# The State of the Syrian Economy at the End of 2015

## A. An Overview

The conflict in Syria has almost completed its fifth year. The war and external economic sanctions caused extensive damage to the Syrian economy. GDP which stood at US$ 60 billion in 2010 has shrunk by more than a half in real terms (IMF estimates, October 2015). Contraction was deepest in the first three years of the crisis, but began to decrease in 2014, as business sector in areas under government control has started to adapt. Real GDP growth went down by 20.6% in 2013, by 18% in 2014 and by 15.8% in 2015 (World Bank).

Many manufacturers resumed production, including those located in Adra industrial city and in the relatively safe industrial zones in the suburbs of Damascus. Also, small-scale merchants and skilled craftsmen from Aleppo, Homs, and Idleb relocated to the coastal provinces, which boosted the economies of Lattakia and Tartous, the cities least affected by the crisis. According to the Syrian Chambers of Industry, 109 factories moved out of Aleppo in 2013 and 2014, of which 41 relocated in Lattakia and 52 in Tartous. Additionally, many factories in Western Aleppo, Homs, and Hama went back to work in recent months.

Nonetheless, almost all farmers, manufacturers, and traders have faced additional operational problems last year, owing to the lack of electricity and frequent power cuts, the continuous closure of Jordanian and Iraqi borders, the sharp drop in the exchange rate of the Syrian pound in the last quarter of 2015, and the considerable reduction of electricity subsidy. All these factors together put upward pressure on the cost of production as well as on the cost of living. It is worth noting that the closure of the Nasib border crossing in April 2015, which is the only functioning crossing between Syria and Jordan, has deprived the economy from exports and foreign earnings worth nearly $1 billion.

The damage affected almost all infrastructure (transport, electricity, water systems, and communication), housing, factories, schools and hospitals, in addition to agricultural land and equipments. The cost of damage to the country’s physical assets has been estimated at around $250 billion. Building and construction suffered the most damage representing 32%, followed by the manufacturing sector 18%, and service sector 9% (ESCWA, April 2015).

According to a recent report by the World Bank (January, 2016), Preliminary assessment of damage in six cities (Aleppo, Dara', Hama, Homs, Idlib and Lattakia) is estimated between US$ 3.6- 4.5 billion, with Aleppo accounting for roughly 40% of the estimated damage among the six cities. Lattakia is the least affected, although it is subject to the increased pressure of infrastructure and services from an increase in Internally Displaced Persons (IDP) in the city. At the same time, Housing is the sector experienced most damage, accounting for more than 65% of the total damage in the six cities.

Geographically, the war has shattered Syria into parts, of which one part becoming under government control and the remaining parts under control of either ISIS, or the Kurds, or other rebel groups, who occupied oil fields and main wheat growing areas in the North. To shed light on some economic impacts of this fragmentation, suffice it to say, the government is currently importing 3 million barrels of oil per month (of which 1.8 million barrels come from Iran), and around 100,000 tons of soft wheat for bread making. Also, transport between provinces has become much more expensive due to difficulties in trucking, which is adding extra burden to the price structure (e.g. transportation cost constitutes 20% of citrus fruit price and 40% of wheat price).

The war has in fact displaced half the population, i.e. more than 12 million people, of which two thirds (7 million) are displaced internally and one third (5 million) have fled to Neighboring Countries (Turkey, Lebanon, Jordan and Iraq) and to Europe. More than 700,000 Syrians arrived in Europe in 2015 seeking safety and better life.

**Table 1: Number of Syrian Refugees in Neighboring Countries (as of January 19, 2016)**

| Host Country | Total Estimated Syrians | Registered Refugees | Percent of Total Registered Refugees |
|---|---|---|---|
| Lebanon | 1,500,000 | 1,069,111 | 23.2 |
| Jordan | 1,400,000 | 635,324 | 13.8 |
| Turkey | 2,750,000 | 2,503,549 | 54.4 |
| Iraq | 250,000 | 245,022 | 5.3 |
| Egypt | 260,000 | 123,585 | 2.7 |
| North Africa | 50,000 | 26,772 | 0.6 |
| **Total persons** | **6,210,000** | **4,603,363** | **100** |

Source: UNHCR. Note: Total estimated Syrian represents Government estimates, including registered Syrian refugees, unregistered Syrian refugees as well as Syrians residing in the host countries under alternative legal frameworks.

UNICEF assess that there are about 13.5 million people in need of humanitarian assistance (including 6 million children) with 8.7 million in acute need (i.e. unable to meet their food requirement), while about 4.5 million are located in areas hard to reach.

UN agencies estimate the cost to meet this humanitarian need to be around US$ 3.18 billion. The World Food Programme (WFP), in partnership with the Syrian Arab Red Crescent (SARC) and 24 other local non-governmental organizations, provide food assistance to more than four million people inside Syria on a monthly basis.
Furthermore, according to UNRWA (March 2015), education is in a state of collapse with more than half of Syrian children no longer attending school in 2015/2016 academic year. Almost half of all children have already lost three years of schooling. Also, life expectancy at birth has fallen to 55.7 years in 2015 from 75.9 years in 2010.

How long it will take for the economy and society to recover after the war is hard to estimate. The war is not over, sanctions are still in place and the political outcome of the conflict is still not clear. But it is worth noting that in Lebanon, it took 20 years after the war for real GDP to recover while in Kuwait real GDP took seven years to recover and in Iraq it took one year; both are countries with substantial oil wealth.

Below are more details on developments in the macro-economic framework, with focus on the foreign trade sector, import financing, the fiscal position, the private banking sector, the foreign currency situation, and the country’s inflation in 2015. This will be followed by an overview of legislations passed by the government in 2015 and early 2016, in addition to Syria international ranking in the World Bank Global Doing Business Report, 2015.

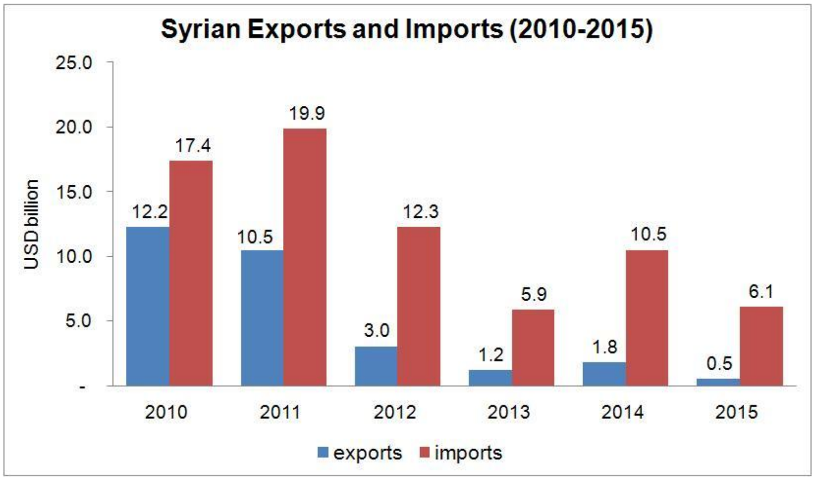
## B. <u>The Foreign Trade Sector</u>

The lost of access to the Nasib border crossing in April 2015 has complicated foreign trade and transit with the Arab gulf markets, hurting framers and other exporters. Consequently, exports slumped from $1.8 billion in 2014 to $520 million in 2015, representing a fall of 70%. The ratio of exports to imports has deteriorated drastically to less than 10 percent, a ratio never seen before. Because of the war, the country's main exports have been limited to agricultural products, textiles and leather, flowers and ceramics. The top destinations of Syrian exports in 2015 were Lebanon, Saudi Arabia, and Egypt.

In an attempt to compensate the losses, the government increased exports of citrus fruit to Russia after Moscow banned food imports from Turkey. The Syrian Chambers of Commerce and Industry pointed out that the country is ready to dispatch 700,000 tons of citrus, mostly orange to the Russian market. However, only 300 tons have been shipped from the Russian Village For Exports and Imports in Lattakia, established in 2015 as an export logistics village with a focus on agro industries, to Novorossiysk port on the black sea.

Data from the Syrian Customs show that the Syrian imports stood at $6 billion in 2015 (an average of $17 million per day), calculated on the basis of the average official exchange rate announced by CBS. Two-thirds ($3.8 billion) of imports have been carried out by the public sector and consisted mainly of fuel oil, wheat, and other basic commodities. The private sector imports have been estimated at lesser amount of $2.2 billion. Foodstuffs (including sugar, rice, tea, tuna fish, and coffee beans), fodder, fertilizers, electrical materials, and industrial supplies comprised the bulk (85%) of private imports. Most of Syria's imports in 2015 have come from Russia, Ukraine, Lebanon, China, Turkey and Cyprus.

**Figure 1: Syrian Exports and Imports (2010-2015)**




## C. <u>Import Financing</u>

As a consequence to the depletion of foreign exchange reserves, the Central Bank of Syria reduced its financing of imports (which used to account for $30 million on average per day prior to the crisis), focusing on financing of essential goods, mainly staple foods, medicine, and raw materials. Such financing was done through the banks and foreign exchange brokerage companies. Traders were asked to use their own means to finance imports of non-essential or luxury goods, while importers of basic goods and raw materials remained eligible for a preferential dollar rate from the central bank.

Currently, Syria is receiving daily inflows of $10 million to fund imports, of which $8 million is coming from personal transfers and the remaining $2.0 million is coming from exports, in addition to benefiting from a new credit line of $1.0 billion extended by Iran in July 2015. This was the second $ 1.0 billion credit line since 2013. Another credit line of $3.6 billion was extended in 2013 to purchase oil products. Two state-owned banks were involved in these credit lines: the Export Development Bank of Iran and the Syrian Commercial Bank.

Additionally and in response to the continued depreciation of the Syrian pound, the Syrian government decided in 2015 to support its intervention policy in the exchange market by introducing an advance deposit scheme for imports (Decision no. 703 of 2015 issued by the Ministry of Economy and Foreign Trade). The new scheme divides imports into three categories:

1) Category A: applies to about 39 items of staple foods and agricultural inputs, which are needed for human consumption and agricultural production, and have no substitutes exist in the local market.
2) Category B: applies to a set of non-essential and consumer goods, and have or could have domestically produced alternatives.
3) Category C: applies to wide range of raw materials and industrial inputs, which are necessary for local industry.

Importers of categories A & B are required to deposit with a local bank an advance payment in Syrian Pounds equal to a percentage of the face value of the import license (50% for category A items and 100% for category B items). This deposit is to be made after receipt of preliminary approval of the Ministry of Economy and Foreign Trade and before the issuance of the final license.

Importers of category A are allowed to convert their advance payment into U.S. dollars at the exchange rate that prevailed at the time of deposit. This will partly protect them from future speculation in the foreign exchange market. Importers of category B are not given similar privilege. Moreover, they are not allowed to release their deposit (which is equal to 100% of import license) until their imports arrive to Syria. No advance payment is required from importers of category C items.

## D. The Fiscal Position

The government's fiscal position has deteriorated since the beginning of the crisis. This has been caused by the sharp drop in government revenues and the continued increase in government expenditure, particularly for security purposes. This resulted in an expanded fiscal deficit and increased public debt. Fiscal deficit went up to 21.8% of GDP in 2015, rising from 18.5% in 2013 (World Bank). The increased deficit was covered through government borrowing from the central bank and borrowing from "friendly" countries.

The decline in government revenues was the result of the destruction of the oil sector (which was a source of approximately $4 billion per year), decreased economic activity and trade, and the absence of financial revenues from territories under rebel control.

To alleviate pressure on the public budget, the government continued to cut subsidies on petroleum products, electricity and bread. Diesel oil price spiraled upward, rising from 80 SYP/liter in 2014 to 135 SYP/liter in 2015; cooking gas price increased from 1,050 SYP/cylinder in 2014 to 1,900 SYP/cylinder in 2015; and the price of one bread bundle (1.5 kg) soared by almost 43%, rising from SYP 35 to SYP 50 in the public sector bakeries. Also, the Ministry of finance asked all public institutions to reduce their current expenditures during the fiscal year 2016 by 30% including overtime and bonus payments.

The table below shows the aggregate budget figures for the period 2010-2016. Actual revenues and expenditures figures for the crisis years are not available yet.

**Table 2: Government Budgets (2010 – 2016), in SYP billions**

| Aggregate Budget Figures | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|
| **1. Public Revenues** | **578** | **649** | **779** | **634** | **866** | **980** | **1,339** |
| Current Revenues | 401 | 407 | 278 | 189 | 318 | 351 | 739 |
| Investment Revenues | 176 | 241 | 501 | 445 | 548 | 629 | 600 |
| **2. Public expenditure** | **754** | **835** | **1,327** | **1,383** | **1,390** | **1,554** | **1,980** |
| Current expenditure | 427 | 455 | 952 | 1,108 | 1,010 | 1,144 | 1,470 |
| Investment expenditure | 327 | 380 | 375 | 275 | 380 | 410 | 510 |
| **3. Fiscal Deficit** | **176** | **186** | **547** | **749** | **524** | **574** | **641** |

## E. The Banking Sector

The banking sector has been affected severely by the crisis and by the external sanctions. The latter in particular interrupted the country's trade and financial transfers.

During the period (2011-2013), banks experienced shrinking demand for loans, deterioration in the quality of loan portfolios (rising NPL's), shrinking placement opportunities abroad, substantial rise in their credit, market and operational risks, and loss of trained staff. The gradual adjustment of business to the crisis circumstances in 2014 and 2015, however, has led to improvement in the performance and profits of the private banking sector. The table below displays key financial indicators of Syrian private banks covering the period (2012 – 2015).

**Table 3: Key Financial Indicators of Syrian Fourteen Private Banks (2012 – 2015) (in SYP billions)**

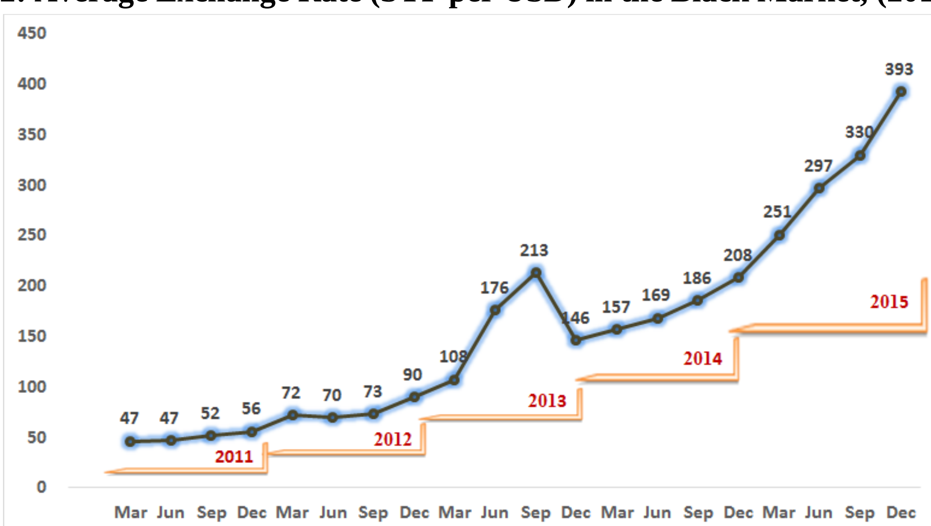
| Key Financial Indicators | 2012 | 2013 | 2014 | Sep 2015 |
|---|---|---|---|---|
| Total Assets | 602,409 | 772,179 | 909,564 | 1,226,430 |
| Net Direct Credit Facilities | 193,010 | 159,347 | 163,770 | 225,408 |
| Non-Performing Loans | 55,828 | 92,564 | 112,540 | 129,001 |
| Customers' Deposits | 378,797 | 481,764 | 549,966 | 581,324 |
| Net Profits (covering three quarters) | 4,549 | 18,055 | 23,642 | 72,422 |
| Net Profits excl. capital revaluation (covering three quarters) | (9,995) | (26,432) | (13,082) | (1,030) |

## F. Continued Depreciation of the Currency

The Syrian currency continued its depreciation against U.S. dollar in the past year, but at a much sharper pace, falling from SYP 208 to the dollar at the end of 2014 to SYP 393 by the end of 2015 (a y-o-y depreciation of 100%). Almost half of the drop has occurred during the last quarter of 2015. To contain the demand of foreign exchange, the government decided to support its intervention policy in 2015 by introducing an advance deposit scheme to ration imports.

The currency depreciation is attributed mainly to the severe destruction of the country's physical assets, the sharp drop in oil and non oil exports and the impact of sanctions on trade and financial transfers.

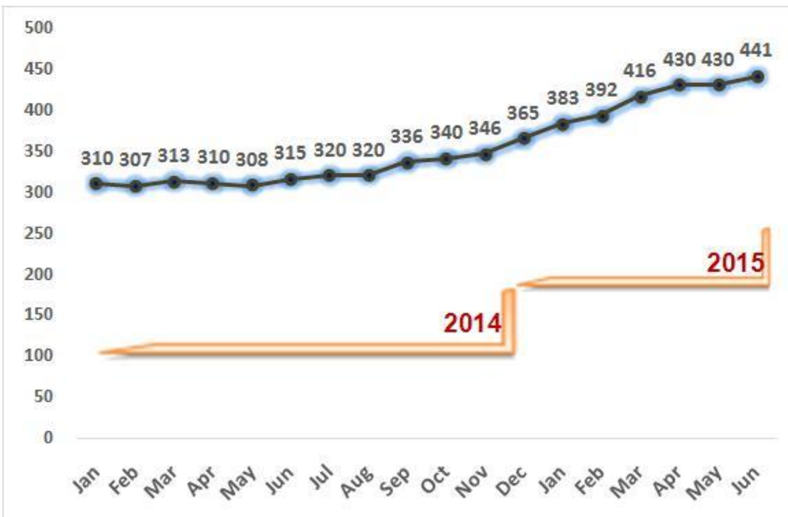
**Figure 2: Average Exchange Rate (SYP per USD) in the Black Market, (2011-2015)**



## G. Inflation

Annual inflation through the past five years was highly correlated with the unprecedented rise of U.S. dollar exchange rate against the Syrian pound. According to the Central Bureau of Statistics, annual inflation in the country increased rapidly through the period of crisis, rising from 4.8% in 2011 to 37.4% in 2012, and peaked at 89.6% in 2013, constituting a total price increase of 173% over the period 2010-2013. The Country's consumer price index continued to rise in 2014 and 2015 fueled mainly by the price increases in gas and fuel oil products, food and beverage items, in addition to clothes.

**Figure 3: The Country's Consumer Price Index (2014-2015)**




Source: Prepared by SCB based on Central Bureau of Statistics.

## H. Overview of Legislations Passed in 2015 and Early 2016

To revive domestic production in Provinces under its control, the government introduced a set of new legislations in late 2015 and early 2016 with the objective of:

1) Controlling non-urgent imports and reducing the pressures on the local currency. The Ministry of Economy and Foreign Trade issued Decision no. 703 of 2015, which imposed advance deposit requirement on imports, in addition to Decision no. 146 of 2016, which put non-tariff barriers on free zones' imports of all goods except those subject to 1% and 5% custom tariffs.
2) Supporting productive investment and domestic production. Law no.3 of 2016 created a new agency for supporting and developing local production and exports, replacing the former Export Development and Promotion Agency.
3) Supporting the development of Small and Medium Enterprises in all sectors, through reducing the regulatory burden of registration, facilitating access to finance and

international markets, and upgrading management skills and capacity. Law no.2 of 2016 established the Small and Medium-Sized Enterprises Development Agency to replace the General Employment and Project Development Agency.

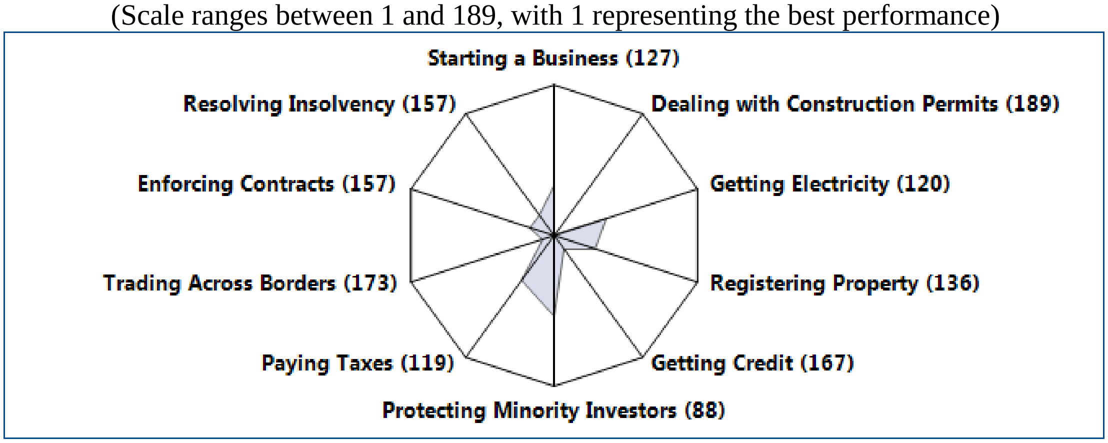
4) Regulating Public-Private Partnership in infrastructure and other development projects, except for oil and gas exploitation (Law no.5 of 2016).

## I. World Bank Ease of Doing Business in Syria 2015

The World Bank Global Annual Doing of Business reports provide an aggregate ranking on the ease of doing business in the world, based on indicator sets that measure and benchmark national regulations applying to domestic business. The 10 indicators included in the ranking are: 1) starting a business, 2) dealing with construction permits, 3) getting electricity, 4) registering property, 5) getting credit, 6) protecting minority investors, 7) paying taxes, 8) trading across borders, 9) enforcing contracts, and 10) resolving insolvency.

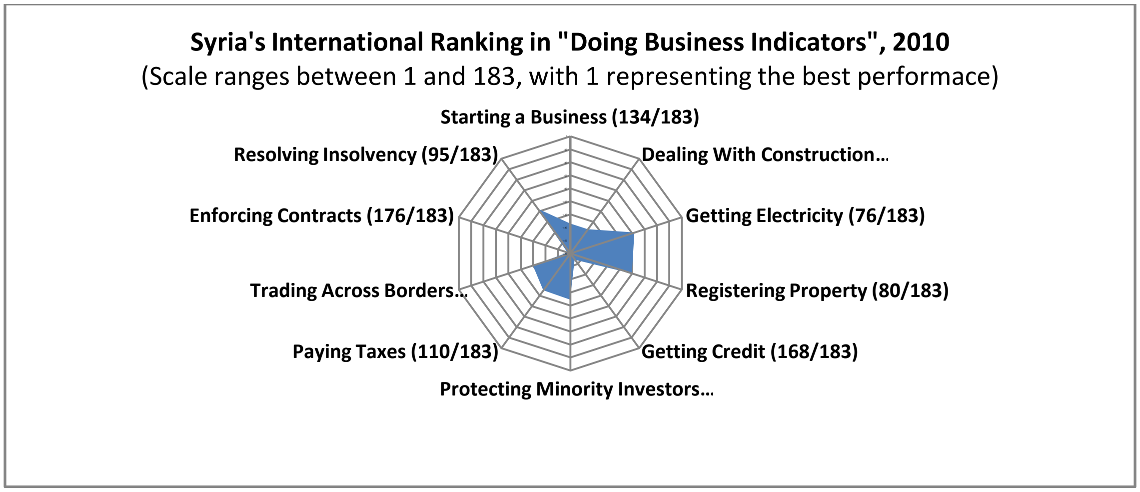
According to the 2015 report, Syria ranked 175 out of 189 countries (compared to a rank of 134 out of 183 countries in 2010), meaning its business environment has become even more non-conducive for doing business compared to other countries. Almost all the indicators were weak, but the worst-performing ones were Dealing with Construction Permits, Trading across Borders, and Getting Credit indicators. The charts below compare Syria's performance within each of the above ten indicators included in the ranking in 2015 and 2010.

**Figure 4: Syria's International Ranking in "Doing Business Indicators", 2015**
(Scale ranges between 1 and 189, with 1 representing the best performance)




Source: Doing Business database.

**Figure 5: Syria's International Ranking in "Doing Business Indicators", 2010**
(Scale ranges between 1 and 183, with 1 representing the best performance)

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