



SYRIA'S FRAGILE ECONOMY

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Syria's economy, which is predominantly state-controlled, has been characterized by the International Monetary Fund (IMF) as a "stable but stagnant economy."¹ This characterization reflects, on the one hand, political stability and the absence of major external shocks and, on the other hand, the failure of the narrowly-based political establishment to implement extensive economic reforms to move the country into the direction of the global market. In the words of Dr. Nabil Sukkar, one of Syria's leading economists and a former World Bank economist, the decision makers in Syria are "scared of taking the plunge." Syria's introduction into the global economy would mean that the small ruling elite "could loosen its grip on power and threaten its privileges."² Under 50 years of Ba'th Party rule, the Syrian economy has remained an old-fashioned, inefficient, and heavily regulated socialist command economy—presided over by a quasi-totalitarian regime characterized by political repression and by large scale corruption at the highest levels of government.

The three revenue streams that Syria relies on annually are oil production; taxes from government services; and the government-owned industrial companies, which are widely politicized, greatly inefficient, and often lose money. The exceptions are the three monopolies: tobacco, telecommunications, and banking. The tobacco monopoly is run by a member of the ruling Asad family, which has a complete ownership of the business and is not subject to pricing control.

IMPEDIMENTS TO GROWTH

In recent years, the Syrian economy has registered anemic growth. In a speech before Ba'th Party loyalists, Prime Minister Muhammad Naji al-Utri admitted that economic growth for 2005 was modest (4.6 percent in 2005, but dropped to 3.5 percent in 2006 in current price). Al-Utri attributed the moderate performance of the Syrian economy to eight negative factors which will be explored more fully in the subsequent analysis:

- Weakness in the performance of some economic sectors and low personal income
- Population growth pressures
- Dependency of export on declining oil production

- Small return on investment
- Low levels of national and foreign investments
- Low productivity and growing unemployment
- Low levels of wages and corresponding low levels of incentives
- Poor technical standards in the production sectors³

What al-Utri did not say, nor one would expect him to say, was that the regime was so preoccupied with events in Lebanon, following the assassination of Prime Minister Rafiq al-Hariri, that the economy had suffered from neglect. Al-Utri is known for his "snail pace," which complements well a regime that abhors radical change.

ECONOMIC FACTS ABOUT SYRIA

By way of introduction, it is important to keep in mind the IMF's observation about the Syrian economy's significant data weakness "in terms of coverage, consistency, periodicity, and timeliness." The IMF pointed to the "poor quality trade statistics" while national account statistics "suffer from methodological problems in their treatment of price subsidies and in capturing the activity in the private sector."⁴ In January 2007, there was an argument at the national level about the rate of unemployment. The Bureau of Statistics placed the number between eight and 8.5 percent, while even the government daily *al-Thawra* noted the "doubts regarding the accuracy of these figures."⁵ These same doubts apply to the size of the Syrian population and its annual rate of growth.

Syria is categorized by the World Bank as a lower middle-income country with a per capita of about \$1,200 U.S. In 2006, the population stood at about 19 million, registering an annual growth of about 2.5 percent and a median age of 20.7 years—a demographic structure that places high pressure on the labor market, which expands at about four percent annually. The World Bank has estimated that the real economic growth averaged 1.25 percent between 1999 and 2003, which is half the percentage of the population growth. The country's gross domestic product (GDP) has, in real terms, remained stagnant over the last four years; in 1987 prices, it rose from 1,006,431 Syrian Pounds (SYP) in 2002 to an estimated SYP 1,155,755 in 2006, or the equivalent of \$18.2 billion and \$21.7 billion at an average exchange rate of SYP 53 to the U.S. dollar, or about three percent per annum in local currency.⁶ The CIA World Factbook estimates the Syrian GDP for 2006 at \$24.26 billion in nominal

terms and at the official exchange rate. The estimated public debt stands at 37.9 percent of GDP in 2006, while consumer price inflation has ranged from seven to eight percent in each of the last four to five years.

Syria's GDP is highly dependent on the oil and agricultural sectors, both subject to uncertainties, being affected by sharp fluctuations in oil prices and rainfall, respectively. The oil sector provides 25 percent of the GDP, half of the government's revenues and about two thirds of its export receipts. The reduction in oil revenues, as a result of lower production and higher consumption, will force the government to seek other sources of income. This has led Dr. Muhammad al-Hussein, the Minister of Finance, to call on government officials to "think of revenues before expenditures." He argues, "Revenues are on the decline and we should think of ways to increase revenues to finance expenditures."⁷ With a tax-to-GDP ratio equal to 10.5 percent of GDP (extremely low by international standards), the IMF maintains that "increasing taxes is paramount for the government to continue to provide basic services once oil revenues taper off."⁸

THE IMF REVIEW OF THE SYRIAN ECONOMY

In a 2005 report, the IMF highlighted the sharp decline in private investments as the most immediate cause for the low economic growth in recent years. The report asserts that "persistent weaknesses in the business climate are the main factors holding back investment."⁹ These weaknesses, which arise despite abundance in domestic savings and large reported holdings of Syrian private assets abroad, have several causes: the regulatory environment in the tax, trade, and exchange

regimes in the financial sector and in public administration, and also by government monopolies and poor governance.

The IMF has also expressed concerns about the medium-term prospects of the Syrian economy. Despite reform measures to address structural rigidities, “the pace and the scope of reforms have fallen short of Syria’s medium term growth and employment challenges.” It warned that:

If structural reforms and fiscal consolidation are not accelerated, there is a risk that oil reserves will be exhausted before the ongoing reforms have had time to generate new sources of growth and income. If this risk were to materialize, Syria may get locked in a cycle of financial volatility, fiscal deterioration, low growth and rising unemployment.¹⁰

The IMF criticized Syria for having one of “the most restrictive trade regimes” with various prohibitions and extensive licensing requirements.¹¹ It said the banking system suffered from “financial repression”¹² and that state banks suffered from “inappropriate accounting, loan classification and provisional rules, collateral appraisal, and the continuous rescheduling of non-performing loans.” Specifically, non-performing loans account for 16.5 percent of total assets.¹³

THE EXTERNAL PRESSURE ON SYRIA

The withdrawal from Lebanon, following the assassination of Rafiq al-Hariri in 2005, was both a political and economic blow to Syria. Preceding these events was the extension in September 2004 of the presidency of Emile Lahoud, a Syrian

collaborator, seen as an act of high-handed diplomacy that indeed backfired. The regime is also under external pressures due to the turmoil it has created in Lebanon, the supply of arms to Hizballah, the uncontrolled daily flow across its border to Iraq of jihadists (many of whom eventually act as suicide bombers), and because it is serving as the headquarters of a variety of terrorist organizations—including the political leadership of the Hamas movement and the Islamic Jihad. Syria has also given shelter to former senior Iraqi Ba’thist officials who plan and finance many insurgent activities in Iraq. From an economic perspective, these activities will keep high the risk for foreign investors. The sovereign risk for Syria’s public debt stock will also remain high given Syria’s poor repayment record, which placed it among the few countries on the World Bank’s non-accrual status (an elegant phrase for default) in the years 1987-2002, and hence it was ineligible to borrow from the multilateral institution.

THE WAR IN IRAQ AND ITS CONSEQUENCES FOR SYRIA

Striving to emerge from diplomatic isolation in the Middle East following its expulsion from Kuwait in 1990, Iraq launched what the former vice president Taha Yasin Ramadan termed as “the diplomacy of deals” (*diblomasiyyat al-safaqat*).¹⁴ Under this unique form of trade diplomacy, trade agreements (or protocols) were concluded with most Arab countries and were driven almost solely by political considerations. These protocols often involved far-reaching concessions by Iraq to its trading partners to generate trade, often in violation of UN sanctions, which were in place at the time. One of the most preferential trade agreements was signed

with Syria in May 2000. Under the protocol, Syria was given preferential status in the export of consumer goods to Iraq. In return, Syria allowed Iraq to smuggle about 200,000 b/d through the Kirkuk-Banias pipeline, in violation of UN sanctions. When confronted in the Security Council on numerous occasions, Syria responded that it was "testing" the pipeline. However, with the invasion of Iraq in 2003, the flow of Iraqi crude oil to Syria was cut off, and trade with Iraq has since lost its preferential advantages.

In recent years, there has been an added problem for Syria because of the arrival of Iraqi refugees, estimated in excess of one million, and thousands more are arriving every month. While the Iraqi refugees have boosted the local demand for consumer products which will help the Syrian industry, they have caused difficulties for the Syrian population, especially in the housing sector, where rents have skyrocketed. Public services, which are of mediocre quality in the first place, have come under tremendous stress. The Iraqi refugees represent a burden on the Syrian budget, which subsidizes the prices of basic food commodities—particularly bread, eggs, and meat, in addition to cooking oil. Indeed, the Iraqi refugees, residing primarily in urban centers, have caused the prices of many basic food commodities to rise as much as 300 percent, causing one Syrian commentator, Mahmoud al-Rasawi, to apply the "Richter Scale" as a price gauge to drive his point.¹⁵ The Syrian dailies use perhaps as much space on the price of eggs as they use on some key economic issues. Unwilling to open the market for competition, the Syrian government resorts to price controls, often too low, forcing producers either to sell their products outside the government-controlled distribution network or to

smuggle them to neighboring markets.¹⁶

There has also been pressure on local schools, which have to absorb approximately 75,000 Iraqi students. The Syrians are concerned that the Iraqi refugees, like the Palestinian refugees from 1948, will permanently stay in Syria, adding another dimension to the Syrian fractured social make-up.¹⁷

The war in Iraq has created another political problem for Syria. The Sunnis in Syria represent 75 percent of the population, while the ruling Alawite elite, together with Druze, Christians, and Kurds represent the other 25 percent. Syria's association with Iran and Hizballah, both Shi'a, has caused tensions among the Sunni majority that their country was being converted into Shi'ism. The fact that the mufti of Syria, Sheikh Ahmad Hassoun, was willing to say in an interview on al-Arabiya TV (Saudi-owned) that the number of those who are converting into Shi'ism is small is an indication that the issue is becoming a matter of concern among the Sunnis.¹⁸

UNFULFILLED PROMISES OF REFORM BY BASHAR AL-ASAD'S REGIME

After assuming power in July 2000, following the death of his father, President Bashar al-Asad promised to introduce economic reforms—such as liberalizing the Syrian economy, opening the market to foreign investments, and licensing foreign banks to operate in Syria. These would be followed by political reforms.

The argument behind this phased reform was that a significant segment of the population is either poor or living below the poverty line, and they would not necessarily appreciate political reforms that were not accompanied by economic measures that

would lift them out of poverty. The attempts for reforms have remained constrained by countervailing domestic interests of a small group of oligarchs, and a commitment to a centralized socialist form of economic management. Under the weight of its own repressive practices and its adventures outside the country, the Syrian regime has become stultified, frozen in time, and incapable of change.

THE RATING OF SYRIA ON VARIOUS INDEXES

Another way to view Syrian politics and the Syrian economy is by looking at the various indexes that rate Syria with other countries. Five indexes are examined: (1) the human development index; (2) the index of economic freedom; (3) the business index; (4) World Economic Forum's competitiveness index; and (5) the corruption perception index.

The Human Development Index

The United Nations Development Program (UNDP) issues a Human Development Index (HDI) that provides a composite measure of three dimensions of human development: living a long and healthy life (measured by life expectancy), being educated (measured by school level), and having a decent standard of living (measured by purchasing power parity—PPP—income). Syria is rated 107 out of 177 countries surveyed.¹⁹

The results of the HDI for Syria are not surprising. A review of the national budget for 2006 (Annex I) shows an uncommon prioritization of expenditures. "Justice" is allocated SYP 84.2 billion or 17 percent and national security is allocated SYP 74.9 billion or 15.1 percent, jointly accounting for 32.1 percent, or about one third of the

budget. The expenditure item for justice would most likely include the cost of running the prisons, a key industry in the Syrian regime. The largest item of expenditure of SYP 100.7 billion, or 20 percent of the total listed under economy and finance, is probably meant as subsidies for food and petroleum products, for which the IMF has repeatedly called to eliminate in order to avoid fiscal shocks in the future. By contrast, "social affairs" expenditures were a meager SYP 8.3 billion, or 1.7 percent. One listing of expenditures missing in the budget is the cost of running "the office of the President." It is likely significant if the budget makers found it necessary to conceal it.

Index of Economic Freedom

The Wall Street Journal and the Heritage Foundation publish an *Annual Index of Economic Freedom*. The 2007 Index of Economic Freedom measures how countries score on a list of 50 independent variables, divided into ten broad factors of economic freedom. Among these factors are trade policy, government intervention in the economy, property rights, and informal market activity (unregulated business activity, usually family-run). The higher a country's score on each factor is, the greater the level of government intervention in the economy and the less economic freedom there is. Countries are then divided into four categories: free (score 80-100); mostly free (score 70-79.9); mostly unfree (score 50-59.9); and repressed (score 0-49.9). In the 2007 Index of Economic Freedom, Syria is rated number 145 out of 157 countries. With a score of 48.2, Syria falls under the category of "repressed," followed by Iran (150), Turkmenistan (152), Libya (155), and North Korea in the last place (157). In the Middle East, Syria is ranked fifteenth

out of 17 ranked countries.²⁰ Iran and Libya occupy numbers 16 and 17.

Syria scores below the world average on nine out of ten economic freedoms, the exception being fiscal freedom due to a low income tax rate. However, it scores the lowest on financial freedom, at only ten percent. Apart from being unsophisticated, this sector is burdened by cumbersome and unclear government regulations, coupled with interest rates fixed by the government.

Business Index

The International Finance Corporation (IFC), the private business arm of the World Bank Group, also rates the ease of doing business with the countries. The

overall ranking is based on the ranking of ten topics beginning with “Starting a Business” and ending with “Closing a Business.” On the ease of doing business, Syria was ranked 130 out of 175 countries rated by the program.

One of the topics rated is “trading Across Border” (2006). The following table compares Syria with the Middle East region and with OECD (Organization of Economic Cooperation and Development). The data is based on a standardized shipment of goods, with every procedure recorded—beginning with the final contractual agreement between the two parties and ending with the delivery of the goods:²¹

Table 1: Syria Doing Business 2007: Trading Across Borders (rank)

| Indicator | Syria | Region | OECD |
|-------------------------------------|--------------|---------------|-------------|
| Documents for export | 9 | 7.1 | 4.8 |
| Time for export (days) | 40 | 27.1 | 10.5 |
| Cost of export (US\$ per container) | 1,300 | 924 | 811 |
| Documents for imports (number) | 11 | 10.3 | 5.9 |
| Time for import (days) | 49 | 35.4 | 12.2 |
| Cost of import (US\$ per container) | 1,962 | 1183 | 883 |

Global Competitiveness Index

The World Economic Forum in Davos, Switzerland, has released its annual report for 2006-2007 on global competitiveness. The countries are grouped into three different categories, with category three the highest and category one the lowest.²² The report rated 13 Arab countries, including Algeria, Bahrain, Egypt, Jordan, Kuwait, Libya, Mauritania, Morocco, Oman, Qatar, Syria, and the United Arab Emirates. Syria was in category three and was rated 12 among the 13 Arab countries—higher only than Mauritania.

A special report on competitiveness in the Arab world underscores the point that the “key to unlocking the potential of the Arab economies, can only take root in societies where freedom of thought, enthusiasm for inquiry and critical thinking are popular values.”²³ Clearly, Syria does not meet these criteria. On a special paragraph on Syria, the report points out that while progress has been made in the fields of health and education, “Syria achieves only inferior results on macroeconomic indicators with a high budget deficit and considerable public debt.” Future progress requires

“comprehensive liberalization of foreign trade and labor markets, facilitating access to finance for business as well as fostering the use of latest technologies.”

The Corruption Perception Index

In its Corruption Perception Index, which scores countries on a scale from zero to ten, with zero indicating the highest levels of perceived corruption, Transparency International (TI) has rated Syria 2.9 and ranked it 93-98 among 163 countries rated. Iran, Libya, and Yemen scored lower than Syria. TI has determined that countries scoring below three indicate that “corruption is perceived as rampant.”²⁴ This view is endorsed by Ghassan al-Rifa’i, the former Syrian minister of economy, who told a gathering in Qatar that the most significant obstacles to foreign investment in Syria “are the horrible bureaucracy and the spread of corruption.”²⁵ The Syrian daily *Tishreen* lamented what it described as “the deluge of corruption” (*tawafan al-fasad*) in the government ministries.²⁶

REFORM MEASURES

Syria has taken hesitant reform steps in the financial markets. It has recognized that a vigorous private market requires a vigorous banking sector that can advance loans or guarantees, open letters of credit in foreign currency, and above all the ability to buy and sell foreign currency. A new banking law (Law 8) was enacted in April 2001 allowing the establishment of private banks. The first bank, the Bank of Syria and Overseas, opened for business in January 2004, becoming the first private bank since banks were nationalized in 1963. Three other Lebanese banks as well as one Saudi and one Jordanian bank have since opened for business, and in early April 2007, a fourth Lebanese bank was licensed to

operate.²⁷ The law allowing the establishment of private banks has limited foreign ownership to 49 percent, meaning that a foreign bank in Syria must operate under Syrian standards and conditions and is not entirely subject to control by its overseas headquarters. Some of these banks are under-funded, they have limited liquidity, and their ability to extend long-term loans is equally limited. They are also constrained in their banking activity by the fact that many of the companies seeking loans do not present a reliable balance sheet and their accounting lacks transparency.²⁸

The old guard of the Ba’th Party has yet to accept the idea of private banks in particular, and the private sector in general. They recently called the banks “parasitic” given that, in their views, there are five million Syrians living below the poverty line, as if the private banks were responsible for the extensive poverty. The banks were also criticized for their reluctance to make long-term loans to new enterprises while the old enterprises would only submit financial statements that were distorted and inaccurate, reflecting a criminal intent for tax evasion.²⁹

A Capital Market Authority was established in early 2006 to set the regulatory framework for the securities market, although such a market is not yet operational since clearing all the bureaucratic hurdles could take a long time. Moreover, most private companies in Syria are individually- or family-owned, and the owners may be reluctant to open their books to public scrutiny before they can go public themselves.

Syria has made some progress in reforming trade policies by reducing the list of prohibited products, abolishing the exclusive rights of import agents, and merging import monopolies. Upon signing a free trade agreement with Turkey, similar

to such agreements with Arab countries, Dr. Abdallah al-Dardari stressed that "whatever the negative consequences of globalization, isolation is far more dangerous for Syria."³⁰

In a modest attempt to isolate the economy from politics, the Syrian government appointed the non-Ba'thist al-Dardari, the head of the Planning Commission, as deputy prime minister for economic affairs during the June 2005 Ba'th Party Congress. Al-Dardari has since been beating the drums of optimism on a daily basis. He has said that the share of the Syrian industry in the GDP will grow to 20 percent in 2010 from the present range of five to seven percent. He has promised that per capita income will be doubled by 2010 and that \$16 billion in foreign direct investments will be obtained in the next five years. The Syrian government admits that the value of the total private investments in Syria throughout 2006 was about \$900 million, of which 30 percent or \$270 million were from foreign sources.³¹

Syria has also approved a new investment law that establishes the Syrian Investment Authority and creates a more investment-friendly environment by simplifying procedures and allowing more incentives, including the repatriation of profit in foreign currency. However, as was pointed out by the Economist Intelligence Unit, "the pace and irreversibility of some of the reforms will remain in doubt... [because] there does not appear to be a consensus within the ruling elite over the speed or necessity of economic reform..." particularly in such sensitive matters as subsidies and the reform of the inefficient, blotted, and money-losing public enterprise.³²

SOCIAL MARKET ECONOMY

Recognizing the failure of its command

economy, the Syrian regime is now promoting the social market economy, sponsored by the Ba'th Party Congress in June 2005. The tenth five year plan, for 2006-2010, approved in January 2006 was designed to move the country in that direction. This economic model stresses two concepts: free market forces and social welfare concerns. The social market economy, as envisaged in post-war Germany, was an amalgamation of principles drawn from liberal capitalism and democratic socialism.

The Ba'th Party conference failed to establish the conceptual framework or the principles for a new and far-reaching economic model to reflect the underlying philosophy of the social market economy. In the absence of a competitive environment, both political and economic, and in the absence of a political will to join the global market, a social market economy remains a mere "slogan," as one Syrian economist labeled it. Slogans, like decrees, do not induce economic reforms which, in the case of Syria, require a wholesale removal of Soviet-era shackles of the economy. As was put aptly by Adib Mayaleh, the governor of the Central Bank of Syria, "we have to move from an oil economy to one based on banking, services and tourism." He added: "Most importantly, we have to change the mindset of Syrians from a socialist system to a market system."³³

During a symposium organized by the Damascus branch of the Ba'th Party on January 26, 2007, questions were asked by the audience as to whether the social market economy was not in violation of the provisions of the Syrian constitution that calls for a socialist economy. Others have complained that the program has not called for sustainable growth and has not addressed the problem of stagnant personal

income. They asked about the social implications of the free trade and complained about the growth of large enterprises, which have exacerbated both the problem of unemployment and the spread of corruption.

In responding to the critics, Minister of Finance Dr. Muhammad al-Hussein sought to reaffirm the constructive role of the socialist economy, which is only being redirected to fit into the new model of the social market economy. Al-Hussein said that creating a free market environment would encourage Syrian capital abroad, which he estimated at \$60-70 billion, to be repatriated.³⁴ What the minister did not say was how, in a country whose laws sentence a trader in foreign exchange to a long prison term, so much money has filtered out through the thick layers of government controls over the banking system.

REFORM BY DECREES

In his attempt to highlight the reform of the Syrian economy in 2005, Prime Minister al-Utri listed 40 laws, 96 legislative decrees (presidential decrees), and 518 organizational decrees. All of these laws and decrees were introduced with the purpose of “achieving economic, financial and administrative reform, simplifying procedures for our brothers the citizens, and for the transformation toward a social market economy.”³⁵

The attempts to deregulate the economy by presidential decrees miss the point, because most of these decrees often impede progress by adding new layers of rules and regulations to an already extensively regulated and highly inefficient market. Yet this is what the Syrian government has been doing and it is precisely the reason the reforms lack credibility as evidenced by the reluctance of investors to put their money

into the Syrian economy. Even more significant is the reluctance of Syrian nationals to repatriate their huge capital kept in foreign investment assets.

FROM SOCIAL MARKET TO TASHARIKIYA

As doubts mount about the working of a social market economy in an environment of an authoritarian political system and extensively regulated economy, there is a new slogan being heard in Syria—that of partnership (*tasharikiya*) between the public and private sectors. In the words of Prime Minister al-Utri, there is no public sector or private sector but “a national sector,” within which the responsibility for sustainable development must be borne by everyone in accordance with “the directions of Mr. President Bashar al-Assad.”³⁶ Experience suggests that sustainable economic development is not likely to occur in response to presidential decrees alone, trumpeted by political slogans. Sustainable economic development will require structural changes in the management of the economy and the liberation of entrepreneurial energies of Syrian manufacturers and businessmen, as indicated by the World Economic Forum, quoted earlier.

SANCTIONS ON SYRIA AND THEIR IMPLICATIONS

On January 7, 2003, the United States Congress passed the “Syria Accountability and Lebanese Sovereignty Restoration Act 2003,” which was signed by President George W. Bush on December 12, 2003. The act calls on the president of the United States to take various measures against Syria including the prohibition “to the

export of products of the United States (other than food and medicine) to Syria,” and the prohibition on U.S. businesses “from investing or operating in Syria” (Section 5 of the Act). This was followed by the sweeping Executive Order 13338 of May 12, 2004, “blocking property of certain persons and prohibiting the export of certain goods to Syria.” On March 9, 2006, the U.S. Department of Treasury issued the final ruling against the Commercial Bank of Syria (CBS) along with its subsidiary, the Syrian Lebanese Commercial Bank. The ruling is sweeping as it “prohibits any U.S. bank, broker-dealer, futures commission merchant, introducing broker or mutual fund from opening or maintaining a correspondent account for or on behalf of CBS.” There may be another point of contention with CBS, which has refused to reimburse the Development Fund of Iraq the proceeds from the illicit sale to Syria of Iraqi oil, as required by Security Council Resolution 1483. The amount at issue was estimated at \$600 million.

Al-Dardari has been trying to be reassuring about the capacity of Syria to weather sanctions. Following the unanimous adoption on October 31, 2005, of U.N. Security Council Resolution 1636, which threatened sanctions on Syria if it did not cooperate with the U.N. investigation of the assassination of al-Hariri, al-Dardari told *The Financial Times* that his government has moved to establish a crisis team to deal with sanctions. He said sanctions would not pose insurmountable obstacles, because there was no shortage of “sanction busting.” Dardari added, “to be honest, sanction busters are everywhere... there are American companies in Canada that sell to Syria.”³⁷

There is a lot of bluffing in Dardari's statement. Sanctions busters can sell to Syria, but they take only cash in advance,

not credit, and because of the risks involved in dealing in violation of international sanctions, they sell at above-market price. Moreover, sanction busters cannot facilitate international financial transactions with global banks and cannot infuse the Syrian economy with foreign direct investments that it needs to create new jobs in a rapidly deteriorating employment situation. Bashar al-Asad's two primary soul-mates, the Iranian President Mahmoud Ahmadinejad and the Venezuelan President Hugo Chavez, both lack the resources to lift the Syrian economy from its doldrums. They are both quick on the draw, but their bullets are mostly blanks.

One of the key ironies about the sanctions on Syria is that its capital Damascus is the headquarters of the Arab League's Office for the boycott of Israel.

THE FROZEN ASSOCIATION AGREEMENT WITH THE EUROPEAN UNION

The European Union is Syria's largest trade partner, and Syria has strived for years to negotiate an association agreement with the EU, similar to the agreements that the EU has with a number of other Arab countries.

After arduous, five-year-long negotiations, a draft agreement was concluded in December 2004. The agreement was initialed but was never signed because of the failure of the Syrian regime to meet many of the provisions stipulated in the agreement. On the political front, the agreement called on Syria to address the EU's concerns about good governance, democracy, and human rights. The agreement also sought to address such crosscutting issues as the status of women (gender disparity) and environmental degradation.

On the economic front, the EU would like Syria to reduce the transaction costs, which implies reducing illicit payments to office holders for doing business in Syria. The association agreement requires that Syria reduce tariffs on imported European goods by 50 percent during the first three years following the signing of the agreement and that it eliminate tariffs on European goods entirely within twelve years, before a full partnership agreement can be reached.

For the moment, however, the signing, let alone the ratification of such an agreement, seems quite remote. It has been reported that Javier Solana, the European Union foreign policy chief, made clear in a visit to Damascus in March 2007 that the Association Agreement would be “unlocked” only “if Syria acts against the suspected flow of weapons to Lebanon and helps ease tensions between the pro-western government and the pro-Syrian opposition.”³⁸

KEY ISSUES IN THE SYRIAN ECONOMY

The Syrian Oil Sector

Oil production in Syria reached its peak in 2000, with 518,000 b/d. However, it continued to decline to about 405,000 b/d in 2006, of which 230,000 b/d were used for local consumption and 175,000 b/d for export. The decline in production over the last few years was cushioned by rising crude oil prices, but this cushion will diminish with the projected decline in both production and export of Syrian crude oil. The prospect of allocating foreign currency for oil imports, in the words of the *Middle East Economic Survey* (which specializes in oil in the Middle East), “has focused minds in Damascus on the need to stem the

decline in production and at the same time prepare for a future without the oil revenues which have cushioned it since the 1990s.”³⁹ Similarly, the IMF has warned Syria that “with a budget relying to the tune of 25 percent of GDP on oil revenues to finance public spending, and with these revenues projected to be halved over the next 10 years, current fiscal policies are clearly unsustainable.”⁴⁰ To finance the growing deficits, Syria has been accumulating new debt, which has risen from 18.6 percent of GDP in 2001 to 37.9 percent in 2006.

The share of crude oil in Syrian exports has also been declining steadily from 70.3 percent in 2002, to an estimated 64.9 percent in 2005, and 48.3 percent forecast for 2008. During this period, the trade balance has gone from a surplus of \$2,210 million in 2002, to an estimated deficit of \$816 million in 2006, and a projected deficit of \$2,343 million in 2008.⁴¹ If Syria were to become a net importer of oil in 2008, or shortly thereafter, the trade balance would show further deterioration.

According to the 2005 study of the Syrian economy by the IMF referred to earlier, the decline in Syrian oil exports is expected to cause a major fiscal and balance-of-payment shock. The study estimates that, in the absence of new oil discoveries, Syria is likely to become a net oil importer within a few years, and will exhaust its oil reserves by the late 2020s. This would reduce the net foreign exchange received from oil from \$3 billion in 2003, to nearly zero by 2010. The shock resulting from lower oil production was masked by a recent spike in oil prices, but price spikes are a two-edged sword. They will benefit Syria as a net oil exporter in the short run, but they could be a source of serious trouble once Syria turns into a net importer of crude oil.

Faced with the challenge of declining

oil production, and at the same time preparing for a future without the oil revenues that have cushioned the Syrian economy since the 1990s, the Syrian government called on international companies to invest in the country's oil and gas sector "with no exception or discrimination."⁴² However, according to Bassam Fatooh, an oil analyst in London, it is not clear whether the new explorations will increase Syrian oil production or merely maintain the present level through compensatory new production.⁴³

Syria has also pursued a number of initiatives with the Iraqi government to re-supply it with Iraqi crude oil which was interrupted after the invasion of Iraq. The United States, which exercises considerable influence over Iraqi oil policies, would likely discourage the Iraqi government from meeting the Syrian demand for oil supply—at least until Syria has taken effective measures to stem the flow of jihadists across its borders.

In terms of refining capacity, Syria is considering a number of options:

- To expand the existing 120,000 b/d Baniyas refinery.
- To build a new 140,000 b/d joint venture refinery east of Homs, which would be owned jointly by Syria, Iran, and Venezuela. A French company is preparing a feasibility study.⁴⁴
- To build a new 140,000 b/d to be owned by Syrian investors and a Kuwaiti company.
- To build a new 70,000 b/d joint venture refinery with a Chinese company.⁴⁵

The Issue of Unemployment

The population has experienced a high

growth rate of about 2.5 percent per annum, bringing the total population from 12.1 million in 1990, to 17.4 million in 2003, and close to 18.5 million in 2005. At the current rate of population growth, at least 300,000 new Syrians enter the work force each year. However, due to a decrease in investment, caused largely by an inhospitable political climate, work opportunities are not increasing proportionately to the increase in the number of work seekers. The Egyptian *Al-Ahram Weekly* estimates that 30 percent of university graduates are unemployed.⁴⁶

Both IMF reports (2005 and 2006) quoted in this article stressed the urgent need for Syria to boost growth in order to (a) diversify and expand the production and export base of the economy before oil resources are depleted; and (b) absorb "a bulge" in entrants into the labor market arising from decades of very rapid population growth.

With the labor force projected to increase at four percent a year, unemployment could exceed 20 percent by the end of the decade. To reverse this trend, which the IMF described as "a daunting challenge," an average employment growth rate of 4.5 percent a year would need to be sustained over the next 10 years.

The rate of unemployment is a subject of controversy in Syria. For political reasons, the government manipulates the figures to lower the rate of unemployment artificially. The International Labor Organization (ILO) has estimated the unemployment rate at close to 18 percent. Using data from the Bureau of Statistics, the government maintains that the rate of unemployment has declined from ten to 11 percent in 2003, to between eight and 8.5 percent in 2006. Yet the government was quick to acknowledge that the lower rate of unemployment is extrapolated from

employment figures in the informal sector, which accounts for at least 40 percent of total employment in the country.⁴⁷ In most countries, the data about employment in the informal sector are notoriously unreliable, because they often count members of one family giving hand to each other to run a store or a small business, for example, and it often falls under the category of “disguised unemployment.” There are also instances, common worldwide, of adding family members as employees in order to conceal potentially taxable income.

The figures of unemployment would have been much higher if the public enterprises were not overstaffed by workers of marginal utility. According to government sources, in many public enterprises the number of workers exceeds by at least 50 percent the required labor force. The surplus labor in public enterprises exacerbates the problem of incompetent or poorly trained and skilled managers.⁴⁸ Workers performance is poor and, given the precarious financial situation of many of these enterprises, the workers are poorly paid and motivated.

A World Bank report has noted that the education system in Syria “is not fully prepared to provide quality education and economically relevant skills to the young labor force.”⁴⁹ As a result, Syrian workers are not economically competitive by regional standards. Massive upgrading of the human resource base will require the opening up of the economy, and upgrading of schools, professors, vocational training systems, as well as civil servants qualified to manage the transition.

A report by the ILO focused on the difficulties underlying the transition of Syrian youth from school to the labor market. The Syrian youth are characterized by a high degree of “lethargy” and a high rate of unemployment, particularly among

those with inferior technical education. Those who are employed work long hours for small wages, and the incentive for productivity is lacking. Most of those who are fortunate enough to get employment do so through connections or family relationships, while the labor exchange bureaus are neither active nor helpful. The report also noticed the bias against female applicants.⁵⁰

To keep unemployment figures down, the government keeps redundant civil servants in their assigned positions. According to the account of Minister of Finance Dr. al-Hussein, two million Syrians receive wages and pensions from the state. He estimated that if every wage or pension earner supports four family members, it means that half of the Syrian population lives on government fixed income.⁵¹ Clearly, such a situation is neither desirable nor sustainable over time.

Syria needs to create 300,000 new jobs every year to alleviate the problem of unemployment. This requires a seven to eight percent annual growth rate that, in turn, requires the doubling of investment as a percentage of GDP from 17 to 35 percent. Such a rate of growth in investment would require a large flow of foreign direct investment, which is not forthcoming in view of Syria’s political isolation within the region—particularly among the Gulf countries, which are the traditional source of investment and tourism in Syria. Changes in the political climate and removing the heavy hand of bureaucracy off the economic levers are necessary in order to shift the economy into a higher gear.

The Agriculture Sector

With the decline of oil revenues, the agricultural sector has regained its

centrality in the country's future economic growth. Syria's initial strategy for the agricultural sector rests on five principles: (1) self-sufficiency in major food staples; (2) the government sets produce prices for six of the seven major crops—namely, wheat, barley, lentils, chickpeas, cotton, and sugar. They are referred to as “the strategic crops;” (3) foreign trade in such crops is a state monopoly; (4) agro-processing plants remained publicly owned; and (5) stem rural migration. In the late 1980s and 1990s, in response to macro-economic crises, Syria modified the strategy to what the UN Food and Agriculture Organization has termed “state-led export promotion.” The shift was anchored in a series of structural adjustment measures such as reduction of subsidies and trade liberalization, and it placed limits on the expansion of the public sector. However, while agricultural production is almost totally privately based and is carried out by a large number of relatively small farm units, the bulk of markets and processing for the main products as well as fertilizer distribution are publicly controlled.⁵²

Thanks to sustained capital investment, infrastructure development, subsidies of inputs, and price supports, Syria has gone from a net importer of many agricultural products to an exporter of cotton, fruits, vegetables, and wheat. One of the prime reasons for this turnaround has been the government's investment in irrigation systems in northern and northeastern Syria—as part of a plan to increase irrigated farmland by 38 percent over the next decade. Syrian exports reflect this turnaround. Aside from oil, which accounted for about two-thirds of export receipts in 2004, and therefore remains the main source of foreign earning, agriculture and animal husbandry accounted for close to 15 percent of export earnings.⁵³

Cotton is the second most important cash crop (after cereals, mainly wheat). It employs 2.7 million farmers and their dependents, or about 15 percent of the population, and will provide the raw material for the expanding Syrian textile industry.⁵⁴

Environmental Problems

The focus on agriculture, coupled with a rapidly growing population, has had negative consequences in terms of environmental degradation. Syria is suffering today from deforestation, overgrazing, soil erosion, desertification, water pollution from raw sewage and petroleum refining wastes, on top of inadequate potable water.⁵⁵

These environmental problems are exacerbated by a serious issue of housing. According to a study by the Syrian economist Dr. Khatam Tamim, the rapidly growing population (estimated at 2.5 percent per annum), the arrival of Iraqi refugees, and the accelerated migration of poor people from the rural areas to the large urban centers have created a serious problem of inadequate accommodation for millions of people. A large area of Damascus has turned into slums. Moreover, with the cost of building material rising to meet the need of construction of tourism, many poor people have now moved into caves, as many poor Egyptians do. Dr. Tamim estimates the randomly constructed sub-standard houses at 1.2 million units, most of them constructed on state-owned land, but the dwellers lack property rights. Construction code violations have reached 36 percent in Damascus and 32 percent in Aleppo.⁵⁶ Against this enormous shortage of adequate dwellings, the prime minister promised the construction of 60,000 housing units in the next five years.⁵⁷

THE DELUSION OF COOPERATION WITH IRAN

Iran and Syria have maintained close strategic relationships since the refusal of Hafiz al-Asad, Bashar's father, to fall in line with the rest of the Arab countries in support of Iraq in its war with Iran. With its isolation from the sources of capital in the Arab oil exporting countries, Syria has turned to Iran for economic collaboration. However, there is a great deal of bluffing in the nature of this collaboration. An example is the recent Iranian private sector mission to Syria and its offer to build an industrial city, which would include a steel mill with a production capacity of 800,000 tons a year, an electric power generation plant of 800 megawatts, a glass factory, a variety of other factories, and a housing complex with 50,000 housing units to house the workers in the new industrial city. The total estimated cost of the project was estimated at \$8 billion to be funded entirely by the Iranian private sector.⁵⁸ Nothing has been heard about this ambitious project since the announcement was made in the wake of a visit to Damascus by an Iranian delegation. It is doubtful that Iranian entrepreneurs are any keener about investing their money in Syria than the Syrians are keen about repatriating their capital from abroad. Given the dwindling fortune of the Iranian economy, due to sanctions and declining oil revenues, such foreign exchange cannot be spared for investment in Syria. Available figures suggest that Iranian investment in Syria has averaged about \$120 million annually.

CONCLUSION

Despite modest economic reforms, which included licensing private banks,

cutting lending interest rates, and raising prices on some subsidized items (most notably gasoline and cement), the Syrian economy remains highly controlled by the government. Long-term economic constraints include declining oil production and exports, weak investment, high unemployment, increasing pressure on water supply, rapid population growth, and economic sanctions.

Syria's authoritarian regime, heavily regulated economy, inadequate infrastructure, outmoded technological base, a bloated public sector, and weak economic institutions combined with declining oil revenues, make the country vulnerable to future shocks while hampering its ability to compete at the regional and international levels.

The regime's preoccupation with the consequences of the assassination of al-Hariri will continue to divert attention from the country's serious problems of growth and unemployment. The threat of sanctions on Syria and the absence of a transparent legal system will discourage foreign direct investments. Despite much bravura about Syria's ability to withstand the effects of sanctions, the Syrian economy could be heavily impacted under such sanctions. All of these factors render the pace and sustainability of the reforms somewhat in doubt.

ANNEX

The Structure of the Syrian Budget for 2006

The Syrian annual budget for 2006 shows total expenditures of SYP 495,000 billion, divided between capital budget of SYP 195 billion and current budget of 300 billion. The following table lists items of expenditure combining the total current and

development budget by category:⁵⁹

Table 2: Syria: 2006-2007 Budget by Categories of Expenditures (capital and current)

| Expenditures | |
|---|----------------------|
| <u>Category</u> | <u>Total (SYPmn)</u> |
| Services Directors | 7,531.39 |
| Justice | 84,282.59 |
| National Security | 74,923.74 |
| Foreign Affairs, Information, & Immigration | 8,126.59 |
| Higher Education | 18,087.62 |
| Education | 31,321.83 |
| Culture | 1,879.61 |
| Social Affairs | 8,331.74 |
| Economy & Finance | 100,722.14 |
| Agriculture, Forestry, & Fisheries | 27,774.94 |
| Extractive Industries | 12,004.44 |
| Manufacturing Industries | 12,110.27 |
| Electricity, Water, & Gas | 36,531.91 |
| Construction | 889.06 |
| Trade | 4,225.69 |
| Transport, Communication, & Storage | 28,520.48 |
| Banking, Insurance, & Real Estate | 4,145.00 |
| Unallocated Expenditures | 33,558.00 |
| Total | 495,000.02 |

Table 3: Syria: 2006-2007 Budget by Categories of Revenues

| Revenues | |
|--------------------------------------|-------------------|
| Taxes & Duties | 191,317.00 |
| Services, Property, & Investments | 35,078.00 |
| Miscellaneous Revenues | 16,757.00 |
| Surplus on State Activities | 192,972.94 |
| Exceptional Financing, Consisting of | 58,875.06 |
| Foreign Loans | 19,240.00 |
| Withdrawals from Reserves | 39,635.06 |
| Total | 495,000.00 |

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NOTES

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