The Political Economy of the Banking Sector in Syria

Samir AITA

Economist, General Manager A Concept mafhoum.com

Editor in chief & GM, Le Monde diplomatique editions arabes

The Conference on Economic Reforms in Syria, April 10-12, 2008

Summary

In Syria, Banking sector reform has been the flagship action announced by the newly plebiscited President Bashar Assad in 2000. More than 7 years later, new private banks have emerged, taking a significant share of the market. This paper put these developments in the context of Syria political economy. First, the literature on the political economy of the banking sector regulation is reviewed, as well as the literature on Syria political economy, to draw a framework for analysis. The political economy of Syria, with a focus on the banking sector is then analyzed in different phases since the effective independence of the country in 1946. Six such phases are identified evolving from state building and national capitalism, towards the Baath radicalization and the emergence of a strong "power system", ending in the current phase qualified as "neo-liberal".

A quick review on the political economy of banking sector regulation

Finance and Politics cannot be separated, and this statement should be considered from both local and international political perspectives, as well as from the perspective of the historical development of a country. It has in fact been argued (Sylla 2003) that leading economies had experienced at some point a "financial revolution", i.e. the creation of modern financial systems during brief periods, and that "the cause-effect relationship seems to run from good finance to economic growth/development, not from economic growth/development to good finance (Demirguc-Kunt & Levine 2004). And the role of government is crucial in that regard, in particular for what concerns the establishment of sound public finances, sound currency and regulations of the sector, in "reforming" (a regulatory action), as well as in managing major crises avoiding the reversal trends in economic and financial developments (Demirguc-Kunt & Levine 2004).

The political economy of financial sectors has received revived attention in the last twenty years especially that the recent financial crises (South East Asia, Argentina, and the presently world) question the financial system and its regulation: why they exist and why they have the form they do? (Kroszner 1998). Positive approaches have been developed to assess the demand and supply of modern financial institutions, and those of regulations, in terms of interest groups. Authors oppose "public interest theory" of regulation, which is assumed to target the maximization of social welfare, to the "private interest theory", "as one of interest group competition in which compact, well-organized groups are able to use the coercive power of the state to capture rents for those groups at the expense of more dispersed groups" (Kroszner 1998, Stigler 1971, Peltzman 1989, Becker 1983). Thus this theory is sometimes called the "capture" theory. And as all reforms and regulations have redistribution effects, this leads to analyze the winners and losers in the struggle for rents, costs and benefits of the regulation for each group, and the mechanisms for resistance to change. A sound economic argument concerning social welfare was seen neither necessary, nor sufficient to bring change. Some group incentives have been assessed as "indirect", such as in the case of regulators who may be offered lucrative employment industries in the industry after leaving the government.

The effectiveness of interest groups was observed to be function: of group cohesion and lobbying power, of cost of change amount and concentration/diffusion among players, and of some ratios of costs to benefits. But typically, technological, legal and/or economic shocks must occur (having all distributional consequences) in order to change the relative strengths of interest groups, in order to enable altering an established political-economy equilibrium.

Also, globalization and liberalization have been approached within such framework. The major drive was technological changes: per example, ATM machines and automated credit-scoring techniques reducing drastically the value of local relationship between the bank and the customer. Large and foreign banks have therefore incentives to increase their lobbying pressure to attain closed markets. The opening of these markets tends to be permitted first through investment in existing banks, rather than *de novo* entry; as local banks would favor such solution, as they can sell out at premium prices, rather than being competed out. However, this is not always the case, especially when the banks are state-owned monopolies, especially if these monopolies are profitable and useful for the governments (Chari & Gupta 2005). Otherwise, political changes and a fall in domestic bank efficiency caused by lack of competition would lead to liberalization, reducing resistances; but the effects of such liberalization on efficiency could be modest (Montinola & Moreno 2001).

Governments have been approached as a special interest group, for whom one of the major issues is the financing (preferably at low cost) of public debt. They tend to favor the opening and deregulation of the market, especially when government debt grows much more rapidly than bank assets. Political economy aspects were depicted in the methods of distribution of securities to investors, and for placing them with foreign investors (Fry 1997).

The necessity of crises for reforms has been argued (Rodrik 1996, Kroszner 1998), while they were recognized to upset old political economy equilibrium and to make strong reforms politically feasible. Also analyzed were the mechanisms which can delay reforms, even in cases where benefits can be shared by all. Information and coordination issues are at stake and "war of attrition" could be observed, resulting from complex bargaining games (Alesina & Drazen 1991), in particular in case of absence or weakness of institutions of conflict management.

The political economy of central banks has also received some attention (Eijffinger 1997, Bernhard & al), mostly within a "public interest" framework. Central bank autonomy was put in balance with the necessity of its role to enhance economic growth and employment, with the cost of disinflation, and with the goal of its accountability: "every society gets the central bank that it deserves". Other research (Bernhard 2003) argues that central banks cannot be considered in isolation from each other: economic and political factors (including foreign policy and interest group pressures) explain the choice of monetary institutions and their policies.

The analysis of the political economy of currency policies had also addressed the global (international monetary system) and the local aspects, and their interaction (Broz & Frieden 2006). Domestically, exchange rate policy (regime and level) has clear distributional and *electoral* implications. Non-democracies adopt more likely fixed exchange rates regimes, because they are more insulated from domestic audiences (favoring trade over employment), can bear politically the costs of the peg, and because central bank independence is "less viable in a closed political system". Governments' policies affect medium term trends of real exchange rates, which were mostly analyzed as trade-offs between competitiveness and purchasing power (seen as mostly affected by prices of foreign goods). However, the political economy mechanisms were found more complex and dependent on the characteristics of the country economy (Blomberg & al. 2005): "*Exchange rates are political. They affect the interest of powerful groups and of consumers*. (…) *Those who ignore the political economy of currency policy will make mistakes in developing feasible exchange rate policies*"(Frieden 2007).

The political economy of Syria: Discussion for a Framework

A wide bibliography exists on Syria internal and external politics, as well as on Syrian economy. However, the political economy of Syria has received little attention per se in the perspectives and frameworks discussed above. Two major contributions were made by Raymond Hinnebusch (and Hinnebusch 1989, 1995 and 2007) Volker Perthes (Perthes 1997 and 2001). Hinnebush discusses initially mostly the political economy of the agrarian sector, which is of importance in Syria, as this were the regime is socially rooted and this sector still accounts today for more than 20% of the GDP. Perthes started from a broader perspective, describing the mechanisms of economic policies decision-making within the authoritarian regime of Hafez Assad. Gray (Gray 1997) made also an interesting contribution applied to the tourism sector.

These contributions have described the competing/cooperating "interest groups" acting in the Syrian society in terms of (structural-functionalist) socio-economic categories (Aoude 1997): peasants (landlords, middle peasants, small peasants and agricultural workers), landlords, merchants, the military, the bureaucracy, the Baath party, etc. The concept of class was discussed, and the categories of "leading class" were used, even locally to express the dynamics of social differentiation in cities and in countryside. The government decision making bodies were detailed, including per example the inter-ministerial "Economic Committee" in charge of major economic decisions[1].

[1] See Figure V.1 in p 208 in Perthes 1997.

The resulting economic policies of the Syrian government were characterized as “state socialism” (before 1970), “state capitalism” (1970-2000) and “market economy” or “neo-liberal economy”. The processes of change which are the most relevant to analyze the interaction between “interest groups”, have been discussed in terms of “Infitah of Abundance” (the 1970’s) or the “Infitah of Poverty” (1980’s-early 1990’s, see Perthes 1997 and Aoude 1997). An interesting discussion of these mechanisms and a review of different research on Syrian political economy (Hinnebusch 1989 and 1995, Kienle 1993, Bahout 1994, Perthes 1997) were made by Joya (Joya 2006), which has focused on arguments on state formation, capitalist development and integration within world economy. Joya introduces several periods to characterize the dynamics of Syrian political economy since the 1960’s:

- The demise of radical Baath and Hafiz Assad’s project of state formation: 1969-1977;
- Popular protest and contestation of state capitalism: 1977-82;
- Crisis of state planned economy: 1983-1985;
- Export-Led development and competitive austerity: 1985-1990;
- The triumph of global capitalism and the end of state planning: 1990-2000;
- Neoliberal economic development and Bashar Al Assad’s regime: 2000-present.

Another earlier discussion of Syrian political economy framework has been given by Nelson (Nelson 1998), which analyzed the 1986 financial crisis and the reforms that followed it, and had concluded (in 1998!) that “*the political legacy of the economic reforms has so weakened the Assad regime that prospects for political stability within Syria are poor; and the transition to democracy, or political liberalization, is the probable outcome of the coming instability*”. Finally, a very interesting analysis has been made by Waldner, where the cases of Turkey and Syria are compared, and the economic policies of the Hafiz Assad era had been characterized as “precocious Keynesianism” (Waldner 1999).

It is out of the scope of this paper, focused on the political economy of the banking sector in Syria, to discuss in details the general frameworks of all these analyses. And it is believed that some of their assumptions (even sometimes the supporting facts) could be challenged by issues described in this paper, leaving room for further research and improvements. However, it is necessary at this stage to introduce several remarks which add some fundamentals supporting the analysis on the banking sector’s political economy.

1. *State and power systems*

A first remark concerns the introduction of state as a (one and unique) “category” or “interest group” in these political economy analyses, with a consistent rationality and a decision making power. This issue is crucial in the assessment of the factors influencing its formation and evolution (the notions of state building or capture) and its decision making processes.

The period after independence in Syria has experienced “state building”, in the sense that many state institutions were created and consolidated in that period: the national army, the central bank, the constitutional and legal framework, etc… And this state building had a capitalist character (contrary to the argument of Joya who characterize it as pre-capitalist), in the sense that it was based on individualization, (tentative) breaking of old regional and confessional ‘asssbiyah[2], introducing state legacy based on markets (and merchants and industrialists). This state building had undergone “socialist” transformations during the period of the unification with Egypt, reconfirmed and radicalized during the early years of the Baath regime. Countryside middle class has seized the state from the hands of city merchants and industrialists. However, what was important since the late 1960’s until recently was not how the state institutions function, but how the core of the power system was controlled by groups, which cohesion depended on old ‘assabiyah(s) (Martinez-Gros 2006). These groups, finally focalized around Hafez Assad, were determinant of all political and political economy issues (Van Dam 1996). The state institutions have then marginal role[3], including the government which take orders instead of implementing policies, and the regional command of the Baath party, which in part of this period was one of the main decision making bodies.

We advocate (Aita *Reform*… 2007) that, for the analysis of the political sphere, and that of political economy, it is more efficient to distinguish between the two categories: the “state”, as an institution or a group of institutions, and the “power system”, which operates at another level and controls critical bodies within the regime, such as the presidency, the “presidential guard” (a specific body inside the army which takes its orders separately from the regular army), and the secret services (which by the way has no constitutional and legal legitimacy in Syria[4]).

The “power system” has its own logic of production and reproduction. It needs in fact to control economic rent (oil revenues, smuggling, etc.) to insure its financing (out of the budget) and maintaining its network of clienteles. It has also its specific “reproduction” rules, as it is necessary to maintain an operating ‘assabiyah. This power system is the decision maker *in fine*, with a major logic: the stability of the regime. The “state” is (“captured” and) left for the execution and day to day management, and could be weakened, especially if some of its institution could challenge (by the way often legitimately) the prerogative of the “power system”[5].

The separation between these categories is not specific to Syria, but is also efficient to explain the stability of “strong regimes and weak states”, in most of the Arab countries[6], and in other parts of the world. The concept can be also efficient and operative to explain some of the recently observed tendencies of the circles of power in “Western democracies”.

---

[2] This terminology refers to the Arab sociologist Ibn Khaldoun, who explains the stability of power systems and governments by the strength of pre-city solidarities made of regional or communitarian identities. See www.exhauss-ibnkhaldoun.com.tn and Martinez-Gros 2006.

[3] Several examples could be given, including for what could concern the banking and monetary sector political economy, such as that the board of the Central Bank had no confirmed members and no meetings for more than 20 years, and that the Commercial Bank of Syria, by the far the biggest bank, had no general manager for years.

[4] See Abdul Hay Sayyed, Chapter on *Governance & Institutional development Issues*, in Aita 2006, the *Road Ahead*… and The Responsibility of the Syrian Security Services on behalf of Syrian Law (in Arabic) Feb 2004 http://www.shrc.org/data/aspx/d9/979.aspx

[5] See Also: AITA Samir: *Economic Reforms, the State and Politics in Syria: Is there any Processes to revive State Institutions?*, Al Hayat, May 30, 2005.

[6] Per example the Saud family the royal family and the “makhzen” (the term means “the shop” in Arabic, but denotes the royal surrounding in Morocco) could be considered as power systems, respectively in Saudi Arabia and Morocco, as well as the Moubarak family and surrounding in Egypt. In Lebanon, there are several such power systems, each controlling a community, the state becoming the measure of the balance of power between them.

2. *Internal vs. foreign political economy*

Another major remark concerns the measure of how much foreign factors influence local political economy. It is first obvious to notice that the different periods characterizing Syria political economy since the 1970's, have been greatly influenced by foreign factors. In a first hand, the flow of Gulf countries financial aid, which in the 1970's has permitted the development of state-owned industries, and then after 1990 (as Syria joined the "war for liberation of Kuwait") to sustain the first economic liberalization period. Then factors related to the political relations with the Gulf countries, and the involvement of actors from these countries, have to be accounted for when analyzing the political economy of Syria. This also applies for the banking and monetary sectors, as even in the period where exchange control was tightened, the Syrian "authorities" needed to handle (and control) the flow of Syrian pounds and hard currencies exchanged (especially during the summer period) with the hundreds of thousands of Syrian expatriates living in these countries. This is, even in the periods when the Syrian Central Bank has been inoperative. The relations between the "power system" and some financial institutions in the Gulf countries were of great importance to stabilize and manage the exchange rate.

On another hand, foreign policy has been always a determinant factor in the Syrian political economy decisions. The periods that Joya entitles "popular contest…" and "crisis of state planned…" have been so, precisely because Syria took the side of Iran during Iran-Iraq war. The period of "neoliberal economic development" (which in fact started in 2004 and not in 2000, as Joya states it) came as a reaction to several foreign "threats": the US sanctions after the invasion of Iraq with the Congress "Syria Accountability Act", that have pushed the Syrian authorities to draft in 6 months the European-Syrian partnership agreement, which was finally blocked, what have pushed the Syrian authorities to make the major step for a major liberalization of the foreign trade (reducing both tariff and non-tariff barriers, and allowing in practice the opening of private banks) (Aita *What reforms*… 2006). Most of these decisions were opposed in their time by state institutions; the "power system" had decided to enact them, as they were felt necessary for the survival of the regime.

Finally, the influence of Lebanon in the Syrian political economy cannot be only considered as a special case of influence of foreign relations. Several evidences sustain that economies of the two countries are much more integrated than what could be thought. It is in fact striking that two countries has experienced their major financial crisis exactly at the same moment (1986). It is also worth noting that many of the managers (and owners) of the Lebanese banks are of Syrian origin and that tight links exist between the present governor of Lebanon Central Bank and the Syrian "power system"[7]. Also, many Lebanese companies have preferential access to Syrian state-owned enterprises for their imports and exports. Finally, the Syrian private sector foreign trade[8] could not been operative for long years without the Syrian banks, which has played the necessary role of financial intermediation.

[7] One of his close relatives, who took his place at his former job in Meryl Lynch Monaco, was the special advisor of the Syrian presidency in the 1990's and early 2000's for the reform of the banking sector in Syria.

[8] Which has become predominant over the state-owned enterprises foreign trade (except oil) since the "export-led development…" period of Joya? Even during this period, we advocate that non-formal procedures were established to finance the foreign currency needs of the private sector, see Aita 2002.

3. *Periodization*

Owing to the above, the political economy of Syria has greatly evolved since its independence[9]. Even the period of political "stability" under Hafez Assad, cannot be treated as a whole, without taking into account the major modifications or reforms which have resulted from internal and foreign pressures and influence. We believe then efficient to adopt the approach of Joya in introducing a periodization of the different phases of the political economy in Syria. However, the periods that Joya introduce and characterize are challenged by facts on the ground. They shall be completed or modified during the following sections.

In particular, the financial crisis of 1986 has been a major event in the modern history of Syria, both in terms of economy and political economy. It has to be accounted for as such, to enable assessing how much it has shaped the modification of strength of "interest groups" and the following evolutions. Similarly, the US lead invasion of Iraq has been a major event, much more than the accession of Bashar Assad to presidency. It also introduced major modifications in the strength of "interest groups" which are currently shaping the evolutions of Syrian political economy, including in the banking sector.

The Phases of the Political Economy of the Banking Sector in Syria

After setting this background, it is useful to start characterizing the different phases of the political economy of Syria, focusing on the banking sector issues, from the independence until the recent reforms, accelerating since 2004.

1. ***Phase 1: State Building and National Capitalism: 1946-1963***

When Syria accessed to independence, the control of money emission, exchange rate and banking sector organization were major issues posed to the nascent state dominated by urban merchants, landowners and industrialists. Money emission was controlled by the Banque de Syrie et du Liban (BSL), a subsidiary of the French Paribas bank; the money was common with that of Lebanon[10], with a double pegging to the French franc and the British pound[11]. This bank was also and by far the largest commercial bank of the country.

France denounced the double pegging following the withdrawal of the French troops (1946), and imposed a pegging to the French franc only. That has lead, after the collapse of the common negotiations with Lebanon and the French, to the monetary separation between the Syrian and the Lebanese pounds (1947) and Syria joining the Breton Woods institutions. An independent monetary law, giving the Syrian government the control of monetary emission, was enacted in 1950, and a central bank law in 1953[12]. This was the first central bank ever created in an Arab

[9] See Aita La *Siria Contamporanea*… 2006: "*Contemporary Syria: a History of Troubles and Constructions*".
[10] As well as the customs, the Port of Beyrouth (the main window for foreign trade), the Tobacco company, etc…
[11] This resulted from the historical that lead the French free and British forces oust Vichy France from Syria in 1942.
[12] The Central Bank of Syria has opened its premises only in 1956, after reimbursing Bank de Syrie et du Liban the dues for this "nationalization". Lebanon created its central bank only in 1964.

country[13]. Besides managing monetary emission and exchange rate, the aims of the Central Bank of Syria were to develop the banking sector and the financing schemes and techniques. Many new banks emerged and the dominance of the BSL has loosed grip on the economy. In addition, innovative financing schemes were introduced to assist the development of agriculture in the Djezireh region, which has lead to unchallenged since high growth in agriculture[14], industry and trade. Thus, this phase can be characterized by the dominance of the state and institution building of the national capitalists, in opposition to foreign and Lebanese capitalism (the latter mainly focused on trade including for the Syrian hinterland, while the Syrian capitalism favored protectionism).

This characterization remains for the continuing period of this phase, as the major nationalization occurred in 1957 following the Suez war on Egypt in late 1956. French and British assets were definitely nationalized, including in banks (and in the BSL in particular). And it is worth noting that this character has not been challenged by the union with Nasser's Egypt (United Arab Republic, Feb. 1958- Sept 1961). In fact, whatever were the nationalistic and socialist ideas of this period; the Syrian state elites refused the unification of currency and the merger of the two central banks. This is while most state institutions were unified, and while the "power system" of Nasser and his Egyptian officers had considerable strength. On another hand, the "socialist measures" enacted on agriculture (land reform) and on industry (nationalization of major industrial companies) came to the banking sector in late July 1961, three months before the collapse of the UAR. They never took effect. In addition, the corresponding law for the nationalizing banks has nominated business community elites at the board of such banks!.

The "separation" period (Sept. 1961- March 1963) that followed stopped the nationalization process (except for French and British assets), but fostered "socialist" ideas within the "capitalist" state and business elites (Aita *l'Economie*…2007), with the birth of the concept of "social market economy". The "state" built by the capitalist "interest groups" has taken its constituency as an independent actor.

2. ***Phase 2: Radical Baath and the socialist state 1963-1969***

This phase has seen new "interest groups" taking over the state and the economy. All banks were definitely nationalized and grouped by specialty (industrial, agricultural, commercial, saving, etc. banks), a much more stringent agrarian reform and industry and trade nationalization program were enacted and the state elites of the former phase were ousted[15]. In matter of politics, this phase was characterized by the struggle between the Baath and officers factions to establish a stable "power system" to rule the country. In matter of political economy, the period was marked by the creation of the network of clientelism between these competing "power systems" with the regional and countryside middle class.

The major mechanisms in political economy during this phase concerned:

---

[13] Egypt which had developed financial markets, created its central bank only in 1957.

[14] In this period, the Djezireh area was named "California of the East".

[15] Even out of the country, this has lead to a massive flow to Lebanon, of capital and of skills, what has made that most of the managers of Lebanese banks in the late 1960's to be of Syrian origin.

- The control of the rent-seeking revenues linked with major state purchase contracts (infrastructure projects, airplanes purchase[16], etc.);

- The taking of control of the agricultural land and of nationalized companies by the new elites, knowing that the agrarian reform has not led simply to the distribution of the land in the form of private ownerships to peasants or to its collectivization. Distribution of usage was made in most cases to “interest groups” supporting the regime, leaving the ownership issue unsettled (see Ababsa 2004 and 2005 and Aita *L’Economie* 2007)[17].

- For what concerns the banking sector, the central bank was deactivated, making only monetary emissions following guidelines of the government and of the regional command of the Baath party, and the banks become instruments of state policy (lending to farmers on program and paying the value of crops which have to be delivered to state distribution companies, etc.).

This phase has then the characters of a socialist state, as it can be observed in some of the Eastern bloc countries, with two major differences: that the land was never collectivized and that the private sector remained active in local small-medium scale trade enterprises (the “Souk”, meaning in Arabic the market).

Should we speak about strong or weak state for this period? It can be considered a period of weak state, in the meaning that the Baath party committees had stronger role than state institutions, whenever a conflict could emerge between these two “interest groups”; and many of the formerly built strong state institutions have been stopped from action during the transformation taking place. It can also be considered a period of strong state, as new state-owned enterprises took control of various sectors of the economy: foreign trade, crops management, banking, etc… But this phase has also been one of a weak “power system”, as in fact the struggle for power were endless, even if the decisions *in fine* have been transferred to this power system.

3. ***Phase III: The demise of Radical Baath and Hafiz Assad project of strong “power system” formation 1970-1979***

What characterizes this phase is the emergence of the establishment of one strong and stable “power system” under the direct control of Hafiz Assad. Major transformations were operated in the structures of both the Baath party and the military forces, in order to enable this. And the dominance of this “power system” was formalized by the promulgation of a new constitution in 1973, which makes the regime presidential and which put the (renewed and now controlled) Baath party “leader of the society and the state” (article 8).

---

[16] One of the major fights between the “power systems” concerned the “revenues” resulting from the purchasing by the Syrian Arab Airlines of French Caravelle airplanes….

[17] On April 2, 2008 President Bashar Assad issued a decree definitely postponing the effects of the agrarian reform for the land which was not ceased by the authorities. According to official statistics, one third of the land seized was only distributed as ownership to farmers.

In a first period, the "new power" system eased somehow the pressures on what remained from the merchant and landowners elites. But its major opening concerned the tourism sector, as it allowed for a selected share of these elite to start in 1973 mixed private-public touristic projects (Aita *L'Economie* 2007, Bahout & Hannoyer 1994, Gray 1997). This has been only made possible by easing exchange control on those ventures. In fact, while all foreigners were forced to pay in hard currencies their services, these companies had the freedom to use at their guise their foreign currencies revenues. Not only Lebanese banks were involved to play a role in the financial intermediation for privately managed in the country, but also this allowed international banks and insurance companies to finance their projects[18]. This aspect of the political economy of the financial sector sealed the alliance between the emerging (unique) "power system" and the new private sector "entrepreneurs".

Another significant issue in this phase concerns the "Infitah of Abundance"; the Syrian authorities starting after the 1973 war and the first oil choc to receive large amounts of aid from Gulf oil producing countries. This aid has been mainly used for the development of state-owned industries (cement, oil refineries, power plants, etc…). Foreign banks, and in particular Lebanese, played then an important role for securing the transfer of the rent which emerged from these projects, towards the members of the "power system" through selected "entrepreneurs" (sic) of the private sector.

Towards the end of this phase, the Syrian troupes intervened in Lebanon in 1976 to avoid the emergence of a leftist state there allied with the Palestinians. The possibility of political economy reasons for this intervention, besides those of the foreign policy and the geostrategic considerations, has not been sufficiently assessed. Also, it is worth noting the emergence of the protests against the "power system" in 1997, with the pamphlets of the bar association, and that of the engineers, etc… which has led to the first massive repression during the Assad regime. This also had resulted to further weakening of state institutions in favor of strengthening the power system[19]. As Waldner states it: "*Despite Asad's introduction of a degree of technocratic rationality into the bureaucracy, however, bureaucratic autonomy has never been part of the bargain linking civil servants to the political elite*" (waldner 1999, p92).

4. ***Phase IV: The crises and the collapse of state capitalism 1979-1986***

Here we advocate for many changes on the periodization introduced by Joya. In fact the former phase can be extended to 1979, as the protest that emerged has not modified considerably the course of events in terms of political economy (and politics). Also, there is strong argument to merge two phases in one.

This phase in fact start by a major crisis and end by another of a different nature, and the whole era is marked by the isolation of the country and tense relations with both Arab Gulf countries

[18] The French investment guarantee agency have financed the establishment of some of these projects in a period where the whole country, and in particular state-owned companies and banks, were not eligible to any international and financing scheme.

[19] This weakening had been observed including in the army, with the emergence of the different "special forces" (Saraya Al Siraa', Saraya Al Siddam, Quwwat Khassa) only devoted to the protection of the core of the "power system".

(which have stopped their financial aid to the country) and the USA and Europe. Also, it is marked by extreme difficulties in the economic situation.

The phase starts in 1979 by Syria taking the side of the (Islamic) revolution in Iran, against Iraq which has waged war with the support of Arab Gulf countries, USA and Europe. The civil unrest in Syria has turned to a sectarian[20] uprising in Aleppo, then Hama, with the assistance of Iraq. The "power system" vacillated until Damascus stopped its call for a general strike. This was followed by fierce (and bloody repression) in Hama and even in the prison of Palmyra. Economically, Assad stopped the liberalization and returned to gain support from the rural bases of the regime. A new agrarian reform law was enacted, reducing the maximal size by a half.

The phase continues with the war with Israel in Lebanon in 1982, and with the confrontation with the US, French and British troops sent to this country. A strong isolation of Syria follows, with most of basic products lacking in the country.

This phase ends, following the collapse of oil prices, by the 1986 major currency crisis in Syria, when in few days the US$ rose from around 3 Syrian pounds to 22.

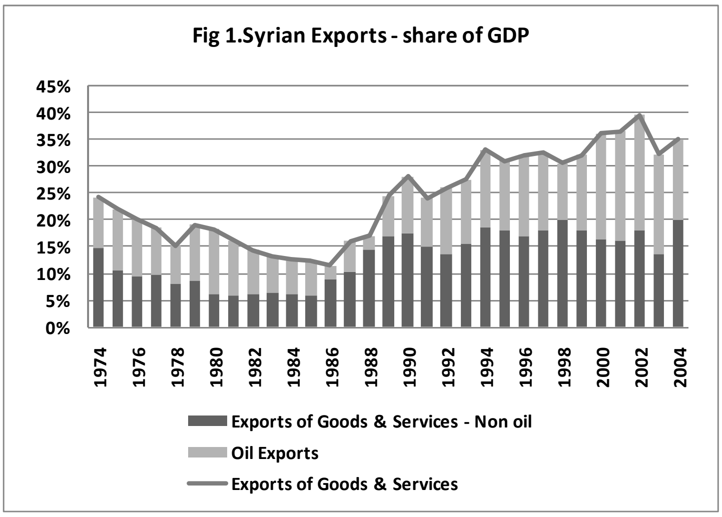
The reasons behind the financial crisis of 1986 have never been well studied. The decline of worldwide oil prices have played a major role, while oil exports constituted at that point a major share of exports and of budget revenues of the country (see Figure 1). But it does not seem to be the only reason. One of the most surprising decisions taken by the Minister of Economy (decree 211 of 1980) which allowed the private sector to perform its imports without central bank intervention for delivering the foreign currencies. The importers were not due to declare the origin of their foreign currencies; and they were even authorized to open accounts in the state-owned Commercial Bank of Syria (CBoS) in such conditions. This is while the type (and quantities) of imports still needed government authorizations, and while the exporters were still forced to deliver the corresponding foreign currency revenues to the Commercial Bank of Syria (and not to the Central Bank)[21]. And this while the border with Lebanon have become formal, allowing Syrian private sector actors (as public[22] sector actors, who were also "allowed" to import without foreign currency delivery by the government) to cross easily to Chtoura in the Bekaa Valley (only around 30 km from Damascus) to perform their financial businesses (as well as different kinds of products smuggling). This "innovative" financing scheme has created new alliances between the Syrian "power system" and an emerging new merchant business community in Syria. It has also permitted to created special alliances with the Lebanese banking community, in the troubled period it was experiencing because of the civil war there. This is besides the clientelism created within the army and the secret services and with the different Lebanese factions.

[20] Although, it has also the character of an urban uprising against the countryside elites.

[21] This measure was alleviated later at the end of this phase forcing the exporters to exchange only 25% of the export revenues to the CBoS, at discounted "official" exchange rate.

[22] The general manager of the major public sector construction company, "Military Housing" (around 90,000 people in that period), has financed the necessary imports by smuggling Syrian pounds to Lebanon. During this troubled period in Lebanon, when most banks have been looted by the different fighting factions, the Syrian pounds were collected and then flown to Gulf countries, to return through Syrian expatriates' remittances and special arrangements with major Gulf financial houses.

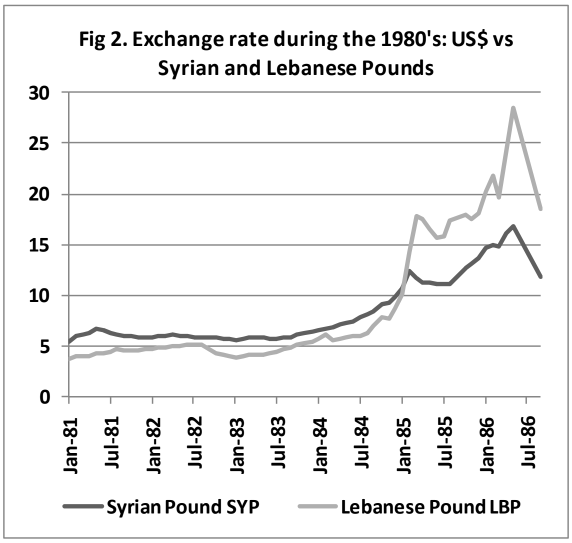
Figure 1. Syrian Exports as share of GPD (according to Chadi BOU HABIB: *International Perspective on Foreign Trade & Investment*; in Samir AITA: *The Road Ahead for Syria*, 2006). Bou Habib argues that Syria's exports of goods and services are historically commanded by the effects of the evolution of oil production and prices, both in the region and in the country itself. The decrease in oil prices in the mid 1980's has hit Syria directly through the value of its oil exports, and indirectly by reducing its non-oil exports to Gulf countries. His calculations over a long period have shown that oil exports were significant, not only since 1990 as usually admitted, but also in the 1970's and early 1980's.



On its side, the Syrian state maintained in this period a significant budget size (around 50% of GDP), to subsidize the social policies within Syria. This model had collapsed in 1986, leaving the country in financial bankruptcy. Law no 24 was enacted condemning the handling of foreign currencies by 25 years of prison.

It is worth noting that the tensions in the exchange rates of the Syrian and Lebanese pounds have shown similar trends and accident during the crisis period (see fig. 2), attesting the strong link between the two financial systems. A strong relation has thus been created between the Syrian power system, and emerging business community and the Lebanese banking sector. But the state capitalism did not collapse before the 1986 financial crisis, as state-owned enterprises remained in control of most of production, as well as of local and foreign trade. The "emerging business community" consisted mainly of intermediaries to state-enterprises.

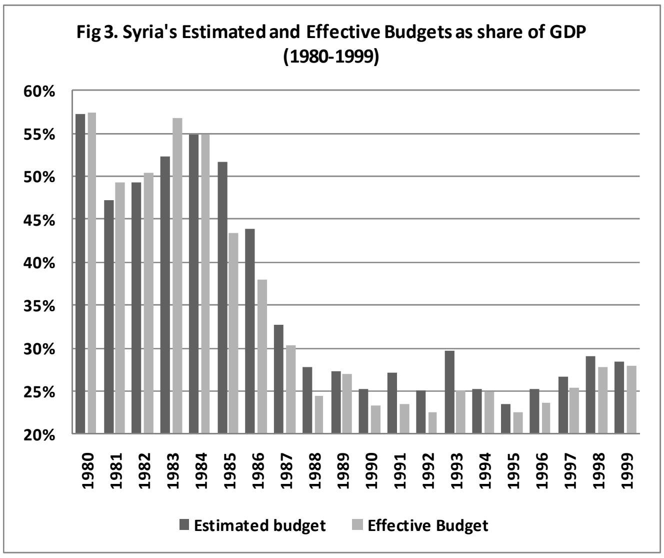
Figure 2. Comparative Evolution of the Exchange rate of the Syrian and Lebanese Pounds (average value for 1 US$; free market in Chtaura for both currencies; source: Syrian Ministry of Economy and Banque du Liban; see Samir AITA, *Infitah* 2002). Tensions on both currencies started to appear in 1983 following the Israeli invasion to Lebanon. The tensions accelerated on the Lebanese pound in early 1985, and experienced a second tension in early 1986. Syrian pounds were smuggled to Lebanon and used to be shipped to the Gulf countries, where a special agreement with the Syrian authorities allowed their transfer to Syria, directly or through the expatriates. The Lebanese and Syrian economies had little integration; however, their (free) exchange markets seem to have been closely linked, as placed in Lebanon. Syria enacted in 1986 a law (no 24) rendering criminal the smuggling of currencies. This had slowed down the depreciation of its currency. On the contrary, the Lebanese pound exchange rate continued to deteriorate considerably until 1992.



5. ***Phase V: The new birth of the private sector and its conflict with the power system 1987-2003***

The major reforms came after the financial crisis of 1986. State capitalism has collapsed and a new scheme had to emerge on the different economic fronts. First, the state stopped enforcing the agrarian reform, accelerated the construction of irrigation projects, and started subsidizing the major crops. This followed by a "barter" deal with the Soviet Union, with the aim of reimbursing the military debts, that has allowed the private sector to develop industries for exports[23], for the first time since the 1960's nationalizations. The slogan had been set for "cooperation" between the private and public sectors, but the latter was rapidly declining. Law no 10 of 1991 was enacted following Madrid conference (Syria joining the war to oust Iraqi forces from Kuwait has helped improving its relations with Arab Gulf countries, the USA and Europe), what confirmed the legalization of the emerging role of the private sector, but what had the immediate effect to make this private sector as the major actor in imports (more than exports) leaving the state-owned foreign trade companies marginalized. In addition, oil production increased dramatically after enabling two major foreign companies (the first dominated by Shell and the second by Elf – now merged with Total-) to explore, discover and produce oil and gas in the country[24]. Also, Arab Gulf countries aid restarted in the early 1990's. But most importantly, the Syrian government applied a major reduction of its – effective – budget size, from 50% to less than 30% of the GDP (see Fig 3). It will only end in 2003.

Figure 3. Syria's Estimated and effective budgets as share of GDP (1980-1999) (source: estimated budget and GDP: Central Bureau of Statistics; effective budget: Official Bulletin of the Syrian Arab Republic). In the early 1980's, the government budget averaged 50% of the GDP; effective budget was also systematically in excess of the forecasted budget at beginning of fiscal year, what had lead to the increase of public debt. The government behavior changed drastically after the financial crisis of 1986. The budget was reduced to around 25% of the GDP; effective budget was systematically below that forecasted; and budget surplus was realized continuously until the early 2000's. This "structural adjustment without reforms" (see Samir AITA, *A view on the Financial and Monetary Aspects of the Syrian Economy*, 2002) had lead to the cleaning of public debts, but also to the stagnation of the Syrian economy between 1997 and 2003.



---

[23] With very low added value, the soviet state foreign trade agency used to buy the products in bulk. This occurred in the last two years before the collapse of the Berlin wall. Syrian exports declined dramatically afterwoods, and could withstand competition on quality and prices.

[24] Oil pipelines from Irak were blown in 1957; an oil authority was created in 1958, and a law of 1964 had nationalized oil producing companies and forbidden exploration and production by foreign companies. In 1974, the Syrian Petroleum company is created, which controlled the activity until the end of the 1980's, where the exploration were allowed again for foreign actors, while production is made through joint "production sharing agreements". In practice, Shell was the largest company in the Syrian economy for most of the 1990's and early 2000's (around 400,000 bpd . Its role is currently diminishing (as well as that of total) after reaching the pick of production for the discovered fields; the production declining now rapidly.

The liberalization measures between 1987 and 1991 could be characterized as “Infitah of Poverty”, but not the remaining period. The economic policies could be characterized as dynamic Keynesianism (selectively precocious), as per example for the encouragement of local industries through “import substitution” policies and later through “export encouragement”. Also, the situation in Lebanon improved dramatically. The Ta’if agreement has set peace in the country, and the Rafiq Hariri government launched an ambitious reconstruction and development program based on extensive budget spending, which has ended in the accumulation of public debts towards levels difficult to sustain (see Nahas 2003 & 2005)[25]. Lebanon growth have created opportunities to the Syrian economy: hundreds of thousands of Syrian lacking jobs in Syria found there opportunities for employment (on a permanent but mostly seasonal bases); Lebanon became an outlet market for Syrian agricultural products (exported mostly informally); and the Syrian private sector found excellent opportunities for financial deposits revenues and lending possibilities with the Lebanese banks[26].

Syria experienced high growth rates of the order of 10% in real term in the beginning of the period (accompanied by high inflation rates). The economy boomed, and private sector enterprises achieved sizeable results[27]. However, this “boom” has lost dynamics in 1996-1997, leaving Syria experiencing a severe recession in 1999. Several reasons were proposed for this rapid decline, including the decline in world oil prices and the stagnation of the peace talks with Israel. However, we believe that structural and political economy issues were determinant for this outcome.

First, and on a general level, a new private “economic elite” had emerged in the early 1990’s, quickly differentiated from the private intermediaries of the state-owned enterprises. After the years of deprivation during the 1980’s, these elites found tremendous opportunities for business development, especially with state “import substitution” protective measures. But they came quickly in conflict with the inconsistencies of state policies. Per example, the Law no 10, supposed to encourage exports through tax exemptions, was in contradiction with direct or indirect taxes on exports, including the obligation to deliver parts (25%) of exports at official exchange rate, much below the actual rate. Intense debates emerged on economic policies, where quickly the necessity to accompany economic reforms with political ones has been pointed out[28], especially for what concerns the reform of state institutions.

---

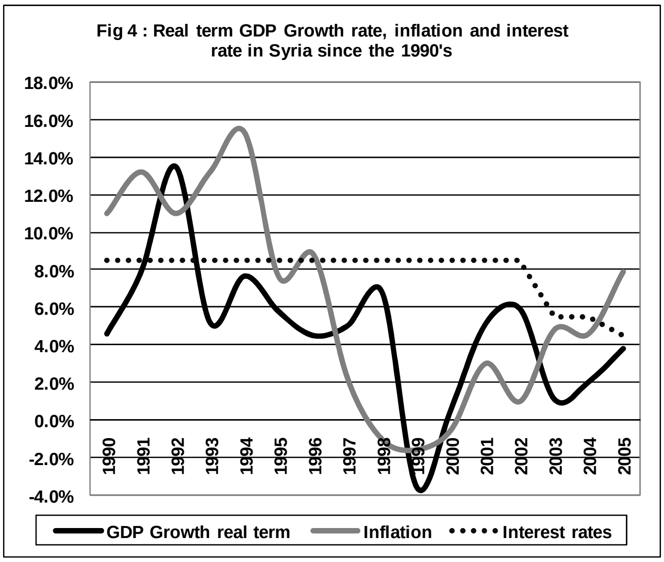
[25] Nahas introduces an excellent political economy analysis of the structural economic and financial situation in Lebanon, which can be useful in the Syrian perspective (Nahas 2005), as well as on the political economy of the banking sector, see http://www.charbelnahas.org/textes/Ecrits_sur_l'economie/Economic_function_of_the_Lebanese_banking_sector.pdf.

[26] To finance the public debt, Lebanon central bank pegged its currency on the US$, while offering substantial deposits rates comparatively to world rates, and to those in Syria maintained stable, below inflation in this period.

[27] Two excellent examples are those of the pharmaceutical and the textile industries.

[28] These debates took place publicly for the first time since two decades, especially during the seminars of the Syrian Economic Sciences society. See parts of its proceedings on http://www.syrianeconomy.org/.

Figure 4. Syria's GDP Growth real term, inflation and interest rate (1990-2005) (source: Central Bureau of Statistics; Central Bank of Syria). The early 1990's was characterized by high growth rates, barely reached in other periods of recent Syria's history. Government policies were key factor in this dynamics, as well as the regional context and oil exports. However, this period was also characterized by high inflation rates, which is to be linked to the redistribution mechanisms that occurred in the Syrian society. The following period experienced lower growth, and even negative growth and deflation in 1999, when oil prices declined considerably. During both periods, interest rate was maintained fixed by the Central Bank, despite the variation of inflation. The first move in interest rate in 2003, was to lower it, despite the tendency of inflation to rise. The new private banks in Syria opened their premises only in 2004.



From the calls for banking sector reforms to the agreement on first private banks

Globally, the "power system" was in this period getting significant rent revenues from oil exports and Lebanon smuggling activities. Its revenues linked to the trade and investments of major state-owned enterprises have declined. The question was to get revenues from the emerging private enterprises, protecting them from cumbersome bureaucratic regulations, which were deliberately maintained in order to put the private sector actors in a situation of illegality, meaning dependency. This has worked for a while, but in few years, strong conflicts appeared, resulting in the bankruptcy of the reluctant business man, even they have achieved sizeable results in developing industries[29].

Also, as the economic growth needed financing and financial intermediation, strong calls emerged from all sides for the reform of the financial and banking system in Syria. Hence, after pointing out that the money in circulation constitutes 79% of the total monetary mass, Aref Dalila, a Marxist economist, questioned the underlying vested interests which have brought and maintained this situation, profiting to foreign banks, and recommended to "*free the Audit Agency from the prepotency of the Ministry of Finance, … free the Central Bank, the Currency Board and the banks from the Ministry of Finance,… and free the economy from bureaucracy and servitude. And if not, there will never be any democracy, or economic and social development.*" (Dalila 1995). Nabil Sukkar, a liberal, made a similar diagnosis. He observed that nationalizations, mergers and specialization of banks in the 60's have not led to the expected objectives, while the private sector is in desperate need for an advanced banking system. He proposed to create a duality, a separation between the state-owned banks servicing the state and the public sector, and new banks servicing the private and mixed sectors. The first banks shall slowly reform and the second banks shall work with healthy companies (Sukkar 1995). He

[29] The case of Riad Seif, one of the main opponents to the regime now, is an excellent illustration. After developing successful textile industries under the brand Adidas,

proposed that new banks to be created to be mixed private-public, with no foreign banks until the reforms progress on state-owned banks and central bank. But no reforms followed these calls, and many others. Instead, Syria experienced in 1995 several “cavalerie” scandals, with “businessmen” proposing very high interest rates and disappearing with the depositors’ savings, what have greatly deteriorated the business climate.

In 1999, in the middle of the recession, Riad Abrash, a prominent economist and civil servant stated bluntly on the resulting effects of this inaction: *I believe that (…) the economic bureaucracy is not capable of performing neither economic reforms, in particular the monetary one, nor structural adjustment without fearing social reactions. Then, and taking into consideration the present context Ceteris Paribus, nothing is to be expected besides the continuation of the present system in its essence, even if formal changes are made.”* (Abrash 1999). The one year later, in February 2000, he added: *“A full year has passed since my 1999 presentation on monetary and banking reforms in Syria, the economic bureaucracy did not take any step, whatever small, since then, towards reforms, neither it changed its methods of work (…) I don’t think it is capable of reforming, whatever nice are its speeches …Then, the situation of the Syrian economy shall remain stagnant in the foreseeable future. If a man wants what he says to be fully truth, he must then tell the whole Truth. Emamnuel Kant.”* (Abrash 2000).

A month later, Hafez Assad died and Bashar Assad became the new President of Syria. In his sermon speech on July 10, 2000, President Bashar made reference to the economic situation, recognizing its bad performance and saying that there had been no clear strategy for economic reform in the past. Nothing in this speech prepared Syrians for the sudden decision made later in December 2000 by the Regional Command of the Baath party, the highest decision-making authority in Syria. The decision sanctioned the creation of new private and mixed sector banks and of a stock market, the issuing of a bank secrecy law, and the reform of exchange rates mechanisms. By this decision, the creation of private banks in Syria became the main symbol of the reform process of the new president. In March 2001, the Private Banks Law was promulgated and, one month later, so was the Bank Secrecy Law. But things moved slowly on the ground, only the active debates continued.

In 2002, Makram Sader, the secretary general of the Lebanese banking association intervened in the Syrian debate, stating surprisingly: “*Atrophy of Syria financial and banking system and inflation of that of Lebanon does not lead then to their complementarities. The distortions behind the atrophy of the first and the inflation of the second do not allow such complementarities. Complementarities are based on natural competitive advantages and not structural distortions which need to be corrected in both countries as an entry to useful and fruitful relations”* (Sader 2001). Of course Syria needs the presence of qualified Arab and international banks creating healthy competition, he stated, but “*the development of banks passes necessarily through a monetary reform creating a credible and independent central regulatory authority. It passes also through a financial reform generating sustainable and sufficient revenues to the State by the mean of an efficient and equitable taxation system. It passes also through the reform of the economic mechanisms creating equilibrium in Foreign exchanges and of the private productive institutions to enable them to sustain competition”*. His minister of economy took a different position, declaring that “*regionally, one can find that Lebanon is in the best position to bring cooperation and assistance, as it has a competitive advantage in financial and banking services*” (Saidi 2002). And this has lead Sukkar to react. He claimed that, although it was a step in the right direction that the reform started by a decision from the Regional Command of the Baath Party, it does not show any clear methodology or program in the rush to translate these policies into decisions, laws and regulations. He was also critical that little energy had been spent on the reform of state-owned banks, concluding: "*For those reasons, I believe that there is no way to reform the public banking sector without total or partial privatization (…)*" (Sukkar 2002) and adding even more surprisingly: "*We have to consider that if we want to create a real advanced monetary and banking system and an independent monetary policy, we shall need a lot of decentralization. Many powers have to be taken from some sides and put in the hands of other sides. And this will create changes in the equilibriums and changes in the centers of decisions. But, is the Government ready to transfer powers to the monetary authorities? Will it accept the concentration of the monetary and financial policies in the hands of the Monetary and Credit Board, headed by the Governor of the Central Bank, instead of the Economic Committee composed of the Deputy Prime Minister for Economic Affairs and the concerned Ministers. (…) The True and complete monetary and banking reform needs major changes in our economic thinking (…) It needs orientation towards separation of powers, assignment of responsibilities and establishment of new relations between the Party and the State in economic affairs. (…)*" (Sukkar 2002).

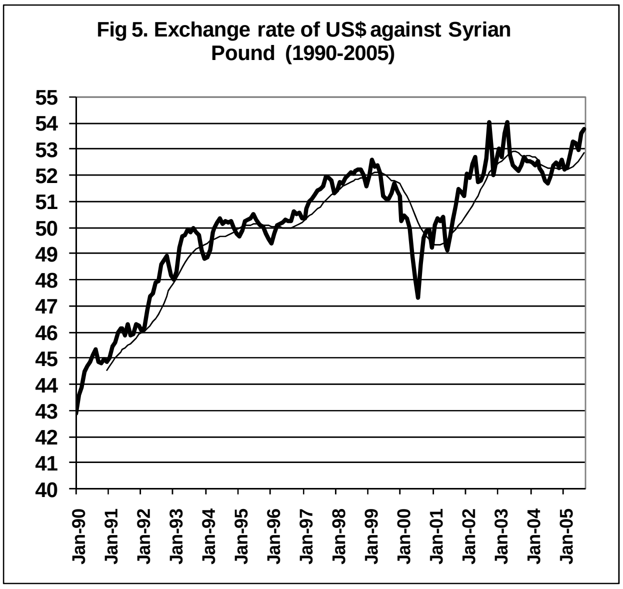
Finally, in March 2002, a new central bank law was promulgated by the presidency, in an atmosphere of controversy, as the governor of the central bank opposed the text, in an official letter to the parliament: "*what we considered as major points were rejected…namely all issues relative to the independence of the Central Bank from Government authorities were refused…as was the right to fix salaries out of the general rules of the public sector, despite the fact that many other public institutions were allowed such exceptions*" (Kabbara 2001). The first applications for private banks licenses were deposited in April 2003, and in July, the first licences were granted.

<u>Foreign exchange: from bankruptcy to high assets low foreign debt</u>

Astonishingly, the evolutions on the front of the foreign exchange have not been subject to serious debates and analyses. This is probably related to the sensitivity of the subject.

After the 1986 crisis and the enactment of law no 24, the Syrian pound still had free trade in Lebanon. Although, this was not officially considered by Lebanon central bank, as the Syrian currency was not supposed to be tradable. The "free market" rate continued its devaluation against US$, but much slower than the Lebanese pound, which have reached a high of more than 2000 LL before being pegged at around 1500 LL for 1 US$. During the 1990's, this "free market" rate SYP evolved slowly from a yearly average of 42 SYP for 1 US$, to around 50. The Syrian currency experienced also strong seasonal variations of more than 10%, attesting on market mechanisms: high demand in the summer with the return of expatriates, low demand in the winter.

Figure 5. Exchange rate of 1 US$ against the Syrian pound (free market, 1990-2005) (source: Ministry of Economy; Commercial Bank of Syria). Whatever was the fixed exchange rate by the authorities, single or multiple, the private sector referred in its business transactions during the whole period to the free exchange rate, which was manly fixed in the small city of Chtoura in Lebanon. The Syrian authorities used to document this unofficial exchange rate daily. The evolution of the exchange rate reflected the transformation of the Syrian economy, in particular in relation to the rise of inflation. It was also de-linked from the Lebanese exchange rate which experienced strong devaluations (1 US$ was changed 2500 Lebanese pounds in 1992, before the permanent pegging by the Bank of Lebanon at 1500 LBP). From an average of 1US$=52 SYP, the Syrian pound experienced some turmoil in the early 2005, reaching a high of 1US$=60 SYP, before a massive intervention of the Central Bank of Syria, which has led lowered the rate to 1US$=46.5, well below it previous mean value.



On its side, the government installed multiple exchange rates mechanisms (more than five), for taxation and public accountability reasons[30]. A “neighboring countries” rate, closer to the free rate (but fixed) were established in 1990 for official trade transactions. However, the real mechanisms of the foreign exchange of this period are still not fully assessed. In fact, very quickly in the 1990’s, the –officially recorded – imports of the private sector exceeded its exports. Also, parts of these exports were assumed fictive as they use to give rights for foreign currencies for imports. This trade deficit of the private sector could not be only financed by workers’ remittances, recorded at much lower levels. An unexplained mechanism of financing existed then, outside the Syrian banking sector (including the central bank). It is worth noting here that oil foreign currencies revenues in this period were managed by the Office of Oil Commercialization, on which the central bank had no control (Aita 2002).

The sizeable oil revenues in the early 90’s and the effective reduction in budget size[31] have helped the country to have budget surplus for almost a decade. This “structural adjustment” has helped building foreign assets at the Central Bank and at the Commercial Bank of Syria. At the end of the decade these foreign assets reached the level of Syria GDP (Aita *AView…* & Aita *the Road ahead…* 2006). This could have constituted a good occasion for strong reforms of the state-owned sector; but they were not tackled with, leaving this opportunity to be qualified as “*a structural adjustment without reforms*”.

---

[30] In fact, the multiple exchange rate mechanics have been introduced since the 1981, but the differences were not as high as in the early 90’s, where the official rate was at around 1 $US=11 SYP, and the free market at around 1 $US=50SYP. The IMF still register the official exchange rate at around 1 $US=11 SYP.

[31] During this period, not only the budget has been downsized from 50% to 35% of the GDP, but typically its spending side was systematically unachieved as most of the investment programs were delayed, and its revenues exceeded plans, as they depended for a large part (65%) on oil revenues, the price of which was underestimated. Consequently, Syria experienced during a decade a budget surplus, which has helped cleaning state accounts and building foreign currency reserves.

One of the reasons of the blockage was linked to foreign pressures. In fact, when the crisis of 1986 occurred, Syria foreign debt was recorded also to be of the level of its GDP. Several countries[32] insisted that Syria solves its default of payment situation through multilateral negotiations with the Paris Club. The Syrian authorities insisted on settling the debt bilaterally, especially that the largest share was constituted by military debts to the –then– former Soviet Union. Imposing Paris Club economic reforms was considered as giving foreign countries access to the management of Syrian political economy. The negotiations stalled, despite the accumulation of Syrian foreign assets, until 1996 when the first breaches were made with bilateral agreement advantageous for Syria. But settling all foreign debts needed to wait until 2005, when finally the – then- Russian debt was settled. The foreign debt has then played no role in fostering internal economic "reforms" despite the severity of the 1986 crisis.

Political economy issues in Phase V

This phase V appears then as characterized by the collapse of state capitalism and the rebirth of the private sector. During it, the "power system", while opening up to the Arab Gulf countries and the "Western" world (triumphing on the Soviet Union and on Iraq, and giving it a mandate on Lebanon new era of peace), managed to avoid foreign interferences in the reform process, and to maintain under control the new emerging local private sector.

The state elites supported the national pride issues against foreign interferences, but showed impatience that reforms are not fostered locally. The business elites were divided between taking profit from the opening made by the "power system" against allegiance, and showing more independence and impatience for further reforms. The Baath elite and that controlling State-owned enterprises had its positions tremendously weakened. However dynamic in the beginning of the 1990's, the mechanics of bargaining between these players freezed in 1996: the peace negotiations with Israel lost their momentum, and… Hafez Assad, the center point of the power system was ill, with rare interventions in public affairs; his son Bassel, promised to succession, died in a car accident. The situation had to wait until new reality appears on the ground changing the terms of the bargain. In 2005, an official document of the State Planning Commission, qualified the period 1997-2003 as the "years lost for the Syrian economy" (SPC 2005).

The reforms of the state-owned banking sector were postponed. And this was made only possible as the Lebanese banks, and marginally other neighboring countries banks, played the effective role of financial intermediation for the Syrian private sector. A strong alliance has been built between the Syrian power system and the Lebanese banking sector. Locally, the Commercial Bank of Syria, which held most of public foreign assets (around US$ 13 billion at end of period), was maintained for years without an effective general manager. Another major state-owned bank, the Real Estate bank, had at its head a major member of the "power system"[33]. It was the only that has operated some modernization, introducing credit cards in Syria (for which, the information system management and the compensation was made by Lebanese banks, contrary to regulations) and automating its procedures[34]. The other banks had weak management. All

[32] France in particular was one of the strongest defendants of this option, even after several European countries and the World Bank have settled its debts with Syria bilaterally.
[33] Mr. Mohammad Makhlouf, the brother in law of Hafez Assad, managed the Real Estate bank.
[34] Until 2005, it was the only state-owned bank (including central bank) which has introduced automatization of procedures.

played a significant role in the clientelism/control relation between the "power system" and the emerging business community. In 2003, all had a significant share of non-performing loans[35], with significant lending from the central bank. The state-owned banking sector, as well as the foreign exchange complex regulations, became a major tool –although not efficient as in Tunisia (Hibou 2006) – in the political economy.

6. ***Phase VI: Neo-liberal Economic Developments 2004-…***

This phase started effectively in 2004, and not with the accession of Bashar Assad to presidency. Hesitations have characterized the first period of his reign. But it was only in 2004, that the new developments in the political economy took place in a new dynamic. Two major aspects characterize the changes in political economy of this phase at a general level: the weakening of 'assabiyah and the foreign threat.

During the long "lost years", the "power system" observed that the mechanisms established by Hafez Assad can no more be operative. A new political economy model has to be established. And whatever were the discussions on a "Chinese" model for development in Syria, the real model was taken on… Dubai (Davis 2007). Power can no more be exerted only through politics and 'assabiyah, it has to be done through strong anchors in the economy; even if this could imply a strong mixture between "power system" private affairs and the public affairs. And this has to be done in opposition with both foreign (large multinationals, foreign countries) and local actors (the state, the private sector). This major change in the model was vital, as oil production in Syria (and corresponding rent-seeking) was on the decline and as new threats have developed nearby (competing "power systems" in other Arab countries, mainly Saudi Arabia and Egypt, including most importantly in Lebanon, around Mr. Rafiq Hariri, and the US invasion of Iraq). Also, this was the model adopted by the different ruling regimes in the Arab countries, from Morocco and Tunisia, to Egypt, Saudi Arabia and Jordan, kingdoms or republics alike, with different degrees of efficiency and success[36].

The first move towards this new model was done through the mobile telephony[37], a new source of significant rent-seeking created by new technology and "effet de mode". Privatization was easier, in the context of an emerging sector: BOT contracts were granted to two companies, one lead by the proper nephew of the President, and the other to a Lebanese businessman, strong ally to the Syrian "power system". The Egyptian Orascom telecommunications, linked with the Egyptian "power system" was quickly ousted from the first venture, Syriatel, which constitute today the first company by its size in the country[38]. Other major ventures came later with the "free shops", and with now large holding companies investing in various sectors, from real estate to cement factories. Privileges were granted to the outer circles of the "power system" for

---

[35] Above 50% for the Industrial bank.

[36] Dubai is most apparently the most successful, but the population is mostly made in this case of "foreigners" (Davis 2007).

[37] It is worth noting that the initial deal for this scheme was made before the full accession of Bashar Assad to presidency, and that simultaneously a strong competition was taking place on the Lebanese lucrative mobile phone sector, between the different power players in the two countries.

[38] Then, surpassing the size of Shell, who has been for long the major oil and gas producer.

starting new businesses, however avoiding any direct privatization. With these developments, the business environment in Syria changed dramatically.

The change was accelerated due to international pressures. In response to US sanctions and the blocking of the European free trade agreement, the country reduced the tariffs and trade barriers, opening widely the country. The level of imports (almost completely done by private sector) more than doubled in one year. The business community which has emerged in the 1990's was directly put in competition with world producers, in particular … China. This allowed for some state procedures rationalization, including starting to clarify public accounts, the taxation and legal system, etc. Such rationalization efforts are since then competing with the establishment of "social safety nets", to overcome the effects of the liberalization on the majority of the population.

The neoliberal character comes from the fact that the liberalization process is much faster than that of regulation, if any, giving the occasion for "crony capitalism".

However, no major efforts were made for the reform of the state-owned banks, even if the issue has received different kinds of consulting and foreign assistance. Three major facts blocks such reforms: the assessment, and eventually cleansing, of lending portfolio of state-owned banks (as the non-performing loans involve major actors, client of the "power system"); the clarification of public accounts (which will take out a tool for selective unofficial policies); and the question on what to do with the Commercial Bank of Syria, a major state institution, which by its balance sheet is amongst the 10 largest banks in the Arab countries. Lately, the decision seems to have been oriented towards the merger between the non-performing banks and the saving banks. This is a way to overcome the first obstacle, without solving its implications.

On another hand, new private banks emerged in the country. This includes Islamic banks. Also, private insurance companies have emerged, and a law has been promulgated for the establishment of a financial market. In less than 4 years, these banks have opened 66 branches[39] and reached around a 20% share of the total balance sheet of the banking sector (CBS 2007). They attracted 75% of new deposits in the banking sector; around half of them were made in foreign currencies. They provided loans amounting only 25% of their deposits; most of them (80%) towards the trade and services sectors, including some niches in retail loans (cars, etc.). Relatively to the growth of the GDP, this result is still modest, especially as the ratio of total deposits in banks to GDP has significantly decreased (Aita *Prices*… 2007), and the ratio of money in circulation to the total monetary mass maintained at 30%[40]. However, many of these banks have outpassed the size of the state-owned banks (except the special case of the Commercial Bank of Syria, which accounted alone for more than 80% of the total balance sheet of the banking sector).

It is worth noting here that the base interest rates in the country (for the SYP), and in first change since in two decades, were decreased in 2003. They are since maintained below the effective inflation rate.

---

[39] While the state-owned banks (excluding the Agricultural bank which is in fact an agricultural development agency) have only 169 branches , and opened only 13 new branches in the same period.

[40] It was assessed that this over normal ratio is directly correlated to the size of the informal economy of a country (see Aita *Factors*… 2007).

From the new private banks: 4 are Lebanese (BEMO Saudi Francais; Banque de Syrie et d'Outre Mer, BSOM; Audi and Byblos), 2 Jordanian (The Arab Bank and The International Bank of Trade & Investment), and 3 originating from the Gulf countries (Syria Gulf Bank; Al Cham Bank and Syria International Islamic Bank). It is worth noting that both BEMO and BSOM mother Lebanese banks are held by families of Syrian origin, that two of them (BSOM and Audi) are the largest banks operating in Lebanon, and that two of the Gulf banks are Islamic banks. Also, as foreign capital was limited to 49%, the remaining 51% reserved for Syrians; the ownership structure of the new banks gave messages about the political economy bargains. Some private banks have chosen to be associated to the "classical" business community and others to the "power system" emerging business community[41].

On the front of foreign exchange, the exchange rates were mostly unified, and a market rate is created and publicized. This development has been accelerated and made effective, following the withdrawal of the Syrian troops from Lebanon in April 2005. Chtoura could no more be the market place for the Syrian foreign exchange. This event has also lead to the fleeing of a large share of Syrian deposits from Lebanese banks. Also more than a million refugees has fled to Syria from Iraq, and exports developed considerably towards this country[42], what has also brought hard currencies to the country. The estimated increase of foreign currency stock in the country far exceeds the amounts deposited in banks (private or public), what has made that remaining is circulating (in paper) in the country (Aita *Prices*… 2007). Syria is then experiencing a new phenomenon: the "dollarization"; money in circulation in hard currencies is believed to be of a size similar to that in Syrian pounds, what is also fostering inflation.

It is also worth noting that the exchange rate has been pegged on the US dollar (within a 5% margin of fluctuation) until recently[43], thus overvaluing the Syrian pound if the differential with world inflation is considered. This policy has encouraged imports, and made it difficult for the production industries, especially in the textile sector. More recently, and for foreign policy reasons (US sanctions), the pegging has changed to the IMF SDR's[44], which somehow reduces the effects of overvaluation. Otherwise, 8 foreign exchange companies were legalized in the country, with a relatively large minimum capital requirement (US$ 5 million), allowing the "informal" players for more than two decades to become part of the new system.

It is very early to set the outcome of these new developments in terms of political economy, especially for what concerns the banking sector. However, several remarks could be tentatively made in this regard:

---

[41] The same Rami Makhlouf, cousin of the president, owner of Syriatel and of the free shop, and major actor of a new holding is a major shareholder of the Byblos bank. The main premises of this bank have been installed in an old building of the special forces and services: a notable symbol of the change in political economy.

[42] Most of it informally, the official statistics of 2005 accounts for a share of 27% of "unclassified commodities", an estimation made of informal exports.

[43] At the end of 2005, the Central Bank intervened massively in the foreign exchange markets, for the first time since decades, as strong tensions appeared on the Syrian pound after the publication of the first investigation report on Rafiq Hariri assassination. The rate of the US$ decrease from 59 SYP to around 50, what has fostered the "dollarization".

[44] Special Drawing Rights, a monetary unit of the International Monetary Fund, which has currently a combined weighting between the US$ 44%, the euro 34%, the British pound 11% and the Japanese Yen 11%. The weighting on SDR's reduces the effects of overvaluation of the Syrian pound, while the US$ is losing value; but tensions are arising in Syria between foreign currencies.

- The opening of the banking sector in Syria has confirmed the roots of alliance between the Syrian “power system” and the Lebanese banking sector. Both parties needed each other; in particular the Syrian “power system” needed to postpone further the reform the state-owned sector, in order to alleviate the political, economic and financial effects of such reform; the Lebanese banking sector was stuck with the Lebanese instability and huge public debt (that it mostly holds, accounting for around half of their balance sheet there) needed new opportunities for development. But in order to make this alliance “structural”, the Syrian authorities need to move further to the Lebanese model, issuing large amounts of public debt’s treasury bills.

- The transformation of the “power system” towards private large (service) businesses is consistent with the liberalization, including in the banking, insurance and monetary market sectors. This liberalization further reduce the strength of the industrial private sector which has emerged in the early 1990’s and its claims for political opening. The overvaluation of the Syrian pound facilitates this weakening.

- Postponing state institutions and state-owned enterprises (including banks) reforms, or slowing it comparatively to the evolutions on the ground (in particular for what concerns the central bank), delay the emergence of state elite, which can operate efficiently regulation and challenge the “power system” on the mixture between private and public interests.

- However, these developments challenge most of the basics of the strong “power system” established by Hafez Assad, as it weakens its initial ‘assabiyah, complexifies the terms and mechanisms of bargaining, and open opportunities for local and foreign actors to challenge it. The most direct outcome could be the transformation of this “power system” to a situation similar to that of Egypt, Saudi Arabia and Tunisia, where the “foreign front” is secured through US and Western support. However, whatever the economic and social challenges (decrease in oil production, unemployment, poverty, etc.), the bases of nationalism (even for what concern local capitalism) and state building are still deeply rooted in the country, including between members of the “power system”.

Extended Bibliography

ABABSA Myriam: *Privatization in Syria: State Farms and the Case of the Euphrates Project*. European University Institute Working papers, RSCSAS no 2005/02, February 2005.

ABABSA Myriam: *Idéologies et Territoires dans un Pays Pionnier : Raqqa et le Projet de l'Euphrate en Jazira Syrienne*. Thèse de Géographie, Université de Tours, 2004.

ABRASH (Al) Riyad (Mohammad): *Bank Lending and the Financing of Development*, SESA Tuesday session 2000, February 22, 2002 (in Arabic) available at http://www.mafhoum.com/syr/articles/abrash/main.htm.

ABRASH (Al) Riad (Mohammad): *Monetary Reform in Syria*, SESA Tuesday session 1999, May 1999 (in Arabic).

AITA Samir: *Prices Increase in Syria… A problem in the Economy or in the Monetary Policy*. Al Hal Magazine, Damascus, Aug. 2007 (in Arabic).

AITA Samir: *Factors Affecting the Framework of a Monetary Policy in Syria*. Workshop on Monetary Policy and Central Banking in the Middle East & North Africa: Policies, politics and prospects, 8th Mediterranean Research meeting, Florence & Montecatini Terme, 21-25 march 2007

AITA Samir: *L'Economie de la Syrie Peut-elle Devenir Sociale? Vous avez dit « Economie Sociale de Marché* ? », in Dupret & al, 2007, pp.561-579.

AITA Samir: *Reform, State & Politics in Syria*. In Radwan & Riesco 2007, pp 173-179, 2007.

AITA Samir: *What Reforms While Storm is Building?* Arab Reform Initiative Policy Brief Paper, no 06, April 2006.

AITA Samir: *La Siria contemporanea: una storia di sconvolgimenti e costruzioni*. In Guidetti, 2006.

AITA Samir (coordinator) : *The Road Ahead for Syria. Country Profile Syria*. Economic Research Forum. February 2006.

AITA Samir: *Syria… A Monopoly on Democracy*. Le Monde diplomatique, English Edition, July 2005.

AITA Samir: *A view on the Financial and Monetary Aspects of the Syrian Economy*. Teshrine newspaper (in Arabic), August 2002.

AITA Samir: *Infitah in the Banking Sector in Syria. The Potential Effects on Foreign Exchange Markets*. Al Bank Wal Mustathmir magazine, in Arabic, March 2002.

ALESINA Alberto & DRAZEN Allan: *Why Are Stabilizations Delayed?*. American Economic Review, 1170-88, Dec. 1991.

AOUDE Ibrahim G.: *The Political Economy of Syria Under Assad – Book Reviews*. Arab Studies Quarterly, Fall 1997.

BAHOUT Joseph & HANNOYER Jean: Les Entrepreneurs Syriens : Economie, Affaires et Politique. Les Cahiers du Cermoc, Beyrouth, 1994.

BECKER Gary S.: *A Theory of Competition among Pressure Groups for Political Influence*. Quarterly Journal of Economics, pp 371-400, 1983.

BERNHARD William & al. (editors): *The Political Economy of Monetary Institutions*. MIT Press, 2003.

BLOMBERG S. Brock, FRIEDEN Jeffry & STEIN Ernesto: *Sustaining Fixed Rates: The Political Economy of Currency Pegs in Latin America*. Journal of Applied Economics, Nov 2005.

BROZ J. Lawrence & FRIEDEN Heffery A.: *The Political Economy of Exchange Rates*. In Wingastt & Wittman 2006, chapter 32.

Central Bank of Syria, CBS: *Quarterly Bulletin*. Vol 45, no 1, 2-3, 2007.

CHARI Anusha & GUPTA Nandini: *The Political Economy of Foreign Entry Deregulation*. International Finance & Macroeconomics Meeting, NBER, Oct 2005.

CLARKE George & al.: *Bank Lending to Small Business in Latin America: Does bank Origin Matter?*. Policy Research Working Paper 2760. Washington World Bank, 2002.

DALILA Aref: *The Monetary Mass in Syria*, Syrian Economic Sciences Society Tuesday session 1995, January 1995 (in Arabic).

DAVIS Mike: *Le Stade Dubaï du Capitalisme*. Editions les Prairies Ordinaires, Paris, 2007 (French translation of articles in the New left Review, reedited in: *The Dreamworlds of Neo-Liberalism*. New Press, 2007).

DEMIRGUC-KUNT Asli & LEVINE Ross (editors): *Financial Structure and Economic Growth: A Cross Country Comparison of Banks, Markets & Development*. MIT Press, 2004.

DUPRET Baudouin & al. (editors): *La Syrie au Présent. Reflets d'une Société*. Sindbad, Actes Sud, 2007.

EIJFFINGER Sylvester C.W.: *The New Political Economy of Central Banking*. Conference entitled "Monetary Theory as a Basis for Monetary Policy", Trento, Italy, Sep. 1997.

FRIEDEN Jeffry. *Globalization and Exchange Rate Policy*. In "The Future of Globalization, edited by Ernesto Zedillo, pp 344-357. New York: Routledge, 2007.

FRY Maxwell J.: *Emancipating the banking System and Developing Markets for Government Debt*. London, Routledge Ed., 1997.

GEORGE Alan: *Syria: Neither Bread Nor Freedom*. Zed Books Ltd, 2003.

GRAY Matthew: *The Political Economy of Tourism in Syria: State, Society and Economy*. Arab Studies Quarterly, V19, Issue 2, pp57-74, 1997.

GUIDETTI Mattia (editor): *Siria. Dalle antiche città-stato alla primavera interrotta di Damasco*. Jaca Book, Rome, 2006.

HIBOU Béatrice : *La Force de l'Obéissance. Economie Politique de la Répression en Tunisie*. Editions La découverte, Paris, 2006.

HINNEBUSCH Raymond: *Syria: Revolution from Above.* Taylor & Francis ed., 2007.

HINNEBUSCH Raymond: *The Political Economy of Economic Liberalization in Syria*. International Journal of Middle East Studies, Vol. 27, No. 3. (1995), pp. 305-320.

HINNEBUSCH Raymond: *Peasant and Bureaucracy in Ba'thist Syria: The Political Economy of Rural Development*. Westview Pr. Ed., 1989.

JOYA Angela: *Economic Liberalization and reform in Syria: 1970-2005?,* SOAS Conference, 2006.

KABBARA Bashar: *A Note on the Modifications Inserted in the Project for the "Monetary Fundamental Law and that of the Central Bank"*, Note to the Syrian Parliament, Central Bank of Syria, November 10, 2001 available at http://www.mafhoum.com/press2/69E11.htm.

KIENLE Eberhard (ed.): *Contemporary Syria: Liberalization between Cold war and Cold Peace*. British Academic Press and SOAS, 1993.

KROSZNER Randall S.: *On the Political Economy of Banking and Financial regulatory Reform in emerging Markets*. CRSP working papers 472, April 1998.

LESCH David W.: *The New Lion of Damascus: Bashar Al Asad and Modern Syria*. Yale University Press, 2005.

LEVERETT Flynt: *Inheriting Syria: Bashar's Trial by Fire*. Brookings Institution, 2005.

MARTINEZ-DIAZ Leonardo: *Banking Sector Opening: Policy Questions and Lessons for developing Countries*. The Brookings Institution. Issue Brief 2007-02, Feb. 2007.

MARTINEZ-GROS Gabriel: *Ibn Khaldûn et les Sept Vies de l'Islam*. Sindbad ed., Paris, 2006.

MONTINOLA Gabriella & MORENO Romano: *The Political Economy of Foreign Bank Entry and Its Impact*: Theory and Case Study. Pacific Basin Working Papers Series, PB 01-11, 2001.

NAHAS Charbel: *Un Programme Socio-Economique pour le Liban*. LCPS & Konrad Adenauer Stiftung, May-Dec. 2005.

NAHAS Charbel: *The Chances of Avoiding the Crisis and the Conditions of Overcoming it; Story of an Attempt of Reform*. Dar al Nahar, (in Arabic), August 2003, 327p.

NELSON Dana Andrew: *Economic Liberalization in Syria: Prospects for Regime Stability and Democratization*. Naval Postgraduate School Thesis, Monterey (CA), June 1998.

OULD AOUDIA Jacques: *Croissance et Réformes dans les Pays Méditerranéens*. Notes et Documents, Agence Française de Développement, no 28, Avril 2006.

PELTZMAN Sam: *The Economic Theory of Regulation after a Decade of Deregulation*. Brookings Papers: Microeconomics, 1-41, 1989.

PERTHES Volker: *Syria Under Bashar Al Asad: Modernisation and the Limits of Change*. Oxford University Press, 2004.

PERTHES Volker: *The Political Economy of the Syrian Succession*. Survival, Vol. 43, no 1, 2001, pp 143-154.

PERTHES Volker: *The Political Economy of Syria Under Assad*. New York, I.B. Tauris, 1997.

PETRAN Tabitha: *Syria*. New York, Praegre Publishers, 1972.

RADWAN Samir & RIESCO Manuel (editors): *The Changing Role of the State*. Economic Research Forum-ERF Publication, 2007.

RAJAN Raghuram G. & ZINGALES Luigi: *The Great Reversals: The Politics of Financial Development in the Twentieth Century*. Journal of Financial Economics, Vol 69, 1, July 2003.

RAJAN Raghuram G. & ZINGALES Luigi: *Saving Capitalism from the Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity*. Princeton University Press, 2004.

RAPAHELI Nimrod: Syria's Fragile Economy. *The Political Economy of Syria Under Bashar Al-Assad.* Middle East Review of International Affairs-MEMRI, Vol 11, no 2, June 2007.

RODRIK Dani: *Understanding Economic Policy Reform*. Journal of Economic Literature, Vol XXXIV, pp9-16, March 1996.

SADER Makram: *The Modernization of the Syrian Banking System: Orientations and Rules*, Syrian Economic Sciences Association Tuesday session 2002, March 27, 2002 (in Arabic) available at http://www.mafhoum.com/syr/articles_01/sader/sader.htm

SAIDI Nasser: *The Reform of the Financial Sector in Syria, Modernization and Economic Growth*, Syrian Economic Sciences Association Tuesday session 2002, March 12, 2002 (in Arabic) available at http://www.mafhoum.com/syr/articles_02/saidi/saidi.htm.

SEALE Patrick: *Asad: The Struggle for Power in Syria*. University of California Press, 1992.

STIGLER George J.: *The Theory of Economic Regulation*. Bell Journal of Economics and Management Science, Vol 2, (1, spring), pp 3-21, 1971.

SUKKAR Nabil : *When Will the Reform of the Banking Sector Start?* Syrian Economic Sciences Association Tuesday session 2002, March 12, 2002 (in Arabic) available at http://www.mafhoum.com/syr/articles_02/soukar/soukar.htm

SUKKAR Nabil: *The Reform of the Banking Sector in Syria*, Syrian Economic Sciences Association Tuesday session 1995, January 1995 (in Arabic).

SYLLA Richard & al. (editors): *The State, the Financial System and Economic Modernization*. Cambridge University Press, 1999.

SYLLA Richard: *The Political Economy of Financial Systems – Historical Perspectives*. Precis for Stanford Conference, Feb 7-8, 2003.

State Planning Commission (SPC): *Analysis of Syria Macroeconomy*. Jan 25, 2005.

VAN DAM Nickolas: The Struggle for Power in Syria: Politics and Society Under Asad and the Baath Party. I.B. Tauris ed., 1996.

WAGNER Alexander F.: *Understanding Exchange Rate Policy Announcements*: A Political Economy Approach. Journal of Public and International Affairs, Vol 14, Spring 2003.

WALDNER David: *State Building and Late Development*, Cornell University Press, 1999.

WEDEEN Lisa: *Ambiguities of Domination: Politics, Rhetoric and Symbols in Contemporary Syria*. University of Chicago Press, 1999.

WEINGAST Barry R. & WITTMAN Donald (editors): *The Oxford Handbook of Political Economy*. Oxford University Press, 2006.