and the UAE already disbursed US$ 250 mn each in 2012, while the UAE decided in January 2013 to advance the disbursement of the remainder of its pledge (US$ 1 bn) by making a deposit in the Jordanian Central Bank. However, the disbursement to the budget will take place only gradually over the period 2013-16, linked to the actual implementation of investment projects in the above-mentioned areas.

October 2012.[4] Half of the second tranche of the SPRING programme (EUR 20 mn) was disbursed at the end of 2012 and the remaining EUR 20 mn after all benchmarks of the GGDC have been met, possibly in the second half of 2013.

1.4. Jordan's external financing needs

Preliminary figures produced by the first IMF in the context of the first review of the SBA point towards the existence of a significant residual financing gap for the remainder of the IMF programme period (ending in July 2015). During 2012, Jordan has covered its balance of payments financing gap through a combination of a sharp drawdown in official reserves, the receipt of several one-off grant disbursements from the GCC countries and disbursements from the IMF and other multilateral and bilateral donors. Based on the new IMF figures, the external financing gap for the IMF programme period (2013-2015) is estimated at USD 5.9 billion (Table 2).

This financing gap is broadly attributed to two main factors; first, a sizeable current account deficit (totalling USD 13 bn) that, despite its downward trend, cannot be fully offset by the capital account surplus (USD 10.5 bn) and, second, the authorities' intention to build up reserves over the period 2013-2015 (in the amount of USD 3.4 bn). With reserves already at a critically low level at the end of 2012 (just above the minimum benchmark of 3 months of imports, as noted), the IMF and the Commission consider it important to aim at a considerable replenishment of official reserves during the programme period. With Jordan's balance of payments remaining very vulnerable to external shocks, notably further disruptions in gas supplies from Egypt and political developments in Syria and other countries in the region, it is deemed unadvisable to continue to cover part of the external financing gap by drawing on the official reserve cushion. On the contrary, it is essential to rebuild the reserve cushion to address unforeseen shocks and restore foreign investor confidence.

Regarding the current account, the main driving factor is the trade deficit, which is exacerbated by an elevated energy import bill, amounting to nearly one-third of total imports. The trade deficit is only partly mitigated by the positive and improving balance on services and current private transfers. Concerning the capital account balance, and contrary to what happens to the current account, it shows a gradual deterioration over the duration of the program. FDI is, however, projected to gradually recover, reaching 6% of GDP in 2015, up from 4% in 2012. It is also assumed that the authorities will issue a substantial amount of Eurobonds in the course of 2013-15 but plans to issue a first Eurobond in late 2012 or early 2013 have been repeatedly delayed due to unfavourable market conditions.

Net of disbursements under the SBA and the World Bank's Development Policy Loan (DPL), Jordan faces a residual external financing gap of USD 4.1 billion during the period 2013-15. Key contributions to covering this gap are, in this order, those of the GCC countries (US$ 3 bn), the US (US$ 563 mn), the EU's MFA (up to EUR 180 mn), France (US$64 mn), and Japan (US$110 mn).[5] The proposed MFA from the EU would contribute to fill in 4.4% of the residual gap.

[4]Benchmarks are essentially linked to the on-going political reform process (adoption of the Political Parties Law, the Electoral Law, the Independent Electoral Commission Law and the Constitutional Court Law), as well as to key measures in the fields of economic and social reform, including the adoption of the Income Tax law, the PPPs law, the Investment law, the new Consumer Protection law, the Audit Bureau law and the Bankruptcy and Insolvency law.

[5]As noted above, the UAE has decided to advance the disbursement time of their remaining USD 1 bn contribution by making a deposit in the Central Bank of Jordan in January 2013. Nevertheless, this decision does not affect net reserves (since it creates for now a commensurate short-term liability of the central bank to the UAE), nor the actual financing accruing to the budget.

Table 2: Jordan's External Financing Gap and Potential Financing Sources (USD mn)

	2012	2013	2014	2015	Total 2013-15
1. Current Account Balance*	**-6,396**	**-5,317**	**-4,444**	**-3,314**	**-13,075**
2. Capital and financial account**	934	3,919	3,863	2,806	**10,588**
3. Overall balance (1+2)	-5,462	-1,398	-581	-508	**-2,487**
4. Reserves ("-" indicates increase)	3,546	-1,037	-1,222	-1,152	**-3,411**
5. Overall External Financing Gap (3+4)	**-1,916**	**-2,435**	**-1,803**	**-1,660**	**-5,898**
6. Exceptional Financing by IMF and WB					
Net IMF Disbursements	378	875	470	352	**1,697**
Disbursements of World Bank's DPL	250	100	0	0	**100**
7. Residual Financing Gap (5+6)	**-1,288**	**-1,460**	**-1,333**	**-1,308**	**-4,101**
Financing of the gap					
EU MFA	0	116	116	0	**232**
France	128	64	0	0	**64**
US bugdetary grants	334	195	184	184	**563**
Japan	65	85	25	0	**110**
GCC countries support	750	1,000	1,000	1,000	**3,000**
Arab Monetary Fund***	-22	0	0	0	**0**
Total	**1,277**	**1,460**	**1,325**	**1,184**	**3,969**
Total MFA as % of the residual gap for 2013-15					**4.4**

* Figures include EU grants financed by the ENPI and the SPRING programme and exclude US budgetary support grants and the USD 5 bn grants announced by the GCC in 2011 to be disbursed during 2012-2016 (approximately USD 1 bn per year).
** Figure for 2012 excludes disbursements under the World Bank Development Policy Loan.
*** The Arab Monetary Fund figure has been reported by the Central Bank of Jordan for past year and relates mostly to small guaranteed loans.
Source: European Commission staff estimates based on discussions with the IMF.

1.5. Structural reform challenges

As underlined at the Joint Dialogue on Economic Reforms conducted by the Commission with the Jordanian authorities last October, Jordan has made significant progress in a number of key reform areas. This includes the adjustment of energy prices, plans to diversify the energy supply, measures to raise women's participation in the labour force, schemes to support SMEs access to finance, and the submission to parliament of legislative proposals on income taxation, PPPs and social security reform. However, substantial structural reform challenges have yet to be addressed. Moreover, many legislative proposals remain stuck in parliament and the dissolution of the parliament and organisation of parliamentary elections held at end-January 2013 further delayed their adoption.

In the **energy sector**, energy supply diversification efforts have been made through the construction of a liquefied natural gas terminal in Aqaba, the development of the production of shale oil from domestic fields and the expansion of domestic gas extraction. Jordan is also taking steps to restructure the oil refinery and downstream distribution system, notably by breaking the monopoly of Jordan Petroleum Refinery Company, the sole importer of crude oil and refined oil products.

The other key component of energy sector reform is the **adjustment of energy and electricity prices**, which is essential both for energy efficiency and security as well as for fiscal consolidation. The authorities increased electricity tariffs twice in 2012 and, under the IMF programme, are committed to implementing new increases in electricity tariffs in the coming years and to announce a medium-term strategy, prepared with input from the USAID, to bring NEPCO, the country's electricity wholesaler and transmission company, back to cost recovery and resolve NEPCO's accumulated debt, which has reached JD 2.3 bn. More specifically, the authorities are considering increasing electricity tariffs by 40% between 2013 and 2017.[6]

Regarding the **social safety net**, the new **social security law** (approved only by Cabinet), which foresees, in addition to changes in the pension system, the creation of a Maternity and an Unemployment fund, is definitely a step forward. The passing of this law represents a benchmark for the EU's Good Governance and Development Contract (GGDC), financed by the SPRING programme. In order to compensate poor households for the adjustment of energy prices, the authorities have recently introduced a system of targeted transfers to the poor to compensate part of the households for the adjustment of energy prices. While the combined reform will help save about TD 350-400 million to the budget (nearly 50% of the subsidies cost foreseen for 2013), representing an important step in the right direction, this cash transfer scheme is not sufficiently targeted on the poor as 80% of the population will be compensated. Finally, a better targeting of the National Aid Fund (NAF), the main state-funded social safety net in Jordan, would have a beneficial effect on the budget and on social security justice.[7]

In the area of **tax reform**, the draft Income Tax Law submitted to Parliament in September 2012 aims at boosting tax collections while increasing the progressivity of taxation. The law, the submission of which was a benchmark of both the IMF programme and the EU's GGDC, focuses, in particular, on lowering the very high exempted threshold (from JD 24,000 to JD 18,000) so as to capture more of the middle-class in the tax base, while increasing the top rates for individuals and increasing rates for corporations.

When it comes to **labour markets**, the need for reform is significant. Jordan faces very high levels of unemployment and very low participation rates (particularly among young people and women). The unemployment rate reached 13.1% during the third quarter of 2012, 10.7% amongst males and 24% amongst females. Joblessness reaches 17% and 48% in the male and female population aged 19-24, respectively. At the same time, there is need to increase participation to labour market, which is among the lowest worldwide (about 40%). Policies adopted by Ministry of Labour during recent years have targeted the reduction of unemployment even in rural and remote areas, while encouraging participation in the labour market, notably among women, including through the recent introduction of a maternity leave, to be financed by the Maternity Fund.

Another structural area where significant weaknesses remain is **public finance management** (PFM), with key challenges being the establishment of a better demarcation between internal financial control, internal audit and external audit, and the strengthening of the independence of the Audit Bureau.

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[6]According to NEPCO, there are plans to increase electricity tariff by 14% in 2013 and by 16% in 2014.

[7]Established in 1986 as a response to the elimination of food subsidies, the NAF has about 88,000 beneficiaries and a budget of more than JD 78 million (0.4% of GDP). Its main assistance programme, the so-called Recurring Financial Aid Programme, is aimed at raising the income of poor families.

While Jordan already has a relatively open **trade regime,**[8] it could benefit from further trade liberalisation. The preparatory process for the launch of **Deep and Comprehensive Free Trade Agreement (DCFTA) negotiations** started in March 2012 in Amman as part of the scoping exercise and both sides have been engaged in continuous dialogue concerning the rules of origin issue. Jordan has also made progress in the preparation of negotiations of an Agreement on Conformity Assessment and Acceptance (ACAA), aimed at facilitating the access of industrial products from Jordan into the EU internal market and vice-versa. Transposition of vertical legislation into Jordanian standards for the three priority sectors (gas appliances, toys and electrical products) has continued. So far, 44 directives have been transposed. Still jeopardising the progress on a technical level is the pending amendment to the Law on Standards and Metrology, without which most of the new standards may not be enforced. The proposed MFA operation could facilitate the adoption of the **amended standards law** with a view to defining the new obligations of stakeholders for product safety and to establishing the new conformity assessment and market surveillance regime in Jordan.

Finally, in the areas of **investment**, MFA could facilitate the passing of the draft PPPs law, while helping improve the institutional and regulatory framework for investment through the adoption of the new Investment Law and by-laws, with positive implications for foreign and domestic investment as well as job creation.

Many of the above-mentioned economic reforms are part of the policy programmes supported by the IMF, the World Bank and the EU's budget support operations. The conditionality of the proposed MFA will complement and reinforce that of these operations.

2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

2.1. Objectives

The objectives of the proposed MFA operation are to:

- Contribute to covering the external financing needs of Jordan in the context of a significant deterioration of the country's external accounts brough about by the negative shocks to the energy sector and the economic and political developments in the region.
- Alleviating Jordan's budgetary financing needs, also in the context of the Syrian regugee crisis.
- Support the fiscal consolidation effort and external stabilisation in the context of the IMF programme.
- Facilitate and encourage efforts of the authorities of Jordan to implement measures identified under the EU-Jordan Action Plan, while reinforcing the EU's economic policy dialogue with the authorities.
- Support structural reform efforts aimed at improving the overall macroeconomic management, strenghening economic governance and transparency, and improving conditions for sustainable growth.

[8] Jordan's average tariff of 13% is relatively low when compared with other countries in the region. Jordan is a member of both the Great Arabic Free Trade Area (GAFTA) and the Agadir Agreement and has also concluded FTAs with the US, Turkey, Syria, the EFTA and Singapore.

2.2. Indicators

The fulfilment of the objectives of the assistance will be assessed by the Commission, including in the context of the ex-post evaluation (see below), on the basis of the following indicators:

- Progress with macroeconomic and financial stabilisation, notably by assessing the degree of adherence to the IMF-supported programme.
- Progress with the implementation of structural reforms, notably the specific policy actions identified as conditions for disbursement of the assistance, which will be included in a Memorandum of Understanding to be negotiated between the Commission and the Jordanian authorities. Conditions will include structural measures relevant for ensuring macroeconomic stability, e.g. measures in the field of public finance management reforms, fiscal reforms, as well as measures to support competitiveness and investment.

3. DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1. Delivery mechanisms

The proposed new MFA would amount to EUR 180 million. Regarding the form of the assistance, the Commission proposes to disburse the full amount in the form of a medium-term loan.

The Commission's intention to include only loans is consistent with the methodology for determining the use of grants and loans in EU MFA endorsed by the EFC in January 2011.[9] This proposal is based on two criteria. **First**, Jordan is a middle-income country with a relatively high per capita income level. Jordan's per capita Gross National Income (GNI) (USD 4,380) is above the average level of the EU's Southern partner countries covered by the European Neighbourhood Policy, representing the fourth highest per capita income in the region following Israel, Lebanon and Algeria.[10] For comparison, in 2010 the Parliament and the Council approved a MFA loan of EUR 500 million to Ukraine and a MFA grant of EUR 90 million to Moldova. Ukraine's per capita GNI was USD 3,120, while that of Moldova was USD 1,980.

Secondly, although Jordan's public debt ratio (80% of GDP at the end of 2012, including government guaranteed debt) is relatively high, having increased in the last couple of years due to the losses of the national electricity company (NEPCO) that accompanied the shocks of the energy sector, Jordan has a rather low external indebtedness level. At the end of 2012, Jordan's external public debt ratio was only about 20%. Following implementation of the envisaged medium-term national strategy for bringing NEPCO back to cost recovery and of additional fiscal consolidation measures, the IMF expects that public debt will gradually decline to reach 78.6% of GDP in 2017. In this context, Jordan's public debt dynamics are expected to be sustainable in the medium term with high probability. Also, the fact that the bulk of Jordan's public debt – 80% of the total by end-2012 – is domestic makes it less vulnerable to international creditors' sentiment. The possibility of granting debt relief to Jordan has not been considered, given Jordan's relatively low external debt ratio.

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[9] See Commission Staff Working Paper of 7.7.2011, SEC (2011)874 on criteria for determining the use of loans and grants in EU MFA.

[10] World Bank's Atlas 2011 figures. GNI per capita is the gross national income, converted to U.S. dollars using the World Bank Atlas method, divided by the midyear population.

The proposal to provide the full MFA in the form of loans is also consistent with the treatment granted by the World Bank and the IMF to Jordan. Indeed, Jordan is not eligible for concessional financing from either the IDA or the IMF's Poverty Reduction and Growth Trust fund.

MFA is an untied and undesignated macroeconomic support instrument, which helps the beneficiary country meet its external financing needs, and may contribute to alleviating budgetary financing needs. The funds would be paid to the Central Bank of Jordan. Subject to provisions to be agreed in the Memorandum of Understanding, including a confirmation of residual budgetary financing needs, the funds may be transferred to the Ministry of Finance of Jordan as the final beneficiary.

3.2. Risk assessment

There are fiduciary, policy and political risks related to the proposed MFA operation.

There is a risk that the macro-financial assistance, which is not dedicated to specific expenses (contrary to project financing, for example), could be used in a fraudulent way. In general terms, this risk is related to factors such as the quality of management systems in the central bank and the ministry of finance, administrative procedures, control and oversight functions, the security of IT systems and the appropriatedness of internal and external audit capabilities.

To mitigate the risks of fraudulent use several measures will be taken. First, the Memorandum of Understanding and the Loan Agreement will comprise a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption. Also, the assistance will be paid to a dedicated account at the Central Bank of Jordan. Moreover, before the agreement on the Memorandum of Understanding is reached, the Commission services will conduct, with the support of external consultants, an Operational Assessment, in order to assess the reliability of financial circuits and administrative procedures that are relevant to this type of assistance and will determine whether the framework for sound financial management of macro-financial assistance is sufficiently effective in Jordan. In the light of this assessment, specific mechanisms applying to the management of the funds by the beneficiaries may be introduced in agreement with the national authorities. The Commission is also using budget support assistance to help the Jordanian authorities improve their public finance management systems and these efforts are strongly supported by other other donors. Against this background, special conditionalities on improving public finance management will potentially be required. Finally, the assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Antifraud Office (OLAF), and the European Court of Auditors.

Another key risk to the operation stems from the regional economic and political uncertainty, notably in Syria, which has direct implications for the Jordanian economy. On the domestic front, the main risk is instability related to difficulties in the political and economic reform process. As noted above, the approval by the parliament of several legislative proposals has been delayed ahead of the organisation of parliamentary elections on 23 January 2013. With the elections now behind, there is a better chance of progress with some of these reforms. However, significant political uncertainties remain. The full implementation of the stabilisation and reform measures contained in the IMF and other programmes supported by the international community, including the proposed MFA operation, might be undermined by social dissatisfaction. The social unrest that followed the energy subsidy reform of mid-November underlines the political challenges associated with this part of the reform programme. A derailment of the adjustment process could put the objectives of the proposed

operation in jeopardy, endanger macroeconomic stability and prevent the effective disbursement of the MFA.
Jordan also remains vulnerable to possible negative exogenous shocks. The supply problems of the energy sector represent another risk given the high dependence of Jordan on imported natural gas from Egypt. Although in the medium-term supply risks should be mitigated by efforts to explore new energy sources (the liquefied natural gas terminal, in particular, could be operation already before 2015), for the next couple of years Jordan will remain very exposed to the security situation in the Sinai Peninsula.
Finally, there are risks stemming from a possible weakening of the European and global economic environment and an increase in international energy and food prices

Having made a thorough assessment of the risks, the Commission services consider that there are sufficiently strong grounds to proceed with the MFA to Jordan.

The Commission services will maintain close contacts with the authorities during the implementation of the macro-financial assistance in order to address quickly any concerns that may arise.

4. ADDED VALUE OF EU INVOLVEMENT

The Community financial support to Jordan reflects the country's strategic importance to the EU in the context of the European Neighbourhood Policy. The instrument of macro-financial assistance is a policy-based instrument directed to alleviate short- and medium-term external financial needs. As a part of the overall EC package of assistance, it would contribute to support the European Union's objectives of economic stability and economic development in Jordan. By helping the authorities's efforts to establish a stable macroeconomic framework, the proposed assistance would help improve the effectiveness of other EU financial assistance to the country, including budgetary support operations.

By helping the country overcome the economic shock caused by the regional crisis, notably in Syria, the external energy supply problems and the domestic Arab Spring-related unrest, the proposed MFA will contribute to promoting macroeconomic stability and political progress in the country. By complementing the resources made available by the international financial institutions, bilateral donors and other EU financial institutions, it contributes to the overall effectiveness of the package of financial support agreed by the international donor community in the aftermath of the crisis.

In addition to the financial impact of the MFA, the proposed programme will strengthen the government's reform commitment and its aspiration towards closer relations with the EU. This result will be achieved, inter alia, through appropriate conditionality for the disbursement of the assistance. In a larger context, the programme will signal to the other countries in the region that the EU is ready to support countries like Jordan, embarking on a clear path towards political reforms, in moments of economic difficulties.

5. GENVAL CRITERIA ON MACRO-FINANCIAL ASSISTANCE

In October 2002, the Council reconfirmed a set of principles for the use of the European Union's macro-financial assistance (Genval criteria)[11]. The five criteria are: (i) the exceptional character of the assistance; (ii) its complementarity to financing of the International Financial Institutions (IFIs); (iii) the existence of policy conditionality attached to the assistance; (iv)

[11] Council conclusions of 8 October 2002 on MFA and the accompanying letter of the Council President to the Commission President.

the existence of political pre-conditions; and (v) strong financial discipline that needs to accompany the MFA.

5.1. Exceptional Character and Limited Timeframe

The proposed MFA operation will be exceptional and limited in time and will run in parallel to the IMF's Stand-By Arrangement (SBA), although with a shorter time span than the SBA itself. Against this background and given the expected time of approval of the programme, the assistance is expected to be implemented in 2013-2014. The disbursement of the first tranche could take place in the second half of 2013 provided that the IMF programs remains on track. The second tranche, conditional on a number of policy measures, agreed with the EU, could be disbursed in the first half of 2014. While in the short-term the country faces substantial balance of payments financing needs, the macroeconomic and structural adjustment programme agreed with the IMF and supported by the proposed MFA is expected to produce a gradual strengthening of the balance of payments and fiscal positions.

5.2. Political preconditions and EU-Jordan relations

MFA is reserved to geographically close third countries that respect democracy and human rights and with which the EU maintains close political and economic links.

Political Preconditions: Jordan is a constitutional monarchy with regular, reasonably fair and free elections, although its democracy still suffers from a number of deficiencies. Since 2011, as part of the Arab Spring changes affecting the region, Jordan has embarked on a series of political reforms, with the Parliament adopting in September 2011 over 40 constitutional amendments, representing a significant step towards a fully-fledged democratic system. The constitutional and other legal amendments included *inter alia*: the establishment of a constitutional court; a new political parties law; a new electoral law; the establishment of an independent elections' commission; restrictions on government's ability to issue provisional (temporary) laws; the abolition of military trials for civilians; and restrictions of the State Security Court's jurisdiction. Some of the above amendments are in line with the commitments included in the new ENP Action Plan, negotiated in 2010.

EU-Jordan relations: The EU has for long had an interest to engage with Jordan, acknowledging Jordan's stabilizing role in the region as well as its mutual economic and financial links. The contractual relations between the EU and Jordan are framed by the Association Agreement in May 2002, which liberalizes trade between the two parties and foresees the strengthening of our bilateral political dialogue and economic cooperation. Bilateral relations have been further reinforced under the EU's European Neighbourhood Policy (ENP), including through the adoption of a five-year ENP Action Plan in 2005, replaced by a new 5-year Action Plan in 2010, which identifies key reform measures in both the political and economic spheres and promotes Jordan's regulatory convergence with the EU. Moreover, Jordan is the first Mediterranean partner country with whom the EU has concluded technical negotiations leading to an "Advanced Status". It is also a member of the Union for the Mediterranean. Economic ties with the EU are also important. In 2011, the EU was Jordan's first source of imports (20.1%), although it was only the seventh destination of Jordan's exports. And the EU has offered to Jordan, as noted, the negotiation of DCFTA with the goal to increase Jordan's integration into the EU single market.

Since the Arab Spring, the EU has declared on various occasions its commitment to support Jordan in its economic and political reform process. Indeed, the EU's commitment to support Jordan's political and economic reform was the main message of the first EU-Jordan Task Force held in Amman in February 2012.

In sum, while Jordan's road to full democracy is not without difficulties and significant uncertainties remain, the country has taken significant steps towards political and economic reform and there is also a strong framework of bilateral relations between the EU and Jordan under the Association Agreement, the ENP and other recent initiatives. Jordan has also responded to EU calls for entering into stronger political, security and economic relations and for sharing responsibility in conflict prevention and resolution and remains a key partner in the region.

In this context, Jordan is considered to satisfy the political preconditions for MFA. A more detailed assessment of the compliance with this criterion, provided by the European External Action Service (EEAS), is reproduced in the Annex of this Staff Working Document. Compliance with this criteria will continue to be monitored by the Commission in liaision with EEAS throughout the life of the MFA operation.

5.3. Complementarity

The proposed MFA would complement the assistance provided by other multilateral and bilateral donors in the context of the IMF-sponsored economic programme. In particular, it would complement, both financially and through coordinated policy conditionality, the economic adjustment and reform programmes supported by the IMF's Stand-By Arrangement and the World Bank's DPL operation. In combination, the total financing provided by the multilateral and bilateral creditors/donors would amount to USD 5.8 billion for the period 2013-15. The EU's MFA would represent 3.1% of the total financing package for 2013-2015, including contributions from the IMF and the World Bank's DPL operations. The EU's MFA would also complement the standard EU aid packages mobilised under the ENPI and the SPRING programme, including the policy matrix of the Good Governance and Development Contract (GGDC) operation.

5.4. Conditionality

As it is normally the case with MFA, the disbursements would be conditional on successful programme reviews under the IMF SBA and on the effective use by Jordan of these IMF funds. In addition, the European Commission and the Jordanian authorities would agree on a specific set of structural reform measures, to be defined in a Memorandum of Understanding. These reform measures will support the authorities' reform agenda and complement the programmes agreed with the IMF, the World Bank and other donors, as well as the policy programmes associated with the EU's budgetary support operations.

The European Commission will seek a broad consensus with the Jordanian authorities, so as to ensure a smooth implementation of the agreed conditionality. These policy conditions should address some of the fundamental weaknesses accumulated over the years by the Jordanian economy. Possible areas of conditionality could in principle include: public finance management; fiscal reforms to increase tax collections and improve the progressivity of the tax system; reforms to strengthen the social safety net; labour market reforms (to reduce unemployment and raise participation rates, notably among women); and measures to improve the regulatory framework for trade and investment.

5.5. Financial Discipline

The planned assistance would be provided in the form of a loan and should be financed through the borrowing operation that the Commission will conduct on behalf of the EU. The budgetary costs of the assistance will correspond to the provisioning, at a rate of 9%, of the amounts disbursed in the guarantee fund for external lending of the EU, from budget line 01 04 01 14 ("the provisioning of the Guarantee Fund"). Assuming that the first loan disbursement will be made in 2013 for the amount of EUR 100 million and the second loan disbursement in 2014 for the amount of EUR 80 million and according to the rules governing the guarantee fund mechanism, the provisioning will take place in the 2015-16 budgets.

To ascertain that the beneficiary has in place a sound financial management in line with the requirements of the Financial Regulation, the Commission services will undertake, as noted, an Operational Assessment that should provide an updated report on the reliability of the financial circuits and administrative controls at the Ministry of Finance and the Central Bank of Jordan, while considering the results of the Public Finance and Financial Accountability (PEFA) assessment of Jordan conducted in 2011 with EU funding, and the regular reports on PFM produced by the EU Delegation.

6. PLANNING OF FUTURE MONITORING AND EVALUATION

This assistance is of exceptional and macroeconomic nature and its monitoring and evaluation will be undertaken in line with the standard Commission procedures.

6.1. Monitoring

Monitoring will involve the review of reports and data provided by the authorities and by review missions to Jordan by Commission staff. To monitor the fulfilment of the objectives of the programme throughout the implementation period of the assistance, the Commission will use two types of indicators:

- Adherence to the IMF-supported programme, including compliance with macroeconomic performance criteria and structural reform benchmarks identified under the SBA, as reported by the IMF in the context of the regular review of the programme.
- Progress in the implementation of structural policy indicators, which are to be agreed with the Jordanian authorities in a Memorandum of Understanding. In this process, the Commission services will monitor key areas of the public finance management system, as they will be identified in the update of the Operational Assessment, so as to have the relevant information on any changes in the control environment. Ahead of the disbursement of the second instalment, the authorities will be asked to submit a compliance statement in relation to the policy conditionalities. In addition, under the Memorandum of Understanding monitoring system, the authorities will be required to submit quarterly reports of certain economic and reform indicators.

Although this assistance is centrally managed, where appropriate, the EU Delegation in Jordan will also be called to provide reporting. An annual report, as well as regular information on developments in the management of the assistance, to the European Parliament and to the Council are foreseen.

6.2. Evaluation

Ex-post evaluations of macro-financial assistance operations are foreseen in the Multi-Annual Evaluation Programme of the Commission's Directorate-General for Economic and Financial Affairs. An ex-post evaluation of the proposed macro-financial assistance to Jordan will be launched within a period of two years after the completion of the operation. A provision for the ex-post evaluation is included in the proposed Decision for the assistance, and will also be included in the Memorandum of Understanding. Budget appropriations from the macroeconomic assistance budget line will be used for this evaluation.

7. ACHIEVING COST-EFFECTIVENESS

The proposed assistance would entail a high degree of cost effectiveness for several reasons:

- First, since the assistance would be leveraged by that provided by the international financial institutions, with which, as noted, it would be closely coordinated, its ultimate impact could be very significant compared to its cost. Moreover, in negotiating specific policy conditions, the Commission will be able to draw on the expertise of those institutions, including the International Monetary Fund and the World Bank, and to influence their conditionality as well in ways that will take into account the EU's views.
- Second, providing a coordinated macroeconomic support to Jordan on behalf of the EU countries, the MFA would be more cost efficient than the provision of a similar total amount of financial support by EU Member States individually.
- Third, part of the assistance would be provided in the form of loans, the budgetary impact of which is more limited.
- In addition, the Commission will aim at achieving synergies with other EU policies and instruments used to support the implementation by the beneficiary of the relevant measures (notably in the area of public finance management).

ANNEX

EUROPEAN EXTERNAL ACTION SERVICE

DIRECTORATE North Africa, Middle East, Arabian Peninsula, Iran and Iraq
DIVISION Middle East I – Egypt, Jordan, Lebanon, Syria

Brussels, 6th March 2013

ASSESSMENT ON JORDAN POLITICAL REFORMS

As reiterated in the course of the latest meeting of the EU-Jordan Association Council in December 2012, the EU values Jordan as a key partner in both the European Neighbourhood Policy (ENP) and the Union for the Mediterranean and is committed to further strengthening a close, constructive and mutually beneficial partnership.

Jordan has kept over the years a constructive and balanced position in promoting stability in the region and in supporting the two-state solution of the Middle East Peace Process. In an overall context of heightened tension in the region, notably due to the civil unrest in Syria, Jordan has kept an open-door policy towards Syrian refugees and played a vital role in providing support and hospitality to the ever-growing number of refugees (over 400.000) fleeing the atrocities.

Despite the political unrest in neighbouring countries, Jordan has so far managed to preserve its domestic stability. Protesters in Jordan did not call for regime change but rather for reform of the existing political system. In this respect, the last couple of years were particularly politically challenging with frequent change of governments. The unfolding events in the Mediterranean region pressured HM King Abdullah to follow through on promises of political reforms and in response to the evolving domestic political situation, HM King Abdullah set up in spring 2011 the National Dialogue Committee and the Royal Committee on Constitutional Review.

The National Dialogue Committee was tasked to propose consensus-based drafts for new electoral and political parties' laws. In June, it presented a number of proposals including inter alia the establishment of an independent electoral commission overseeing the elections process (in lieu of the Ministry of Interior) and a draft law aiming at facilitating the creation of political parties. Both drafts were eventually adopted by the Parliament with some changes.

The Royal Committee on Constitutional Review, entrusted to carry out an in-depth review of the Constitution, submitted in August its recommendations to the Parliament. A month later, the Parliament endorsed 41 constitutional amendments representing an important quality leap in Jordan's reform process and the largest change of the Constitution since its adoption in 1952.

The EU fully supports Jordan reform process, both politically and financially. In recognition of the progress made by Jordan in delivering of on-going political and economic reform measures, the EU provided in 2012 to Jordan an additional financial aid of € 70 million from the SPRING (Support for Partnership, Reform and Inclusive Growth) Programme. This was announced by the HR-VP Ashton during the first meeting of the EU-Jordan Task Force held in February 2012.

The political reforms initiated in 2011 continued in 2012 in particular with the establishment of the Independent Electoral Commission and of the Constitutional Court, the adoption of a new political parties' law and a new electoral law. It is noteworthy that some of these laws are in line with the commitments made by the Jordanian authorities in the framework of the joint EU-Jordan ENP Action Plan negotiated in 2010.

Legislative elections took place in January 2013. For the first time, Jordan (Independent Electoral Commission) extended an invitation to the EU to deploy an Electoral Observation Mission (EU EOM). The EU EOM in its preliminary statement indicated that the legislative elections were well organised and administered. It commended the Independent Election Commission for its successful implementation of the electoral process as a whole.

The new electoral law (adopted in July 2012**)** has been strongly criticised by many political and reformist forces. As in November 2010, the Islamic Action Front, main opposition party, boycotted the parliamentary elections. Despite some improvements (a few additional seats attributed to the urban districts, a new voters' registration process), the electoral law does not ensure equality in the number of people represented and does not provide equality of votes.

As regards the **bilateral ties**, over the last years, the EU and Jordan have developed excellent relations and have made significant strides in building a closer relationship notably through the entering into force in 2002 of the Association Agreement and further consolidated in the framework of the European Neighbourhood Policy and of the Union for the Mediterranean.

On several occasions, Jordan has been a frontrunner among the Mediterranean partners. The "advanced status" partnership and the new EU-Jordan ENP Action Plan agreed in 2010 set the framework of our enhanced relations and reflect our mutual commitment to achieving closer integration.

Jordan was the first country in the Near East to sign (in December 2010) a Euro-Med Aviation Agreement aiming at creating a common aviation market with the EU and boosting tourism, business and trade activities.

In December 2012, the EU and Jordan signed the Framework Protocol to the Association Agreement allowing Jordan's participation in some Union programmes.

In December 2012, the kick-off meeting of the Dialogue on Migration, Mobility and Security took place in Amman.

The offer of a Deep and Comprehensive Free Trade Area (DCFTA) will aim at progressively integrating Jordan into the EU single market thereby strengthening Jordan's economy.

In sum, while a number of difficulties and challenges remain, Jordan is making steady progress in its path of strengthening the democratic institutions, including multi-party parliamentary system, the rule of law and the respect of human rights. The EU will continue to support Jordan in pursuing these efforts paving the way to a more inclusive and participatory political system. In the framework of the "advanced status" partnership, Jordan is also further developing its cooperation with the EU. In this context, the political preconditions for Macro-Financial Assistance can be considered to be satisfied.