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Ex-ante evaluation statement

Accompanying the document

Proposal for a

DECISION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

providing further macro-financial assistance to the Hashemite Kingdom of Jordan

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Ex-ante evaluation statement

Further EU Macro-Financial Assistance to the Hashemite Kingdom of Jordan

TABLE OF CONTENTS

1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT 3
1.1 Introduction 3
1.2 Jordan's macroeconomic situation 4
1.3 Structural reform challenges 7
1.4 IMF and other donor support 9
1.5 Progress under the first MFA operation (MFA-I) 11
1.6 Jordan's external financing needs 12
2. OBJECTIVES AND MONITORING INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE 14
2.1 Objectives 14
2.2 Monitoring indicators 15
3. DELIVERY MECHANISMS AND RISK ASSESSMENT 15
3.1 Delivery mechanisms 15
3.2 Risk assessment 16
4. ADDED VALUE OF EU INVOLVEMENT 17
5. ASSESSMENT OF CRITERIA APPLICABLE TO MACRO-FINANCIAL ASSISTANCE 17
5.1 Exceptional Character and Limited Time-frame 17
5.2 Political preconditions and EU-Jordan relations 18
5.3 Complementarity 19
5.4 Conditionality 19
5.5 Financial Discipline 19
6. EVALUATION AND COST-EFFECTIVENESS 20
6.1 Evaluation 20
6.2 Achieving cost-effectiveness 20

Annex: Assessment on Jordanian political reforms prepared by the European External Action Service

1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT

1.1 Introduction

Since early 2011, the Jordanian economy has been significantly affected by the ongoing regional unrest, notably in neighbouring Iraq and Syria. Combined with a weaker global environment, this regional unrest has taken a heavy toll on external receipts and has strained public finances. Lower tourism and FDI inflows, blocked trade routes, and 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 weighed on Jordan's external and fiscal position. The Syrian conflict has impacted Jordan not only by disrupting trade with and through Syria but also by causing an inflow of around 1.3 million of Syrian refugees into Jordan that has increased pressure on Jordan's fiscal position, public services and infrastructure. While Jordan has so far managed to maintained macroeconomic stability through a combination of prudent macroeconomic policies, selected structural reforms and substantial donor support, the situation remains vulnerable.

In 2012, Jordan and the IMF agreed on a first adjustment programme, which was supported by a three-year Stand-By Arrangement (SBA) in the amount of USD 2 billion. Under this programme, which was successfully completed in August 2015, Jordan made considerable progress in terms of fiscal consolidation (also helped by the decline in oil prices), current account adjustment and reserve build-up. The IMF programme was complemented by a first Macro-Financial Assistance (MFA-I) from the EU in the amount of EUR 180 million, which was adopted by the European Parliament and the Council in December 2013 and was disbursed in two tranches of EUR 100 million and EUR 80 million in February 2015 and in October 2015, respectively.

The persistent conflicts in neighbouring Syria and Iraq have continued, however, to disrupt Jordan's foreign trade and undermine investor and tourist confidence. Indeed, the Jordanian economy suffered a major setback in 2015, with growth decelerating, revenues from exports and tourism declining markedly and FDI contracting by 38%. And while Jordan's fiscal and current account imbalances have declined in recent years, also supported by the decline in international oil prices, they remain sizeable, and the country is facing substantial debt repayment obligations in the coming years.

In this difficult context, in November of last year, the Jordanian government published a concept paper (Jordanian Economic Response to the Syrian Crisis: Piloting the Holistic Approach) calling for increased support from the international community to address the economic consequences of the Syrian crisis, and in particular the presence of a large number of Syrian refugees in Jordan. At the conference 'Supporting Syria and the Region', held in London on 4 February 2016, the international community pledged about USD 10 billion to help the countries most affected by the Syrian refugee crisis. Of this amount, the EU pledged EUR 2.39 billion for the countries affected by the Syrian refugee crisis including a EUR 200 million loan for the purpose of a second Macro-Financial Assistance operation (MFA-II) to Jordan. On 3 March, through a letter from the Ministry of Planning and International Cooperation to the Commissioner for Economic and Financial Affairs Taxation and Customs, the Jordanian authorities formalised their request for a new MFA from the EU.[1] The new proposed MFA operation will be part of the so-called Jordan Compact, a document that the

[1] In this letter, the authorities requested a new MFA in the amount of EUR 350 million.

EU and Jordan are discussing and that will contain precise commitments on both sides (including financial assistance from the EU) to address a number of policy priorities.

At the same time, Jordan and the IMF are having discussions on a successor financial arrangement, which is expected to be put in place during the second semester of 2016. The arrangement, which will probably take the form of an Extended Fund Facility (EFF), would support a new economic adjustment and reform programme probably covering 3 years.

In this context, and consistent with the pledge made at the London conference, the European Commission intends to submit to the European Parliament and the Council a proposal for a second MFA to Jordan of up to EUR 200 million, in the form of medium-term loans. Although this amount is lower than the amount requested by the Jordanian authorities, it is justified based on an updated assessment of the country's external financing needs, burden-sharing considerations and the room for manoeuvre available in the EU budget.

The proposed EU MFA, which would complement the assistance provided by the IMF, would help Jordan cover part of its residual external financing needs, for the period 2016-17, estimated at about USD 3.2 billion. Since it is intended that the assistance would be channelled to the budget, the new assistance (as the previous one) would also help Jordan cover part of the fiscal costs associated with the Syrian refugee crisis.

The proposed assistance would promote measures building on the reform efforts supported by the previous MFA and would complement the policy programmes of the IMF, the World Bank and the budgetary support operations financed by the European Neighbourhood Instrument (ENI). These measures are likely to cover reform areas such as public financial management (PFM) and other aspects of economic governance, tax reform, the strengthening of the social safety net, energy and water sector reforms, trade and investment, and the labour market, including measures to facilitate the integration of Syrian refugees into the Jordanian labour market.

1.2 Jordan's macroeconomic situation

Despite the difficult regional situation and the implementation of restrictive macroeconomic policies, Jordan has so far managed to avoid a recession. *Growth* averaged 2.7% in the period 2011-2014, supported by the receipt of substantial financial assistance from foreign donors. However, the intensification of the Syrian crisis in 2015, through its effects on trade, tourism and investor confidence, as well as the slowdown in the Gulf Cooperation Council (GCC) economies, which are not only important trading partners for Jordan but also an important source of tourism, remittances and financial flows, contributed to a deceleration of growth to 2.4% from 3.1% in 2014. This is the lowest growth rate recorded in Jordan since 2010. For 2016, real GDP growth is expected to recover moderately (to around 3%) supported by low oil prices and some rebound in confidence related to the assistance packages announced by donors.

The deceleration of the economy resulted in a sizeable increase in *unemployment*. After declining from 12.6% in 2013 to 11.9% in 2014, the unemployment rate increased again to 13.6% in the fourth quarter of 2015 and to 14.6% during the first quarter of 2016. Unemployment remains particularly high for young people and women (33% and 23.7%, respectively, in the first quarter of 2016).

Helped by sharp declines in food and fuel-related prices, *consumer prices* fell by 0.9% in 2015 (with core inflation at about 2%, however, partly reflecting the demand from Syrian refugees). Consumer price inflation is expected to recover this year as fuel prices stabilise or pick up somewhat, but it is expected to remain low (in the 1%-1.5% range).

Jordan has made substantial progress with fiscal consolidation since its *fiscal deficit* jumped in 2012-2013, largely reflecting adjustment measures taken in the context of the IMF programme (including the introduction of a new income tax law in 2015) and the decline in oil prices, which allowed to reduce markedly the operating loss of NEPCO (the national electricity company) and the state transfers to this company. Thus, the overall fiscal balance, which includes transfers to NEPCO and to WAJ (the Water Authority of Jordan) as well as grants, declined from a peak of about 11% of GDP in 2013 to 3.5% of GDP in 2015.

Table 1: Jordan – Selected macroeconomic indicators, 2012-2017

	2012	2013	2014	2015 Prel.	2016 Proj.	2017 Proj.
	(Annual percentage change, unless otherwise indicated)					
National Accounts						
Real GDP growth	2.7	2.8	3.1	2.4	3.2	3.7
Population (million)	6.4	6.53	6.68	6.82	6.98	7.13
Consumer price index, period average	4.6	4.8	2.9	-0.9	1.2	2.1
GDP per capita (USD)	4,843	5,152	5,375	5,513	5,705	5,932
Unemployment rate (in percent, eop)	12.2	12.6	11.9	13.6	14.6*	
	(In percent of GDP, unless otherwise indicated)					
Consolidated government operations						
Revenue and grants (i)	23.0	24.1	27.9	25.0	25.1	25.7
Expenditure (ii)	31.9	35.3	38.0	29.0	30.4	30.8
Overall fiscal balance (i – ii)	-8.9	-11.1	-10.3	-3.5	-3.4	-2.0
Primary government balance (1)	-10.4	-4.7	-4.5	-5.2	-3.7	-2.5
Combined public sector deficit (2)	-12.7	-9.4	-9.2	-6.1	-3.2	-2.2
Government and government-guaranteed gross debt	80.2	86.7	89.0	93.4	92.1	89.1
External sector						
Current account balance	-15.2	-10.3	-6.6	-8.8	-6.4	-5.6
Current account balance excluding grants	-20.0	-17.1	-11.9	-11.7	-9.4	-10.4
Gross international reserves, eop (USD bn)	5,299	12,060	14,973	15,678	16,100	16,471
- In months of next year's imports of goods/services	2.4	5.2	7.0	7.8	7.4	7.5
Foreign direct investment, net	4.8	5.3	5.2	2.9	3.5	6.0
Nominal exchange rate (peg to the USD)	1.41	1.41	1.41	1.41	1.41	1.41
Total external debt	57.8	65.1	63.9	66	64.5	62.7

* First quarter

(1) Excluding grants and transfers to NEPCO and WAJ
(2) Sum of the primary central government deficit, excluding grants and transfers to NEPCO and WAJ, and NEPCO's operating loss

Sources: Jordanian authorities and preliminary IMF staff estimates

The improvement in the underlying fiscal position is, however, somewhat exaggerated if one only looks at the overall fiscal balance, which has benefited from the impact of the decline in oil prices. To better assess the underlying fiscal trend, the IMF prefers to use another indicator, the so-called primary deficit of the central government, excluding grants and transfers to NEPCO and to WAJ. While this measure also shows an improvement since 2012 (see Table 1), the improvement is less marked and the measure deteriorated again 2015 (increasing to 5.2% of GDP from 4.5% of GDP in 2014) and is more than three percentage points of GDP above what the IMF had programmed. The deterioration in 2015 reflected the impact of the economic slowdown on revenues, which more than compensated for the positive effect of the entry into force of the new income tax. The combined deficit of the central government and NEPCO (which adds to the above-mentioned primary deficit measure

NEPCO's operating loss) remains above 6% of GDP and is also substantially above what had been targeted under the IMF's SBA programme (3.5% of GDP).

The persistent fragility of the fiscal position is further highlighted by the fact that Jordan continues to be very dependent, in order to cover its fiscal gap, on foreign grants (which are expected to remain lower in the coming years than they were in 2012-2014, reflecting the impact of lower oil prices on the finances of GCC donors) [2] and by the risk that oil prices will recover more markedly than currently assumed. Moreover, Jordan must continue to accommodate the significant fiscal cost related to the Syrian refugees. According to authorities' estimates, the total number of Syrian refugees is already about 1.3 million (or 20% of the Jordanian population), although only around 630.000 of them are registered. The fiscal cost of the refugees mainly takes the form of higher expenditure in subsidies, health, education and infrastructure. According to the Jordanian authorities, the cost of direct and indirect expenses related to the hosting the Syrian refugees has amounted to approximately USD 6.6 billion since the beginning of the Syrian conflict.

Reflecting substantial borrowing from foreign donors, as well as the issuance of international bonds, Jordan's gross *public debt* increased further to 93.4% of GDP end the end of 2015, continuing an upward trend observed since 2008, when the ratio stood at 60.2% of GDP. The public debt's dynamics are, however, judged by the IMF to be sustainable provided that the country continues to deliver on further medium-term fiscal adjustment and to be supported by the international community. Credit ratings by Moody's and S&P have remained since mid-2013 at B1 and BB-, respectively. However, S&P revised, in April 2016, its outlook for the long-term rating of Jordan to negative from stable reflecting the unsupportive regional environment and the country's high dependency on foreign grants.

Regarding *monetary policy*, the Central Bank of Jordan (CBJ) reduced the rediscount rate from 4.25% in early 2015 to 3.75% in July 2015, as inflation had turned negative while lending to the private sector (4.4%) remained subdued. This decision was also motivated by the comfortable level of international reserves and expectations of a narrowing current account deficit. Growing confidence in the dinar contributed to a slight reduction of the dollarization ratio, to about 25% in February 2016. The current fixed exchange rate policy (peg to the USD) has continued to serve the economy well by helping anchor inflation expectations.

The escalation of the conflicts in Syria and Iraq in 2015 weighed, as noted, on exports, tourism and investor confidence. Exports decreased by 6.6% as a result of disrupted trade routes while income from tourism dropped by 7.1%, reflecting a sizeable decrease in tourists' arrivals from 4.1 million in 2014 to 3.7 million in 2015. Workers remittances increased only marginally (by 1.5%) in 2015. Despite these unfavourable developments, the *current account* deficit (excluding grants) is estimated to have shrunk to 11.7% of GDP for 2015 compared to 11.9% in 2014. This was driven by a deep decline (of 41%) in energy imports, reflecting lower oil prices, which, together with the weakening of domestic demand, led to a sizeable drop of 11.5% in total imports. Since it peaked at 20% of GDP in 2012, the current account deficit (excluding grants) has been consistently shrinking, supported by fiscal consolidation, the replacement of fuel imports with cheaper gas imports and the decline in oil prices from the second half of 2014. Including grants, however, the current account deficit declined from over 15% of GDP in 2012 to 6.6% in 2014 but it is estimated to have increased again to 8.8% of GDP in 2015, reflecting the above-mentioned marked decline in foreign grants. In sum, while there has been quite an impressive adjustment in the current account since 2012 the deficit remains very large, especially if foreign grants are excluded, and this despite the low level oil

[2] Between 2013 and 2015, foreign grants averaged 3.6% of GDP. In 2015, foreign grants declined to 3.3% of GDP.

prices. External pressures continued in the first quarter of 2016, leading to a sizeable widening of the trade deficit (by 13%) compared to the same period in 2015. This was the result of a significant fall in exports by 12% combined with a 4% increase in imports. Remittances also contracted by 4.4% in the first two months of 2016 year-on-year.

The decline in *foreign direct investment*, from USD 1.8 billion in 2014 to around USD 1.2 billion in 2015 created further pressures to the external position. Despite the sizeable decline in FDI, the capital and financial account recorded a net inflow of USD 2.2 billion in 2015, compared to a net inflow of USD 1.2 in 2014. This was made possible by the issuance in June of two Eurobonds guaranteed by the US Treasury for a total of USD 1.5 billion (a 7-year USD 1 billion bond with a 2.578% coupon and a 10-year USD 500 million bond with a 3% coupon) and the issuance in November of a non-guaranteed Eurobond of USD 500 million with a ten-year maturity and an annual coupon of 6.1%.[3]

In March 2016, net *international reserves* stood at a comfortable level of USD 13.4 billion, equivalent to around 7 months of next year's imports. Including gold, international reserves stood at about USD 15 billion. Jordan's external debt has been on an upward trend, having risen from about 57% of GDP in 2012 to 66% of GDP at the end of 2015. The IMF projects that it will enter a downward trend starting from 2016.

1.3 Structural reform challenges

In the context of the adjustment and reform programmes supported by the assistance of the IMF, the World Bank and the EU's first MFA operation, which was completed in October 2015, the Jordanian authorities made significant progress in a number of key structural reform areas.

Structural reform progress since 2012 included improvements in tax policy and administration, steps to strengthen PFM, efforts to diversify energy supply (partly in response to the interruption of gas imports from Egypt), the elimination of fuel subsidies and the related introduction of a system of cash transfers to compensate households, and the revamping of the investment framework. However, substantial structural reform challenges have yet to be addressed and there is substantial scope for strengthening economic governance. Moreover, some legislative proposals (e.g. for the Audit Bureau law) remain stuck in parliament, with their adoption having been significantly delayed.

In the area of *taxatio*n, and following several delays, the Jordanian parliament adopted a new income tax law in January 2015, which increased progressivity by raising tax rates and introduced new tax grids. However, its fiscal impact was weaker than initially agreed with the IMF and the reform maintained an excessive number of exemptions. A revision of the income tax law aimed at lowering the threshold of the tax-exempted income and widening the tax base remains a key challenge if Jordan is to move decisively to a more equitable tax system while sustaining fiscal consolidation efforts. There is also ample room for raising tax collections by continuing to improve tax administration.

Substantial progress was achieved in *PFM reform*. Consistent with what was foreseen in the conditionality of MFA-I and the budgetary support operations financed by the ENI, the authorities adopted in late 2014 and early 2015 new regulations better defining the scope of internal control and internal audit and strengthening internal control standards and the institutional setting. They have also increased staffing and training in internal financial control units while making progress with the certification of internal auditors. This should facilitate

[3] It should also be noted that on 23 May 2016, NEPCO launched the first Islamic Sukuk bond for USD 105.7 million at an interest rate of 3.5% maturing in 2021.

the transition of the Audit Bureau from pre-audit to post-audit activities. Unfortunately, however, the draft new law on the Audit Bureau, which was submitted to parliament in 2013, has yet to be adopted, as noted. If adopted as proposed, it should help strengthen the Audit's bureau independence and remit while eliminating its involvement in pre-audit activities. There is also substantial scope for improving budget preparation, in particular by enhancing financial and programme performance analysis, and for strengthening public debt management, a challenge that has become more pressing following the rapid increase in public debt levels witnessed in recent years. Another problem in PFM that needs to be addressed is the payment arrears in the health care system.

Jordan liberalised the *prices of most fuel products* at the end of 2012 and has been gradually increasing electricity tariffs in recent years, as part of a plan agreed with the IMF under the SBA programme, to bring them to cost recovery and thus eliminate the operating losses of NEPCO. These efforts continued throughout 2015, even though the authorities increased by only 7.5% NEPCO’s electricity tariffs at the beginning of 2015 instead of by the 15% increase foreseen in the IMF programme. The Budget Law for 2016 does not foresee any increase in electricity tariffs as NEPCO is still benefiting for the low oil prices (and the increased reliance on cheaper imports of liquefied natural gas) for its electricity production. While the smaller increase finally adopted the parliament in 2015 has been partly justified by the lower than initially assumed international oil prices, NEPCO remains exposed to a rebound in oil prices, which underlines the importance of pursuing the strategy of tariff increases to ensure full cost-recovery. Efforts to reform the water sector and bring Water Authority of Jordan, which is contributing significanlty to the fiscal deficit, to operational cost recovery should also continue.

At the same time, consistent with *Jordan's Energy Strategy*, the authorities have continued to advance with their plans to diversify energy sources and increase energy efficiency. A significant step has been the entry into operation in mid-2015 of the new Liquefied Natural Gas terminal in Aqaba and the upgrading of the Liquefied Propane Gas terminal. Agreements have also been signed for the provision of gas from Cyprus and Algeria and of electricity from Saudi Arabia. Other projects being implemented or planned concern shale oil, nuclear energy and renewable energies. This is combined with the implementation of an ambitious energy efficiency plan aimed at achieving 20% energy savings by 2020. At the same time, the government is working to develop a comprehensive regulatory framework for the entire energy sector. All these efforts should help Jordan cover the increased demand for electricity in the coming years and to reduce further the cost for energy imports (reduced already from 18.7% of GDP in 2012 to 11% of GDP in 2015). Despite their large upfront costs, these projects are expected to create significant fiscal benefits provided that oil prices stay on average above USD 50 per barrel in the next 10 years.

In order to compensate households for the elimination of fuel subsidies, the authorities introduced at the end of 2012 a *cash transfer programme*. While the programme was not sufficiently targeted on the poor households, it helped achieve substantial fiscal savings. Moreover, substantial progress was achieved subsequently to improve the targeting of the programme. However, the programme was interrupted during 2014 reflecting the decline of oil prices since the scheme foresees the interruption of the cash compensation if international oil prices decline below USD 100 per barrel. Another significant step towards strengthening the *social safety net* was the adoption of the Social Security Law in 2014, which foresees the introduction of the Unemployment Fund and of the Maternity Fund. The Maternity Fund, which helps finance the cost of maternity leave, should have a positive effect on Jordan's still very low rates of participation of women in the labour force.

Labour market reform remains an important challenge. Indeed, unemployment is, as noted, very high, particularly among women and youth, while the presence of refugees has increased competition for work in some sectors and regions. Labour policies should be revised to improve skills matching, ensure training opportunities, promote entrepreneurship and expand worker's mobility. As part of the Jordan Compact, the authorities will take measures to increase the employment of the Syrian refugees in certain sectors - granting the necessary work permits - supported by EU, including through a relaxation in the rules of origin. The new IMF programme is also expected to emphasize labour market reforms.

The authorities have taken important steps to improve the *investment framework*, consistent with what was foreseen in the conditionality of MFA-I. Following the adoption of a new Investment Law in 2014, they adopted in 2015 by-laws clarifying tax exemptions and streamlining investment incentives. Also, a high-level Council for Competitiveness and Innovation was established with the participation of the private sector to review competitiveness issues. A new PPP law in line with international practice was adopted in November 2014 while the PPP Unit in the Ministry of Finance became operational last year.

While Jordan already has a relatively open trade regime,[4] it could benefit from further *trade liberalisation*. The preparatory process for the launch of Deep and Comprehensive Free Trade Area (DCFTA) negotiations started in December 2011 but has not yet been completed, reflecting disagreements in a number of areas, including rules of origin and public procurement. As noted earlier, both sides have been engaged in negotiations concerning a temporary relaxation of the rules of origin by the EU side applicable to their bilateral trade under the Association Agreement, which should facilitate Jordanian exports to the EU and create additional employment opportunities for both Jordanians and Syrian refugees in certain sectors. As foreseen in the MFA-I programme, Jordan has also made progress in the preparation of negotiations of an Agreement on Conformity Assessment and Acceptance (ACAA), aimed at facilitating access of industrial products from Jordan to the EU internal market and vice-versa. In June 2015, the Parliament endorsed amendments to make legislation on Standards and Metrology compatible with both the EU and WTO requirements. Jordan has decided to focus for now the ACAA-related harmonisation efforts on electrical products, toys, gas appliances and pressure equipment as priority sectors, although negotiations have not yet been launched.

Overall, although reform progress has been substantial, structural reform efforts should be pursued and intensified in order Jordan to achieve the double goal of fiscal consolidation and growth enhancement in a challenging regional environment. In May 2015, the government published *Jordan 2025*, a 10-year economic blueprint to support comprehensive and sustainable economic development and strengthen social cohesion. It represents a long-term strategy, entailing about 400 policy actions aimed at safeguarding macroeconomic and financial stability, achieving high and sustainable growth rates, improving competitiveness and reducing unemployment and poverty.

1.4 IMF and other donor support

In August 2015, Jordan completed the USD 2 billion (800% of quota), three-year SBA programme agreed with the *IMF* in 2012. Through this programme, the country made considerable progress in terms of fiscal consolidation (also helped by the decline in oil prices), current account adjustment and reserve build-up. The implementation of the structural part of the programme was more mixed, with good progress in areas such as fuel subsidy reform, financial supervision and energy and water security but a more hesitant implementation in the areas of income tax reform, electricity tariff adjustment and PFM.

[4] 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.

The Jordanian authorities and the IMF staff are currently negotiating a successor arrangement, which is expected to be in place in the second semester of 2016. The new IMF programme, which will probably take the form of a 3-year EFF, is expected to have an increased focus on structural issues, including, as noted, labour market reform. The size of the new IMF programme is expected to be in the order of USD 1 billion. Following and IMF staff visit at the end of March and early April, a negotiating mission of the IMF took place between mid-May and early June which made substantial progress towards agreeing on a new programme.

The *World Bank* has provided a number of policy-based loans, mostly in the form of Development Policy Loans (DPLs) to Jordan since 2012 to support the country's macroeconomic adjustment and reform efforts. A first DPL, amounting to USD 250 million and aimed at enhancing governance, fiscal management, public sector efficiency and private sector-led growth, was made available in 2012 and was followed in 2014 by another DPL of the same amount and focusing on the same reform areas. In 2014, the World Bank also approved a USD 150 million emergency project loan to help Jordan deal with the health implications of the Syrian refugee inflow. In September 2015, it approved a third DPL of USD 250 million to support the water and energy sectors and in March 2016 a USD 100 million DPL to support the creation of about 100,000 new jobs for Jordanians citizens and Syrian refugees in the next five years. For this particular DPL, the World Bank's Board has granted, on an exceptional basis, concessional terms given the extraordinary situation and fiscal costs related to presence of large numbers of Syrian refugees.

On 15 April 2016, as part of the so-called *MENA Financing Initiative* launched by the World Bank Group in cooperation with the United Nations and the Islamic Development Bank, eight countries (Canada, France, Germany, Japan, the Netherlands, Norway, the United Kingdom, the United States) and the EU pledged USD1.64 billion to help communities in Jordan and Lebanon hosting Syrian refugees, as well as to finance recovery from conflict and reconstruction needs across the Middle East and Northern Africa (MENA) region. The overall pledge includes USD 141 million in grants, USD 1 billion in soft loans and USD 500 million in guarantees. Out of the overall pledge, projects worth around USD 800 million are expected to be generated in 2017, mostly benefiting Jordan and Lebanon.

Since Jordan became a country of operations of the European Bank for Reconstruction and Development (*EBRD)* in 2012, the Bank has approved projects in the amount of USD 534 million for the country. Most of these resources have been channelled to projects in the energy, infrastructure, industry, commerce, agribusiness and financial institutions areas. Cumulative disbursements until May 2016 amounted to USD 266 million.

Regarding bilateral donor assistance, in 2011, the *Gulf Cooperation Council (GCC) countries* decided to allocate USD 5 billion in grants to finance development projects in Jordan during the 2012-2016 period. This amount was divided between Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates, with each country paying USD 1.25 billion. As of the end of 2015, the above resources had been almost entirely spent by the Jordanian government with the exception of the Qatar pledge, which has not been disbursed. The funds were directed to projects related to transport infrastructure, health, education, energy, water and local development. Although discussions are still in progress the GCC countries, combined, are expected to provide to Jordan in 2016-2017 with about USD 1.2 billion in budget support grants .

The United States Agency for International Development (USAID) assistance programme to Jordan is one of the largest USAID programmes in the world, having disbursed from 2011 to 2015 around USD 4.67 billion grants in sectors like humanitarian aid, health, water supply, governance, economic development and others. In September 2015, USAID approved a USD 429.7 million grant for similar projects. The *United States (US)* has also supported Jordan by providing guarantees for the issuance of Jordan sovereign bonds in the US market (USD 1.25 billion in 2013, USD 1 billion in 2014 and USD 1.5 billion in 2015).

Between 1999 and 2015 *Japan* has provided to Jordan USD 475 million in the form of grants and USD 530 million in the form of concessional loans, in addition to the technical assistance. In 2015, the Japanese development agency disbursed to Jordan approximately USD 204 million, in the context of the policy loan for fiscal and public service reform, and about USD 92 million to UN and international organisations in Jordan for projects related to the Syrian crisis. In March 2016, Jordan and Japan signed a USD 16.4 million grant agreement for the purchase of equipment and services for the ministries of water and municipal affairs. As part of the effort to cover its financing needs, Jordan has requested in 2016 a new development policy loan from Japan in the amount of USD 300 million.

France, through the Agence Française pour le Development (AFD), has been providing substantial assistance to Jordan. This included the provision in 2012 of a budget support loan in the amount of EUR 150 million focusing on policy actions in the energy sector. This was followed by the additional loans in the amount of about EUR 95 million in 2014 and EUR 75 million in 2015, the latter being the first tranche of a EUR 150 million budget support loan focusing on the water sector. For 2016, AFD is providing the second tranche (EUR 75 million) of the EUR 150 million budget support loan approved in 2015. It has also approved two project loans, a EUR 55 million loan to finance the Green Corridor electricity transmission network, co-financed by the EU budget and the EIB, and a EUR 39.1 million loan municipal water project.

Since the outbreak of the Syrian crisis *the EU* has allocated almost EUR 1.13 billion to Jordan. This includes, in addition to the EUR 180 million from the previous MFA operation, EUR 500 million in regular programmed bilateral cooperation for Jordan financed under the ENI, about EUR 250 million from the humanitarian budget and more than EUR 30 million from the Instrument contributing to Stability and Peace. Also, since 2012, UNICEF has received a total of EUR 24 million from the EU for child protection, water and sanitation, and child cash programmes in Jordan. Looking forward, and as part of the Jordan Compact currently under negotiation, the EU is tentatively planning to provide to Jordan about EUR 550 million in grants for the next three years plus the EUR 200 million of the proposed new MFA loan.

Moreover, an increasing part of non-humanitarian aid for countries affected by the Syrian crisis is channelled through the EU Regional Trust Fund in response to the Syrian crisis, also known as the 'Madad Fund', founded at the end of 2014. This fund primarily addresses longer term resilience needs of Syrian refugees in neighbouring countries, as well as the hosting communities. It aims to do so in a coherent way by merging various EU financial instruments and contributions from Member States into one single, flexible and quick mechanism. With recent pledges from 20 Member States (amounting to over EUR 63 million) and contributions from various EU instruments, the available resources of the Madad Fund amounted to more than EUR 700 million in March 2016. Out of these, a total of EUR 390 million, including EUR 83 million for Jordan, have already been allocated by the Trust Fund Board.

Between 2011 and 2015, the EIB has made available EUR 264 million to Jordan for private sector development, water sector and green energy projects.

1.5 Progress under the first MFA operation (MFA-I)

Following an official request from the Jordanian authorities in December 2012, the Commission adopted on 29 April 2013 the proposal for a first MFA to Jordan of up to EUR 180 million in the form of loans. The assistance was intended to help Jordan deal with the economic impact of negative shocks stemming from regional political instability, including disruptions in the supply of gas from Egypt and the Syrian conflict, which was affecting both the balance of payments and the fiscal position, notably through the inflow of Syrian refugees.

The Commission's proposal was adopted by the European Parliament and the Council on 11 December 2013[5].

Following the consultation of the Member States' Committee on Macro-Financial Assistance on 4 March 2014, the MoU and Loan Facility Agreement related to this assistance were signed at an official ceremony in Brussels on 18 March 2014. As part of the preparations for this MFA operation, an Operational Assessment was conducted in April 2013 and confirmed the reliability of the country's financial and administrative circuits.

The assistance was disbursed in two tranches. The first tranche, of EUR 100 million, which was conditional on the IMF programme being on track, was disbursed on 10 February 2015. The disbursement was delayed by several months reflecting Jordan's need to amend certain aspects of its public debt legislation. The disbursement of the second tranche, of EUR 80 million, was subject also to the fulfilment of a set of policy conditions specified in a Memorandum of Understanding (MoU) signed by the EU and the Jordanian authorities. These conditions fell under the following thematic areas: public finance management and tax reform; the strengthening and the social safety net and labour market reform; the investment framework and trade; and energy sector reform. The conditions of the programme were broadly fulfilled, with the exception of one condition regarding the Audit Bureau law, for which a waiver was granted. Thus, with the 7th and final review of the IMF programme having been successfully completed on 31 July, the Commission proceeded on 15 October 2015 to the disbursement of the second tranche of the assistance.

1.6 Jordan's external financing needs

The projections made by the IMF staff, in February 2016, point towards significant balance of payments needs for the period 2016-2017, with the *total external financing gap* estimated at USD 3.2 billion (USD 2 billion in 2016 and USD 1.2 billion in 2017; see Table 2).This financing gap can be broadly attributed to three factors: a persistently large current account deficit, significant debt amortization requirements, especially for 2016, and some build-up of foreign exchange reserves. Each of these factors is analysed in what follows.

The IMF foresees that the *current account deficit* including grants will gradually narrow (to 6.4% of GDP in 2016 and to 5.6% of GDP by 2017), reflecting a moderate recovery of exports and tourist inflows, a reduced import bill (under the assumption that oil prices remain at relatively low levels) and a significant increase in foreign grants. However, the deficit is expected to remain sizeable, particularly if foreign grants are excluded. Moreover, despite the downward trend in the current account deficit including grants, the deficit is not expected to be covered by the surplus in the capital and financial account during the 2016-2017 period. Having dropped, as noted, in 2015 (to an estimated USD 1.2 billion), net FDI inflows are projected to recover moderately in 2016 (to USD 1.3 billion) and more significantly (to USD 1.7 billion) in 2017, reflecting the hoped-for boost in investor's confidence related to the package of international donor support announced at the London conference, the continued implementation of prudent macroeconomic policies in the context of the new IMF programme and the assumed continued ability of the authorities to maintain, social peace and consensus domestically. These inflows of FDI will however still remain significantly below their pre-2011 conflict levels, notably as a percentage of GDP.[6]

[5] Decision No 1351/2013/EU of the European Parliament and of the Council of 11 December 2013 on providing macro-financial assistance to the Hashemite Kingdom of Jordan, OJ L 341, 18.12.2013, p. 4.

[6] Net FDI inflows averaged about 10.3% of GDP in the period 2003-2008, compared to a projected average of 4.7% in 2016-17.

The second factor contributing to the estimated external financing gap is, as noted, the significant *debt amortisation*s foreseen, notably for 2016. Although decreased when compared to 2015 (USD 939 million), debt amortisations will remain significant in 2016 and 2017, amounting to USD 618 million and USD 534 million respectively, while they are estimated to jump to USD 1 billion in 2018.

A third factor contributing to the estimated external financing gap, although to a much lesser extent, is the *build-up of net international reserves*. Although the current level of reserves (representing, as noted, about 7 months of imports) can be considered as comfortable, the authorities and the IMF consider that it is important to maintain them close to their current levels, given Jordan's vulnerable external position to a sharp rebound in oil prices and persistent regional political instability and Jordan’s dependency on foreign grants. In fact, the moderate assumed build-up of reserves is less than the amount necessary to maintain the import-cover ratio due to the projected growth in imports. This ratio is projected to decline slightly (from 7.8 months of imports in 2015 to 7.5 months of imports in 2017).

Although the amounts of the new IMF programme are yet to be defined, the preliminary intention is to go for a 3-year EFF starting in the second semester of 2016 and for an amount of around USD 1 billion. Assuming some frontloading of *IMF disbursements* to take into account that the external financing gap is relatively larger at the beginning of the programme, purchases from the IMF in the period 2016-2017 are assumed to be about USD 600 million. Taking into account the IMF repurchase obligations stemming from the recent SBA (which amount to USD 268 million in 2016 and USD 492 million in 2017), our projections imply that net IMF financing would be relatively small in 2016 (about USD 65 million) in 2016 and negative (USD 225 million) in 2017. This means that a significant part of the total projected external financing gap for the period 2016-2017 is expected to be covered by other donors, including the EU.

According to preliminary information, *the World Bank* is expected to disburse to Jordan a USD 250 million DPL in 2016, and a further USD 100 million DPL in 2017. The Bank is expected to finalise its Country Partnership Framework for Jordan for 2017-2022 by September 2016. In total, the budget support amounts provided by the World Bank would represent around 11% of the projected external financing gap for 2016 and 2017.

After deducting net IMF disbursements and disbursements of World Bank policy-based loans, this would still leave a *residual external financing gap* of USD 3.1 billion for the period 2016-2017 to be covered by other donors. The proposed new MFA operation of EUR 200 million would, therefore, cover 7.4% of the estimated residual financing gap.

The remainder of the residual external financing gap is expected to be covered by budgetary support grants to be provided by the GCC countries (about USD 1.2 billion), budget support grants from the US (about USD 650 million), a USD 258 million policy loan from the Arab Monetary Fund, the EUR 75 million budgetary support loan from France and EU grants provided under budgetary support operations (about EUR 160 million). Several other donors (e.g. Japan) are currently reviewing their strategy for Jordan – following the London conference – and they are likely to contribute additional funds. The USA might also consider providing new sovereign bond guarantees.

Table 2: Jordan's External Financing Gap and Potential Financing Sources

(USD million)	2015	2016	2017	Total 2016-17
1. Current account balance*	**-4,617**	**-3,797**	**-3,334**	**-7,130**
2. Capital and financial account	1,602	2,155	2,554	4,709
3. Overall balance (1+2)	**-3,015**	**-1,642**	**-780**	**-2,421**
4. Reserves ("-" indicates increase)	-526	-421	-393	-814
5. Overall External Financing Gap (3+4)		**-2,063**	**-1,173**	**-3,235**
6. Exceptional Financing by IMF and WB	**807**	**314**	**-125**	**189**
Net IMF Disbursements	557	64	-225	-161
Disbursements of World Bank's DPL	250	250	100	350
7. Residual Financing Gap (5+6)		**-1,748**	**-1,298**	**-3,046**
Financing of the gap				
EU MFA-II		**113**	**113**	**227**
EU budget support grants		96	87	184
France budget support loan		84	0	84
USA budget support grants		417	231	648
GCC budget support grants		649	546	1,195
Arab Monetary Fund policy loan		258	0	258
Other grants		4	5	9
Total identified sources		**1,622**	**983**	**2,604**
*Other financing sources***		*127*	*315*	*442*

Total MFA-II as % of the residual gap for 2016-2017 **7.4%**

* For the period 2016-2017 excludes official grants in the form of policy-based budgetary support.

** Mainly issuance of international bonds (possibly with US guarantees) and Sukuk bonds

Sources: IMF staff estimates and projections (February 2016), Jordanian authorities and Commission staff calculations.

The Commission and the IMF also assume, as shown in the table below, that Jordan may have to access the international markets without donor guarantees, as it did in 2015, in order to cover part of the residual external financing gap; whether in the form of international bonds or of Sukuk bonds.

2. Objectives and monitoring indicators of the Macro-Financial Assistance

2.1 Objectives

The objectives of the proposed MFA operation are to:

i) Contribute to covering the external financing needs of Jordan in the context of a sizeable external financing gap brought about by the impact of on-going regional conflicts and instability. Alleviate Jordan's budgetary financing needs, which partly reflect the impact of regional instability, including in particular the fiscal cost related to the influx of Syrian refugees.

ii) Support the fiscal consolidation effort and external stabilisation in the context of expected the IMF programme.

iii) Support structural reform efforts aimed at improving the overall macroeconomic management, strenghening economic governance and transparency, and improving conditions for sustainable growth.

iv) Facilitate and encourage efforts by the Jordanian authorities to implement measures identified under the EU-Jordan Association Agreement and in the context of the bilateral cooperation programmes, support regulatory convergence and economic integration with the EU and strengthen the EU's economic policy dialogue with the authorities.

2.2 Monitoring 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:

i) Progress with macroeconomic and financial stabilisation, notably by assessing the degree of adherence to the IMF-supported programme.

ii) 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.

3. DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1 Delivery mechanisms

The MFA-II operation under consideration would amount to maximum of EUR 200 million. Given the proposed size of the operation, the European Commission is considering releasing the assistance in two equal instalments of EUR 100 million each. The first instalment would be disbursed at the end of 2016 while the second would be disbursed in the second quarter of 2017.

The Commission proposes providing the full amount of the assistance in the form of a medium-term loan. This is consistent with the methodology for determining the use of grants and loans in EU MFA operations, as endorsed by the Economic and Financial Committee in January 2011, which takes into account the following criteria:[7]

Firstly, Jordan is an upper middle-income country with a relatively high per capita income level. Jordan’s per capita Gross National Income (GNI), which amounted to USD 5,160 in 2014, is the fifth highest per capita income in the Southern neighbourhood, after Israel, Lebanon, Libya, and Algeria.[8]

[7] “Criteria for Determining the Use of Grants in EU Macro-Financial Assistance”, note of the European Commission to the EFC, January 2011.

[8] World Bank’s Atlas 2014 figures. GNI per capita is the gross national income, converted to US dollars using the World Bank Atlas method, divided by the country’s population.

Secondly, while Jordan's public debt ratio has significantly increased in recent years reaching 93% of GDP in 2015, the public debt dynamics are judged to be sustainable provided the authorities continue to deliver on further medium-term fiscal adjustment. According to the IMF's latest Debt Sustainability Assessment (DSA), Jordan's public debt ratio is expected to peak in 2015 and then start declining. Jordan's external debt, although it has also increased substantially in recent years, remains at a manageable level. Having reached 66% of GDP at the end of last year, it is projected to enter a downward trend from 2016.

Thirdly, Jordan is not eligible for concessional financing from either the IDA or the IMF's Poverty Reduction and Growth Trust.

3.2 Risk assessment

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

There is a risk that the MFA, 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 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 of the Central Bank of Jordan. Moreover, the Commission services will undertake an Operational Assessment with the support of external consultants before they implement the proposed MFA-II operation in order to assess the reliability of financial circuits and administrative procedures that are relevant to this type of assistance and to determine that the framework for sound financial management of macro-financial assistance is sufficiently effective in Jordan. The Commission is also using budget support assistance to help the Jordanian authorities improve their PFM 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.

A second risk stems from the possibility that Jordan will fail to service the financial liabilities towards the EU stemming from the proposed MFA loans (*default or credit risk*), which could be caused by a significant additional deterioration of the balance of payments and fiscal position of the country or/and by unforeseen events. This risk is mitigated, however, by the fact that the EU's MFA would be part of an international package of official assistance led by the IMF that is supporting an adjustment and reform programme aimed at restoring fiscal and balance of payments sustainability through the implementation of a series of policy measures, included those to be agreed in the MoU between the EU and the Jordanian authorities. Moreover, the risks for the EU budget are in a first instance covered by the EU's Guarantee Fund for external actions.

Another key risk to the operation stems from the *regional political and security situation*, in particular the spillovers from the conflicts in Syria and Iraq, which could result in an intensification of their economic impact on Jordan and fuel domestic social unrest. A derailment of the adjustment process could put the objectives of the IMF-supported programme in jeopardy, endanger macroeconomic stability and prevent the effective disbursement of MFA-II.

Finally, there are *other risks* stemming from a possible recovery of international oil prices, from a possible weakening of the global economic environment and, alternatively, from a further weakening of the GCC countries caused by a protracted period of low oil prices, which may also entail a reduction in aid flows from them.

Having made a thorough assessment of the risks, the Commission services consider that there are sufficient grounds and guarantees to proceed with the proposed 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 Union's financial support to Jordan reflects the country's strategic importance to the EU in the context of the European Neighbourhood Policy. The MFA instrument is a policy-based instrument directed to alleviate short- and medium-term external financial needs. As a part of the overall EU package of assistance, it would contribute to support the European Union's objectives of economic stability and economic development in Jordan. By supporting the authorities' efforts to establish a stable macroeconomic framework and improve economic governance, 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 difficulties caused by the regional conflicts and the refugee crisis, the proposed MFA will contribute to promoting macroeconomic stability and political progress in the country, helping in this way also address the root causes of the refugee and migration crisis. By complementing the resources made available by the international financial institutions, bilateral donors and other EU financial institutions, it should contribute to the overall effectiveness of the package of financial support agreed by the international donor community.

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 economic and political reforms, in challenging economic circumstances.

5. ASSESSMENT OF CRITERIA APPLICABLE TO MACRO-FINANCIAL ASSISTANCE[9]

5.1 Exceptional Character and Limited Time-frame

The MFA-II operation would be exceptional, aiming to support the restoration of a sustainable external finance situation of Jordan. It would run in parallel to the IMF arrangement, currently under negotiation, which is expected to start in the second semester of 2016. The proposed MFA-II would only be implemented if such an IMF arrangement is put in place, and only during a strict timeframe covering the first two years of the new IMF programme. Against this background and given the expected time of approval of the programme, the assistance is expected to be implemented in 2016-2017. The disbursement of the first tranche could take place at the end of 2016 provided that the IMF program has been

[9] Established Commission practice in line with the Joint Declaration by the European Parliament and the Council adopted together with Decision No 778/2013/EU of the European Parliament and of the Council of 12 August 2013 providing further macro-financial assistance to Georgia, OJ L 218, 14.8.2013, p. 15.

signed and remains on track. The second tranche, conditional on a number of policy measures, agreed with the EU, could be disbursed in the second quarter of 2017. While in the short-term the country faces substantial balance of payments financing needs, the macroeconomic and structural adjustment programme to be 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 effective democratic mechanisms (including a multi-party parliamentary system) and the rule of law and that guarantee human rights, and with which the EU maintains close political and economic links. Countries that are covered by the ENP, like Jordan, are eligible for MFA.

Political preconditions: A pre-condition for granting MFA is that the eligible country respects effective democratic mechanisms, including a multi-party parliamentary system and the rule of law, and guarantees respect for human rights. Since 2011, Jordan has embarked, under the leadership of H.M. King Abdullah II, on a number of political reforms to strengthen parliamentary democracy and the rule of law. A Constitutional Court and an Independent Electoral Commission have been set up and a number of major laws, including the Electoral Act and the Political Parties Act as well as laws on decentralisation and municipalities, have been passed by the Jordanian Parliament. In recent years, Jordan has also strengthened the protection of civil and political rights granted to women. While there is still room for reinforcing its democratic institutions and legal framework and for making its democracy more representative of the different social and ethnic groups, Jordan has managed to make progress in this area despite a difficult regional environment and continues to exert a stabilising and moderating role in the region. In this context, the political preconditions for MFA may be considered to be satisfied.[10]

EU-Jordan relations: The EU and Jordan have developed a close political and economic relationship over the years. In 2010, an Advanced Status partnership was agreed between the EU and Jordan that entails expanded areas of cooperation. The legal basis for the EU-Jordan relationship is the Association Agreement that entered into force on 1 May 2002 and the different cooperation and dialogue instruments created under the ENP. Jordan is also a member of the Union for the Mediterranean. The EU aims to assist Jordan in the implementation of its own reform process based on the priorities and actions defined in the Single Support Framework adopted for 2014-2017. In response to the conflicts in Syria and Iraq, and with a view to further strengthening the solid and multi-faceted relationship between the EU and Jordan, the two sides have started negotiations on a new Partnership Priorities Agreement which will guide EU-Jordan relations for the period 2016-2020. The partnership priorities involve the fulfilment of mutual commitments, to be specified in the EU-Jordan Compact, also currently under negotiation.

Jordan's economic ties with the EU are very important. In 2014, the EU was Jordan's second largest trading partner, with a trading share of 15.5% after Saudi Arabia with 17.7% and before the US (third trading partner with a share of 8.5%). A preparatory process for launching negotiations on a Deep and Comprehensive Free Trade Area (DCFTA) is on-going. The DCFTA would aim at improving market access opportunities and the investment climate and at promoting closer economic integration between the EU and Jordan. It would extend

[10] A complete assessment of the satisfaction of the political precondition for MFA, provided by the European External Action Service, can be seen in the Annex of this document.

significantly beyond the scope of the existing Association Agreement to include trade in services, government procurement, competition, intellectual property rights and investment protection. Overall, the future DCFTA could lead to a gradual integration of Jordan's economy into the EU single market. While the actual negotiations on the DCFTA have yet to be launched, both sides have, as noted, started discussions on a temporary relaxation of the rules of origin applicable to their bilateral trade, which it is hoped will provide a boost to Jordanian exports to the EU and create additional employment opportunities for Jordanians and Syrian refugees.

In sum, Jordan has taken important steps towards strengthening democratic rights and the rule of law. There is also a solid and intensifying framework of bilateral relations between the EU and Jordan under the Association Agreement, the ENP, the interest to launch negotiations for a DCFTA and the recent initiatives of Partnership Priorities Agreement and the Jordan Compact. The political preconditions for considering a MFA, and the criterion referring to the relations with the EU, are therefore considered to be satisfied.

5.3 Complementarity

The proposed MFA-II would complement the assistance provided by other multilateral and bilateral donors in the context of the new IMF-sponsored economic programme. Part of the financing to be provided by donors remains to be identified but, based on the information currently available and assuming an IMF programme of a structure as described in the previous section, donors other than the EU are expected to cover at least 74% of the estimated external financing gap for the period 2016-2017. The proposed new MFA would represent 7.4% of the residual financing gap. This is consistent with the existing burden-sharing guidelines applicable to MFA, while it ensures also the value added and significance of the EU's involvement.

The proposed MFA would also complement the standard EU aid packages mobilised under the ENI and contribute to EU's new package of assistance related to the Syrian refugee crisis, as it will be defined in the Jordan Compact. Since it is intended that the assistance would be channelled to the budget, the assistance would help cover part of the fiscal cost associated with the large stock of refugees. By supporting the adoption from the Jordanian authorities of an appropriate framework for macroeconomic policy and structural reforms, the EU's MFA-II would enhance, as noted, the added value and effectiveness of the EU's involvement through other financial instruments.

5.4 Conditionality

Disbursements under the proposed MFA-II operation would be conditional on successful programme reviews under the IMF programme and on the effective use by Jordan of these IMF funds. In addition, the Commission and the Jordanian authorities would agree on a specific set of structural reform measures, to be defined in a MoU. These reform measures will build upon those implemented under MFA I. They would 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 and other crisis-related programmes. They would be consistent with the main economic reform priorities agreed between the EU and Jordan in the context of the Single Support Framework 2014-2017, the Partnership Priorities Agreement and the Jordan Compact.

Possible areas of conditionality could in principle include: PFM and other aspects of economic governance; tax reforms; reforms to strengthen the social safety net; labour market reforms (including measures to support the integration of Syrian refugees in Jordan's labour market); energy and water sector reforms; and measures to improve the regulatory framework for trade and investment, including measures that could prepare the ground for the future DCFTA agreement.

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 impact of the assistance will correspond to the provisioning of the EU's Guarantee Fund for external actions, at a rate of 9% of the amounts disbursed, from budget line 01 03 06 ("Provisioning of the Guarantee Fund"). Assuming that the first loan disbursement (amounting to EUR 100 million) is made in 2016 and the second loan disbursement (amounting to EUR 100 million) is made in 2017, and in line with the rules governing the guarantee fund mechanism, the provisioning will take place in the 2018-19 budgets. This distribution of tranches takes into account the pressing external financing needs of Jordan, concentrated in 2016.

To ascertain that the beneficiary has in place a sound financial management in line with the requirements of the Financial Regulation, the European Commission services undertook in 2013 (in preparation for the MFA-I operation for Jordan) an Operational Assessment that provided a positive report on the reliability of the financial circuits and administrative controls at the Ministry of Finance and the Central Bank of Jordan. To update this assessment, the European Commission will undertake a new Operational Assessment before it implements the proposed MFA-II operation. Also, developments in this area will continue to be closely monitored thought regular progress reports on PFM reforms produced by the EU Delegation in Amman. In addition, the results of the new Public Expenditure and Financial Accountability (PEFA) assessment of Jordan, financed by the EU, are expected to be available in late 2016 and will help to monitor progress and identify remaining challenges in the area of PFM.

6. EVALUATION AND COST-EFFECTIVENESS

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

6.1 Evaluation

Ex-post evaluations of MFA 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 MFA 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 macro-financial assistance grant budget line will be used for this evaluation.

6.2 Achieving cost-effectiveness

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

i) 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 IMF and the World Bank, and to influence their conditionality as well in ways that will take into account the EU's views.

ii) 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.

iii) The entire proposed assistance would be provided in the form of loans, the budgetary impact of which is more limited.

iv) Finally, 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 PFM).

ANNEX

EUROPEAN EXTERNAL ACTION SERVICE

Head of Division

Middle East and North Africa
MENA.1. Egypt, Syria, Lebanon, Jordan

Brussels, 6 June 2016
PD/ma Ares(2016)

NOTE TO THE FILE

ASSESSMENT ON Jordan's POLITICAL REFORMS

Since 2011, Jordan has embarked, under the leadership of H.M. King Abdullah II, on a number of political reforms to strengthen parliamentary democracy and the rule of law. A Constitutional Court and an Independent Electoral Commission have been set up and a number of major laws, including the Electoral Act and the Law on Political Parties, as well as laws on decentralisation and municipalities, have been passed by the Jordanian Parliament. Following the dissolution of Parliament (in place since January 2013) on 29 May 2016, elections are expected in September. A new government under the leadership of Hani Mulqi was appointed on 1 June 2016.

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Political reform continues despite daunting challenges

Under the leadership of King Abdullah II, Jordan has embarked on a political and economic reform process since early 2011; the country has gone through a sui generis response to the Arab Spring unfolding across the region. While the events in neighbouring countries implied a strong focus on security and continued stability of the political system, this occurred in parallel with a number of changes introduced in view of enhancing a system of 'parliamentary government' and strengthening the rule of law and public participation. It is in that light that new institutions were created (Constitutional Court, Independent Election Commission) and that the above mentioned legislation was introduced. EU financial support is oriented amongst other on enhancing democratic governance in Jordan, through institutional support (justice sector, parliament, election commission) as well as through support of democratic stakeholders (civil society organisations, political parties, media).

Jordan's progress in gradually transitioning towards a more democratic political system, despite substantial challenges, represents an important case in the region, in particular when compared with other countries in the region. Consequently, the political preconditions for Macro-Financial Assistance may be considered to be satisfied.

This being said, as witnessed over the past two years with the increasing influence of extremist ideology and terrorist activities in the region, the challenge will remain for Jordan to pursue a significant rhythm of reform and enhancing an open and inclusive society. Jordan faces a number of interconnected challenges on the economic front (high youth employment, decrease of investments and trade resulting from the regional context), at risk of increasing the attractiveness of extremist ideology and terrorist activities and of decreasing political space and the enjoyment of fundamental freedoms.

On the human rights front Civil society actors are increasingly concerned by anti-terrorist legislation potentially limiting fundamental freedoms, the growing number of reported cases of torture and mistreatment in detention, and more generally by their diminishing public space. Restricted freedoms of expression have also been noted in the media.

No significant changes are expected in the short term to the current institutional system in Jordan and the process of political reform will need to be pursued in view of strengthening the legislative and judiciary power branches and enhancing their independence. Significant legislation has been adopted, which needs to materialise further. On the individual rights front, further steps are necessary to ensure access to justice and right to a fair trial, prohibition of torture, women's rights. Economic and political empowerment of youth and women will be essential in view of enhancing stability and democracy in the country.

EU-Jordan Relations

The EU and Jordan enjoy excellent relations and have been linked by an Association Agreement signed in 2002 (advanced status since 2010).

The EU and Jordan are allies in international politics (eg International Syria Support Group, Middle East Peace Process) and have largely congruent views on the root causes of and responses to regional and global crises. For instance, the King of Jordan has been an advocate for tolerant society, inter-religious and inter-cultural dialogue (Aqaba retreat). JO has concluded a peace treaty with Israel (1994) and King Abdullah II is the custodian of the Holy Sites in Jerusalem. JO has played an active role on the multilateral and regional front (eg UNSC member 2014-15; UfM co presidency with EU since 2012).

Overall excellent EU-Jordan relations have been symbolised by a number of highest-level meetings since the beginning of the year. EU Principals (EU Presidents and Commissioners) met Queen Rania in January and King Abdullah II in March. HRVP Mogherini visited Jordan on 22 March; Commissioner Hahn's last visit dates from January. The 4 February London Conference on Syria and the region was another opportunity for senior-level contacts.

The high intensity of contacts reflect both:

(i) mutual commitment to further strengthen the EU-Jordan partnership, going beyond the humanitarian and development domain (eg security, mobility, trade);

(ii) high expectations from Jordan's side that the EU will sustain its financial support to Jordan, both bilaterally and in view of the impact of the refugee crisis. Jordan has been quite prominent on the 'rules of origin request' in the context of the EU-Jordan Compact, as it sees this as a test of the EU's commitment towards Jordan.

Partnership Priorities/Compact 2016-18/20

In the spirit of the ENP review, the EU has proposed to Jordan partnership priorities for 2016-18 (possible extension to 2020) which would cover political dialogue and assistance across a range of areas: security including counter-terrorism; mobility (implementation of the EU-Jordan Mobility Partnership); trade; macro-financial assistance; bilateral assistance in support of economic development, job creation, quality education; democratisation, rule of law, human rights.

In the meantime, cooperation has expanded on different files:

- security/counter terrorism: a 15 March EU-Jordan workshop will engender a road map and cooperation into different areas of work, associating both EU agencies, and member states; EU and JO are committed to a regular dialogue on security issues, addressing both root causes and response;
- mobility partnership: following a mandate given by Council to COM on 11 April, negotiations between EU and JO are expected to start soon on visa facilitation and readmission;
- humanitarian and bilateral assistance: the EU expects to commit close to €300M for bilateral cooperation, support to host communities and refugees in 2016;
- elections: parliamentary elections are expected for September and the EU has been invited to observe. An exploratory mission will be deployed to look into the advisability, feasibility and usefulness of deploying an EU Election Observation Mission. Such a mission, if decided, will be a component of EU's support to strengthening political, electoral and parliamentary institutions in the country.

In sum, while major political, security, economic and social challenges remain, Jordan has made progress towards establishing a democratic system based on the rule of law and respect for human rights. The EU is fully committed to support Jordan in this challenging transition process. In this context, the political preconditions for Macro-Financial Assistance may be considered to be satisfied, although they will have to be closely monitored during the life of the proposed Macro-Financial Assistance operation.

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