It’s the Economy, Syria

Nizan Feldman

As in his first inauguration address to parliament in 2000, Bashar Asad’s speech after being sworn in for a second term in July 2007 also made detailed reference to the economic sphere. Citing statistical data published by the International Monetary Fund (IMF), Asad enumerated a series of economic achievements made possible, he maintained, thanks to the reforms implemented by his regime.

The satisfaction Asad displayed was not detached from reality. Syria’s economy improved in 2006, growing at a rate of 4.4 percent while reducing its external debt, improving its trade balance, and creating new jobs. The IMF indicates a direct connection between the economic reforms spearheaded by the regime and the growth Syria is experiencing. In their reports, however, the IMF and the World Bank do not indicate that improvements in economic indicators have expanded Syria’s ability to allocate resources for military buildup purposes. While consistent real GDP growth would enable Syria to increase spending on weapon systems, without the need to alter the existing ratio between military spending and GDP, it is highly doubtful whether the current recovery in Syria’s economy has created the conditions necessary for achieving sustainable growth. On the contrary: Syria’s economy suffers from a series of chronic problems likely to intensify in the coming years due to the rapid erosion of oil reserves. Even the most favorable published reports regarding Syria’s economic policy have indicated that the pace of reform being led by the government is not fast enough to deal with the economic challenges Syria can expect.

The likelihood that Syria will indeed take the far-reaching steps recommended by the IMF depends on the regime’s willingness to carry out a policy that reduces its control over the economy. However the functioning of Syria’s economy is not solely dependent on measures introduced by the regime on a domestic level, but also on Syria’s policy in the international arena. This article analyzes the reciprocal relationship between Syrian economic performance and processes that are occurring on the international stage. Both Syria’s economic policy and external policy were responsible for the economic stagnation the country experienced between 2000 and 2005. The repercussions of this stagnation drove the regime to institute a moderate change in economic policy in 2005. The regime’s recently launched reforms are, to a considerable extent, responsible for the economic improvement Syria has experienced; however, economic growth cannot continue over time if no significant change occurs in Syria’s international standing.

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The Sources of Stagnation: Economic Policy and International Processes

When Bashar Asad rose to power, he declared his intention to spearhead reforms to enable the gradual abandonment of the old economic model and replace it with a model that adopts several free market principles. Yet between 2000 and 2005, only limited economic reforms were launched in Syria,[1] and these did not create growth conditions. In recent years the IMF and the World Bank have urged Syria to carry out a series of economic reforms aimed at downsizing the public sector and making it more efficient while developing the private sector. A considerable portion of the IMF's recommended reforms are compatible with the moves promised by the regime back in 2000, promises that for the most part were not realized.

The gap between rhetoric and the steps that were actually taken was felt in economic performance. Between 1999 and 2004, Syrians' standard of living began to slide as the rate of population growth exceeded the average rate of real growth. The recession's effects were discernable in most economic indicators: the economy was unsuccessful in creating new jobs for absorbing the 300,000 citizens who join the workforce each year, and the rise in unemployment contributed to an increase in the poverty rate. According to UN data, approximately 5.1 million Syrian citizens (30.1 percent of the population) were living under the poverty line in 2004, with 2 million of them unable to provide for their basic needs. Correspondingly, in 2000-4, there was a worsening of Syria's trade balance while its external debt swelled steadily.[2]

Significantly, Syria's economic stagnation stemmed not only from the government's hesitancy and concern over introducing liberalization measures, but was also the outcome of developments in the regional arena.

The American army's entry into Iraq set into motion a series of processes that impacted on Syria's economy on several levels. In 2000 trade relations between Syria and Iraq were established under a "gentleman's agreement" according to which Syrian products would enjoy preferential Iraqi customs rates, and in exchange Syria would allow Iraq to violate a UN resolution and smuggle oil via its territory. The war in Iraq cut off the profits Syria was making from this arrangement, and Syria immediately lost a convenient market for its exports as well as access to cheap oil.[3] At the same time, Syria was forced to contend with a flood of Iraqi refugees pouring into the country. Beginning in 2003, more than one and a half million refugees[4] (more than 8 percent of the population of Syria) flowed into Syrian territory. This sharp rise in population, which in any case was growing by 2.4 percent per year, constitutes an enormous burden on various government services such as the education and health systems.

Syria's ability to deal with these challenges could have been greater if not for the deterioration of Syria's relations with the West. Rising tensions between Syria and the US drove the US in 2003 to legislate the Syria Accountability and Lebanese Sovereignty Restoration Act. This act obliges the American president to impose sanctions on Syria if it does not: cease its support for international terror groups; end its occupation of Lebanon; stop developing weapons of mass destruction; and stop supporting and abetting terrorist activity in Iraq. The sanctions included a prohibition on selling arms to Syria (in any case forbidden under previous legislation) and a prohibition to sell dual use products.

Furthermore, the president must select at least two further sanctions from a general menu of sanctions.[5]

In May 2004, President Bush signed Executive Order 1388, which instructs implementation of the act. Out of the six possible sanctions, Bush opted for the ban on exports of American products to Syria and the disallowance of passage of Syrian aircraft over US airspace. At the same time, the president, based on other legislation, imposed two further sanctions on Syria. He instructed American financial agencies to sever relations with the Commercial Bank of Syria, and he froze the financial assets of a series of Syrian officials.[6]

Both Syrian and American entities at first tended to dismiss the damage the sanctions could cause Syria, seeing that trade relations between Syria and the US were in any case limited. Indeed, a reduced scale of US imports does not constitute a danger to Syria's system of commerce. But the reality of Syria being under the watchful eye of the US reduces its attractiveness in the eyes of foreign investors. The concern of foreign companies over the tightening of American sanctions combined with the fear that their activities in Syria are liable to be seen in an unfavorable light by American sources discourages foreign investment.[7]

In addition, the tension between the countries constitutes an obstacle to Syria's joining the World Trade Organization (WTO). In 2001, Syria's request to join the organization was rejected due in part to intensive US efforts to block acceptance. In 2005 Syria renewed its request to join; however, it is a reasonable assumption that as long as no change occurs in relations between the countries, the US will maintain its efforts to prevent Syria from joining the organization. Syria's continued non-inclusion in the WTO will make it difficult for Syria to compensate for its drop in income from oil exports through increased export of other goods, since the competitiveness of its products will remain lower than that of WTO member countries.

Syria could blunt this damage if it succeeds in improving its relations with the European Union, which is Syria's largest trade partner. Over the past decade Syria has expressed its desire to take part in the Barcelona process and sign an Association Agreement.[8] Signing the agreement could improve the competitiveness of Syrian products in Europe and would likely create a basis for expanding economic cooperation between the sides. Syria's foreign policy, however, prevents it from achieving these goals. Syria is the only country among those included in the Barcelona process that has not succeeded in upgrading the trade agreement. In 1997 negotiations between the sides began and led to the initialing of an agreement in October 2004. However, the agreement was not ratified by EU countries because Syria, they argued, had not implemented all of the required political and economic reforms, and its foreign policy was counter to the spirit of the Barcelona process. These claims became official EU policy after the assassination of Rafiq al-Hariri in February 2005.

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In past months there has been a certain narrowing of the gap regarding economic issues between Syria and key EU members, which have expressed willingness to extend economic assistance to Syria for absorbing refugees from Iraq. Javier Solana, the High Representative for EU Foreign Policy, explained that the EU seeks to deepen its economic relations with Syria. Nevertheless, Solana and other senior officials have made it clear that the Association Agreement will not be implemented so long as Syria does not cease its subversive activities in Lebanon or take action to curb the smuggling of arms from its territory into Lebanon and Iraq.[9]

The damage caused to Syria by international pressure is much higher than the direct damage caused to its economy following the withdrawal of the Syrian armed forces from Lebanon in 2005. Following the withdrawal there were assessments that a large number of the Syrians employed in Lebanon would fear staying there, but in fact, the number of those who returned to Syria was not large, and for all the workers who left, new workers came in. The Lebanese job market continues to employ 300,000–500,000 Syrian workers,[10] who send back a considerable portion of their income to Syria. Furthermore, there is no evidence of harm to the reciprocal financial relations and extent of trade between the countries.[11]

Reports analyzing the direct reasons for Syria's economic stagnation in 2000-5 point to decreased private investment as the key factor that prevented growth.[12] The difficulty in encouraging investment is closely tied to the business environment, which the government is not rushing to make more efficient, and thus constitutes a factor complementing the international pressure levied on Syria.

Signs of Change?

Extensive attention was devoted to the economic crisis that has gripped Syria at the tenth conference of the Baath party held in July 2005. At the conference, the launching of a program adopting the social market economy model was announced; this model encourages an economy that relies on market principles while aiming to preserve social welfare. The economic program for advancing the model, called FYP, was officially approved in January 2006. The program, based on many of the recommendations appearing in IMF reports, acknowledges the need to increase the relative proportion of the non-oil sectors in the GDP.[13]

According to IMF forecasts, already by the year 2012 Syria's expenses for importing oil will be higher than its oil export income. Out of the 400,000 thousand barrels of oil Syria produces each day, it exports only 175,000. Oil exports account for approximately 66 percent of overall income from exports, and this income constitutes the source for approximately 25 percent of government spending.[14] The Syrian government is already trying to encourage foreign companies to invest in the country's oil and gas industry. But even massive investment can only slightly delay the rapid erosion of oil reserves.[15] If Syria wishes to soften the real and financial damage from this process, it must develop numerous sectors that are not connected to the energy industry and ensure that their products can compete in international markets. The principles outlined in the FYP are meant to propel Syria in this direction, but along with promises of change in the economic scheme, the government also emphasizes the importance of implementing a cautious policy.

The government's economic declarations are compatible with the policy it has been carrying out since the end of 2005. Along with Syria's hesitancy and unwillingness to reduce government involvement in the economic activity of some key sectors, one can point to a series of steps intended for improving the business environment.

In January 2007, Asad signed two orders that alter the investment law that has been applied since 1991. One of the orders allows investors to purchase ownership on land necessary for realizing the project they are investing in. The order assures foreign investors that no restrictions will be imposed on mobilizing their profits on investment, and that they will benefit from a customs exemption on essential equipment for a project's realization. The second order calls for the establishment of the Syrian Investment Authority, meant for accelerating the process of obtaining approval for opening businesses.[16]

In 2006 a corporate income tax reform was implemented, with rates dropping drastically; and at the end of 2005, a law was enacted for enabling the reactivation of the stock exchange.[17] Over the past two years, there has been an increase in the level of exposure of the Syrian economy to international markets in light of the signing of a trade agreement with Turkey and following a decrease in customs rates.[18] At the same time the government has cancelled a series of non-trade barrier restrictions. An additional process that attests to the desire to increase exposure to international markets is the change in the exchange rate regimen. Since 2006, a uniform exchange rate has prevailed in Syria for all sectors, and there are in fact almost no restrictions on importers as to accessibility to foreign currency. In January 2007, the government announced a gradual transition to a managed float exchange rate regimen that would replace the permanent linkage (currency peg) of the pound to the dollar.

These processes were felt in economic activities. Liberalization of the banking industry and the altered exchange rate increased the willingness of exporters to deposit their profits in local banks. Similarly, expanded credit access contributed to an increase in private consumption and a rise of 250 percent in the scale of private investment.[19]

In 2006, Syria's GDP grew by 4.4 percent while the non-oil GDP grew more than 6 percent. Economic growth affected the job market and the unemployment rate fell below 10 percent.[20] Growth is expected to continue during the coming year as well. However, one should not conclude that this growth is based on firm foundations and will accompany the economy over time. Indeed, this economic growth is mainly attributable to a significant rise in private consumption and a sharp increase in the scale of exports, most of which stems from expanded demand from the Gulf states, which are enjoying economic growth.[21] A considerable portion of the economy's momentum originated from one-time events, such as a significant reduction in Syria's external debt, which in 2005 was cut by about $11 billion after Russia waived approximately 73 percent of the debts Syria had accumulated. In addition, the flow of refugees from Iraq boosted private consumption and high oil prices continue to work in Syria's favor.

The Syrian economy remains centralist, and despite the reforms is ranked 135 out of 170 countries in the World Bank's *Doing Business* ranking.[22] Syria's per capita GDP stands at approximately $1,300, low in relation to neighboring countries.[23] In order to prevent a sharp decrease in the standard of living, Syria must not only grow at a faster rate, but must also base its growth on more stable foundations, such as growth in the business sector product and a rise in the scale of investments.[24]

In the past two years Syria has attempted to signal Western companies that it is worthwhile expanding their business operations in the country. But only a handful of Western companies became convinced this was indeed worthwhile; most of the growth in foreign investment came as a result of ex-

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panded activities of Persian Gulf companies. The activity of these companies did indeed contribute to economic growth and could, in the future, boost various sectors, e.g., the tourism industry, real estate, food, and textiles. But the process could be much more profitable if Syria succeeds in increasing the number of companies applying for tenders. Moreover, without investment from Western companies, Syria will find it difficult to develop sectors such as telecommunications and petrochemicals, and it is doubtful if Syria could succeed in restoring the energy industry.

In order to attract significant investment, Syria must continue improving its business environment. However even if Syria faithfully adopts all of the economic steps recommended by the IMF, it will find it hard to deal with expected challenges. The desire of foreign investors to avoid friction with American elements will continue to be an obstacle to the development of different sectors in the country. This was apparent in the argument presented by the Syrian prime minister last August. He claimed that pressure from American companies prevented the Japanese Mitsubishi firm from competing in a tender for rehabilitating Syria's electricity network, and that pressure from former French prime minister Jacques Chirac prevented the French Alstom firm from competing in a similar tender.[25]

Syria will find it difficult to increase the volume of exports on a scale that could compensate for the expected drop in income from oil exports if it is unsuccessful in joining the WTO and does not upgrade its relations with the EU. Expanded business ties with the Gulf states, Russia, and China can only partially compensate for the expected drop in income due to the erosion of oil reserves. Moreover, it would be a mistake to imagine that the tightening of economic ties between Syria and Iran is the solution to Syria's economic problems. Indeed, the economic-strategic relationship between the countries doesn't stop at financial aid for purchasing arms, but also includes broad business cooperation in civilian areas. The scale of investment in Syria by Iranian groups has grown over the past three years, and in 2006 was estimated to be approximately $400 million; this has turned Iran into the third largest investor in Syria, after Saudi Arabia and Turkey. In September 2007, official Syrian and Iranian bodies declared that the scale of Iranian projects in Syria was expected to grow to an overall sum of $10 billion over the next five years.[26] However, despite this and other declarations, it is clear to both sides that the Iranian economy itself is not sufficiently strong or diverse in order to compensate for the economic damage likely to be caused to Syria's economy by international isolation, especially when Syria will be losing a considerable portion of its income from oil exports.

Conclusion

More than once the argument has been raised that the Syrian government has no interest in steering economic processes for raising the standard of living in the country, since these processes would intensify demand for political liberalization. Building a business community will increase the demand for transparency, impacting on numerous elements closely associated with the government that rake in profits thanks to corruption in the public sector and a state-controlled economy. At the same time, rising unemployment, growing poverty, and threat of financial collapse present an equally great danger to the regime's stability.

Table 1. Key Economic Indicators in Syria's Economy 2003-2006

	2003	2004	2005	2006
GDP ($ billions)	22.7	25	28.6	34.9
Real GDP growth	1.1	2.8	3.3	4.4
Real increase in non-Oil GDP	2.5	5	6	6.5
CPI period average	5.8	4.4	7.2	10
Population (millions)	17.6	18.8	19.3	20.4
External debt (% of GDP) *	77.3	73.2	23.3	19.4
Defense spending (% of GDP)	5.3	5.9	5.3	5.1

* The sharp drop in debt is the result of the cancelled debt to Russia.
The table is based on data presented in IMF surveys, which relies on Syrian authorities and the processing of data by IMF economists.

The cautious economic policy led by Syria in the past two years reflects an attempt to strike a balance between the two conflicting arguments. The fact that a moderate change in economic policy combined with several exogenous processes provided a boost to the economy attests to the economic momentum Syria could experience if the government decides to intensify the pace of reform while succeeding in freeing itself from international isolation. But although the government is aware of the economic challenges it faces, it has chosen to implement only some of the economic steps likely to lay the foundations for steady growth. Moreover, Syria has not launched any significant processes for shaking off its international economic isolation. When senior government officials are asked by international institutions why Syria does not increase the pace of reform, they reply that overly rapid implementation would likely undermine the country's political and social stability.[27] The logic of this argument is valid as well for the international arena: the wish to lay the foundations for economic growth does not at the moment constitute a sufficient condition for changing foreign policy.

The economic growth Syria has experienced, which is expected to continue next year as well, has provided the country with breathing space for facing its international isolation. In addition, the improvement in Syria's fiscal situation and its reduced external debt have enabled the country to exploit more efficiently its renewed security ties with Russia. Real GDP growth will enable Syria to increase defense spending without altering the ratio between government spending and GDP.

However, most of the economic signs indicate that economic growth in Syria cannot continue for a long time under current conditions. Without an acceleration of the economic reform announced by the government and barring rapprochement with West,

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Bashar Asad will likely not be able to boast about the performance of Syria's economy when his third term is set to begin seven years from now.

Notes

1 Most of the reforms led by the government during this time focused on developing the banking sector. In 2001 a new banking law came into force, intended to enable the renewal of private banking activity in the country, which was halted in 1963 after the nationalization of banks. Since 2004, there are a number of private local banks operating in Syria as well as some foreign banks.

2 Soren Schmidt, "The Missed Opportunity for Economic Reform in Syria," *Mediterranean Politics,* 11, no. 1 (2006): 91-97.

3 The scale of bilateral trade between Iraq and Syria in 2000–3 stood at more than $5 billion, but this amount is much higher if trade in oil is included.

4 There are various estimates regarding the number of refugees Syria has absorbed in the past four years. The number cited here is based on IMF publications.

5 The menu includes the following sanctions: a ban on exports to Syria, including food and medicine; a prohibition on American business activity in Syria; disallowance of passage of Syrian aircraft over US airspace; downgrading diplomatic relations between the countries; imposing limitations on Syrian diplomatic movement in the US; and blocking economic transactions that include Syrian assets.

6 Alferd Prados and J. M. Sharp, "Syria: Political Condition and Relation with the United States after the Iraqi War," *CRS Report for the Congress* RL 32727, January 10, 2005, p. 21, http://www.usembassy.it/pdf/other/RL32727.pdf.

7 This argument was presented a number of times by Dr. Nabil Sukkar, one of Syria's leading economists. See, for example, his statements in a July 2005 interview to *Executive,* http://www.executive-magazine.com/73/article.php?id=460.

8 The Barcelona process is the popular name of the EU Mediterranean Policy, which was launched in 1995. The aim of the policy is to create an environment of economic and political stability on the southern border of the EU. This objective is to be achieved by creating a free trade zone by the year 2010 among the countries connected with the process and via the signing of Association Agreements between those countries and the EU. These agreements are meant for improving trade conditions between the sides and comprise a basis for cooperation on a series of economic and political topics.

9 These declarations were made by Solana during his visit to Damascus in March 2007. See for example "Problems still Mar Relations with Syria – EU," *The Daily Star,* March 16, 2007, http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/EN/pressReview/93260.pdf.

10 This number climbs to one million when taking into account temporary and illegal workers.

11 Mona Yacoubian, "Syria's Role in Lebanon," *United States Institute of Peace*, November, 2006, http://www.usip.org/pubs/usipeace_briefings/2006/1109_syria_lebanon.html.

12 See for example International Monetary Fund, "Syrian Arab Republic: 2005 Article IV Consultation- Staff Report," *IMF Country Report*, No.05/356, October, 2005, p. 22, http://www.imf.org/external/pubs/ft/scr/2005/cr05356.pdf.

13 The full name of the plan is the Five-Year Plan for 2006-2010.

14 "Falling Oil Revenue Pushes Syria to Adjust Fiscal Policies," *IMF Survey* 35, no. 19, October 2006,http://www.imf.org/external/pubs/ft/survey/2006/101606.pdf.

15 Ibid.

16 "Modest Reforms: Syria's Economy is Becoming a Little Bit More Open," *The Economist,* January 2007.

17 The government hopes for trade on the stock exchange, which was stopped over forty years ago, to be renewed at the end of the year, but it is doubtful if the stock exchange will indeed open in 2007.

18 The average customs rate, which stood at 20 percent over the past three years, is currently

14.5 percent; the maximum customs rate fell from 225 percent to 60 percent.

19 This refers to a rise in the scale of investments authorized under the Syrian Investment Act (Law #10) and not necessarily the scale of actual investment. International Monetary Fund, "Syrian Arab Republic: 2005 Article IV Consultation Mission Preliminary Conclusions," May 16, 2007.

20 Although this statistic is presented in an IMF report, it is in dispute. There are other extremely high estimates regarding the true rate of unemployment in the country.

21 According to estimates, in 2006 there was a 30 percent rise in the export of non-oil products.

22 International Monetary Fund, "Syrian Arab Republic: 2007 Article IV Consultation Mission Preliminary Conclusions," May 16, 2007. For a look at the ranking see http://www.doingbusiness.org/EconomyRankings/.

23 Per capita GDP is presented in current prices. Per capita GDP in relation to purchasing power (PPP) was $4,100 in 2006, lower than Jordan ($5,100), Lebanon ($5,100), and of course lower than Turkey and the Gulf states. See *CIA World Factbook*, https://www.cia.gov/library/publications/the-world-factbook/fields/2004.html.

24 This is the unequivocal conclusion of a complimentary report published in May 2007 by the International Monetary Fund. International Monetary Fund, "Syrian Arab Republic: 2007 Article IV Consultation Mission Preliminary Conclusions," May 16, 2007.

25 Hugh Naylor, "Tired of Energy Ills, Syrian Doubt the West Is Blame," *New York Times*, August 15, 2007.

26 Hugh Naylor, "Syria, Seeking Investors, Turns Cautiously to Iran," *International Herald Tribune*, October 4, 2007.

27 "Is Syria a Reforming Character ?" *The Economist,* January 2, 2007, http://www.economist.com/daily/news/displaystory.cfm?story_id=8482744.