

Chapter 12

The Politics of Economic Liberalization in Syria

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1. Introduction

Already during the reign of the late president Hafez Al Asad (1971-2000) Syria took several steps toward liberalizing its statist economy. However, since the early 90s emphasis on the private sector as engine of jobs, growth and foreign exchange has been pronounced. At the same time Syria is heading towards deeper economic integration within the region through the Grand Arab Free Trade Area (GAFTA) and with Europe through a Free Trade Agreement, expected to be signed by the end of 2003.

In this essay, I advance an explanation of Syria's gradual development during the 90s toward a liberalized economy and its specific form by applying a state-centered approach, explaining the reactions of the Syrian political regime to economic issues. As a consequence of choosing a state-centered approach, I emphasize political factors in explaining economic policies.

I assert that economic liberalization in Syria takes place as a defensive regime reaction to the de-legitimizing economic ills of the statist economy. Due to its precarious legitimacy, the Asad regime is however neither inclined nor able to undertake a restructuring of the regime coalition or institutionalization of a rule-based capitalist economy.⁸⁵ The regime is therefore left with countering the structural economic crisis with what I term pain-less "stroke-of-the-pen" economic reforms. The result is, I maintain, that economic liberalization does not transcend the inward oriented ISI economic framework, does not reduce the high transactions costs of the Syrian economy and does not allow Syria to link up to global value chains and by implication create new comparative advantages for the Syrian economy. Although the Syrian private sector during the 90s has increased its

⁸⁵ E.g. fundamental reform of the enforcers of the "rules of the game": bureaucracy and the judiciary, necessary to underpin a rule based capitalist economy.

role relative to the state sector, the end result is that growth has been lagging since the mid 90s and that growth prospects for an unforeseeable future seems gloomy.

I will first give an account of the main economic issues in Syria during the 90s as well as an account of the constitutive political elements of the Asad regime. On this background, I will explain the reaction of the regime as a defensive reaction to the economic crisis of the statist economy, mediated through a hierarchy of “filters”: the international system, social forces, ideological legitimacy and leadership strategy and capability.⁸⁶

Then follows four recent case stories, which illustrate how the functioning of the Syrian state entrenches the Syrian economy in existing unfavorable terms of trade and prevents it from moving to a more favorable position vis-à-vis the international market.

Based on an understanding of the politics of economic liberalization, their causes, form and extent, I shall finally evaluate the ability of these economic policies to promote sustainable economic growth.

2. Economic developments since 1990

Syria had in year 2000 a total GNP of 17 billion \$. Average GNP per inhabitant was 940 \$ and compares unfavorably to neighboring Lebanon: 4,010 \$, Jordan: 1,710 \$, Turkey: 3,100 \$ and Israel: 16,710 \$ (World Bank a, 2002). During the 90s Syria experienced declining annual growth rates per capita and with almost zero growth at the end of the millennium ended up with an overall growth of 2.1% per capita on an annual basis during the period 1991 – 2001 (World Bank b, 2002).

Growth during the first half of the 90s came as a result of a combination of several related factors: expansion of the role of the private sector in meeting domestic demand, export of manufactured goods to the Eastern Bloc countries, injection of foreign exchange remittances from Syrian workers in Lebanon and ,finally, a substantial increase of Syrian oil production. At the mid-90s the middle classes demand for Syrian manufactured Western “ersatz” goods were saturated, exports to the Eastern Bloc came to an end as the barter deals were not renewed by the now former socialist countries, the Lebanon reconstruction boom ended and the increase in oil production

⁸⁶ The idea to this structure of explanation is with some modifications from Hinnebusch, 2001.

leveled off. While overall industrial production contracted, exports of manufactured goods declined by a dramatic 65% from 1990 to 2000 and reached the negligible figure of 201 million \$; i.e. 1% of the total Syrian GNP or 1/30 of total exports! In addition to the drastic reduction in manufacturing exports, the composition of exports moved further down the technological ladder towards resource-based and low-technology goods. In a report by UNIDO from 2003 (UNIDO, 2003) Syria comes out no.75 out of 88 countries surveyed by UNIDO for their Competitive Industrial Performance Index.

However, oil-revenues more than compensated for the collapse of export of manufactures. In 2000 almost 80% of Syria's foreign exchange earnings came from oil exports⁸⁷, while official labor remittances and agricultural exports made up the rest.

The domestic market is characterized by high tariff protection vis-à-vis the exterior (effective duty rates were 29.7 % in 1997; the highest in the Middle East (Henry & Springborg, 2001: 68)⁸⁸ as well as limitations to new entrants to the domestic markets. The consequence is a high domestic price level, which - when added to the high transaction costs caused by corruption, absence of private bank facilities, inefficiency in customs clearance, etc. - result in high costs relative to other countries.

Although the private sector is now allowed to invest in almost all sectors and has been encouraged to do so in particular by law no.10 from 1991, which gave it free access to repatriate foreign exchange as well as lengthy tax holidays, Syrian investments of foreign exchange held overseas were mainly directed towards the tourist and services sectors, while genuine FDI's⁸⁹ exclusively have been directed to the oil sector. In addition to Syria's lack of international competitiveness, foreign investors have been scared away by lack of enforcement facilities of property rights as well as the risks of future regional turmoil and possible Syrian political instability.

State expenditure is mainly directed towards subsidizing state industries, the agricultural sector and financing a bloated state bureaucracy. The state

⁸⁷ Oil revenue provides almost 50% of state revenue and almost 20% of GNP.

⁸⁸ World Bank, World Development Indicators, 1999. Cited from Henry & Springborg, 2001.

⁸⁹ Which does not exceed a level of 100 mio. \$ annually.

employs roughly 1/3 of total labor force which is paid wages with steady decreasing purchase power.

Public welfare services, such as education and health services, have not been able to keep up with the growth of the population and public investments in either human (economic relevant education) or physical (electronic and spatial means of communication, electricity etc.) infrastructure is almost nil.

Structurally, the Syrian economy may be said increasingly to revert to the status it had when it embarked on its ISI development strategy, i.e. exporter of raw materials (oil and manual labor) and without self-centered growth dynamics. As the Syrian population continues to increase at a rate of 2.5% yearly, adding every year more than 250,000 entrants to the labor market (4.0 – 4.5% of the labor force), the result is that the official unemployment rate is more than 20 %, while unofficially e.g. unemployment of those aged 15 to 24 may have exceeded more than 70% in 1999 (European Commission, 2002: 9).

The proportion of oil production which may be exported is steadily diminishing as production levels have been steady during the 90s while domestic oil consumption is increasing by a level of 5% annually.

The economic situation may be described as critical, although not alarming in the sense of resulting in hunger, hyper-inflation, unraveling of public services or the like. However, aggregate figures are probably concealing a much graver socio-economic deterioration for large parts of the population. Due to lack of appropriate figures, it is not possible to document this, but it seems plausible to reason, that the replacement of income from productive activities with oil revenue is the main reason for the dramatic increase in unemployment and by implication for a much more skewed income distribution.

Improvement of the economy has been recognized as the top priority of the government at several occasions by the president since 2000 Bashar Al Asad (Oxford Business Group, 2002: 15)⁹⁰, although so far to no avail.

⁹⁰ In his inauguration speech in June 2000 as well as during a recent speech he gave when the new government took up work.

3. Regime formation

The Ba'ath regime came to power in 1963 and has remained in power ever since. The regime is presently headed by Bashar Al Asad, who took over the presidency in 2000, when his father Hafez Al Asad died. Although there have been modifications⁹¹ during this long period, the basic structural features of state-economy relations remain. The constitutive political elements of this regime need therefore to be highlighted in order to understand subsequent path-dependent development.

The regime came about in similar circumstances as in other Middle Eastern state; i.e. as a military regime, which came to power on the back of nationalist Arab and socialist developmentalist ideologies. Pre-Ba'ath power bases, urban and landed bourgeoisie, were eliminated through nationalizations and land-reform, while popular participation was demobilized by means of political repression and state controlled corporate-like labor and peasants organizations. At the most radical phase of the Ba'ath regime almost all medium and larger industrial establishments, all foreign trade, all financial institutions, all larger construction establishment and consumer warehouses were owned by the state and the remaining private industrial sector was subjugated to administrative pricing, while the agricultural sector was organized into state-run pseudo-cooperatives.

Core regime elite developments became quickly characterized by a steady pursuance of self-interests and factional fights where primordial sectarian loyalties played a growing role. Increasingly, the core regime elite was dominated by Alawites⁹² and regime security came to depend completely on Alawi military commanders.⁹³

⁹¹ In particular the developments from a nationalist platform during the period between 1963-65 under Salah-Edin Bitar and Michel Aflaq, through the radical nationalist and state-socialist period in 1965-70 under Salah Jedid to the period since 1970 under Hafez Al Asad, with a more nationalist and state-capitalist platform.

⁹² A minority group in Syria, which makes up 10-15% of the population and which previously were a disadvantaged group vis-à-vis the previously political and economical dominant Sunni's.

⁹³ Alawitization of the regime elite came subsequent to the implementation of redistributionary reforms. This supports the explanation of alawitization as a result of the logic of the internal power struggle, rather than as a result of social conflict.

Although the regime has never rested on a broad legitimacy⁹⁴ it has been accepted by virtue of its social accomplishments, its nationalist steadfastness vis-à-vis Israel and the charismatic leadership of Hafez Al Asad, who during the turbulent 70s and 80s was seen as a bulwark against breakdown of civil and national security as experienced elsewhere in the Middle East. The regime has continuously been at odds with the Islamic movement which it suppressed violently during the 80s.

The regime's legitimacy is precarious and has on several occasions been contested by the Islamist forces. The fundamental "cement" of the regime is not a broad ideological mobilization of the population, but rather patron-client relations which exist between the regime and the considerable petty-bourgeoisie of the "Suq" (who benefits from the protection from outside competition, which the high tariffs give them), small and medium landowners (who benefits from above market prices of their produce and subsidized inputs), employees of state industries, employees of the state bureaucracy⁹⁵, state-dependent capitalists and the military.⁹⁶

The patron-client relationship between the regime and its supportive coalition has been financed at start by redistribution (nationalizations and land reform), subsequently by real growth of the economy due to replacement of traditional sectors of the economy with modern type economic relations, then by strategic rents⁹⁷ and finally and increasingly by oil revenues.

As a consequence of the predominant patron-client relationship between ruler and ruled, relations between state and economy are not institutionalized and bureaucracy and judiciary both serve the whims of the regime rather than enforcing and adjudicating collective rules.

⁹⁴ Gained in e.g. national liberalization movements like Bourghiba in Tunisia or as savor of the fatherland like Ataturk. Lack of legitimacy has of course been further compounded by the regimes lack of representativeness vis-à-vis the highly heterogeneous sectarian composition of Syrian society.

⁹⁵ Although their salaries were devalued considerably by high inflation (another hallmark of ISI) during the 80s.

⁹⁶ Who organized themselves in a pampered "state within the state" and engaged in legal civil economic activities as well as illegal (smuggling between Lebanon and Syria).

⁹⁷ From the Soviet Union and the Gulf countries.

Concomitant with the increasing dysfunction of the statist economy and demographic growth, the regime has been unable to deliver its part of the bargain within the patron-client relationship between rulers and ruled. As a result, the regime has been looking for reforms which generate economic growth and in this way restore some of its legitimacy.

4. International Relations

A small country like Syria is critically dependent on its relationship with dominant powers, whether with regard to access to markets, imports, financial assistance or with regard to security.

In spite of its inward looking economic development strategy, Syrian foreign trade has over the years persistently made up around $\frac{1}{4}$ of its GNP. If Syria could not sell its oil at international markets and import its needs, in particular of capital goods and intermediate production inputs, its economy would come to a halt. Syria is therefore deeply dependent on the goodwill of other countries for the exchange of goods.

In matters of security, the relationship of a small country to dominant powers may ultimately decide the survival of the state and is therefore of the highest priority in its "raison d'état" considerations. In particular in contexts of high levels of regional conflicts as has existed in the Middle East since the creation of Israel in 1948, such relationships seem to "over-determine" other relationships and influence considerably the framework for elaborating economic policies of the country.

During the Cold War Syria was within the Soviet orbit and received considerable economic and military aid from the Soviet Union. The alliance with the Soviet Union provided Syria with strategic protection in the regional Arab-Israeli conflict. Economic development strategies were heavily influenced by Soviet thinking, for instance through the steady flow of Syrian students to Eastern Bloc universities. Favorable barter deals and economic aid to investments in heavy industries further enticed Syria into the statist economic planning system of the Eastern Bloc.

Syria's position in the Middle Eastern regional power system determined its position in relation to the East-West divide of the Cold War. In particular, the shift in strategic partnership of Egypt immediately after the October/Yom Kippur War in 1973 pre-empted Syria's option of a similar early shift in alliance (Hinnebusch, 2001) and to a large degree explains why

Syria delayed its geo-political re-orientation until the collapse of the Eastern Bloc in 1989/90. However, when this took place, Syria pragmatically and swiftly changed its orientation, which was marked by its participation in 1991 in the operation Desert Storm, putting an end to Saddam Hussein's occupation of Kuwait and in the ensuing Madrid conference on a Middle East peace settlement.

Syria did cash in on this by aid from the Gulf countries and responded favorably to the new assertion of the EU in the 90s as a regional political power and decided to participate in the Euro-Mediterranean partnership which the EU launched in 1995. However, Syria's continued conflict with Israel, in particular by proxy in Southern Lebanon, blocked its further integration into the American sphere of influence and prevented it from being offered technical and economic assistance from the World Bank and IMF, which could have facilitated a full transition to a more liberal economy.

The Euro-Mediterranean partnership has a geo-political perspective of linking the Southern Mediterranean countries to Europe and views economic relationships as strategic in furthering the goals of the partnership: peace and stability. Although the EU still has not gone much beyond launching empty slogans of free trade, cooperation etc. and has offered limited and ill-implemented economic assistance to Syria, it is obvious that this relationship is viewed with increasing interest and attention by the Syrian regime, in particular as the U.S. since early 2003 has become distinctly hostile towards Syria.

In 2003 the EU has decided to develop a "deepening" of its relationship with the Southern Mediterranean countries⁹⁸ by offering a sort of "discount" EU membership, which would give countries a stake in the EU's internal market and free movement of people, commensurate with the degree these countries align their legislation with the communitarian "acquis" as well as their demonstration of shared political values ("Wider Europe – New Neighborhood strategy" (European Commission a, 2003).

⁹⁸ and Russia, Ukraine, Moldova and Belarus.

In ideological terms as well as in future material enticement this new strategic partnership serves at least to convince the regime that an open market-economy is the only realistic alternative to its statist economy.

5. Social forces

Besides being constituted vis-à-vis the external environment, the state and its policies are also constituted vis-à-vis domestic social forces.

It is generally agreed that the Middle Eastern state, in casu the Syrian state, maintains considerable autonomy vis-à-vis society. State elites have not been found to represent neither classes nor sectarian groups in the sense of pursuing the direct or indirect interests of such groups.

However, in the long run no regime survives without some degree of legitimacy, whether ideological or material. As John Waterbury has remarked: "Repression and terror are to authoritarian states what reserve requirements are to a bank. They are only effective, if there is no run on them" (Waterbury, 2001:26). So, elites seem to be caught between their relative autonomy (which to a considerable degree are used to pursue their self-interests) and their need to "service" social forces.

Servicing social forces has a particularistic and a general character. The Syrian regime services the list of state-dependent actors by continuing its statist economy, although this takes place at the cost of the steady increasing groups of marginalized, un- and underemployed recent emigrants from rural areas who settle in the suburbs of the cities. However, some state-dependent groups, like employees of the bureaucracy and state industry workers, have also seen their income reduced drastically over the years. The agricultural sector seems however to have maintained steady incomes. The only clear winners during the 90s seem to be elite members themselves and the one hundred or so families of state-dependent predominantly commercial bourgeoisie (who is composed of relatives or partners of the power elite).

Access to the resources of the state have to some degree in particular benefited members of the Alawite community, whether as subsidized peasants, as privileged employees in the security services and the bureaucracy or as business partners to the state-dependent, commercial bourgeoisie. It is however not possible to characterize the Asad regime as an ethnic regime, as the Alawi community as such has not benefited

systematically from the Alawi character of the regime. The close identification of the regime with certain Alawi elite groups should rather be understood in the context of the factional (and fratricidal) in-fights, which took place between the Ba'ath elite during the 60s, where factions felt back on primordial loyalties in the power contest. The closer one gets to the military nucleus of the regime, the more pronounced is the preponderance of Alawi members, while the accessibility in economic fields of elite members from other confessions (in particular from the Sunni commercial bourgeoisie from Damascus) is much greater.

The relative autonomous position of the Asad regime is thus being squeezed by, on one hand, the demand to improve general economic performance resulting from the deterioration of social and economic conditions and, on the other hand, the demands of particularistic state-dependent groups, whose interests must be serviced in exchange of political support in a classical patron-client relationship.

Vested interests in an open marked economy can hardly be identified in Syria to-day, due to the almost non-existence of an industrial bourgeoisie which can compete in international markets.⁹⁹ An understanding of the initiation of economic liberalization policies in Syria must therefore be seen as an attempt of the regime to respond to the overall economic quagmire of the Syrian economy at the expense of the particularistic interests of the groups within its supportive coalition. The economic stagnation of the Syrian economy seems to have pushed the regime to take a somewhat higher political short-term risk in order to salvage the regime in the medium-term. Whether this strategy will work, is a question I will return to in the final section of this essay.

6. Ideological legitimacy

As noted, the regime was historically based on an ideological legitimacy which rested on social equity and nationalism.

The most important element of nationalism was anti-Zionism. Anti-Zionism has however slowly but surely developed from non-recognition of the state

⁹⁹ Which is also why an interest-based, society-centered explanation of economic liberalization is not fruitful and why on the contrary, such an explanation must take departure in a statist approach.

of Israel to a limited goal of recuperating the Golan and a decent settlement of the Palestinian question.

In parallel with the disillusionment caused by the corrupt practices of the regime and the global decline of socialist ideology, socialism and social equity are ideological beacons, which seem to have lost ground to Islamic ideology (which however also contains an important element of social equity). In comparison to classic political and economic nationalism, Islamism asserts cultural nationalism, i.e. up-holding of the moors and morals of Islamic culture, which is contrasted to Western or Westernized culture. Lately, a discourse on democracy has also gained some influence.

The ideological legitimacy of the regime has thus been considerably enervated by the contending ideologies of Islamism and democracy over the years and in particular since the passing away of Hafez Al Asad. As noted, Syria has however not experienced a deep and all encompassing economic crisis. Experiences from e.g. Turkey and Israel point to the effects of such crisis in reconfiguring the political landscape and the possibility of a capable regime to use the de-legitimization of the incumbent economic system, which the crisis produces, to reshuffle regime coalition by excorporating some of the old participants and incorporating new participants (Waterbury, 1999).

Economic liberalism as promoted by the regime during the 90s seem to have been accepted as the only alternative to statism, although it doesn't mobilize any enthusiasm except from isolated individual pundits, due to its checkered record of increasing income disparities, not producing new jobs and threatening existing jobs in state and protected industries.

The anti-Western and moralist discourse of the Islamist is the element most at odds with further opening-up and "globalization" and in particular increased American involvement in the economy would be much resented, due to the alliance of the U.S. with Israel. Increased American economic cooperation is although at present rather hypothetical, due to the passing of a bill in the U.S. Congress in November 2003 limiting diplomatic and economic relations between the U.S. and Syria. The EU is therefore the only geo-strategic partner left for Syria. EU's potential leverage vis-à-vis Syria has of course increased tremendously as a result.

As long as further economic liberalization is not based on a kind of national, social pact including the Islamists, the regime is clearly vulnerable to the resentment caused by the inevitable social costs of deeper economic liberalization. At the same time, the regime is exposed to a nationalist discourse, that the regime is “selling out the country” and “corrupting” the Islamic identity of the Syrian people. The regime is exposed to such critique in particular due to its Alawite (minority) character and Sunni-Muslim (majority) character of the Islamist movement.

7. Leadership strategy and capability

As mentioned in section 2, economic liberalization reforms in the beginning of the 90s increased the role of the private sector relative to the state and partly liberalized foreign trade. Such reforms may be described as “stroke-of-the-pen” reforms, which are characterized by low organizational complexity and limited involvement of beneficiaries (Page & Gelder, 2001). Liberalizations were not underpinned by institutional reforms ensuring enforcement and adjudication of rules (bureaucracy and judiciary), privatization, public expenditure reform¹⁰⁰ and education and health reform. Such reforms are all characterized as being of considerable higher organizational complexity and requiring a higher degree of consensus and involvement of beneficiaries.

Contrary to “stroke-of-the-pen” reforms, institutional reforms entail a more thorough restructuring of the coalition which supports the regime as such reforms produce long-term winners, but short-term losers and are therefore politically more difficult and risky.

“Stroke-of-the-pen” reforms do not increase competition and by implication lower transaction costs by institutionalizing a level economic playing field, but allows the state elite to continue to direct its favors to loyalists or to members of the elite itself. During the 90s, the Alawi political elite, including very much the Presidential family itself, became more and more intertwined with the Damascene Sunni economic elites in the new “private” economic activities, which depended on a privileged access to state favors, whether in restriction of competition, subsidized state input or even outright bestowment of private monopolies. The self-interests of the very core of the

¹⁰⁰ Changes in the composition of expenditures and reform of the way and efficiency of provision of public goods and services.

regime elite seem to have been a factor in restricting the ability (and inclination) of the incumbent president to pursue more overall political objectives in his economic policies (Chaudhry, 1989).

8. Case stories

Attracting foreign investors: The case of the mobile phone company.

As one of the last countries, Syria finally introduced mobile phone services in year 2000. The Government licensed two private companies to supply the services: Syriatel and “94”.

Syriatel is owned by the Egyptian company Orascom (25%) and Rami Makhoulf (75%), who is a cousin of the President. Orascom provided the management. The license with the Government was a Built-own-transfer (BOT) contract for 15 years.

The company started in January 2000, together with another mobile phone company, “94”, which is owned by the Lebanese minister of communication Mekati and Rami Makhoulf. There is no competition on prices, as these are set by the state agency, Syrian Telecommunication Establishment. Competition between the two companies is restricted to marketing, customer service and signal coverage. The operation is hugely profitable.

In January 2002 Rami Makhoulf contended that he did not receive his proper share of profits. Rami Makhoulf’s people controlled the cashier department and stopped paying suppliers to the company.

On this background the court in Damascus decided in March 2002 to impose a legal guard (Haaris al Qidaai) and appointed Naader Kalai (board member and representative of Makhoulf) as legal caretaker of the company until the dispute between the two owners was solved. The authorities started now to harass the Egyptian management: The Egyptian CEO as well as the Egyptian marketing director received threats from the Mukhabaraat (Intelligence). The Lebanese lawyer of Orascom was not allowed to re-enter into Syria. Finally, in April 2002 the CEO was given a notice by the authorities of three days to leave the country, which he did.

Orascom now filed a lawsuit in the UK against Rami Makhoulf on the basis that Orascom is registered in a UK dominion in the Bahamas. The case has recently been settled by agreement on reparation payment to Orascom.

The case shows how enforcement authorities (the courts and police) are manipulated by members of the regime and that the higher authorities (the President) allow this to take place, although the result is to scare potential foreign investors away. The balancing of collective interests (to attract foreign investors) and particularistic interests (to line the pockets of Rami Makhlouf) unequivocally falls out to the latter.

Exporters vs. domestic market producers: The case of thread.

Housaam Kotob is one of number of small textile and garment producers. Kotob exports knitted fabric made of mix'es of synthetic fibers and cotton to Jordan and Lebanon. Thread is used as an input in the production. As a measure to promote exports, tariff rates on all raw materials were in May 2001 reduced from the rates of 7 and 20 percent to the rate of 1 percent. Thread was classified as a production input and therefore as a raw material and as a consequence only leveled the 1 percent customs rate. The lower custom rate enabled Kotob and other exporters to buy better and cheaper thread, which in turn strengthened their competitiveness in export markets.

While textile and garment producers are small companies and not organized within a branch industrial organization. The companies are of great numbers and many of them are engaged in exports. The two Syrian producers of thread and suppliers of the protected Syrian market are large companies and supplies only the domestic market.

These two companies whose owners had good relations with Government circles, felt the cold winds of increased competition and petitioned the Government to move thread back into the high-custom category. The Government did this immediately and without consulting the exporting textile and garment producers, with the effect that the small advantage that the industry had gained in export markets disappeared.

Exports of textiles and garments are facing increased competition every year from Far Eastern producers. From 2004, when the international multi-fiber agreement expires, Far Eastern producers will have full access to the European market and Syrian producers marginal better access to that market will disappear.

The case story shows, that although the Syrian Government had good intentions to help exporters, it quickly acquiesced to the demands of

politically well connected business operators. Once again, collective interests lost out to particularistic interests.

Private Banks

For a number of years the Syrian Government announced that it intended to allow private banks to operate alongside the state run Commercial Bank of Syria and three other smaller specialized state banks. In 2003 the Government finally permitted five private banks to start operating. At least 51% of the equity of these banks comes as stipulated in the Syrian law on private banks from Syrian nationals, while the remainder comes from Lebanese or Saudi private banks.

The Government has also passed a new law on the role of the Central Bank to oversee these private banks and establishing a new board of Governors of the Central Bank with powers to fix interest rates and manage exchange rates.

On paper, such a reform seems revolutionary compared to the previous banking system, which mainly bankrolled the state sector and could be viewed more like a general directorate under the ministries of Finance and Economy. Bank services for private companies and individuals were mainly provided by the Lebanese banks located in the Lebanese border town, Shtura, only an hour drive from Damascus.

However, the question is what these new banks will bring in addition to the convenience for Syrian businessmen of doing their banking in Damascus in stead of in Lebanon.

First, these banks will not improve access to hard currency for investment purposes. In Syria hard currency is basically earned by the state from its export of oil and these proceeds will continue to flow through the Commercial Bank to cover the hard currency deficit of the state sector.

Secondly, facilitating investments in local currency by accumulating savings and direct these to investments, is still critically dependent on whether profitable investments exist. While all the existing protected, private semi-monopolists have majority shares in the new banks, it remains also to be seen whether these banks would at all finance new ventures, which would increase domestic competition.

Thirdly, it also remains to be seen whether these new banks will receive the confidence, so critical for financial institutions, of its customers. Will the Board of Governors, which consist of state appointed officials and does not include any independent businessmen, e.g. call in the equity capital of a private bank in case it defaults on its obligations towards its depositors,

without regard to that this bank is owned by one of hundred families, which makes up the military-commercial elite running the country?

It also remains to be seen, whether the bank secrecy on which Lebanese banks thrive (whether in relation to legal or illegal transactions!), will be respected by the Syrian authorities, irregardless of political expediency.

Such critical junctures will clearly have to be passed before confidence in the new private bank system may be said to have been established.

The bank reform is an example of a “stroke-of-the-pen” reform, which impact will depend entirely on future painful decisions, like re-directing the hard currency earned in the country to the private sector – which may only be done by getting rid of the state industries – and institutionalizing clear rules of the game separating the realm of politics from the realm of economics.

Free Trade Agreement with the EU.

In December 2003 Syria and the EU reached an understanding on the technical level on an Association Agreement. The agreement is expected to be approved with minor modifications by the political competent levels on both sides. Besides clauses on political issues (convergence of positions, democracy and human rights) and civil security (anti-terrorism) the agreement stipulates the gradual implementation of a Free Trade Zone between Syria and the EU for industrial goods. Access of Syrian agricultural goods will only be free of customs within specified quotas. Exports to the EU of agricultural goods beyond these quotas will be subject to standard tariffs for Most Favored Nation partners. In tariff terms the advantage to Syria of the agreement will roughly be equal to the EU Common External Tariff, or 6.5% on average, which the EU levies on Most Favored Nation partners.

Syria enjoys already a preferential status with the EU through the General System of Preferences scheme (GSP) by which the EU unilaterally gives tariff reductions to developing countries. However, the actual rate of utilization of EU GSP preferences by Syrian exporters is on an average only 30% and varies from sector to sector. For types of manufactured products, where Syria still enjoys a slight comparative advantage, the utilization rate is negligible. The utilization rate for “Clothing” is e.g. only 3.4%, while it is 0.2% for “Textiles” and 30% for “Leather goods”. For the category of “Live plants, flowers, fruits and vegetables” it is 60% (European Commission b, 2003).

The limited use of GSP preferential access to the EU market suggests that tariff preferences are not enough to ensure increased competitiveness of exports.

The EU industries are on the contrary ready for competition with Syrian industries. During the period of implementation of the agreement a substantial part of existing Syrian production is expected to be closed as a result of this competition.¹⁰¹

The Free Trade Agreement is yet another “stroke-of-the-pen” reform. Such an agreement would be a logical step, if a political agreement existed on how Syria could become ready for liberalizing its trade. This would entail hard and painful choices involving building a political constituency for economic reform, changing taxation and redistribution as well as rebuilding a proper regulative framework and institutionalizing administration and enforcement of rules. Such agreement does not exist in Syria and the effect of liberalizing trade will on this background, most probably only lead to a further de-industrialization of Syria. Considering the expected implementation period of 17 years¹⁰² it seems plausible to view it as a sort of ideological window dressing meant to appease the EU for geopolitical reasons.¹⁰³

9. Development issues

Economic liberalization in Syria seems to have exhausted its “easy” phase already in the middle of the 90s. The relative success of the easy phase was not seized by the regime to mobilize support for a subsequent and more painful phase, which would increase competition, underpin rules reform with institutional reform, lower transaction costs, create growth in exports and link Syrian industries to international value-added networks. Or in short: to create international comparative advantages to replace existing unfavorable comparative advantages.

So far the regime seems neither to have had the inclination and/or the ability to engineer such demanding changes in the Syrian political economy,

¹⁰¹ The Delegation of the European Commission has informed the author that 2/3 of small and medium industries in Portugal closed down as a result of accession to the EU. However, at the same time a number of new Portuguese industries owed their existence to the accession and in total Portugal gained largely from its membership.

¹⁰² An expected 5 years for ratification in all EU member states + 12 years of gradual implementation of the provisions of the agreement.

¹⁰³ Rather than viewing the agreement as a sort of strategic developmental lock-in decision in order to overcome internal political elite blockages.

but on the contrary has allowed the Syrian economy to further regress into a low-productive, increasingly rentier economy.

The regime has a number of reasons to desire to reform the Syrian economy. The costs of such reforms are however compounded by Syria's unfavorable position in the international system, the inability of the regime to neutralize ideological critique from its political Islamic opposition, the constraints of the political system to forge a broader reform consensus and the inability of the leadership to raise above the fray of the short-sighted interests of regime elite members.

The result is that the gap between the political risks involved in the gigantic task of restructuring the Syrian political economy and the limited legitimacy of the regime, seem to maintain Syria on its course toward social and economic implosion.

However, the regime might very soon know the actual political costs of serving the self-interests of the members of the regime itself and its supportive state-dependent coalition in stead of delivering economic performance by providing collective goods catering to the long-term needs of the economy.

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