Opportunities in Syria's Economic Reforms

> The government has initiated sweeping reforms designed to integrate Syria into the global economy but the pace of change has to be expedited to achieve the desired results, says **Nabil Sukkar**, former Senior Economist at the World Bank and the Managing Director of the Syrian Consulting Bureau for Development and Investment in Damascus.

The Syrian economy achieved impressive growth rates in the 1970s, ranging between 7% and 10% a year, as a result of large public investments supported by substantial inflow of official capital assistance. Most of this capital was received from the Arab Gulf countries. But economic growth sputtered throughout the 1980s, following a drop in official capital assistance and as a result of public enterprise fatigue, only to pick up again in the first half of the 1990s averaged about 7% a year, and was a result of two factors.

The first of these was an increase in Syria's crude oil export proceeds with the commissioning of new oil fields, and the second was economic reforms introduced between 1987 and 1991. The high growth did not last long and by the mid-1990s the Syrian economy again slowed to a 2.6% a year growth. Rigidity in administration and production regimes, a complex regulatory environment and uncertainty over the direction of economic policy, combined with several years of drought to adversely affect growth.

Among measures that have impacted on growth was a deflationary fiscal policy pursued during this period. Investment fell markedly, and private investment fell the most. Investment rate reached 17.6% of GDP in the year 2000 compared to 27% in 1995.

Despite the slowdown, the economy has been displaying positive macro-economic signs, especially because of high prices of oil. The balance of trade has been in surplus for the past two years, inflation has ranged between 2% and 3% while the currency has been stable for almost a decade

Syria: Ratio of Investment to GDP, 1995-2000

1995	1996	1997	1998	1999	2000
27.1%	22.6%	20.8%	20.5%	18.8%	17.6%

Economic reform

Economic reform in Syria was initially sparked by a foreign exchange crisis in 1996, which caused acute production shortage and supply bottlenecks. To cope with the situation, the government introduced a number of ad hoc and piecemeal measures over the next five years to increase the role of the private sector, particularly in industry and foreign trade. Controls on prices, trade and foreign exchanges were eased, and more emphasis placed on non-oil exports. The culmination of these measures was the introduction of Law No 10 in May 1991, which offered private domestic and foreign investors generous tax and other incentives.

These measures, together with the increased oil revenues cited earlier (with

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the commissioning of the high-grade Deir Eezzor field), improved the flow of foreign exchange and helped revive the public sector economy. But the new oil money also created government complacency that led to a virtual suspension of economic reform after investment law No 10. The regulatory environment that was needed to accompany the law was not introduced, and thus, while it was hoped that the investment law would be the beginning of a major transformation in the economy, it marked the end of a short period of reform.

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Economic reforms came back on the agenda when the late President Hafez Al-Assad formed a new government in March 2000 with a mandate for economic and administrative change. Four months later, President Bashar Al-Assad assumed power and made reform and integration of Syria into the world economy a priority for his government. He introduced a series of far reaching reforms and appointed several committees to look into other areas for improvement

Regulatory reforms

The measures introduced by the new government are aimed at strengthening the financial sector and improving the regulatory environment in which it operates. Among measures that deal with regulatory reforms is an amended Law No 10m which offers new incentives for investment while removing some of the original legislation.

The Higher Council of Investment has been given discretionary authority to grant additional income tax exemptions if the project is deemed to be of "special importance" or is located in a less developed area of the country, and allow projects approved under this law to retain more than 75% of their export proceeds and to open foreign exchange accounts abroad.

The amended Law No 10 also permits projects incorporated as limited liability companies or corporations to prepare their company's Articles of Association as required by the nature of the project rather in accordance with the provisions of the 1949 Commercial law. As well, certain corporate entities have been exempted from stamp duties.

Investors from abroad can now repatriate their capital five years after their initial investment, according to the market value of the investment at the time of capital liquidation.

There is now a fixed tax levy at flat rate of 25% on net income realized by corporations in the private or mixed sectors that offer their shares to the public. This rate includes the war effort tax and the local administration tax.

As for import and foreign exchange regime, tariffs on imported raw materials have been reduced to 1%, and the ban on the importation of cars removed. The Central Bank of Syria can now buy foreign exchange from the public at the real market rate, and new rules replacing Law No 24 of 1986 place less severe penalties on violations of exchange control regulations.

An export strategy has been prepared and a tariff rebate regime has been introduced for the benefit of exporters of textiles and foodstuffs.

A draft legislation aims to reform state enterprises to make them more autonomous and free of central government interference. These enterprises have been restructured into holding and subsidiary companies similar to Egypt's reforms of the early 1990s.

A State Ministry for Administrative Reform has prepared a broad strategy for civil service reform, as part of which public sector salaries were increased by 25%, the first such increase since 1994.

Strategies for reforms in basic and higher education have been prepared, and include the establishment of new technology faculties at four universities. Additionally, basic education and university education have been opened to the private sector, leaving open the possibility of establishing branches of Arab and foreign schools and universities.

A US$1 billion programme initiated by the government aims to reduce unemployment through the introduction of new public sector projects that create new job opportunities.

As a further step toward Syria's integration into the world community, a Copyright Protection Law has been introduced earlier this year.

Financial reforms

Financial sector reform received particular attention, at the urging of the new President. Legislation was signed in April to allow establishment of private banks. A year before, private banks were allowed in Syria's Free Zones. A bank secrecy law was also introduced, and two draft legislations, one for introducing a new money and credit law are being discussed at present.

Establishing private banks represents a major departure from Baath Party ideology, which until recently considered banking to be the monopoly of the public sector. Banks in Syria were nationalized in the mid-1960s and since then five public sector specialized (and monopoly) banks have been in operation, acting more like an extension of the government finance system. The public sector received 70% of the credit and the functions of the central bank were substantially curtailed. Also monetary policy was shelved. The interest rate structure has been frozen since 1981.

The new banking law allows Syrian individuals and institutions to establish 100% privately owned banks, and banks in collaboration with the public sector, in which case the latter would hold 25% of bank shares. The new law also allows Arab and non-Arab individuals and institutions to establish banks, but only in association with the Syrian private or public sector, and provided that provided that foreign ownership does not exceed 49% the bank's capital share. Also bank capital should not be less than US$ 30 million, no one individual may own more than 5% of a bank's shares and the new banks will be subject to a flat tax of 25% on profits. As of this writing, the law's "Directives" have not been issued by the Ministry of Economy and Foreign Trade and hence no banks have been licensed yet.

The draft legislation for establishing a stock market has been the subject of a heated debate that centers on two main issues. The first is whether Syria is ready for a stock market in the absence of company financial disclosure regulations and agreed international accounting and audit standards, and in the absence of local technical capability to supervise the market effectively and transparently. The second issue is who should own and operate the "bourse", whether it should be the Union of the Chambers of Commerce, as the draft law stipulates, or another entity, consisting perhaps of banks or stock brokers or both.

The other important draft legislation under discussion has been the new Money and Credit Council (to be headed by the Governor of the Central Bank), and re-affirms the autonomy of the Council in both drawing up and implementing monetary policy. The draft law also sets the broad rules and regulations for banking supervision.

The above financial sector reforms are of particular importance. The immediate need now is to establish a strong supervisory structure at the central bank (strong in regulations as well as in ability to administrator) and put in place strict and transparent conditions for licensing new private banks. Next in order of priority are the reactivations of monetary policy, starting with the introduction of a flexible interest rate regime, and restructuring existing public sector banks. The latter should be carried out in conjunction with reforming state owned enterprises and introducing fiscal reform, if it were to be effective. Establishing a stock market, in my opinion, can be delayed.

What next?

The reform measures adopted so far are in the right direction and have noticeably accelerated in the past year, but these still do not live up to the internal and external challenges faced by the country. Reform has been slow and hesitant and is still being pursued on an ad hoc and piecemeal basis. The government declared its adherence to economic reform, but there is still no conceptual framework for reform and no comprehensive programme.

The challenges facing Syria, both internal and external are immense, and the relatively stable macro-economic situation at present should not hide the severe problems in the "real" economy. Nor should it blur the critical threats and opportunities facing Syria, arising from the tide of globalization, the new inter-Arab economic integration scheme Syria is joining the Euro-Med Partnership Scheme and the prospect of an eventual political settlement in the region.

The Syrian economy is not ready to meet these challenges yet. It suffers from a whole list of problems, most important of which are a sluggish and unsustainable economic growth (arising from a heavy dependence on external aid at certain times on rainfall). Other inhibitive factors include the rigidities in production structures and institutions, high tariff protection, low skills and technological capability, slow productivity increases, heavy dependence on dwindling oil reserves (with oil accounting for 70-80%) of exports and directly or indirectly for 45-50% of central government revenues), unemployment rising to an alarming level of 20% (mostly among the youth), and last, but not least, a regulatory environment (licensing, trade, foreign exchange fiscal, labor and other regulations) that is still entrenched in the legacy of central planning.

To cope with all of the above, Syria needs to raise investment from its present rate of 17-18 % to about 30-35% of GDP and to realize significant annual productivity increases, so as to generate economic growth in the range of 7-8% a year. Such a high growth is necessary not only to eventually bring Syria out of its present state of underdevelopment, but also to absorb most of the present 20% unemployed and the new entrants to the labor force (amounting to some 200.000-250.000 a year).

To do so, Syria cannot continue with its present hesitant reforms. It has to undertake a determined reform-cum-development effort and to make a full commitment to a market economy. Only then will it be able to attract the "big" investments, both domestic and foreign, that will make a difference for its needed growth. "Big investments" will not come in, if the door is half open and half closed. At the same time, a commitment to a market economy does not mean abandonment of the role of the state, or of the pursuit of national economic

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development, or of social justice. In fact, official commitment to these objectives and a new defined role of the state.

Prescriptions

What is needed is the following:

First, a clarity of vision on the future of the Syrian economy in the globalizing and regionalizing worlds, and a formulation of a conceptual framework to guide its reform and its future growth. Such a framework has to bring a new economic thinking, one that embraces "the market" and one that defines roles for the private and the public sectors. The two sectors should be in partnership, the first would focus on economic productive activities and the second primarily on social development.

Second, a comprehensive and interrelated structural and institutional reform program is needed with the clear objectives of increasing both the investment and the productivity of investment. The programme should have a time frame and a rational sequencing of measures. Energizing the private sector should be a focus of reform. Privatization, the sense of selling public assets, need not be a priority at this stage, and not before a clear regulatory framework is in place.

Third, economic reform should be linked to (i) a detailed and equally comprehensive social reform programme, one that includes, amongst other things, measures to cope with the initial negative consequence of reform (to avoid the pitfalls of reform in other countries); (ii) the country's development plan (with identified development priorities and productivity increase measures) and (iii) to a national science and technology plan, involving concentrated efforts at education skill and technological upgrading.

Fourth, civil service reform should be part and parcel of this reform-cum development effort, and

Fifth, activating civil society institutions are needed to work with the government, in coping with the unlimited opportunities and challenges of development, globalization and regionalization.

Finally, it should be noted that the 1990s was a lost decade for Syria's reform, and Syria cannot lose another a decade or even half a decade. Calls for "cautiousness" as well as calls for "stability above reform" formulas are exaggerated. Excessive cautiousness could be more damaging than excessive speed, especially with the rising tide of globalization and ICT technology advances in the world: and rising unemployment could itself threaten social cohesiveness and stability, if not put in check. This is not a call for a shock approach to reform. It is rather a call for a well planned, well focused reform-cum development with clear targets, policy instruments and time frames. China's reform model should be copied not just for its postponement of privatization and its maintenance of the political infrastructure, but also for its official adoption of the "market" from the beginning and for undertaking a comprehensive reform approach.

Last but not least, Syria is a country with diversified production base and considerable potential. It has high investment opportunities in practically all sectors of the economy and an entrepreneurial class that was constrained in the past, but is now preparing itself to assume a leading business role, once an enabling regulatory environment is put in place. And Syria has a new leadership dedicated to reform and to take Syria into the global economy.

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